Fundamentals of Cafeteria Plans, Health Reimbursement Arrangements and Health Savings Accounts

- Cafeteria Plans (FSAs) – 1978
- Health Reimbursement Arrangements (HRAs) – 2002
- Health Savings Accounts (HSAs) – 2003
What is a Cafeteria Plan?

A program that employers can use to help employees pay for certain expenses with pre-tax dollars

• Health Insurance Premiums
• Certain Medical Expenses
• Qualified Child/Adult care expenses

Cafeteria Plans

Basic Code and Regulatory Requirements

• Must have a written Plan Document
• Claims must be paid at least monthly
• Coverage must generally be 12 months
• Must be adequate substantiation
• Must have annual elections
• Must pass discrimination testing

Cafeteria Plans

Basic Code and Regulatory Requirements

• Elections must be made prospective (in advance)
• Elections are irrevocable, except for qualifying change of status
• Unclaimed “balances” are forfeited (no deferred compensation - use or lose rule)
• Expenses must be substantiated
Cafeteria Plans

Basic Code and Regulatory Requirements

- Uniform Coverage Rule (Employees can receive the full elected funds prior to full payroll deduction for the plan year – Health FSA and LP FSA plans only)
- Expenses must be incurred in the coverage period (plan year) to be eligible

Cafeteria Plans

4 Most Popular Cafeteria Plans

- Premium Only Payment Plan (POP)
- Health Flexible Spending Account (Health FSA)
- Limited Purpose Health FSA (LPFSA)
- Dependent Care Assistance Plan (DCAP)

Cafeteria Plans

Premium Only Plans

- It is designed for one purpose… for the employee’s share of the employer-sponsored health insurance plan premium.
- Employee contributes through pre-tax payroll deductions.
- Processed through payroll system.
- No reimbursement/claim forms.
Cafeteria Plans

Internal Revenue Code Requirements

- Health Care Spending Accounts
  - Internal Revenue Code §125
  - The "no deferred compensation" and claims substantiation rules
  - The nondiscrimination, reporting, disclosures and other rules for Code § 125
  - Reimbursement must be for medical care (as defined by Code § 213(d))

Cafeteria Plans

Traditional Health FSAs

- An individual account funded by employee salary reduction on a pre-tax basis.
- Amounts are used exclusively to reimburse qualified unreimbursed medical expenses incurred by the employee, spouse and/or dependents.
- Uniform Coverage Rule

Cafeteria Plans

Traditional Health FSAs

- The Plan decides how much a Participant may contribute on an annual basis.
  (Plan years beginning on or after 1/1/2018 – IRS max $2,650 in Employee pre-tax contributions)
Examples of Qualified Expenses

- Medical - includes o.v. co-payments, deductibles & co-insurance
- Dental and Orthodontic expenses
- Vision - Eye exams, eyeglasses, contact lenses (i.e., Lasik eye surgery)
- Prescription drug co-payments (Retail & mail order)
- OTC non-drug related items
- Prescribed OTC drugs/medicines

Limited Purpose Health FSA

- Design for employees enrolled in a qualified Health Savings Account (HSA)
- An individual account funded by employee salary reduction on a pre-tax basis.
- Amounts are used exclusively to reimburse qualified unreimbursed dental/vision expenses incurred by the employee, spouse and/or dependents.
- Uniform Coverage Rule

Examples of Qualified Expenses

- Dental / Vision o.v. co-payments, deductibles & co-insurance
- Dental and Orthodontic expenses
- Vision - Eye exams, eyeglasses, contact lenses (i.e., Lasik eye surgery)
- Qualified medical expenses that exceed the IRS minimum deductible (if permitted)
Cafeteria Plans

Deferred Compensation Prohibition (Use it or Lose it Rule)
• Prohibits Cafeteria Plans from allowing participants to carry over unused contributions from one year to another unless an exception applies.
• Participants are forced to “forfeit” unused balances.
• 2 exceptions to the rule

Cafeteria Plans

Health FSA Grace Period
• IRS Notice 2005-42 permits a participant a 2-½ month extension from the end of the Plan Year to incur and spend down any funds remaining in the Health FSA Plan.
• Modifies but does not eliminate “Use-it-or-Lose it” rule
• January 1 to March 15
• Run-out period still applicable

Cafeteria Plans

Health FSA Carryover
• IRS Notice 2013-71 permits Health FSA plan’s to implement a carryover feature in their Plans
• Modifies but does not eliminate “Use-it-or-Lose it” rule
• Maximum of $500
• Run out period still applicable
### Cafeteria Plans

**Internal Revenue Code Requirements**

- Dependent Care Spending Accounts
  - Code §129 reimbursement rules
  - The “no deferred compensation” and claims substantiation rules contained in Prop. Treas. Reg. §1.125-2 Q/A7
  - The nondiscrimination, reporting, disclosures and other rules for Code § 129

### Cafeteria Plans

**Dependent Care Assistance Program (DCAP)**

- An individual account funded by employee salary reduction on a pre-tax basis.
- Amounts are used exclusively to reimburse the employee for employment-related dependent care
- Funds are available as funds are withdrawn from payroll check.
- DCAP contribution level
  - $5,000 per year maximum (IRS)

### Cafeteria Plans

**DCAP Spend Down (Optional)**

- Spend down feature permitted after termination from plan during Plan Year
  - Prop. Regs. permit participants to spend down remaining balances in DCAP plans if they have terminated from the plan during the plan year.
Cafeteria Plans

Advantages for Employee

• No Federal Income Tax
• No FICA Tax
• No Medicare/SS Tax
• No State Taxes

Cafeteria Plans

Debit Card

• IRS Revenue Ruling 2003-43
  • Allows use of cards for Health Care Spending Account
  • Retains substantiation requirements
  • Allows some auto-adjudication
  • Defines card parameters
  • Defines procedures for ineligible expenses

Cafeteria Plans

Debit Card

• What Is a Debit Card?
  • A debit card allows a participant to pay for a qualified medical expense at the time of service by simply swiping the card through an electronic machine.
  • It is connected directly to your Health FSA.
Cafeteria Plans

Claims Substantiation
All expenses the card is used for must be substantiated with the exception of:
1. Co-Payment Match Claims
2. Recurring Previously Approved Claims
3. Real-Time Verified Claims

Do I have to substantiate my debit card expense?
Not all debit card transactions are automatically substantiated!!
The following need substantiation:
• Dental / Orthodontic expenses
• Vision Expenses
• Medical expenses applied to deductible and/or co-insurance
• Medical expenses excluded from plan
• 90% Merchant purchases

Debit Card Issues
• Ineligible claims expenses
• Claims not properly substantiated
  • Require Repayment
  • Offset Future Claims
  • Deny Access to Card
  • Withhold from Pay
HRAs

Basic Code and Regulatory Requirements
• May only be funded with Employer contributions
• Cannot be offered under a Cafeteria Plan
• Must be integrated with group health plan coverage (some exceptions)
• No specific Code section governing HRAs
• Tax favored treatment under the general principles of Code § 105 and § 106

HRAs

Basic Code and Regulatory Requirements
• New rule defining QSEHRAs (Qualified Small Employer HRA)
• Tax exclusions for employee
  • Code § 105 – exclusion for payment or reimbursement from employer-provided health coverage
  • Code § 106 – exclusion for health care coverage provided by employer
HRAs

What are HRAs?
- The HRA provides a specific “bank” of money that employees can access now or later for medical expenses.
- The employer offsets HRA expense by reducing basic health benefits (higher deductibles, co-pays, etc.)
- Offers the most control in CDHP options

HRAs

HRA “Musts”
- HRAs must be funded solely with employer contributions.
- HRAs must pay only for substantiated (IRS Code Section 213) medical expenses.
- HRAs must only reimburse expenses for those enrolled in related medical plan

HRAs

HRAs “Can” Be Designed to Cover Only Specific Expenses
- Medical
- Dental
- Vision
- Prescription Medication
HRAs

HRA “Cans”
• HRAs can allow former employees (retirees) continued access to unused funds in the reimbursement account.
• HRAs can carry over unused funds from year to year.

HRA Plan Design Trends

HRA Rollover Trends
MOST COMMON
• 100% rollover of unused funds
• Cap rollover ($10-$15,000)
• Maximum rollover ($ or %)
• No rollover – use it or lose it
LEAST COMMON
HRA Plan Design Trends

HRA Rollover Trends

MOST COMMON
- Save for post-employment:
  - While enrolled in plan – use dollars for limited benefits
  - At retirement – use for Section 213 expenses, Medicare supplemental policies and COBRA premiums
- If no retirement or post-employment benefit, lose money when no longer an active employee (COBRA eligible)

LEAST COMMON

HRA Plan Design Trends

HRA Funding

MOST COMMON
- $ based on single or family enrollment in health plan – usually a % of deductible and/or coinsurance
- Flat dollar – Everyone gets same amount

LEAST COMMON

HRA Plan Design Trends

HRA Funding Schedule

MOST COMMON
- Total year contribution available on day one of plan year
- Monthly basis
- Pro-rate late enrollees

LEAST COMMON
HRA Plan Design Trends

HRA Funding Schedule

**MOST COMMON**
- Can only be used for current plan year expenses (can apply run out)
- Reimburse any plan year expense as long as enrolled in medical plan
- 2 year plan

**LEAST COMMON**

HRA Plan Design Trends

HRA & FSA Coordination

**MOST COMMON**
- HRA is the first payer
- FSA dollars may be used first
- Participants choose which plan pays first

**LEAST COMMON**

HRA Plan Design Trends

**Employer Funding**

- Do not have to physically fund account
- Can fund as expenses are reimbursed
- Considered Group Health Plan (subject to COBRA)
  - Can be included in medical premium
  - Can be separate premium
  - Can require enrollment in medical plan to continue under COBRA
Health Savings Accounts (HSAs)

Basic Code and Regulatory Requirements
Basic rules contain in Code § 223
• Created as part of the Medical Prescription Drug, Improvement and Modernization Act of 2003 (MMA)
• May be funded on a pre-tax basis through a Cafeteria Plan

2 Separate Plans!
1. Qualified High Deductible Health Plan (HDHP)
2. Health Savings Account (HSA)
What is an HSA?
A tax-exempt trust or custodial account established by an individual exclusively for the purpose of paying qualified medical expenses.

Who Can Establish an HSA?
An individual who...
• Is covered by a Qualified High Deductible Health Plan (HDHP).
• Is not covered by another non-qualified health plan.
  • Traditional Health FSA
  • Traditional Health Reimbursement Arrangements

What Is a High Deductible Health Plan (HDHP)?
A medical plan that has specified minimum limits for the annual deductible and maximum limits for out-of-pocket expenses.
HSAs

Qualified HDHPs
- Self-Only Coverage
  - Minimum deductible of $1,350 and a maximum $6,650 out-of-pocket expense
- Family Coverage
  - Minimum deductible of $2,700 and a maximum $13,300 out-of-pocket expense
*Subject to COLA each year

HSAs

Qualified HDHPs
- NO first dollar benefits can be paid below the deductible level.
  - i.e., office visit & RX co-payments
  - All qualified medical expenses must be applied to the deductible before the HDHP pays any benefits.
  - Only exception are the three “P’s”

HSAs

The Three “P”s...
- Can have “first dollar” coverage for...
  - “Permitted Insurance”
  - “Permitted Coverage”
  - “Preventive Care”
- Cannot provide benefits for any year until the deductible is met.
HSAs

“Permitted Insurance”
- Specified Disease or Illness
- Insurance that pays a fixed amount for hospitalization
- Workers Compensation
- Property / Casualty / Automobile

HSAs

“Permitted Coverage”
- Dental coverage
- Vision coverage
- Qualified long-term care
- Accident coverage
- Disability coverage

HSAs

“Preventive Care”
- Routine prenatal and well child care
- Child and adult immunizations
- Tobacco cessation programs
- Obesity weight loss programs
- Screening benefits
HSAs

Who May Contribute to an HSA?

• HSA Established by an Employee
  • An Employee, Employer or both
• HSA Established by a Self-employed Individual
  • The Individual
• Can only contribute while enrolled in qualified HDHP
  • If no longer enrolled – can no longer contribute

Who May Contribute to an HSA?

• HSA Established by an Employee
  • HSA account is owned by the Employee
• Yearly Contribution limits
  • Single $3,450
  • Family $6,900
• Catch up Contribution (55 or older)
  • $1,000
  * Subject to COLA each year

HSAs

Record Maintenance

The individual who establishes the HSA is required to maintain records of expenses sufficient to show that distributions were made exclusively for qualified medical expenses.
HSAs

What Can HSAs Be Used For?
• Reimbursement must be for medical care (as defined by Code § 213(d)) to obtain tax free distribution
• Non medical expenses (significant tax penalty)
• Employee, Legal Spouse, Children
• Can continue to receive distributions after eligibility ends

HSAs

Who Is Considered HSA Eligible?
• Any individual with qualifying HDHP coverage, so long as he or she has no other disqualifying health coverage
• 2 groups on NOT eligible
  • Those who can be claimed as a tax dependent under another individual
  • Those who are entitled to Medicare