



What You Need To Know About  
Health Savings Accounts,  
Health Reimbursement Accounts  
and  
Flexible Spending Accounts!



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# Constructive Receipt Rules

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- Treasury Regulation Section 1.451-1(a)
  - **“compensation is included in gross income for the taxable year in which it is actually or constructively received by the taxpayer unless includable for a different year in accordance with the taxpayer’s method of accounting”**

# Constructive Receipt Rules

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- Treasury Regulation Section 1.451-2(a)
  - **“income although not actually reduced to a taxpayer’s possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may have drawn upon it at any time”**

# Constructive Receipt Problem

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- When an employer allows an employee a choice between taxable and nontaxable compensation.

*Ex:           Medical Insurance  
                  or  
                  A Higher Salary*

- Cash-out or opt-out incentive programs can also cause this constructive receipt problem to arise

# The Solution

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## *Cafeteria Plans*

- A cafeteria plan is a **written plan** under which all participants are employees and the participants may choose among two or more benefits consisting of cash and qualified benefits
- This allows employees the option to trade taxable compensation in exchange for nontaxable fringe benefits (typically accomplished through salary reduction)

# The Solution

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## *Cafeteria Plans*

- **Section 125 Plans**

“cash (including certain taxable benefits) provided under a nondiscriminatory cafeteria plan will not be included in a participant’s gross income merely because the participant has the opportunity, before the cash becomes available to the participant, to choose among cash and the non-taxable benefits under the plan”

# Beating the Tax Man

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- Contributions to a properly structured cafeteria plan are not subject to:

Employees

FICA

Federal

State

(Except N.J., PA for Day Care)

Employers

FICA



***Employees Save Approx. 30% on Allowed Items!***

***Employers Save 7.65%, Usually Enough to Cover Plan Costs!***

# Who Can Sponsor a Cafeteria Plan?

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- All employers who have employees may sponsor a cafeteria plan
  - This includes corporations, partnerships, sole proprietorships, limited liability companies and governments

# Who Can and Cannot Participate in a Cafeteria Plan?

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- Both current and former employees can participate
- Not eligible:
  - Individuals who are more than 2% stockholders in a subchapter S corp.
  - Sole proprietors
  - Partners
  - Outside directors

# What Benefits Can Be Offered?

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- Coverage under an Accident or Health Plan
- Coverage under a Indemnity Plan
- Coverage under Accident Death & Dismemberment
- Coverage under a Disability Policy
- Group Term Life Insurance
- Dependent Care Assistance
- Adoption Assistance
- Buying and/or Selling Vacation Days
- Contributions for Post-Retirement Life Insurance  
(Educational Institutions Only)
- 401(k) Plan
- HSA Plans

# What Benefits Cannot Be Offered?

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- Educational assistance programs
- Scholarship programs
- Dependent group term life insurance
- Long-term care insurance
- Transportation and parking benefits
- De Minimis fringe benefits
- Archer MSA's
- Cash value life insurance
- Section 403(b) and 457 plans

# Regulatory Requirements

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A cafeteria plan must be written in the form of a plan document that includes:

- 1. A description of the benefits offered
- 2. Eligibility rules
- 3. Plan year
- 4. Timing of participant elections
- 5. Maximum amount of employer and employee contributions
- 6. Description of employer credits

# Regulatory Requirements

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- Cafeteria plans must be offered on a nondiscriminatory basis
- Highly Compensated individuals can be considered to be:
  - An officer of the company
  - A shareholder owning more than 5% of the stock
  - An employee earning
    - \$ 95,000 for 2005
    - \$100,000 for 2006
  - An employee who is in the 20% top paid group
  - A spouse or dependent of an individual described above

# Cafeteria Plans & Flexible Spending Accounts

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- **Premium Conversion (Only) Plans** allow employees to reduce their taxable income in exchange for participation in the employer sponsored health plan
  - Enrollment Can Be Accomplished Using the Following:
    - Positive or Affirmative Election
    - Negative or Automatic
    - Evergreen Basis

# Cafeteria Plans & Flexible Spending Accounts

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## ■ **Medical Reimbursement Accounts**

Health FSA's allow participants to receive reimbursement for eligible out-of-pocket medical, dental & vision expenses

- Annual Open Enrollment
- Uniform Coverage Rule
- Election is Irrevocable for the Plan Year
  - Permitted Exceptions
    - Change of Family Status
    - Loss of Coverage
    - Change of Employment Status
    - No Statutory Maximum

# Cafeteria Plans & Flexible Spending Accounts

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## ■ Medical Reimbursement Accounts

- Any Expenses That Occur Prior to Termination Are Entitled to Full Original Annual Election
- Document Can Be Structured to Allow:
  - Run Out Period for Claim Submission
  - Grace Period
  - Allows Participants Up to An Additional 2 ½ Months to Incur Expenses

# Flex Debit Card

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The Flex Debit Card is a “debit-like” credit card that electronically accesses a participant’s account at the point-of-service

The Flex Debit Card can be used at the following merchant category codes including, but not limited to:

- Doctor’s office

- Pharmacy

- Hospital

- Other Medical Providers for Ancillary Services

Additional Documentation May Be Required to Meet IRS Regs

# Cafeteria Plans & Flexible Spending Accounts

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- **Dependent Care Assistance Accounts** enable participants to receive reimbursement for incurred child or elder care expenses
  - Annual Open Enrollment
  - Statutory Limit \$5000
  - No Uniform Coverage Rule
  - Election is Irrevocable for the Plan Year
    - Permitted Exceptions
      - Change of Family Status
      - Change of Employment Status
      - Change of Day Care Provider
  - Reportable on Box 10 on Employee W-2

# Cafeteria Plans & Flexible Spending Accounts

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## ■ Premium Reimbursement Accounts

Enables reimbursement of premiums paid for individually owned health insurance policies, i.e. non-employer sponsored medical and/or disability insurance

- No Statutory Limit
- No Uniform Coverage Rule

## ■ Adoption Assistance Accounts

Allows for reimbursement of qualified adoption expenses

- 2008 Limit \$11,650
- Benefit Phases Out for Taxpayers with Income Over Specified Amount (Indexed Annually)
- Amounts Are Still Subject to FICA Taxes
- No Uniform Coverage Rule
- 5% Owners Subject to Utilization Test
- Reportable W-2 Box 12 Code T



# Health Reimbursement Accounts

***“When Something Old is New Again”***

# How Do HRA's Fit?

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- A Company Will Negotiate With the Insurance Carrier for A High Deductible Medical Plan
- Premium Rates Could Be Reduced By An Average of 20% to 30%!
- The Company Then Uses The Savings From The Reduced Premiums to Fund The Whole / Portion of the Increased Liability to The Employees
- Funds Are Only Paid Out If Expenses Are Incurred

# Health Reimbursement Accounts

## Benefits

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- Reimbursements to employees are funded with tax-deductible dollars.
- Employees receive reimbursements tax-free.
- Unlike traditional FSA accounts, unused balances can be carried forward from year to year.
- Any employer with common law employees can establish an HRA
- Sole Proprietors, partners and 2% shareholders of Sub-Chapter S corporations cannot benefit tax-free.

# Health Reimbursement Account

## Rules and Regs

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- HRA's can be set up to pay out on a "schedule" in order to ease the employer cash flow burden under the plan.
- HRA's can also be set up to "accrue" on less than an annual basis i.e. monthly, quarterly, etc...
- Discrimination in favor of highly compensated employees is not allowed
- Plans in excess of 100 participants must file a 5500 with the IRS.
- Participants in the medical reimbursement portion are eligible for COBRA.

# Health Reimbursement Account Design Options

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- **Gap Plan** – Also known as “integrated” or “linked” plans they compliment high deductible insurance products by paying only for items eligible under the insurance plan.
- **Unrestricted** – Pays all medical expenses not covered by insurance, including but not limited to, insurance co-pays, dental, vision, etc...
- **Restricted** – Coverage is limited or restricted to specifically named expenses, i.e. prescription co-pays only.

# Health Reimbursement Account Payment Choices

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- **Rollover** – Unused account balances roll-over and can be used in future years
- **Refill** – Benefit maximum remains constant and is replenished on an annual basis.
- **Employer decides which option is best based on overall planning and budgetary needs!**

# Health Reimbursement Accounts

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- HRA's can be offered in conjunction with an FSA
- Eligible expenses do not have to be incurred within the plan year
- Most employers operate plans on an "unfunded" basis, paying benefits out of general assets
- HRA's can never allow for cashing out of unused balances

## Sample Current Plan Costs

	<i><b>Total</b></i>	<i><b>Singles</b></i>	<i><b>Emp + Sp</b></i>	<i><b>Emp+ 1</b></i>	<i><b>Family</b></i>
<b>Number of Employees</b>	202	92	0	0	110
<b>Current Monthly Rates</b>		\$445.11	\$0.00	\$0.00	\$1,122.83

### *2004 Current Plan Costs:*

	<i><b>Monthly</b></i>	<i><b>Annually</b></i>	<i><b>Totals</b></i>
<b>Health Insurance Costs</b>	\$164,461.42	\$1,973,537.04	

### **Total Costs**

**\$1,973,537.04**

### Sample Renewal Estimate @

**15.00%**

	<i><b>Total</b></i>	<i><b>Singles</b></i>	<i><b>Emp + Sp</b></i>	<i><b>Emp+ 1</b></i>	<i><b>Family</b></i>
<b>Number of Employees</b>	202	92	0	0	110
<b>Current Monthly Rates</b>		\$511.87	\$0.00	\$0.00	\$1,291.25

### *2005 Renewal Plan Costs:*

	<i><b>Monthly</b></i>	<i><b>Annually</b></i>	<i><b>Annual Totals</b></i>
<b>Health Insurance Costs</b>	\$189,129.58	\$2,269,554.90	

### **Total Costs**

**\$2,269,554.90**

## Sample Proposed Plans Costs

### Partially Self Funded \$ 2500 / \$ 5000 Deductible (\$75000 Spec)

	<i>Total</i>	<i>Singles</i>	<i>Emp + Sp</i>	<i>Emp+ 1</i>	<i>Family</i>
<b>Number of Employees</b>	<b>202</b>	92	0	0	110
<b>Current Monthly Rates</b>		\$231.41	\$0.00	\$0.00	\$487.36
					<b>Annual</b>
<b>2005 Renewal Plan Costs:</b>			<b>Monthly</b>	<b>Annually</b>	<b>Totals</b>
<b>Health Insurance Costs</b>			\$74,899.32	\$898,791.84	
<b>Total Costs</b>					<b>\$898,791.84</b>

### Health Reimbursement Accounts

	<i>Total</i>	<i>Singles</i>	<i>Emp + Sp</i>	<i>Emp+ 1</i>	<i>Family</i>
<b>Number of Employees</b>	<b>202</b>	92	0	0	110
<b>Estimated HRA Amounts</b>		\$2,500.00	\$0.00	\$0.00	\$5,000.00
					<b>Annual</b>
			<b>Monthly</b>	<b>Annually</b>	<b>Totals</b>
<b>Total HRA Bank Liability</b>			\$65,000.00	\$780,000.00	
<b>Maximum HRA Liability</b>					<b>\$780,000.00</b>
<b>Estimated HRA Utilization (40%)</b>					<b>\$312,000.00</b>
<b>Maximum Plan Costs (Max Health + Max HRA)</b>					<b>\$1,678,791.84</b>
<b>Estimated Plan Costs (Max Health + Est. HRA)</b>					<b>\$1,210,791.84</b>
<b>Estimated Plan Costs Vs. Renewal</b>					<b>-\$1,058,763.06</b>

# Health Savings Accounts (HSA)

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- Established In December of 2003 under IRS Code 223
- The health plan is paired with an HSA account to cover eligible expenses not covered by the insurance policy
- Eligible individuals cannot be covered under another health plan that is **not** a qualified high deductible plan
- Specified disease coverage, hospital indemnity, and auto insurance do not count as other coverage
- Vision, dental, accident, and disability also do not count as other coverage.
- Eligible individuals must **not** be entitled to Medicare and must not be eligible to be claimed as a dependent on another person's tax return

# Health Savings Accounts (HSA) Guidelines

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- Annual deductible on insurance policy must be at least \$1,050 for individuals and \$2,100 for families
- Out-of-pocket maximums are limited to \$5,250 for individuals and \$10,500 for families for in-network expenses (2006 limits)
- Single contribution limit is lesser of \$2700 or 100% of the HDHP deductible
- Family contribution limit is lesser of \$5,450 or 100% of HDHP deductible

# Health Savings Accounts (HSA) Guidelines

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- HSA contributions can be made by both employer and employee
- Contribution must be made to a government approved trustee or custodian. Banks under IRC(n)408 and insurance companies under IRC816 automatically qualify
- All assets of an HSA belong to the employee. Accounts are “portable”
- Employer contributions cannot be recouped or restricted in anyway
- Qualified withdrawals are tax-free and penalty-free

# Health Savings Accounts (HSA) Guidelines

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- **Employer Contributions Are Subject to IRS Guidelines**
  - A Comparable Participating Employee is Considered to Be In the Same Category of Health Insurance Coverage
  - Contributions May Be Based On:
    - Single Health Coverage
    - Family Health Coverage

# Health Savings Accounts (HSA) Guidelines

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- **Qualified Expenses:**
  - Medical expenses as defined by IRC213(d) including: doctor's visits, prescription costs, dental, vision, as well as many alternative therapies, to name a few...
  - COBRA Premiums
  - Health insurance premiums while individual is receiving unemployment compensation
  - Long Term Care Insurance

# HSA Plan Coordination

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- A person is not allowed to have an FSA and/or an HRA along with an HSA if all three cover Section 213d expenses
- The HRA or FSA would be allowed along with an HSA if used only for dental, vision, and preventive care expenses
- An HRA also could be offered with an HSA if reimbursements were allowed only at retirement

# HSA Plan Coordination

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- An HRA or FSA could be used with an HSA if they only reimbursed expenses after the deductible was met on the high-deductible health plan
- An HRA could also be used with an HSA if the individual elects to suspend reimbursements for a period of time. Claims incurred during that time could not be submitted later for reimbursement, however, contributions by the employer could still be made to the HRA.

# Follow Up Questions!

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