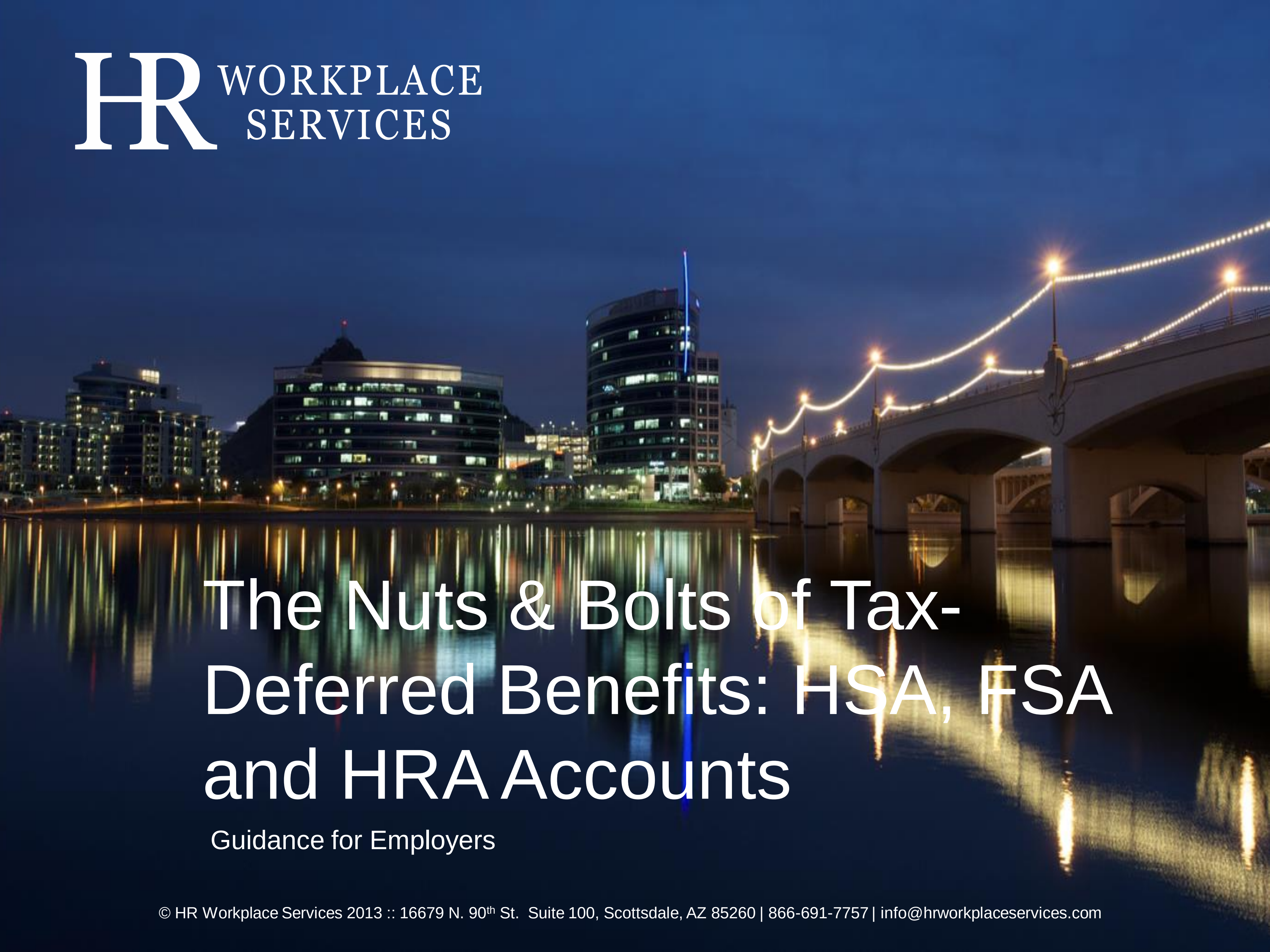

HR WORKPLACE SERVICES

The Nuts & Bolts of Tax-Deferred Benefits: HSA, FSA and HRA Accounts

Guidance for Employers

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Agenda

- Background and Concepts
- HSAs, HRAs & Health FSAs: The Basics
- Design and Compliance Requirements
- Coordination Considerations
- Tax-Deferred Benefits: Stacking
- Q & A

Type your question
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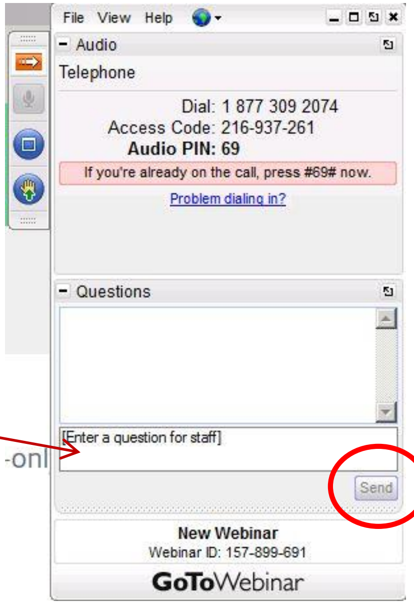

Background and Concepts

Background and Concepts

Theory of Consumer Directed Health Care (CDHC) Plans is to change the role of employees from passive beneficiaries to active, informed consumers. To do so, CDHC plans provide employees with:

- Greater financial stake in medical spending, including choice between spending and saving available funds
- More choice in health care providers
- More information about provider costs and quality
- More information about their own health problems, treatment alternatives and lifestyle choices affecting their health

Background and Concepts

Tax-Deferred Health Spending Accounts under the Internal Revenue Code:

- ***Health Savings Account ("HSA")***
  - Introduced by 2003 Medicare reform legislation
  - Successor to Medical Savings Accounts under HIPAA
- ***Health Reimbursement Arrangement ("HRA")***
  - HRAs with carryovers confirmed by IRS guidance in 2002
  - HRAs available prior to 2002 under I.R.C. Section 105
  - Small Employer HRA *("QSEHRA")*
- ***Health Flexible Spending Account ("health FSA")***
  - Permitted under I.R.C. for more than 25 years; precursor to CDHC
  - Usually offered as a component of cafeteria plans

HSAs, HRAs and Health FSAs: The Basics

Health Savings Accounts (HSAs) – The Basics

- HSAs permit pre-tax employee and employer contributions (usually through cafeteria plans) and tax-free withdrawals for qualified medical expenses
- Accounts are employee owned
- Assets are held and invested in separate account by outside custodian or trustee
- Assets are never forfeited to employer and unspent funds accumulate year-to-year; no use-it-or-lose-it rule
- No employer review and approval (adjudication) of account withdrawals; employees may withdraw for non-medical spending subject to paying taxes and (generally) 10% penalty

Health Savings Accounts (HSAs) – The Basics

- Eligibility for contributions to HSA conditioned on employee coverage under high deductible health plan (HDHP) and only limited coverage under low deductible plans

- To qualify as HDHP, insurance coverage must have deductible of at least $1,350/$2,700 for single/family coverage, and annual out-of-pocket maximum of $6,650/$13,300 (2018 amounts) (amounts apply for in-network expenses)

- Primarily regulated by IRS; HSAs are not subject to ERISA if certain requirements are met; other federal health laws generally not applicable

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Health Reimbursement Accounts (HRAs) – The Basics

- HRAs permit tax-free employer contributions and tax-free withdrawals for qualified medical expenses
- Accounts are employer owned
- Employee contributions not permitted; employer contributions must be outside cafeteria plan
- Usually unfunded; employer "contributions" are credited to bookkeeping reserves within employer general assets
- Use-it-or-lose-it rule is not required (but is permitted). Employees may thus accumulate unspent account assets from year to year, but employer may set limit on permitted carryover

Health Reimbursement Accounts (HRAs) – The Basics

- Employer or third party administrator reviews and approves ("adjudicates") employee spending from HRA
- Forfeitures of unspent amounts permitted at termination of employment
- High deductible insurance coverage not required, but in practice most employers offer HRAs in conjunction with some form of high deductible plan
- Primarily regulated under Internal Revenue Code and ERISA; other applicable federal laws: ERISA, COBRA, HIPAA, NMHPA, MHPA, WHCRA, MSP, FMLA, USERRA

Health Flexible Spending Accounts (FSAs) – The Basics

- Health FSAs permit pre-tax employee contributions and tax-free reimbursements for qualified medical expenses
- Usually funded by crediting employee salary reductions under cafeteria plans to bookkeeping reserves within employer general assets
- Employer or third party administrator reviews and approves ("adjudicates") employee spending from account

Health Flexible Spending Accounts (FSAs) – The Basics

- Use-it-or-lose-it rule applies: unspent funds are forfeited to employer at end of year; 2½ month grace period at year-end if plan so provides
- Carry-over option of up to $500
- Uniform coverage rule applies: entire annual salary reduction available for employee to withdraw at beginning of year
- Primarily regulated under Internal Revenue Code and ERISA; other applicable federal laws: COBRA, HIPAA, NMHPA, MHPA, WHCRA, MSP, FMLA, USERRA

Design and Compliance Requirements

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Eligibility

HSAs	HRAs	Health FSAs
• Any individual (including self-employed) who satisfies Code definition of “eligible individual” as of first day of month is eligible to make or receive HSA contributions for that month.	• Any employee or retiree is eligible; self-employed individuals are not.	• Any employee or former employee under COBRA is eligible; retirees, self-employed individuals are not (self employed individuals include partners, more than 2% Sub S shareholders, independent contractors).

HSAs: Additional Eligibility Requirements

Additional requirements for eligibility to make or receive contributions to HSA:

- Coverage by a HDHP
- Non-HDHP coverage prohibited (other than permitted exceptions such as dental/vision coverage, long-term care, specific disease insurance)
- Not enrolled in Medicare
- Not claimed as someone else's tax dependent

- Note: HSA-eligible self-employed individuals may not make pre-tax contributions through cafeteria plan; instead they take above-the-line income tax deduction.
- Note: Withdrawals from HSA are permitted at any time without regard to whether HSA eligibility rules continue to be satisfied.

Expenses Qualified for Payment or Reimbursement

HSAs	HRAs	Health FSAs
Unreimbursed medical expenses under Section 213(d) of the Code are tax-free	Unreimbursed medical expenses under Section 213(d) of the Code	Unreimbursed medical expenses under Section 213(d) of the Code
No insurance premiums (except for COBRA coverage, long term care insurance, health insurance while unemployed, and post-65 health insurance policy.)	Includes *insurance premiums* – even for Medicare Part B or Medicare supplemental policies and long term care insurance (but no long term care services)	Insurance premiums and premiums for not qualified long term care services may not be paid or reimbursed
No Medicare supplemental policies	Expenses incurred post-employment are payable if HRA includes spend-down provisions	Post-employment spend-down provisions not permitted

HSA distributions are allowed for non-medical purposes but will be taxable and subject to 10% excise tax unless certain exceptions are met (e.g., post age 65 and death).

Adjudication

HSAs	HRAs	Health FSAs
• No adjudication by employers is required or permitted. Participant must keep receipts in a “shoe box.”	• Expenses must be substantiated and adjudicated (or auto-adjudicated).	• Expenses must be substantiated and adjudicated (or auto-adjudicated).

Adjudication

Health FSAs & HRAs

Debit cards - can be used to auto-adjudicate co-pays (including multiples of co-pays), recurring expenses, and real-time verified expenses (only at vendors with health MCCs); and expenses under an inventory information approval system (at any vendor/strict recordkeeping requirements).

EOB rollovers – insurers send EOBs to TPAs who make automatic reimbursements from HRAs and health FSAs to participants.

HSAs

Debit cards - can be used (with medical filtering) but employee must have another method of obtaining money from account.

EOB rollovers – permitted but undesirable to employee whose goal is saving money in an HSA.

Funding

HSAs	HRAs	Health FSAs
Salary reductions or employer contributions through a cafeteria plan, other employer contributions, after-tax contributions of individual	Employer contributions only (but not under the cafeteria plan)!	Salary reductions or employer contributions
Lesser of HDHP deductible or $3,450 for self-only coverage and $6,900 for family coverage (2018 amounts)	None, if non-discriminatory	None, if non-discriminatory
Additional "catch-up" contributions permitted for individuals age 55 and over – Catch-up amount is $1,000 for 2018		

Carryovers

HSAs	HRAs	Health FSAs
• Carryovers required	• Carryovers permitted, not required	• Limited carryover (limited to a 2½ month grace period **or** $500, but not both)

Carryover is fundamental to CDHC; it is intended to change employee focus from annual spending and forfeiture to long-term medical and financial benefits resulting from careful attention to health care and spending.

Sick or Vacation Leave Contributions

HSAs	HRAs	Health FSAs
• Can sell time under cafeteria plan and put money in HSA.	• Can contribute unused sick or vacation time to HRA, either when active or retiring	• Can sell time under cafeteria plan and put money in Health FSA.

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Nondiscrimination Rules

HSAs

- Contributions must be "comparable" unless offered through a cafeteria plan — then must satisfy cafeteria plan non-discrimination (Section 125).

HRAs

- Cannot discriminate in favor of highly compensated individuals as to eligibility to participate or benefits (Section 105(h)).

Health FSAs

- Cannot discriminate in favor of highly compensated individuals as to eligibility to participate or benefits (Section 105(h)).
- Dependent Care accounts are subject to Section 129 rules.

Comparability Rules for HSAs

Final regulations issued regarding comparable contributions:

- **General Rule**: Employers choosing to contribute to HSAs must make comparable contributions to the HSAs of all groups of comparable employees (or subject to 35% excise tax).
  - Exclude collectively bargained, self-employed, and employees ineligible for HSAs
  - Test different groups: full-time employees, part-time employees, former employees, self-only and family coverage (with three tiers: self +1, self +2, self + 3 or more)
- **Exception**: Comparability rule does not apply to employer contributions made “through” a cafeteria plan.

Comparability Rules for HSAs

When are employer contributions to HSAs made "through" a cafeteria plan?

- If employees can make contributions to their HSA by salary reduction through the cafeteria plan, then any additional employer contributions are also "through" the cafeteria plan.
  - Even if some employees do not make salary reductions.
  - Do not need to offer a cash out option for employer contribution.
- If cashable flex credits are available for HSA contributions, then would be considered "through" the cafeteria plan, even without salary reductions.
- Non-cashable flex credits?

Uniform Coverage Rule or Pay As Funded?

HSAs

- Can pay as funded – be careful in advancing funds

HRAs

- Can pay as funded or advance funds

Health FSAs

- Uniform Coverage Rule applies (i.e., the entire annual salary reduction amount must be available for withdrawal from beginning of year)

Earnings

HSAs	HRAs	Health FSAs
• Typically will be earnings, which will be tax-free	• Typically no earnings; if in trust, then non-taxable	• Typically no earnings; if in trust, then non-taxable

Election Changes

HSAs	HRAs	Health FSAs
• Can change election as often as you want, as long as it is prospective (no election changes between general purpose health FSA and limited purpose health FSA)	• No change of election rules	• Subject to strict rules regarding changes of elections

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Ordering Rules

HSAs	HRAs	Health FSAs
• No ordering rules	• Can be payor of last resort or pay before the Health FSA	• Generally the payor of last resort. • If Health FSA and HRA offered together, can draft so that HRA is payor of last resort.

COBRA

HSAs	HRAs	Health FSAs
• No COBRA (but this account is portable and non-forfeitable)	• COBRA rules apply (sometimes unclear how)	• COBRA rules apply, with a special limitation

HIPAA and ERISA

HSAs	HRAs	Health FSAs
• HIPAA and ERISA typically will NOT apply (see DOL Field Assistance Bulletin 2004-1 regarding application of ERISA).	• HIPAA and ERISA will apply to most employers.	• HIPAA and ERISA will apply to most employers.

Medicare Part D

HSAs	HRAs	Health FSAs
• No Notices required • Reimbursements for prescription drugs count toward out-of-pocket limit for retirees but are not eligible for subsidy	• Notices are required by deadline • Reimbursements do not count toward out-of-pocket limit for retirees but may qualify for subsidy!	• No Notices required • Reimbursements for prescription drugs count toward out-of-pocket limit for retirees but are not eligible for subsidy

How Do Tax-Deferred Benefits Interact With Each Other?

Coordination Considerations

Coordination – HRAs and Health FSAs

Design options and limitations

- Contributions – no direct or indirect funding of HRA with salary reduction money
- Limit allowable expenses?
- Allow carryovers or spend-downs?
- How should withdrawals be ordered?
- Transitional issues – plan documents and forms

Coordination – HSAs and Health FSAs

Design options

- Limited purpose health FSA
    - Vision, dental, preventive care, mix and match
    - Problems: How do you administer preventive care FSA?
- High deductible health FSA
    - Limited use

Coordination – HSAs and Health FSAs

Transitional issues

– Mid-year implementation of HSA and limited purpose health FSA

- Mid-year change in election not permitted between general purpose health FSA and limited purpose health FSA
- Could adopt limited purpose health FSA mid-year, merge general purpose health FSA balances for all employees

– Problems arising from 2½ month grace period for health FSAs

- Extends period of health FSA coverage making employee ineligible for HSAs
- Employees cannot voluntarily restrict coverage during grace period to a limited purpose health FSA to avoid this problem.
- Employers can transfer all general purpose health FSA participants to the limited purpose health FSA during the grace period.

Coordination – HSAs and HRAs

HSAs are compatible with restricted HRAs:

- High deductible HRA
  - – If deductible of HRA is lower than HDHP, then lower deductible will determine contribution limit to HSA
- Limited purpose HRA
  - Reimburse expenses of dental, vision or preventive care
  - Reimburse expenses of permitted insurance
- Retirement HRA (medical expenses reimbursed only after the individual retires even if contributions made currently)
- Suspended HRA (employee elects prior to HRA coverage period to forgo payment or reimbursement by HRA for medical expenses incurred during the coverage period)

Coordination for Retirees

Retiree coverage — both HRAs and HSAs are suitable

Employer involvement in retiree coverage

– HRA withdrawals continue to be administered by employer after retirement

– HSA withdrawals are never administered by employer

Reimbursable expenses for retirees

– HRAs may pay premiums for Medicare Part B, Medicare supplement policies, long term care insurance

– HSAs may pay costs of qualified long term care insurance contracts and, after age 65, may pay for any health insurance other than Medicare supplement policies

Tax-Deferred Benefits: Stacking

Tax-Deferred Benefits: Stacking

Plan Design Options:

HDHP → Limited Purpose Health FSA → High Deductible HRA for Rx coverage → HSA

HDHP → Limited Purpose Health FSA → Suspended HRA → HSA

HDHP → Limited Purpose Health FSA → Retirement HRA funded with cash-outs of vacation time → HSA

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Thank you!

Questions and Answers