



Not All Health Savings Plans Are Created Equal

Insights

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Health Savings Accounts (HSAs) have gained in popularity since the implementation of the Affordable Care Act, but many employers are unclear about how they differ from more traditional Flexible Spending Accounts (FSAs). An employee can't have both. Here's why an HSA may make sense for your employees.

Limitations on FSAs

Congress wants to help people pay for medical expenses by allowing certain costs to be paid on a pretax basis. One method created to achieve this goal is the FSA. Think of an FSA as an annual budget for medical expenses. Employees can elect to put a certain amount of money aside to pay for medical expenses on a pretax basis.

There are a few catches, though. There is a cap on how much can be put aside. For 2015, the Internal Revenue Service (IRS) will allow employees to set aside \$2,550. This limit keeps employees with high out-of-pocket medical expenses from getting significant tax benefits.

Another downside is that employees have to elect the amount they will put aside before the plan year begins. This is great for employees with fixed medical costs such as prescription eye glasses or copays for specialist appointments. It's not as great for employees who can't predict what they'll spend on healthcare in the coming year.

In addition, with just a few exceptions, employees must use the amount they put aside during the plan year or it will be lost. This causes employees who participate to underestimate their costs, and many employees shy away from participating altogether.

Furthermore, an FSA is not a funded vehicle, and dollars put aside in an FSA cannot be invested. Additionally, an FSA must be employer-sponsored, and can only benefit employees, not partners or sole proprietors.

Advantages of HSAs

In contrast, think of an HSA as a retirement plan for medical expenses. Unlike an FSA, unused HSA amounts roll over from year to year and accrue earnings.

This vehicle was created in response to the move toward consumer-driven healthcare. The idea is to encourage people to participate in high-deductible health plans that require participants to pay

encourage people to participate in high-deductible health plans that require participants to pay more from their own pockets before coverage kicks in. The government hopes that people who participate in these plans will be more value conscious when they decide when and how to purchase medical care. To the extent that employees participate in a qualifying high-deductible health plan and have no other impermissible health coverage (which includes any amounts left in an FSA), they can maintain an HSA.

The IRS refers to HSAs as a triple threat because contributions go in on a pretax basis, they accrue earnings without taxation, and the amounts used to pay for qualifying medical expenses, escape taxation. An HSA is a real account that individuals can open by themselves or with the help of an employer. Like a retirement plan, some penalties apply if a participant requests a distribution for nonmedical expenses before the age of 65. But after reaching age 65, a participant can request a distribution for nonmedical expenses. The distribution will be taxed but there are no penalties.

In essence, the HSA can serve as a backup retirement plan. If a participant dies and has elected a spouse as the beneficiary, the spouse can maintain the HSA for their own medical expenses. Otherwise, the account is distributed upon the death of the participant, and beneficiaries are taxed on the value of the account but no penalties apply. Like an IRA, an HSA belongs to the individual and is unrelated to the individual's job. In other words, the individual does not lose the account upon termination of employment or exiting from the workforce.

Finally, the maximum HSA contribution per year is higher than the maximum FSA contribution. For self-only coverage, the limit is \$3,350 this year; for family coverage, it is \$6,650.

Many employers shy away from high-deductible plans because the cost to employees who utilize the plans can be high. But healthy employees may benefit greatly from the lower premiums of a high-deductible plan and the chance to fund an HSA. Consider the many advantages of HSAs when weighing your company's healthcare options.

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