Financial Planning Newsletter

March 2012 | Volume 2, Issue 3

Phone: 925.242.2544 Email: info@claritywa.com Website: www.claritywealthadvisors.com

Health Funding Accounts

Hello!

Recently, we have received questions from clients regarding the differences between the various health funding accounts available through their employer and in the marketplace. These include Flexible Spending Accounts (FSAs), Health Savings Accounts (HSAs), and Health Reimbursement Arrangement (HRA) Accounts. We thought it would be helpful to provide a summary of the characteristics for each one and have created a comparison chart which can be found in the Additional Clarity section of our website. Given the rising costs of health care, it is beneficial to take advantage of accounts that are funded with pre-tax dollars which can be accessed tax-free as long as they are used for qualified health care expenses.

Flexible Spending Accounts (FSAs)

These employer-sponsored accounts allow an individual to pay for eligible medical expenses on a pre-tax basis (there are also similar accounts for dependent and child-care expenses) and are also known as a flex plan or reimbursement account. The funds are deducted directly from an employee's paycheck on a pre-tax basis and deposited into an FSA.

How They Work

FSAs are established by an employer and may be offered in conjunction with other employer-provided benefits as part of a cafeteria plan. The annual contribution is funded with pre-tax dollars and deducted from the employee’s paycheck in equal installments each pay period and placed in a special account by the employer. The employer may also make contributions.

One consideration regarding medical FSAs is that 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. Therefore, if the employee experiences a qualifying event during the first couple of pay periods, the entire amount of the annual contribution can be claimed against the FSA benefits. 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.

Eligibility

During open enrollment, the employee must decide how much money to contribute for the year and the maximum amount is usually determined by the employer. 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. Those that are self-employed are not eligible to contribute to an FSA.

Contribution Limits

While the IRS does not stipulate a limit on the amount of money the employee or employer can contribute to the accounts, the plan itself must prescribe either a maximum dollar amount or maximum percentage of compensation that can be contributed to a healthcare FSA.

Distributions

The most common use of FSA funds is for medical expenses not paid for by insurance which can include deductibles, copayments, and coinsurance and unreimbursed 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". Beginning in 2011, over-the-counter (OTC) medications cannot be paid with medical FSA dollars without a prescription.

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. Generally, contributed amounts that are not spent 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.

Heath Savings Accounts (HSAs)

These tax-favored savings accounts are utilized for individuals enrolled in a high-deductible health plan (HDHP). For 2012, an HDHP must have an annual deductible of at least $1,200 for individuals and $2,400 for family coverage and has out-of-pocket maximums of no more than $6,050 for individuals and $12,100 for family coverage to be eligible to contribute to an HSA.

Contributions to these accounts are not subject to federal income tax, earnings grow tax-deferred, and tax-free distributions can be made for qualified health-related expenses.

How They Work

Contributions are made by either the individual or the individual's employer and are limited to a maximum amount each year. Unlike employer matching contributions to a 401(k) plan which may have a vesting schedule, all HSA contributions are immediately vested even if they are made by the employer.

A person is under no obligation to contribute to his or her employer-sponsored HSA, although employers may require that payroll contributions be made only to the sponsored HSA plan. If HSA funds go unused in one year, they roll over into the next year and continue to accumulate, unlike a flexible spending account (FSA), where there is a "use it or lose it" provision.

Eligibility

In years where an individual and/or family have an HSA-compatible HDHP, they are eligible to contribute to an HSA. If an individual no longer is covered under an HDHP, the HSA funds remain in the account and can continue to be used for qualified medical expenses but the individual cannot make additional contributions since they are no longer covered by an HDHP.

Those enrolled in Medicare are not eligible to contribute to an HSA.

Contribution Limits

For 2012, the maximum contribution to an HSA is $3,100 for individual coverage and $6,250 for family coverage. For individuals ages 55 and over, an additional catch-up contribution of $1,000 per individual is allowed.

Distributions

HSA funds may currently be used to pay for qualified medical expenses at any time without federal tax liability or penalty. Most HSA providers give their accountholders a debit card or checkbook so they may access their HSA. Beginning in 2011, over-the-counter (OTC) medications cannot be paid with HSA dollars without a prescription. Withdrawals for non-medical expenses before age 65 are taxed as ordinary income and assessed a 10% penalty.

Heath Reimbursement Arrangement (HRAs) Accounts

An HRA is an employer-sponsored account offered to employees where distributions can be made to pay for qualified medical expenses, including deductibles and co-insurance amounts. Contributions to an HRA account are made by the employer only and not considered income to the employee.

How They Work

The employer contributes a predetermined annual amount to each employee's account. The employee may use the funds in the HRA to pay for medical care; covered expenses are paid from the HRA until the HRA balance is exhausted. Any unused balances are carried forward to future years.

When an employee leaves an employer, HRA funds are not portable, however these plans are subject to continuation of coverage, in accordance with COBRA provisions.

Eligibility

These must be set up by an employer for the benefit of its employees. HRA accounts work in conjunction with high deductible health plans (HDHPs) or conventional PPO insurance plans. Self-employed individuals are not eligible for HRA accounts.

Contribution Limits

While the IRS does not stipulate a limit on the amount of money the employee or employer can contribute to the accounts, the plan itself must prescribe either a maximum dollar amount that can be contributed to an HRA account.

Distributions

HRA funds may currently be used to pay for qualified medical expenses and qualified health insurance premiums without federal tax liability or penalty.