FLEXIBLE SPENDING ACCOUNTS (FSA)

DEFINITION

Flexible Spending Accounts (FSAs), also known as flex plans or reimbursement accounts, are an employer-sponsored benefit that allows an individual to pay for eligible medical expenses on a pre-tax basis (there are also similar accounts for dependent and child-care expenses). The funds are deducted directly from an employee's paycheck and deposited into an FSA.

HOW THEY WORK

ELIGIBILITY

FSAs are established by an employer and may be offered in conjunction with other employer-provided benefits as part of a cafeteria plan. Employers have flexibility in offering various combinations of benefits in designing their plan. Employees do not have to be covered under any other health care plan to participate. Those that are self-employed are not eligible to contribute to an FSA.

There is generally only one opportunity a year to enroll, unless the employee has a qualified "family status change," such as marriage, birth, divorce, or loss of a spouse's insurance coverage.

CONTRIBUTIONS

At the beginning of the plan year (which usually starts January 1st), the employee must decide how much money to contribute for the year. The amount designated for the year is then taken out of the employee’s paycheck in equal installments each pay period and placed in a special account by the employer. Since these funds are not subject to payroll or federal and state income taxes, they can result in substantial tax savings. The employer may also make contributions.

CONTRIBUTION LIMITS

In 2015, for Healthcare Flexible Spending Accounts, the IRS has set a maximum contribution of $2,550.

DISTRIBUTIONS

Depending on the FSA plan, a debit card may be used to access the account funds. Participants may use the debit card to pay for their FSA-eligible expenses at the point of sale. Otherwise, paper forms must be filled out to make file a claim. Funds in an FSA must be used by the end of the plan year. Employees have three months after the end of the calendar year to submit claims for eligible expenses incurred during the previous calendar year.

QUALIFIED EXPENSES

The most common use of FSA funds is for medical expenses not paid for by insurance; this usually means deductibles, copayments, and coinsurance for the employee's health plan, but may also include expenses not covered by the health plan, such as dental and vision expenses. A medical FSA cannot pay for health insurance premiums, cosmetic items, cosmetic surgery, controlled substances (in violation of federal law), or items that improve "general health". All items must be intended to treat or prevent a specific medical condition. Allowable items are generally the same as those allowable for the medical tax deduction, as outlined in IRS publication 502.

Beginning in 2011, over-the-counter (OTC) medications cannot be paid with FSA dollars without a prescription.

FORFEITURE

Generally, contributed amounts that are not used by the end of the plan year are forfeited. This is often referred to as the "use it or lose it" provision. For this reason, it is important for an employee to base their contribution on an estimate of the qualifying expenses they anticipate incurring during the year.

PRE-FUNDING

One caveat for both employers and employees to consider is called "pre-funding." The participating employee's entire annual contribution is available at the start of the plan year or after the first contribution to the FSA is received by the FSA vendor, depending on the plan. This means that if the employee experiences a qualifying event early in the year, the entire amount of the annual contribution can be claimed against the FSA benefits. Subsequently, if the employee is terminated, quits, or is unable to return to work, he or she does not have to repay the money to the employer.