Benefits Toolkit:

Employer's Guide to HSAs, FSAs and HRAs

Provided by Troy Benefits Consulting

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Introduction

Employees have many choices when selecting their employer-provided benefits, but most hinge on their financial and health care needs. Amid economic turmoil and rising health care costs, workers are looking for guidance now more than ever to maximize every hard-earned dollar. Fortunately, employers are uniquely poised to provide their employees with the benefits and financial education they want.

Savings accounts can round out a top-tier benefits package. Such accounts help employees save on health-related costs and taxes and are also valuable to employers. Three standard tax-free savings accounts that employees can use to pay for qualified medical expenses include health savings accounts (HSAs), flexible spending accounts (FSAs) and health reimbursement accounts (HRAs). Such savings accounts can help employers save on health care expenses while offering employees options to use pre-tax dollars for eligible medical, dental and vision costs.

These types of savings accounts can fit into employers' larger picture of expanded financial wellness support. Today's workers want and need guidance and resources to help stretch their health care dollars. And when employees experience lower financial stress, employers may see greater employee productivity and morale and lower absenteeism. As many employers still face employee attraction and retention challenges across American workplaces, comprehensive benefits offerings can help secure talent, making it a win-win for employers.

This Benefits Toolkit analyzes savings accounts, specifically HSAs, FSAs and HRAs, and their importance to employees and organizations. Additionally, it explores the benefits of savings accounts and employer tips to increase utilization. Please note that the various considerations and strategies outlined within this toolkit are merely suggestions and are not intended to be exhaustive. Employers should consult legal counsel before making any changes to benefits packages.

Why Health Care Accounts Matter

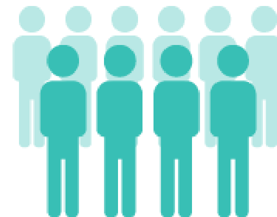
Benefits packages matter now more than ever, and savings accounts are often key offerings. Moreover, financial matters are a leading cause of employee stress and a major distraction at work. Employers can alleviate some of that stress to help employees focus better on the job. As a result, the workforce could experience higher engagement, increased productivity, fewer absences, and improved health and well-being.

Savvy employers are focusing on revamping or expanding current benefits to compete in the tight race for workers, and valuable savings tools are critical. This section explores the reasons why savings accounts matter to employees and employers alike.

Inflation

The U.S. inflation rate has reached its highest level in four decades, and Americans shouldn't plan on seeing relief any time soon. Inflation has led to significant price increases across many everyday consumer goods. As employees face increased financial difficulty, many employers are trying to help. While every employer may take a different approach to address inflation and its impact on their employees, many are reevaluating their benefits and building meaningful packages to help mitigate the effects employees face.

Only 4 in 10 Americans could cover a $1,000 emergency expense with their savings accounts, according to a Bankrate survey.



Unfortunately, many employees are unprepared for an extended economic downturn or recession and may not have enough money saved to cover emergency expenses. As a result, employees are quick to use money held in their retirement plans to pay for those unexpected expenses—or make short-term financial decisions that may have a negative long-term impact.

With savings stretched thin and a potential recession on the horizon, employees need guidance on prioritizing spending and paying bills. With savings accounts, employers have a unique opportunity to help employees avoid making poor financial decisions at the expense of their overall financial well-being.

Health Literacy and Medical Debt

More than 1 in 3 Americans have difficulty with everyday health tasks, such as reading a prescription drug label or making an educated health care decision, according to the U.S. Department of Education's National Assessment of Adult Literacy (NAAL). Low health literacy often results in higher utilization of essential and expensive health care services, such as emergency care and inpatient visits, which can add up quickly. Consequently, the NAAL estimates that low health literacy costs the United States up to $236 billion every year. Employers can promote employee engagement in health care decision-making by offering educational resources alongside valuable savings accounts. Not only does offering savings accounts help employees save for and cover qualified medical expenses, but employers can also help increase their workers' health literacy by explaining how accounts work and ways to maximize their dollars. The overall goal is to help make employees better health care consumers in an effort to offset unnecessary medical debt. In turn, improved health literacy of employees could lead to better business outcomes, such as higher employee productivity and lower health care costs.

The Kaiser Family Foundation estimates that 100 million adults—about 4 in 10 adults—have medical or dental debt. Many expect repaying the debt to take years, and about 1 in 5 say they do not expect to ever pay it all off.

Furthermore, medical debt is a specific concern and challenge for many people. According to the White House, medical debt is the largest source of debt in collections. Medical debt is not just a financial issue, as it can have adverse health effects. Research revealed that almost half of individuals with medical debt intentionally avoid seeking health care. Low health literacy and medical debt have many people floundering through their health care decisions and bills. Today's workers need health care guidance, and employers are poised to offer such direction and resources.

Attraction and Retention

The labor market was tight in 2022 and shows no signs of stopping in 2023. Labor metrics indicate that even though the market has slightly improved from last year, it remains a tight market. It's a safe bet that employers will continue struggling to compete for top talent in 2023.

Several terms have been coined to describe employment practices and behaviors over the past couple of years, such as "quick quitting," "quiet quitting" and "the Great Resignation." Undoubtedly, employers' expectations and workers' desires and must-haves have changed throughout this time, and workplaces have been perpetually impacted. Now, many organizations anticipate entering the Great Rebalance, which implies a rebalancing of the employer-employee relationship. Workers are returning to more typical career security and leverage levels following a highly worker-friendly market. As employers continue to compete for top talent, comprehensive and fulfilling benefits packages—including savings accounts—will play a critical role.

Understanding Savings and Spending Accounts

In an effort to respond to the rising costs of health care, many employers are offering tax-favored accounts, such as HSAs, FSAs and HRAs. It's important to keep in mind that the IRS generally regulates these benefits and sets rules and annual limits. This section provides an overview of HSAs, FSAs and HRAs, including employee eligibility and contribution limits, and why they are useful for both employees and employers.

HSA

HSAs can be a powerful tax savings tool. An HSA is a tax-exempt trust or custodial account established to pay qualified medical expenses. To contribute to an HSA, employees must be enrolled in a high deductible health plan (HDHP).

Employee Eligibility

To be eligible to contribute to an HSA, an individual must be covered by a qualifying HDHP. In addition, the individual cannot be covered by any other health coverage (with some narrow exceptions), enrolled in Medicare or be eligible to be claimed as a dependent on another person's tax return.

An individual may contribute to an HSA in any month in which they are covered under an HDHP on the first day of the month.

Contributions

Both employers and employees can make HSA contributions. In general, HSA contributions made by an eligible individual are tax-deductible, and employer HSA contributions made on behalf of an eligible employee are excluded from the employee's gross income. Interest and other earnings on HSA contributions accumulate tax-free. Amounts distributed from an HSA for qualified medical expenses are also generally tax-free. Keep in mind that some states define income differently than the IRS. As a result, HSAs that are tax-exempt at the federal level may not be tax-exempt at the state level.

In 2023, eligible individuals may contribute up to $3,850 for single coverage and $7,750 for family coverage into an HSA. In 2024, the amount increases to $4,150 for individual coverage and $8,300 for family coverage. Individuals age 55 or older by the end of the tax year are permitted to make "catch-up contributions" and can contribute up to an additional $1,000 annually.

HSA contributions do not have to be made in equal amounts each month. An eligible individual can contribute a lump sum or in any amount or frequency they wish. All funds in an HSA roll over to the following year.

Eligible Expenses

An HSA may reimburse qualified medical expenses incurred by the account beneficiary and their spouse and dependents. Visit the IRS' website for a complete list of qualified medical expenses.

In addition to qualified medical expenses, the Consolidated Omnibus Budget Reconciliation Act (COBRA) premiums and qualified long-term care premiums may be reimbursed from an HSA.

Why an HSA?

HSAs can be helpful for saving for current and future health care expenses—as long as the rules are followed. They provide triple tax benefits through tax-free contributions—interest, other earnings and eligible distributions are all tax-free. Funds in this type of account roll over from year to year, even if the individual is no longer eligible to contribute to the account. Additionally, an HSA is portable, meaning if an individual changes jobs, medical coverage or has other life changes, they can still use accumulated HSA funds. HSA funds are also an inheritable asset.

While the savings benefits are evident for employees, HSAs can also save employers money. Since employees own their HSA accounts, they're responsible for managing their funds—unlike with FSAs and HRAs—leaving employers with fewer administrative expenses. In addition, organizations are eligible for a tax deduction for any contributions they make to employees' HSA accounts, making it even easier to incentivize these plans.

FSA

An FSA is an account in an employee's name that reimburses the employee for qualified health care or dependent care expenses, helping reduce out-of-pocket expenses. It allows an employee to fund qualified expenses with pre-tax dollars deducted from the employee's paychecks. The employee can receive cash reimbursement up to the account's total value for covered expenses incurred during the benefit plan year and any applicable grace period.

There are two types of FSAs: health care accounts and dependent care accounts. A dependent care FSA is also called a dependent care assistance plan (DCAP).

An employee can elect to have both accounts and contribute separate pre-tax dollars. These accounts are kept separate, so an employee couldn't be reimbursed for dependent care expenses from their health care account.

Employee Eligibility

Unlike an HSA, employees do not need to be covered by an HDHP to participate in an FSA. They can be offered with any other type of health plan.

Contributions

Both employers and employees can make health FSA contributions. Employees may contribute pre-tax dollars to their health FSAs through a Section 125 plan (or cafeteria plan). Also, employers do not pay Federal Insurance Contributions Act (FICA) or unemployment taxes on employees' health FSA contributions.

Often, employers will set a maximum annual amount that employees may contribute to their health FSAs. Effective for plan years beginning on or after Jan. 1, 2013, the Affordable Care Act (ACA) limits employees' pre-tax health FSA contributions each year. Employers may continue to impose limits on employee health FSA contributions as long as the employer's limit does not exceed the ACA's maximum limit. Employers can set up employees with an FSA, and contributions are taken out of each paycheck—before taxes—in equal installments throughout the plan year. These dollars are then placed into employees' FSA.

In 2024, employees can contribute up to an annual maximum of $3,200 to a health FSA. If an employee is married, their spouse can put up to $3,200 in an FSA with their employer.

The DCAP maximum for 2024 is not subject to inflation, remaining at $2,500 for those married and filing separately and $5,000 for those who are single or married and filing jointly.

FSAs employ a "use-it-or-lose-it" model. If there are unused FSA funds at the end of the year (or after the grace period), the employee forfeits those funds. This dollar amount is adjusted for inflation, and $640 is the limit on FSA carryovers for plan years beginning in 2024. It should be noted that any amount carried over does not count toward the maximum contribution limit.

Grace Period

As an optional plan design feature, FSAs may incorporate a grace period after the end of the plan year. The grace period is an exception to the general use-it-or-lose-it rule by allowing plan participants to incur eligible expenses for a period after the plan year ends. IRS guidance provides that FSAs may "include a grace period of up to the fifteenth day of the third month immediately following the end of each plan year." In other words, employers may add up to a 2.5-month grace period to the end of their FSA's plan year. For example, an FSA with a plan year ending on Dec. 31, 2023, may incorporate a grace period that allows plan participants to continue to incur expenses through March 15, 2024. If an employer decides to add a grace period to its FSA, it must amend the plan documents to describe the grace period.

Eligible Expenses

Funds from a health FSA can help pay for copays, deductibles, prescription drugs, medical equipment and other qualified medical expenses. Qualifying medical expenses are unreimbursed medical care expenses, as defined under Section 213(d) of the Internal Revenue Code. Visit the IRS' website for a full list of qualified expenses.

A DCAP can be used to pay for the care of dependent children under the age of 13 by a babysitter, day care center, or a before- or after-school program. Care for a disabled spouse, parent or child older than age 12 is also eligible for reimbursement. For more information about dependent care expenses, visit the IRS' website.

Why an FSA?

FSAs benefit employees with out-of-pocket medical, dental, vision, hearing or dependent care expenses beyond an insurance plan. Employees need to determine their annual election amount at open enrollment time, so it's a good idea to consider medical needs for the year before choosing a contribution amount. FSAs can help employees save money by using tax-free funds to pay for qualified expenses while saving on taxes since FSA contributions decrease their taxable income. This flexible account allows employees to withdraw funds at any time when used for qualified expenses.

FSAs also benefit employers. The cost of FSAs to employers is relatively minimal and often offset by the tax savings an employer receives since the employee payroll deductions are taken pre-tax. An FSA is a top benefit to consider when making total rewards decisions since the account gives employees a tangible way to reduce out-of-pocket expenses for themselves and their dependents. Also, there are minimal expenses for the employer to provide the benefit when tax savings are considered. Ultimately, FSAs directly benefit employees while also being a cost-effective offering for employers.

HRA

An HRA is an employer-sponsored arrangement that reimburses employees on a tax-free basis for their eligible medical expenses. Unlike an HSA, employees do not need to participate in an HDHP to be eligible for an HRA. However, it is common for HRAs to be paired with an HDHP to maximize savings and increase employee awareness of medical spending.

Unlike the other accounts discussed in this section, HRAs are entirely funded by employer contributions.

Employee Eligibility

If an employer offers an HRA, they will establish eligibility rules, a maximum reimbursement amount and a list of eligible expenses. This account can either be offered to any eligible employee or only certain types of employees (e.g., full-time, part-time or seasonal status, salaried or hourly workers and work locations). HRAs may reimburse employees for their eligible medical expenses as well as their enrolled spouses' and dependents' eligible medical expenses.

Additionally, employers have considerable design flexibility with respect to their HRAs, including establishing the maximum reimbursement amount under the HRA. This limit may vary for different groups of employees, although employers are generally prohibited from basing contributions on an employee's age, length of service or compensation.

Contributions

Employer contributions are generally tax-deductible and excluded from an employee's gross income. Unlike HSAs and health FSAs, employees cannot contribute to an HRA. Most employers with HRAs create notional, or unfunded, accounts for each participating employee and reimburse eligible medical expenses up to each employee's HRA balance. Employers may link HRA contributions with employee behavior, such as participating in a wellness program. After incurring medical expenses, employees submit claims to the HRA administrator for reimbursement.

Eligible Expenses

Eligible medical expenses are unreimbursed medical care expenses, as defined under Section 213(d) of the Internal Revenue Code, which broadly defines "medical care" to include amounts paid "for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body."

The following are examples of common medical care expenses that an HRA may reimburse:

Drugs and medicine
(including over-the-counter drugs without a prescription)

Orthodontia

Drug addiction treatment

Eye exams, eyeglasses, contact lenses or vision correction surgery

Deductibles, copayments and coinsurance
(if the underlying expense is for medical care)

Dental exams and procedures

Hearing exams and hearing aids

Fertility treatments

Durable medical equipment (e.g., crutches)

Genetic testing or counseling
(to the extent the testing is done to diagnose a medical condition or to determine possible defects)

Menstrual care products

An employer can more narrowly define the expenses that can be reimbursed from its HRA. Unlike HSAs, HRAs cannot be used to pay for nonmedical expenses.

Why an HRA?

Since HRAs are employer-funded, being able to use the funds for qualified medical expenses reduces the amount employees spend on health care. Most importantly, an HRA may be attractive to employees because it removes any financial burden they may face in making contributions.

HRAs can significantly benefit employers. HRAs offer employers more control over the account than they would have over FSAs or HSAs. It's important to remember that employers get to choose which employee classes and types of medical expenses to cover and can even decide whether to allow balance carryovers. Moreover, an HRA can be a valuable recruiting and retention tool since it's an employer-provided account and fund for employees. As with any benefits offering, HRA design choices should be reviewed by the employer's advisors to ensure compliance with legal requirements.

Workplace Considerations

While many employers offer savings and spending accounts as part of their benefits packages, there are nuances to take into account and tips to increase employee engagement and utilization of accounts. This section explores key considerations for employers looking to offer HSAs, FSAs and HRAs as part of their employee benefits packages.

Employee Engagement and Utilization

Meaningful and comprehensive benefits can help promote employee engagement from the start. Suppose employees have a robust benefits package available to them. In that case, they are more likely to actively make plan decisions and be interested in learning more to fully take advantage of available benefits, perks and resources. When done correctly, employee engagement results in benefits utilization.

The following are strategies to increase employee engagement and utilization with employer-offered spending and savings accounts:

- ***Empower employees through education.** One of the first steps in helping engage employees in their benefits selection is education. Employers have a unique opportunity to provide data and information to help employees understand the savings potential of leveraging HSAs, FSAs and HRAs, if available. General financial wellness education is in demand from today's workers, so employers can use this to help employees better understand their finances and offer solutions to save money, afford health care expenses and stretch their hard-earned dollars further.*
- ***Leverage providers' tools.** When available, lean on available information and tools offered by benefits providers. Oftentimes, resources are already available for employees, so use them as is or inquire about ways to customize tools based on the organization. For example, a calculator tool could help employees better understand how much to contribute and make the most out of their accounts. Also, younger generations generally prefer to use online technology to access their health care and make decisions. Knowledge of this consumption habit can be used to increase engagement.*
- ***Communicate via multiple channels.** Repetition is effective. Multichannel communication is necessary for employee engagement and information retention. Communications should be simple and offer various ways for employees to learn about their benefits. Reminders can go a long way as well for important decision-making deadlines.*
- ***Incentivize behaviors.** As with any workplace initiative or program, employees sometimes need encouragement to participate in all potential benefits offerings. Employers should consider if incentives fit into plans. For example, they could offer seed money or matching contributions in HSAs to help encourage employees to participate and contribute money.*

Common Pitfalls to Avoid

Conversely, there are also common challenges employers may face when they offer HSAs, FSAs and HRAs. Consider the following pitfalls related to accounts to avoid:

- ***Administration**—Certain accounts, such as HRAs and FSAs, will require higher levels of administration, so it's important for employers to consider that and have a plan in place so administration doesn't get in the way of employees utilizing the accounts. Generally, the more benefits an employer offers, the more administrative overhead costs. Sometimes employers opt to outsource with a third-party administrator who can take some of the responsibility.*
- ***Legal compliance**—Employers may struggle with rules related to contributions, eligibility and unused funds. One-on-one benefit review during open enrollment could help catch such mistakes. Furthermore, offering any type of employee benefit raises concerns regarding legal compliance. Mistakes could result in lawsuits, regulatory fines and related legal fees. Employers should consult legal counsel before making any benefits changes, including the design, structure, implementation and administration of offerings.*

Regardless of which account or arrangement is being offered, employers should carefully review their options and decide on benefits that are best for their organization and workers. HSAs, FSAs and HRAs might not be the right choice for every company, so it's essential to carefully consider whether these benefits are a great offering for employees or potentially an unnecessary burden on the employer.

Summary

Benefits packages matter more than ever in today's tight competition for talent. Financial issues are a leading cause of employee stress and a significant distraction at work, as many workers struggle with medical debt and rising inflation. Employers have a great opportunity to alleviate many of these concerns by offering employee benefits that can help stretch health care dollars and providing the education and guidance many workers desperately want and need.

HSAs, FSAs and HRAs are three common accounts in which employers can offer employees more options to use pre-tax dollars for eligible medical, dental and vision costs while saving on health care expenses. These accounts have proven to be popular offerings due to various benefits to both employees and employers. When workers are better health care consumers, they will not only be healthier and experience lower costs, but employers will see the trickle effect as well.

Benefits options can be overwhelming for employees and employers alike, but our team can partner with you to develop and maintain a competitive benefits package. Contact Troy Benefits Consulting to further discuss savings accounts and other employee benefits at your organization.

Appendix

This appendix features valuable information about HSAs, FSAs and HRAs, including cheat sheets, infographics and posters and Benefits Insights articles.

Please consult with Troy Benefits Consulting if you have any questions about these materials or would like additional employee communication resources (e.g., articles, videos, postcards and presentations) about savings accounts, arrangements or other benefits.

Printing Help

There are many printable resources in this appendix. Please follow the instructions below if you need help printing individual pages.

1. *Choose the "Print" option from the "File" menu.*
2. *Under the "Settings" option, click on the arrow next to "Print All Pages" to access the drop-down menu. Select "Custom Print" and enter the page number range you would like to print, or enter the page number range you would like to print in the "Pages" box.*
3. *Click "Print." For more information, please visit the Microsoft Word printing support page.*

is pleased to now offer the option of a flexible spending account (FSA)!

What are the benefits of an FSA? What are the disadvantages?

- It **saves you money**. An FSA is an employer-sponsored savings account that allows you to put aside money tax-free that can be used to pay for qualified medical expenses.
- It is a **tax-saver**. Contributions to your FSA are made with pre-tax dollars. Since your taxable income is decreased by your contributions, you pay less in taxes.
- It is **flexible**. You can withdraw health FSA funds at any time for qualified medical expenses, even if it's only the beginning of the year and you haven't contributed the entire yearly amount yet.
- It requires **careful planning**. FSAs operate under a use-or-lose rule, meaning that if you don't use the money in your FSA by the end of the plan year, you lose it. Some employers, however, may offer a grace period or allow you to carry over.
- It is **not portable**. If you change jobs, you typically forfeit the funds left in your FSA.
- It requires **proof**. You must fill out all the necessary forms and show receipts for FSA-eligible purchases in order to be reimbursed.

For more information about FSAs, contact HR.

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is pleased to now offer the option of a high deductible health plan (HDHP) in conjunction with a health savings account (HSA)!

Why might an HSA be the right choice for you?

- It **saves you money**. For individuals with few regular health expenses, paying a traditional health plan premium can feel like throwing money out the window. HDHPs come with much lower premiums than traditional health plans, meaning less money gets deducted from your paychecks. Plus, HSAs are basically "cash" accounts, so you may be able to negotiate pricing on many medical services.
- It's **portable**. Even if you change jobs, you get to keep your HSA.
- It's a **tax saver**. Contributions to your HSA are made with pre-tax dollars. Since your taxable income is decreased by your contributions, you pay less in taxes.
- It allows for an **improved retirement account**. Funds roll over at the end of each year and accumulate tax-free, as does the interest on the account. Also, once you reach the age of 55, you are allowed to make additional "catch-up" contributions to your HSA until age 65.
- It puts **money in your pocket**! You never lose unused HSA funds. They always roll over to the next year.
  - ** Please note: State laws differ. Contributions made to your HSA may not be deductible from state income taxes.*

For more information about HSAs, contact Human Resources at .

is pleased to now offer the option of a high deductible health plan (HDHP) in conjunction with a health reimbursement arrangement (HRA)!

Why might this plan option be the right choice for you?

- **It saves you money**. For individuals with few regular health expenses, paying a traditional health plan premium can feel like **wasting money**. HDHPs come with much lower premiums than traditional health plans, meaning less money is deducted from your paychecks.
- An HRA is a fund that is **paid for solely with your employer's money**.
- You can use your HRA to pay **qualified medical expenses**, COBRA benefits, long-term care or Medicare premiums.
- **Preventive care**, such as routine physicals and child immunizations, is typically covered 100 percent by your health plan, so these types of charges **will not be charged** against your HRA fund.
- **It puts money in your pocket!** You don't lose unused HRA funds at the end of each year. Remaining HRA funds roll over to the next year to be used for qualified medical expenses, COBRA benefits, long-term care or Medicare premiums.

For more information about HRAs, contact Human Resources.

Health Savings Accounts

In an effort to respond to the rising costs of health care, many employers are offering tax-favored accounts, such as health flexible spending accounts (health FSAs), health reimbursement arrangements (HRAs) and health savings accounts (HSAs).

What is a health savings account?

An HSA is a tax-exempt trust or custodial account established for the purpose of paying qualified medical expenses. An HSA accompanies a high deductible health plan (HDHP).

HSAs can be a powerful tax savings tool. In general, HSA contributions made by an eligible individual are tax-deductible, and employer HSA contributions made on behalf of an eligible employee are excluded from the employee's gross income. Interest and other earnings on HSA contributions accumulate tax-free. Amounts distributed from an HSA for qualified medical expenses are generally tax-free as well.

Keep in mind that some states define income differently than the IRS. As a result, HSAs that are tax-exempt at the federal level may not be tax-exempt at the state level.

Who can establish an HSA?

An individual may contribute to an HSA in any month in which he or she is covered under an HDHP on the first day of the month. The individual cannot be covered by another health plan that is not an HDHP (with certain exceptions), and he or she cannot be entitled to Medicare benefits or be claimed on another person's tax return. Self-employed individuals are eligible to establish an HSA.

What expenses are eligible for tax-free reimbursement from an HSA?

An HSA may reimburse qualified medical expenses incurred by the account beneficiary and his or her spouse and dependents. In addition to qualified medical expenses, COBRA premiums and qualified long-term care (QLTC) premiums may be reimbursed from an HSA. A full list of qualified medical expenses can be found here.

What expenses are not eligible for tax-free reimbursement from an HSA?

The following expenses may not be reimbursed from an HSA:

- *Premiums for Medicare supplemental policies;*
- *Expenses covered by another insurance plan;*
- *Expenses incurred prior to the date the HSA was established; or*
- *Any expenses other than qualified medical expenses and the HSA reimbursable premiums described above.*

The amount withdrawn from an HSA for a non-qualifying medical expense is added to the account beneficiary's income and subject to a 20% penalty. If funds are distributed as a result of the account beneficiary's death, disability or after he or she becomes eligible for Medicare, the 20% penalty does not apply.

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How much can an individual contribute to an HSA?

In 2023, eligible individuals may contribute up to $3,850 for single coverage and $7,750 for family coverage. In 2024, it increases to $4,150 for individual coverage and $8,300 for family coverage. Individuals who are age 55 or older by the end of the tax year are permitted to make "catch-up contributions" and can contribute up to an additional $1,000 annually.

HSA contributions do not have to be made in equal amounts each month. An eligible individual can contribute in a lump sum or in any amounts or frequency he or she wishes.

Also, the HSA contribution limit is reduced by any contributions made to a medical savings account (MSA) in the same year. Rollover contributions from another HSA or MSA can be accepted. These rollover contributions are not subject to the annual contribution limit.

Where can I find more information on HSAs?

To find more information about HSAs, visit: www.irs.gov/publications/p969/ar02.html.

HSAs may not be right for all employers or individuals. Please contact Troy Benefits Consulting for assistance in determining what tax-advantaged account will best meet your goals.

Benefits Insights

Brought to you by the insurance professionals at
Troy Benefits Consulting

Flexible Spending Accounts

A flexible spending account (FSA) is an account in an employee's name that reimburses the employee for qualified health care or dependent care expenses. It allows an employee to fund qualified expenses with pre-tax dollars deducted from the employee's paychecks. The employee can receive cash reimbursement up to the total value of the account for covered expenses incurred during the benefit plan year and any applicable grace period.

"Use-it-or-lose-it" Rule

As required by the Internal Revenue Service (IRS), an FSA has a "use-it-or-lose-it" provision stating that any unused funds at the end of the plan year (plus any applicable grace period) will be forfeited. When electing an FSA during open enrollment, the employee must specify how much he or she would like to contribute to the FSA for the year. The goal is to choose an amount that will cover medical or dependent care expenses, but that is not so high that the money will be forfeited at the end of the year.

The IRS allows employers to offer an extended deadline, or grace period, of 2 ½ months after the end of a plan year to use FSA funds. Thus, for a plan year ending Dec. 31, employees would have until March 15 to spend the funds in their FSAs. This provision is strictly optional; the employer must choose to implement it.*

In addition, employers may allow participants to carry over up to $640 in unused funds into the next year, for the 2024 plan year. Similar to the grace period rule, this carry-over rule is strictly optional, and employers must choose to implement it. The carry-over provision is only available if the plan does not also incorporate the grace period rule.*

Types of FSAs

There are two different types of FSAs: health care accounts and dependent care accounts. An employee can elect to have both types of accounts and contribute separate pre-tax dollars to each. These accounts are kept separate; for instance, an employee could not be reimbursed for dependent care expenses from his or her health care account.

Health Care Accounts

A health care FSA reimburses employees for eligible medical expenses, up to the amount contributed for the plan year. A health care FSA offered through a cafeteria plan must limit the amount of salary reduction contributions that employees can make.

For 2023, the contribution limit is $3,050. For 2024, the limit is $3,200.

A health care FSA only reimburses employees for money spent on medical care, as defined under Section 213(d) of the Tax Code. Section 213(d) of the Tax Code defines "medical care" to include amounts paid "for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body."

Examples of qualified medical expenses include deductibles and copayments for an individual's health plan. Eye exams, eyeglasses, contact lenses, hearing exams, hearing aids, physical exams and smoking cessation programs are also covered. For a complete list of qualified medical expenses, visit the IRS website.

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Dependent Care Accounts

The second type of FSA is a dependent care account. This account can be used to pay for care of dependent children under the age of 13 by a babysitter, day care center, or before- or after-school program. Care for a disabled spouse, parent or child over the age of 12 is also eligible for reimbursement.*

Many of the same general rules that apply to health care FSAs also apply to dependent care accounts, such as the "use it or lose it" rule. However, there are some other important differences between the two types of accounts. For dependent care accounts:

- *There is an annual limit as to how much an employee can contribute. This amount is $5,000, or, if lower, the maximum amount that can be excluded from the employee's income under Section 129 of the Tax Code when the employee's election is made;*
    - *The American Rescue Plan Act temporarily raises pre-tax contribution limits for a DCAP for calendar year 2021. For this calendar year, a married employee who files a joint tax return or an unmarried employee may place up to $10,500 in a DCAP. A married employee who files a separate tax return may place up to $5,250 in a DCAP.*
- *The money in a dependent care account is not available until it has been deposited by the employee; and*
- *Dependent care expenses cannot be reimbursed until they are actually incurred. This can be an issue when child care centers "pre-bill" for services, and employees are required to pay in advance.*

For more information on FSA plan design and compliance, contact Troy Benefits Consulting today.

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Health Reimbursement Arrangements

Health reimbursement arrangements (HRAs) are plans designed to help employers and employees lower health care costs. Allowed under sections 105 and 106 of the Internal Revenue Code, HRAs enable employers to reimburse employees for out-of-pocket medical expenses not covered by insurance. HRAs are often combined with high-deductible health plan coverage.

What are HRAs?

HRAs are employer-paid health care arrangements that are often paired with high-deductible health plans to lower health care costs. Typically, an employer creates an unfunded HRA account for each participating employee and reimburses the employee up to the HRA's account balance for substantiated medical expenses not covered by insurance, such as insurance deductibles and copayments.

How do HRAs work?

If an employer chooses to offer an HRA, it establishes eligibility rules, a maximum reimbursement amount and a list of eligible expenses. (This list must comply with section 213(d) medical expenses as defined in the Internal Revenue Code.) After incurring medical expenses, employees submit claims to the HRA administrator for reimbursement.

Tax implications

For employers, all HRA reimbursements are tax-deductible. For employees, contribution amounts made by employers are tax-free and reimbursements for medical expenses are also tax-free.

Advantages

Employers benefit from offering HRAs by reducing insurance costs and restructuring health benefits. By moving employees to high-deductible health plans, costs are more predictable and controlled as employees are encouraged to become better health care consumers. HRAs motivate employees to make better health care and future planning decisions.

Employees benefit from the protection HRAs provide against catastrophic medical costs. HRA funds can be used to cover a wide range of health care expenses, but unlike health flexible spending accounts (FSAs), HRAs can be designed to allow funds to be carried over year to year. However, unused HRA amounts may not be cashed out—only carried over to the following year. Also, employers may establish account caps on total HRA account balances and include rollover maximums on carryover balances.

What expenses are not eligible for reimbursement through HRAs?

The following expenses are considered ineligible for HRA reimbursement:

- *Medical expenses not defined as eligible under an employer's plan*
- *Medical expenses that do not meet the definition of "medical care" under Internal Revenue Code section 213(d)*
- *Medical expenses incurred by an employee, employee's spouse or any eligible dependents prior to the effective date in the program*
- *Medical expenses that can be reimbursed to an employee through another source, such as group health insurance*

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Basic HRA legal requirements

1. ***Only Employer Contributions*** *– HRAs must be funded solely with employer contributions. No direct or indirect employee contributions are allowed.*

2. ***No Cafeteria Plan Funding*** *– An HRA can be offered with a group health plan that is offered under a cafeteria plan; the HRA itself may not be funded with pre-tax salary reductions or otherwise under a cafeteria plan.*

3. ***Reimbursements for Certain Individuals Only*** *– An HRA may reimburse medical care expenses only if they were incurred by employees or former employees (including retirees) and their spouses and tax dependents. This also includes adult children who are under age 27 as of the end of the taxable year. HRA coverage must be in effect at the time the expense is incurred.*

4. ***Reimbursements for Certain Medical Expenses Only*** *– HRAs may reimburse only substantiated medical expenses described in Internal Revenue Code section 213(d). Such expenses include out-of-pocket medical expenses, dental and vision expenses and prescription drugs.*

   Under the Affordable Care Act (ACA), HRAs may be used to reimburse the cost of over-the-counter medicines or drugs only if they are purchased with a prescription. This rule does not apply to reimbursement for the cost of insulin, which is permitted even if the insulin is purchased without a prescription.

5. ***No Cash-Out of Unused Amounts*** *– Unused HRA amounts cannot be cashed out and can only be used for reimbursement of medical care expenses. If an HRA includes a spend-down feature, terminated employees can spend down their HRA balances for medical expenses incurred after termination. After an employee's death, only reimbursement of qualifying medical expenses of a surviving spouse or tax dependent is allowed.*

6. ***COBRA*** *– COBRA applies to an HRA. The legal issues surrounding COBRA and HRAs are complex, so consult with legal counsel.*

7. ***Coordination with Health FSA*** *– HRA may be coordinated with a health FSA to modify which pays first. If no rule is established, the HRA pays first and the health FSA pays last.*

8. ***Section 105 Nondiscrimination Rules*** *– Nondiscrimination rules apply to self-insured medical plans and consequently are applicable to most HRAs. Under these rules, a self-funded HRA cannot discriminate in favor of highly compensated employees, and must satisfy the eligibility and benefits tests.*

9. ***HIPAA Rules*** *– An HRA is a health plan that is subject to HIPAA's privacy and security rules.*

10. ***ERISA*** *– An HRA is a welfare benefit plan and is covered under ERISA unless it is a governmental or church plan.*

Permissible HRA Designs

The ACA's market reforms (for example, the prohibition on annual limits) restrict the types of HRAs that employers can offer. Most stand-alone HRAs are prohibited due to the ACA's reforms, although HRAs that are integrated with other group health plan coverage are permissible. Permissible HRA designs include the following:

- *HRAs that are integrated with other group health plan coverage will not violate the ACA's market reforms, as long as the group health plan coverage complies. An HRA is considered integrated with an employer's group health coverage if, under the terms of the HRA, the HRA is available only to employees who are enrolled in another group health plan that does not consist solely of excepted benefits and certain other criteria are satisfied.*

- *Stand-alone HRAs (or HRAs that do not meet the requirements for integration) are not permitted, unless the HRA qualifies for an exception. For example, retiree-only HRAs are not subject to the ACA's market reforms and may be offered on a stand-alone basis. Prior to 2020, employers couldn't offer a stand-alone HRA for employees to purchase individual coverage, inside or outside of an Exchange, without violating the ACA's market reforms and risking exposure to severe financial penalties. (Beginning in 2020, employers may use an individual coverage HRA to reimburse*

eligible employees for individual health insurance premiums, subject to certain requirements.)

- *A qualified small employer HRA (or QSEHRA) is an exception to the prohibition on stand-alone HRAs. Small employers that do not maintain traditional group health plans can use a QSEHRA to reimburse employees' out-of-pocket medical care expenses, including premiums for individual health insurance policies. Only small employers that are not subject to the ACA's employer shared responsibility rules may adopt QSEHRAs. Additional design requirements, including a maximum benefit limit, apply to these HRAs.*

Effective for 2020 plan years, employers have the following two additional HRA options available to them:

- *As an alternative to traditional group health plan coverage, employers may use an individual coverage HRA to reimburse the cost of individual market premiums on a tax-preferred basis, subject to certain conditions.*
- *Employers that offer traditional group health plan coverage may provide a non-integrated HRA of up to $1,800 per year (as adjusted) to reimburse certain qualified medical expenses.*

How do HRAs compare or differ from FSAs and HSAs?

HRAs are the only tax-favored accounts among this group that are owned and funded solely by employers. Unlike health FSAs and HSAs, there are no prescribed limits set by the IRS for HRAs. Also, unlike health FSAs but similar to HSAs, the uniform coverage rule does not apply to HRAs. Also, unlike health FSAs, but similar to HSAs, HRA funds can be rolled over from year to year.

HRA and health FSA rules

HRAs are generally but not always health FSAs, yet are not subject to the following FSA rules:

- *Prohibition against carrying unused benefits into future plan years does not apply.*
- *The mandatory 12-month period of coverage does not apply, which gives employers more flexibility in designing an HRA.*
- *The uniform coverage rule does not apply, so the maximum amount of reimbursement under an HRA does not have to be available at all times during the period of coverage.*
- *An expense incurred by a participant in one year may be properly paid out of the HRA balance attributable to a subsequent year, provided that the individual was a participant when the expense was incurred and remains a participant in the subsequent year.*

HRA and HSA comparison

- *No HDHP is required. HRAs combined with another health plan allow for additional flexibility. Group health plan covered offered with an HRA does not have minimum deductibles or maximum out-of-pocket limitations.*
- *HRAs give plan sponsors more control (for example, employers can decide whether the HRA will forfeit balances at termination, and they can choose what qualified medical expenses the HRA will cover).*
- *HRAs have no limits on how much an employer can contribute in any given month, year or other coverage period.*
- *HRAs are not subject to the comparable contribution requirements but are subject to Internal Revenue Code section 105 nondiscrimination requirements.*
- *HRAs require less coordination with other plans than is required by an HSA.*
- *HRAs do not have to be funded and are often simply credits that are not backed by actual contributions.*

Coordination of benefits issues

- *An individual may not have a general purpose HRA and contribute to an HSA.*
- *An individual may have certain types of HRA coverage and still be eligible for an HSA:*
  - *Limited purpose HRA*
  - *Suspended HRA*
  - *HDHP with post-deductible HRA coverage*
  - *Retirement HRA*

    - *Combination of the above*

Key plan design questions

- ***Stand–Alone HRA or HRA + health plan?***
    - *Stand-Alone*
        - *Limited availability due to the ACA's annual limit prohibition*
        - *Retiree-only*
        - *Reimbursement for excepted benefits, for example, dental or vision expenses*
        - *QSEHRA*
        - *Individual coverage HRA (effective for 2020)*
        - *Preserve HSA eligibility (depending on design)*
    - *HRA/Health Plan*
        - *High flexibility*
        - *Employer can limit the availability of HRA COBRA coverage to qualified beneficiaries who also elect health plan's COBRA coverage.*

- ***Who will be eligible to participate?***
  As long as the HRA passes nondiscrimination testing, employers can cover all employees, only those participating in the health plan, only retirees or a limited class of employees. However, to be considered integrated with other group health coverage for purposes of the ACA's annual limit rules, HRA eligibility must be restricted to employees who are enrolled in other group health plan coverage (regardless of whether the employer sponsors the other group health coverage). Self-employed individuals, including partners in a partnership and more than 2% shareholders in an S corporation cannot participate in an HRA on a tax-favored basis.

- ***What expenses are reimbursable?***
    - *If an HRA is offered along with an HSA/HDHP, HRA coverage must be limited to certain expenses or designed to permit reimbursements after the HDHP deductible has been met.*

    - *Expenses an HRA can reimburse are limited to qualified medical expenses; however, an employer may choose to be more restrictive on what the plan will reimburse.*

- ***How much will the employer contribute?***
  There is no specified cap on the amount an employer is allowed to contribute to an HRA. However, nondiscrimination rules apply to the benefits provided under HRAs. Employers must be careful to structure HRA contributions so that they do not discriminate in favor of highly compensated employees. An employer can choose to credit an employee's HRA account once per year, on a pro rata monthly basis or on each payday.

- ***How will the HRA be funded?***
  HRAs must be funded solely by the employer and may not be part of a cafeteria plan. Employers must decide whether the HRA will be funded through a separate account or whether reimbursements will be made from employer general assets (unfunded). Most employers maintain their HRAs on an unfunded basis.

- ***Will carryovers be allowed?***
  Employers may allow carryovers of unused account balances on HRAs, but they don't have to. Employers can allow unlimited carryovers or put limits on carryovers. Caps can be placed on the carryover amounts and plan sponsors can also set a maximum contribution each year.

- ***How will reimbursements be processed?***
  Because substantiation is required for HRA reimbursements, and due to privacy concerns, employers may consider hiring a third-party administrator (TPA) to substantiate claims. Employers should complete a due diligence of TPAs and have service agreements and business associate contracts reviewed by counsel. Employers should also consider if they want caps on reimbursements. If the employer also sponsors a health FSA, the employer should consider how the claims will be ordered.

- ***Forfeit account balances or permit spend-downs?***
  An employer may choose either to forfeit unused amounts in an employee's HRA when the employee terminates employment or allow employees to spend down their accounts. COBRA must be offered.

  HRAs may or may not be the right solution for all employers. Please contact your Troy Benefits

Consulting representative for assistance in determining what tax-advantaged account will best meet your goals.

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Comparing HSAs, HRAs and FSAs: Which Approach Is Best?

Employers are increasingly looking to consumer driven health plans to help soften the blow of continually rising health care costs. Depending on the model, consumer driven health plans typically include health reimbursement arrangements (HRAs), flexible spending accounts (FSAs) or health savings accounts (HSAs).

Consumer driven health plans generally increase employees' stake in their own health care costs. In most cases, a consumer driven health plan covers a wide range of medical expenses, but also includes more cost-sharing for participants (for example, higher deductibles). Some plans incorporate an HRA, health FSA or HSA to help employees pay for their out-of-pocket medical expenses on a tax-free basis. This article provides some basic information about the similarities and differences between HRAs, FSAs and HSAs.

HSAs

Due to their tax-favored status, HSAs have strict rules regarding eligibility and contributions. In order to make or receive HSA contributions, individuals must meet the following qualifications:

- *Be covered by a high deductible health plan (HDHP)*
- *Not have any other health coverage (with some exceptions)*
- *Not be claimed as a dependent on another person's tax return*
- *Not be covered by Medicare*

The employer and employee can contribute to the HSA in the same year, subject to annual limits. Employers may allow employees to make pre-tax salary reduction contributions to fund their HSAs. Individuals may roll over unspent funds in the HSA from year to year. Since the HSA is a tax-exempt account owned by the employee, he or she may keep the account upon termination of employment or retirement.

Health FSAs

Health FSAs provide a means for employees to reduce their income tax liability through salary reduction. Employees can contribute a portion of their own salary to an account designated to pay for health care expenses. These pre-tax contributions are exempt from income and payroll taxes. The Affordable Care Act (ACA) limits employee's pre-tax contributions to their health FSAs to $3,200 (adjusted for inflation for future plan years).

There are some strict design requirements for health FSAs that have negatively impacted their popularity. While any individual who satisfies the HSA eligibility criteria can make HSA contributions, only employees can participate in a health FSA. This means that, while self-employed individuals can establish health FSAs for their employees, they cannot set up their own accounts.

In addition, FSAs have a "use-it-or-lose-it" provision. In general, employees are required to elect a specific amount of salary reduction at the beginning of the year, and then must use every dollar in the account by the end of that year. Because annual medical expenses are hard to predict, employees often overfund the accounts and then spend unnecessarily at the end of the year to avoid forfeiting the money in their accounts.*

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To help avoid this problem, the IRS allows health FSAs to incorporate either a grace period or carry-over feature. Health FSAs with a grace period allow participants to access unused amounts remaining in an FSA at the end of the plan year to pay for expenses incurred during a grace period of up to two and a half months after the end of the plan year. Alternatively, health FSAs may allow participants to carry over up to $640 of unused funds remaining at the end of a plan year to be used for qualified medical expenses incurred during the following plan year.*

Health FSAs are also subject to a uniform coverage rule, which requires the health FSA to operate like an insurance plan, with the employer assuming the risk of loss. Under this rule, an employee's maximum reimbursement amount for a year must be available at any time during the coverage period, even if a reimbursement would exceed the year-to-date contributions to the employee's FSA.

Health FSAs are group health plans that are subject to laws such as the ACA, the Health Insurance Portability and Accountability Act (HIPAA) and the Consolidated Omnibus Budget Reconciliation Act (COBRA).

HRAs

HRAs allow employees to use employer contributions to pay for (or reimburse) eligible medical care expenses. HRAs can only be funded with employer money; employees cannot make contributions to their HRAs. Unlike health FSAs, unused HRA balances may accumulate from year to year.

There is no specified cap on the amount an employer is allowed to contribute to an HRA. Also, an HRA is not subject to the uniform coverage rule that applies to health FSAs. However, like health FSAs, only employees can participate in an HRA, which means that self-employed individuals cannot participate in an HRA on a tax-favored basis.

Like health FSAs, HRAs are group health plans that are subject to laws such as HIPAA and COBRA. Under the ACA, most HRAs must be "integrated" with another group health plan to satisfy certain market reforms.

Deciding on the Right Approach

Introducing consumerism into your health plan requires an evaluation of the benefits and disadvantages of HSAs, FSAs and HRAs. No one solution is right for every employer. If your organization is considering implementing a consumer driven health plan, your Troy Benefits Consulting representative can help you decide which plan is best for you.