# FSAs, HRAs, HSAs

JUST

THE

BASICS

**Med-Pay, Inc.**

| Eligibility | HSA | FSA | HRA |
|---|---|---|---|
| Small Employers | Yes | Yes | Yes |
| Large Employers | Yes | Yes | Yes |
| Self-Employed | Yes | No | No |
| Plan Document | No | Yes | Yes |
| High-Ded Insurance Reqrd | Yes | No | No |
| Annual IRS 5500 | No | Yes | Yes |
| COBRA Applies | No | Yes | Yes |
| HIPAA Certification | No | No, generally | Yes |
| EE Retains Account | Yes | No | No* |
| Employer Contributions | Optional | Optional | Required |
| Employee Contributions | Optional | Optional | No |
| Employee Tax | Deductible “above the line” on IRS Form 1040 | Contributions are Tax-Free | Reimbursements are Tax-Free |
| Employer Pre-funds Acct | No | Yes | No |
| Roll Over | Yes | No** | Yes |
| Medical Expenses Reimbursed | Yes | Yes | Yes |
| Long-Term Care Premiums Paid from Account | Yes | No | Yes |
| Convert to Taxable Income | Yes | No | No |

# Flexible Spending Accounts

- Pre-tax savings for “out of pocket” medical expenses.
- ? New regulation May 2003: Debit cards OK for FSAs!!
- ? New regulation Sep 2003: FSA OK for OTC “medicine”!!
  - Claritin, cold medicine, pain relievers, antacids. But Not “general”.
- 80% employers offer HFSA; >20% of employees choose it.
- 25 million potential FSA eligibles….perhaps 5 million users.
- “Use it or lose it” rule a significant deterrent to health FSA.
- Employees cannot accurately forecast medical expenses.
- “Forfeiture” policy now counterproductive!

# FSAs – Future Remedies ?

- Make *in*flexible spending accounts….***flexible***!!
- ? Permit $500 rollover of unspent health FSA funds?
- President Bush supports $500 rollover – Moving forward in 2004!
- Allow $500 rollover into employee’s 401(k)?
- FSA for long term care insurance premiums?
- ? “Use it or tax it” a no-fault option to limit budget impact.

# Health Reimbursement Arrangements

- HRA = High deductible policy + ER $ + EE out-of-pocket
  - June 2002 Treasury regulations give HRAs green light.
  - HRA is <u>not</u> a salary reduction arrangement.
  - Must make sure no employee pre-tax $ in HRA.
- Are employer HRA dollars <u>taxable</u> to the employee? <u>No.</u>
- Can HRA dollars be <u>rolled over</u> to following year? <u>Yes.</u>
- Where employer is setting aside the funds, there is no use it or lose it rule -- even if with a Section 125 plan (FSA).
- Can design your HRA and FSA to allow employee to use FSA $ first, but must set it up that way ("stacking").
- HRA popularity gaining due to cost-saving potential.

# Health Savings Accounts (HSA)

- Congress included HSAs in historic Medicare drug bill.
- HSA can receive employee and employer dollars.
- High Deductible Health Plan required:
  - Minimum $1,000 individual /$2,000 family coverage
- Out-of-pocket maximum: $5,000 individual / $10,000 family.
- Individual owns the health savings account.
- Unlimited rollover. So it’s completely portable!
- Contributions in, earnings and distributions out, are all tax-free!!!
  - http://www.treas.gov/offices/public-affairs/hsa/
- HSAs: first big step toward “401(k)” for healthcare.
- Employers likely to take closer look at HSAs in 2004.
- Prescription & OTC drug issues being resolved.
- June UST “guidance” on HSA-HRA-FSA flexibility key!!

# The Basics of HSAs
# U.S. Treasury Department
# Washington, DC

April 2004

# HSA Overview

- HSA is money put in an account owned by an individual to pay for future medical expenses.
- Must be used in conjunction with “High Deductible Health Plan” (HDHP)
  – Insurance that does not cover first dollar medical expenses (except for prevention)

# HSA Overview

- HSAs were created in Medicare legislation signed into law by President Bush on December 8, 2003
- HSAs modeled after Archer MSAs
  - Created in 1996
  - Limited in many ways
    - Who could have
    - Total number created

# Who Is Eligible for HSAs?

- Any individual that:
  - Is covered by a HDHP
  - Is not covered by other health insurance
    - does not apply to specific injury insurance and accident, disability, dental care, vision care, long-term care
  - Is not eligible for Medicare
  - Can't be claimed as a dependent on someone else's tax return
- Contrast with Archer MSA rules
  - Had to be employed by small employer (50 or fewer)

# What Is a "High Deductible Health Plan" (HDHP)?

- Health insurance plan with minimum deductible of:
  - $1,000 (self-only coverage)
  - $2,000 (family coverage)
- Annual out-of-pocket (including deductibles and co-pays) does not exceed:
  - $5,000 (self-only coverage)
  - $10,000 (family coverage)
  - These are lower than Archer MSAs
- HDHPs can have:
  - first dollar coverage (no deductible) for preventive care
  - higher out-of-pocket (copays & coinsurance) for non-network services

# HSA Contribution Rules

- Contribution to HSA can be made by either the employer or the individual, or both
  - If made by the individual, it is an “above-the-line” deduction
  - If made by the employer, it is not taxable to the employee (excluded from income)
  - Can be made by others on behalf of individual and deducted by the individual
- All contributions are aggregated

# HSA Contribution Rules

- Maximum amount that can be contributed to an HSA (and deducted) = lesser of:
  - Amount of High Deductible

    or
  - Maximum specified in law (indexed annually by M-CPI)
    - $2,600 (self-only coverage) - 2004
    - $5,150 (family coverage) - 2004
- Reduced by any contribution to an Archer MSA

# HSA Contribution Rules

| | Deductible Amount | OOP Max | Max HAS Deposit (2004) |
|---|---|---|---|
| **Single Coverage** | $1,000 | $5,000 | $1,000 |
| | $1,500 | $5,000 | $1,500 |
| | $2,000 | $5,000 | $2,000 |
| | $2,500 | $5,000 | $2,500 |
| | $3,000 | $5,000 | $2,600 |
| **Family Coverage** | $2,000 | $10,000 | $2,000 |
| | $3,000 | $10,000 | $3,000 |
| | $4,000 | $10,000 | $4,000 |
| | $5,000 | $10,000 | $5,000 |
| | $6,000 | $10,000 | $5,150 |

# HSA Contribution Rules

- HSA contribution rules more generous than Archer MSAs
  - Contributions to Archer MSAs are limited to:
    - 75% of the deductible amount for family (65% for self-only plans)
    - Employee’s compensation or self-employment income
  - If employer made a contribution, employee could not

# HSA Contribution Rules

- For individuals age 55 and older, additional “catch-up” contributions to HSA allowed
  - 2004 - $500
  - 2005 - $600
  - 2006 - $700
  - 2007 - $800
  - 2008 - $900
  - 2009 and after - $1,000
- Contributions must stop once an individual is eligible for Medicare

# HSA Contribution Rules

- Rollovers from Archer MSAs and other HSAs permitted
- Contributions can be made through cafeteria plans
- Employer contributions to HSA must be "comparable" for all employees participating in the HSA
  - If not comparable, there will be an excise tax equal to 35% of the amount the employer contributed to employees' HSAs

# HSA Contribution Rules

- In order to meet the requirement that the employer make comparable contributions, the employer must make contributions:
  - which are the same amount

  or

  - which are the same percentage of the annual deductible
- Count only employees who are eligible individuals covered by the employer and who have the "same category of coverage" (i.e., self-only or family)
- Part-time employees are tested separately
  - "Part-time" means customarily employed fewer than 30 hours per week

# HSA Distributions

- Distribution is tax-free if taken for "qualified medical expenses"
  - Now includes over-the-counter drugs
- Cannot be used to pay for other health insurance except:
  - COBRA continuation coverage
  - Health plan coverage while receiving unemployment compensation
  - For individuals eligible for Medicare:
- Medicare premiums and out-of-pocket expenses (Part A,
- Part B, Medicare HMOs, new prescription drug coverage)
  - Employee share of premiums for employer-based coverage
  - Cannot pay Medigap premiums
- Qualified long-term care insurance

# HSA Distributions

- Distributions are tax-free if taken for:
  - person covered by the high deductible
  - spouse of the individual
  - any dependent of the individual
- Spouse and dependents don't need to be covered by the HDHP
- If not used for qualified medical expenses, then amount is included in income
- 10% additional tax if taken for non-medical expenses, except when taken after:
  - Individual dies or becomes disabled
  - Individual is eligible for Medicare
- Compare to 15% additional tax for Archer MSAs

# HSA Distributions

- HSA custodian must report all distributions
  - not required to check for eligibility
- Under Archer MSA rules, the MSA custodian does not have to determine whether MSA distributions are used for medical purposes; the individual does that
- Given the less stringent distribution rules for HSAs, we assume many Archer MSA holders will roll over to HSAs

# HSA Distributions

- Should the HSA account holder keep receipts?
  - YES! May need to prove that deductible was met
  - Not all medical expenses paid out of the HSA have to be charged against the deductible (e.g. dental care, vision care)

# Estate Treatment of HSAs

- If married, the spouse is treated as the owner
- In other cases:
  - The account will no longer be treated as an HAS upon the death of the individual
  - The account will become taxable to the recipient of it (including the estate of the individual)
    - Taxable amount will be reduced by any qualified medical expenses incurred by the deceased individual before death and paid by the recipient of the HSA
    - The taxable amount will also be reduced by the amount of estate tax paid due to inclusion of the HSA into the deceased individual's estate

# Advantages of HSAs

- HSA accounts encourage savings for future medical expenses
  - Non-covered services under future coverage
  - When employer-sponsored coverage is lost during periods of unemployment
    - COBRA continuation coverage
    - Other coverage
  - Medical expenses after retirement (before Medicare eligibility)
  - Insurance coverage after Medicare eligibility (except Medigap)
  - Out-of-pocket expenses for Medicare
  - Long-term care expenses

# Advantages of HSAs

- Accounts are owned by the individual (not an employer). The individual decides:
  - How much to contribute
  - How much to use for medical expenses
  - Which medical expenses to pay from the account
  - Whether to pay for medical expenses from the account or save the account for future use
  - Which company will hold the account
  - What type of investments to grow account

# Advantages of HSAs

- Accounts are completely portable, regardless of:
  - Whether the individual is employed or not
  - Which employer the individual works for
  - Which state an individuals moves to
  - Age or marital status changes
  - Future medical coverage

# Advantages of HSAs

- No “use it or lose it rules” like Flexible Spending Arrangements (FSAs)
  - Unspent balances in accounts remain in the account until spent on medical care
  - Encourages account holders to spend their funds more wisely on their medical care
  - Encourages account holders to shop around for the best value for the health care dollars
- Accounts can grow through investment earnings, just like an IRA
  - Many different investment options could be pursued
  - Individual chooses investment option that best meets their needs

# Advantages of HSAs

- HDHP premiums should be cheaper than health insurance with traditional deductibles
- Favorable tax treatment
  - Contributions
  - Disbursements
  - Investment earnings
- President Bush has proposed an above-the-line deduction for HDHP premiums

# How to Open an HSA

- Purchase HDHP coverage
  - Check current insurance company
  - Contact licensed agent or broker
  - Contact state insurance department
- Establish a “trustee”
  - Banks
  - Credit unions
  - Insurance companies
  - Model form available

# Treasury Assistance

- Web site
  - www.treas.gov
- Voice mailbox
  - (202) 622-4HSA
- E-mail address
  - HSAInfo@do.treas.gov
- Taking referrals from 1-800-MEDICARE