

Employee Benefits Alert



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Health FSA/HRA/HSA Side-by-Side Comparison Chart

This chart summarizes the major differences among health flexible spending accounts, health reimbursement arrangements, and health savings accounts. It is not intended to cover all possible features or issues. Please refer to the related sections of the *Willis On-line Compliance Manual* for additional information.

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
Tax Code Authority	Sections 105, 106 and 125	Sections 105 and 106 (as interpreted in Notice 2002-45 and Rev. Rul. 2002-41)	Section 223 (and guidance in Notice 2004-2, Rev. Rul. 2004-38, Rev. Rul. 2004-45, Rev. Proc. 2004-25, FABs 2004-1 and 2006-02, Notice 2004-43, Notice 2004-50, IRS Final Regulations published 7/31/06, and the Tax Relief and Health Care Coverage Act of 2006)
ELIGIBILITY TO MAKE/RECEIVE CONTRIBUTIONS			
Employees	Yes, can make and receive contributions	Yes, can receive contributions but only employer may make contributions.	Yes, an eligible individual can make and receive contributions. Eligible individual must be covered by HDHP, not covered by other health plan (see limited exceptions below) that is not an HDHP, not be claimed as a dependent on another person's tax return, and not be enrolled in Medicare
Self-Employed (Partners and 2% S-Corp. Shareholders)	No	No	Yes, can make tax deductible contributions; with appropriate accounting and documentation, companies can make pre-tax deductions on behalf of partners and 2% S-corporation shareholders

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
Pre-tax Contributions Through Cafeteria Plan Permissible	Yes	No	Yes, except self-employed individuals may not contribute through cafeteria plan
Permissible Contribution Sources	Employer and employee (employee contributions usually made pre-tax)	Employer only (employee after-tax contributions theoretically permissible)	<p>Employer, employee (employee contributions may be pre-tax or after-tax (in which case federal tax break is obtained when individual files tax return)), and even unrelated third parties, including state governments, may contribute</p> <p>A one-time Qualified HSA Distribution from a health FSA or HRA may be made (must have health FSA or HRA balance as of 9/21/06 and is subject to certain other limitations and requirements). This is a rollover contribution and does not reduce annual contribution limit</p> <p>A one-time IRA Qualified HSA Funding Distribution may be made (subject to certain limitations and requirements). This is a transfer and reduces, dollar for dollar, individual's annual contribution limit</p>
Specific Health Coverage Required	No	No	<p>Yes, must have high deductible health plan (HDHP) coverage:</p> <p>Minimum annual deductible in 2007: \$1,100 single/\$2,200 family (lower deductibles, even first dollar coverage, – can apply to preventive care expenses)</p>

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
			<p>Maximum out-of-pocket limit in 2007: \$5,500 single/ \$11,000 family.</p> <p>Higher limits can apply to out-of-network expenses and payments for expenses that exceed usual, customary and reasonable limits, or for penalties for failure to obtain pre certification or utilization review. Discounts, reasonable lifetime caps (such as \$1 million) and reasonable limits on specific benefits (such as limits on chiropractic care) are permitted</p>
Other Health Coverage Permitted	Yes	Yes	<p>Non-HDHP coverage is not permitted, except preventive care, dental, vision, accident, disability, long-term care, worker's compensation, liability, property damage, specified disease or illness (e.g., cancer coverage), fixed indemnity hospitalization, EAP, wellness and disease management, and discount cards are allowed</p> <p>Generally may not combine with health FSA or HRA (except if FSA/HRA only reimburses dental, vision or other excepted expenses, retiree-only expenses, suspended HRA, and FSA during 2½ month grace period if FSA balance is zero or will be contributed to HSA)</p> <p>Prescription drug plans and state mandates (other than mandates that comply with IRS' definition of preventive benefits) that pay benefits before the HDHP deductible are not permitted</p>

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
			Spouse's coverage that does not cover employee will not prevent employee from qualifying as eligible individual
Employee Choice Permitted	Yes	Yes	Yes, employee may choose between HDHP and LDHP. Employees choosing an LDHP are not eligible individuals
Age Limit	None	None	Tax-favored contributions are not allowed by or for those individuals who are enrolled in Medicare Part A or B. Eligible individuals age 65 or older who are not enrolled in Medicare Parts A or B may make or receive tax-deductible HSA contributions
Statutory Limits on Contributions	None, except nondiscrimination requirements apply (most employer plans have annual limits between \$2,000 and \$5,000)	None, except nondiscrimination requirements apply (most have limits that are a portion of the annual deductible under employer's health plan)	Adjusted annually - 2007 limits : (1) \$2,850 for employees with single coverage; or (2) \$5,650 for employees with family coverage Catch-up for age 55 and over – \$800 in 2007 (increases in \$100 steps to \$1,000 in 2009) Except for the catch-up contribution, eligible spouses can split contribution equally or allocate different split For the catch-up contribution, each eligible spouse must open up his or her own HSA in order to be able to deposit his or her catch-up contribution

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
Consequences of Excess Contributions	N/A	N/A	<p>Excess contribution and earnings are included in individual's gross income and subject to 6% excise tax unless excess contributions plus related earnings are withdrawn prior to the date the individual files federal tax return (including extensions).</p> <p>Individuals who become eligible individuals after the beginning of the calendar year and who utilize the special limit may face tax consequences if individual does not remain an eligible individual during testing period. Excess contribution is included in gross earnings + 10% penalty for tax year in which occurs first month of ineligibility. Exception for death or disability</p> <p>Individuals who receive one-time Qualified HSA Distribution from health FSA or HRA, or who make one-time qualified transfer from IRA, may face tax consequences if individual does not remain an eligible individual during testing period. Excess contribution is included in earnings +10% penalty for tax year in which occurs first month of ineligibility. Exception for death or disability</p>
Nondiscrimination Requirements	Yes, §§105(h) and 125 prohibit discrimination in favor of highly compensated employees for eligibility and benefits, §125 also prohibits concentration of benefits in favor of key employees	Yes, §105(h) prohibits discrimination in eligibility and benefits provisions in favor of highly compensated employees	



Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
		<p>Yes, if employer makes direct contributions, subject to “comparability requirements” (excise tax applies to employer for violations); if made through cafeteria plan, subject to § 125 nondiscrimination</p> <p>Comparability - Contributions are comparable if same amount or percent of deductible for comparable participating employees (same category of employees and same category of coverage)</p> <p>Set categories of employees are: current full-time, current part-time, former employees</p> <p>Categories of coverage are self only and family coverage sub-categories which are self plus one, self plus two, self plus three or more</p> <p>Testing for self only is conducted separately. Each family sub-category may be tested separately but contribution to a sub-category that covers more people cannot be less than the contribution to a sub-category that covers fewer people.</p> <p>Employer can discriminate in favor of non-HCES in making contributions to HSAs</p> <p>Partners, self-employed and independent contractors NOT employees for comparability purposes</p> <p>If health benefits subject of good faith bargaining, union employees NOT included in comparability testing</p>

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
			§ 125 Nondiscrimination - However, if contributions are made through a cafeteria plan, §125 nondiscrimination rules apply to the contributions. If plan document permits employees to make pre-tax salary reduction contributions to HSAs, (and thus have right to receive cash or other benefits in lieu of HSA pre-tax contribution) then employees are not required to have an election with respect to employer's non-elective contribution to HSAs made through cafeteria plan
PERMISSIBLE/REQUIRED FEATURES			
Tax-Favored Reimbursable Medical Expenses	All deductible (§ 213(d)) medical expenses (including non-prescription drugs) <i>except</i> long-term care expenses and insurance premiums	All deductible (§ 213(d)) medical expenses (including non-prescription drugs and insurance premiums) <i>except</i> long-term care expenses	All deductible (§ 213(d)) medical (including non-prescription drugs) and long-term care expenses except most insurance premiums (for exceptions see below)
Premiums for Medical Coverage Reimbursable	No	Yes, for any health plan	Yes, but only for COBRA, qualified long-term care coverage up to certain limits, and health plan coverage while receiving unemployment compensation. Individuals age 65 and older can use HSA for retiree's contribution to employer's retiree health coverage and Medicare premiums but not for Medicare supplemental insurance
Long-Term Care Reimbursable	No, neither LTC expenses nor coverage	Yes, LTC expenses excluded, but LTC coverage can be reimbursed	Yes, expenses for long-term care services can be reimbursed and expenses, up to certain limits, for a qualified long-term care contract can be reimbursed

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
Vesting Schedule Allowed	No, 100% vested but subject to “use-it-or-lose-it” rule	Yes, employer may incorporate in plan design	No, all funds are 100% vested
Carryover Allowed	Starting in 2005, up to two months and 15 days after year end if permitted by plan provision	Yes, but not required, depends on plan design	Yes, required as part of HSA design
Distribution of Any Remaining Balance at Account Beneficiary’s Death	No, but expenses incurred before death can be reimbursed and COBRA applies if account is “underspent” at death	No, right to reimbursement is lost unless plan design extends coverage, but COBRA may apply. May be used to reimburse expenses for spouse or other dependent after death of employee If plan contains provision permitting payments to beneficiaries OTHER than spouse or dependent, ALL reimbursements paid are included in employee’s gross income. (Transition rule applies for plans containing such a provision on or before August 14, 2006.)	HSA becomes HSA of surviving spouse and transfer is not taxable. Other beneficiaries will have taxable income on fair market value of HSA’s assets; any distributions (if anything is left after paying last expenses of account beneficiary)
Portable	No Employer may make a one-time Qualified HSA Distribution from a health FSA (must have health FSA balance as of 9/21/06 and is subject to certain other limitations and requirements)	No, but can be designed to allow use following retirement, termination, or while covered by another employer’s plan Employer may make a one-time Qualified HSA Distribution from an HRA (must have HRA balance as of 9/21/06 and is subject to certain other limitations and requirements)	Yes, required as part of HSA design

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
Uniform Availability Required	Yes	No	No, but employer must provide comparable contributions if it funds the HSA or contributions subject to section 125 nondiscrimination tests if made through a cafeteria plan
Pre-Funding Required	No	No	Yes. May reimburse expenses incurred only AFTER establishment of HSA
May be Offered With Other Accounts	Yes, provided ordering rules are followed	Yes, provided ordering rules are followed and HRAs are properly limited	No, unless FSAs and HRAs are properly limited
Return of Mistaken Distributions	Not addressed	Not addressed	Yes, if there is a mistake of fact due to reasonable cause, convincing evidence of same, and repaid prior to April 15 of year following time account beneficiary first knows or should have known of mistake, income and excise tax can be avoided

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
Use of Prior Year Contributions for Expense Reimbursements	Only medical expenses incurred in the current year (plus those incurred within two month and 15 day extension if plan permits) can be reimbursed with current year contributions	No requirement, plan design can determine if reimbursement can be deferred indefinitely, and when or if balances will be forfeited	Deferred indefinitely for any expenses incurred after HSA established and plan cannot require other time limits or forfeitures
Change in Elections Permitted	Yes, but only by following §125 rules	N/A – Amounts are non-elective	Yes, but changes may only be made prospectively (§125 rules do not apply to HSAs)
Full Availability of All Contributions Required – “At Risk” Rule	Yes, up to annual limit regardless of how much employee has contributed	Not required, but plan design can permit advance distributions	Funds must be in HSA before reimbursements can be paid; employer or individual is permitted to prefund HSA for full year and make full amount available if plan design permits it, subject to possible excise tax. Once contributions are made they cannot be restricted
TAX TREATMENT			
Employer Contributions	Deductible by employer, not taxable to employee	Deductible by employer, not taxable to employee	Deductible by employer, not taxable to employee
Participant Contributions	After-tax participant contributions are rare, and are not deductible on the participant’s tax return; pre-tax participant contributions are treated as employer contributions	After-tax participant contributions are rare, and are not deductible on the participant’s tax return; no pre-tax participant contributions are permitted	Pre-tax participant contributions are permitted (when made through a cafeteria plan). After-tax participant contributions (regardless of who makes the contribution) are deductible by the <i>individual</i> who owns the HSA on the individual’s tax return

	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
Earnings	Plans usually are unfunded and accounts have no earnings, but any earnings would be excluded from employee's income	Plans usually are unfunded and have no earnings, but any earnings would be excluded from employee's income	Plans are funded, assets may be invested and earnings are excluded from account owner's income
Distributions for Qualifying Medical Expenses	Excluded from employee's income	Excluded from employee's income	Excluded from account owner's income
Distributions for Other Purposes	N/A (other than Qualified HSA Distributions from a health FSA; distributions for other purposes disqualify cafeteria plan, making all pre-tax amounts taxable)	N/A (other than Qualified HSA Distributions from an HRA; distributions for other purposes disqualify HRA making all amounts credited to an individual under it taxable to that individual)	Subject to income tax and 10% penalty (distributions made after death, disability or reaching age 65 are exempt from 10% penalty); distributions made for other purposes do not disqualify HSA
Substantiation of Claims Required	Yes, by plan administrator or delegee	Yes, by plan administrator or delegee	No, but account owner must be able to document on audit

APPLICABILITY OF OTHER PROVISIONS/LAWS

ERISA	Yes	Yes	<p>Yes, for underlying HDHP</p> <p>HSA can be exempt but must avoid employer sponsorship or endorsement. Employer cannot limit reimbursement more than IRC §223, cannot restrict transfers to other HSA providers, cannot make or influence investment decisions, cannot communicate that HSA is a welfare benefit plan, cannot receive compensation</p> <p>Employer may do following and still avoid ERISA status: unilaterally open HSA, limit number of HSA providers that can solicit employees, select HSA provider that offers limited number of investment options (if they are reasonable), pay HSA fees</p> <p>Employer can also avoid any responsibility for HSA trustee or custodian</p>
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	Health Flexible Spending Account (Health FSA)	Health Reimbursement Arrangement (HRA)	Health Savings Account (HSA)
SPD Required	Yes	Yes	Yes, for underlying HDHP No, for HSA, unless HSA is subject to ERISA
5500 Required	Yes, if 5500 exceptions do not apply	Yes, if 5500 exceptions do not apply	Yes, for HDHP, unless exceptions apply No, for HSA unless HSA is subject to ERISA and no exceptions apply
COBRA	Yes (limited exemption applies in some cases)	Yes	Yes, for underlying HDHP No for HSA unless HSA is subject to ERISA (practically speaking, there would not be a qualifying event since there is no loss of coverage with HSA)
HIPAA Portability (including issuing certificates of creditable coverage)	Most FSAs funded only with employee contributions are exempt	Yes	Yes, for underlying HDHP Unclear for HSA, probably covered if HSA is subject to ERISA
HIPAA Nondiscrimination	Most FSAs funded only with employee contributions are exempt	Yes	Yes, for underlying HDHP Unclear for HSA, probably covered if HSA is subject to ERISA
HIPAA Privacy	Yes	Yes	Yes, for underlying HDHP Unclear, but employer is not responsible for HSA compliance unless HSA is subject to ERISA
Medicare Secondary Payer	No, MSP rules do not apply	Yes, MSP rules apply	Yes, for underlying HDHP MSP rules apply if HSA is subject to ERISA; otherwise MSP rules do not apply

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