Health Reimbursement Arrangements:

A Sound Choice For Employers

JANET LETOURNEAU

QPA, CFCI, is the chief compliance officer at MHM Resources, in Kansas City, MO. She draws upon more than 14 years of experience with flexible benefits plans and tax laws to perform consulting services and monitor quality control.

LeTourneau is a frequent speaker to employer groups and conferences and is a board member of the Cafeteria Plan Advisors Council (CPAC). She is the lead instructor for the Section 125 administrators training workshop.

A Qualified Plan Administrator (QPA), LeTourneau was one of the first people in the country to earn the CFCI designation sponsored by the Employer's Council on Flexible Compensation. She is a certified trainer in the Certified in Flexible Compensation Instructor (CFCI) program.

LeTourneau can be reached at MHM Resources, 11440 Tomahawk Creek Parkway, Leawood, KS 66211. Telephone: 913-234-1083. Email: ***janl@mhmbiz.com****.*

Health savings accounts (HSAs) may have taken over the spotlight in recent months, but health reimbursement arrangements (HRAs) are still a viable benefit and helpful to employers and employees.

Employers may not want to fund an employee's HSA, but instead will provide medical expense reimbursement through an HRA. HRAs provide more employer control over eligible medical expense reimbursement.

What Is an HRA?

Sometimes called defined contribution plans or healthcare accounts, HRAs allow an employer to repay the unreimbursed medical expenses of employees along with an option to roll unused funds forward. Unlike a Section 125 health flexible spending account (FSA), in which the IRS requires the annual election to be available on the first day of the plan year, only a portion of the HRA limit is added to each account once per month or pay period. This means no surprises and no big hits to the employer's checkbook. The employer will only be liable for a portion of each employee's HRA annual limit.

An HRA account may reimburse any or all of the same expenses as a health FSA. Expenses defined in IRC Section 213(d) as "medically necessary" include co-pays, deductibles, office visits, vision care expenses, prescriptions and most dental expenses. Expenses related to cosmetic services such as teeth bleaching or face-lifts would not be eligible for reimbursement.

Employees may request reimbursement for medical expenses at the time services are rendered, accumulate them for reimbursement in the future, or save the funds in the HRA for retiree health benefits. Services for eligible expenses must be provided while the employee is covered by the HRA, but the plan document may specify that requests for reimbursement need not occur until months or even years later. Because funds may be allowed to accumulate from year to year, the employee decides when and how to best spend his medical benefit dollars.

What Is Really Different?

IRC Section 105 has been around for a long time. Employers established these stand-alone plans to provide tax-free reimbursement of employees' qualified medical expenses. This is also the IRS code section that governs the favorable tax treatment of self-insured plans and health FSAs.

Formal guidance from the IRS that allows the carryover of unused amounts to later years in an HRA can reimburse employees for the purchase of health insurance. In addition, the guidance provides that HRAs may allow former employees, including retirees, continued access to unused dollars.

This means an HRA is just like a health FSA without the "use-it-or-lose-it" rule. Although fully employer funded, HRAs enable employees to have more choice and greater control over their healthcare coverage.

How Does It Work?

An employer establishes an HRA by adopting a formal plan and distributing a summary plan description (SPD) to all eligible employees. The SPD describes, among other things, the amount of money available in each employee's personal health account for the coverage period. As eligible expenses are submitted, the employee's personal account is reduced and paid to him on a non-taxable basis.

At the end of the HRA coverage period, a new period begins with additional employer funding available. Plus, at the employer's option, the plan can be designed so that dollars not spent by employees can be rolled over to fund future employee expenses.

What's in store for those employees who accumulate their benefit cash from year to year? Depending on the plan document and employer objectives, employees could accumulate all their medical expenses and receive a large, one-time reimbursement. They could cushion themselves against a catastrophic disease or accident, or even fund health benefits after their retirement. The plan can even allow employees to use their account balance to purchase long term care insurance.

Here's an example of how two employees benefited from their employer's HRA plan.

Jill's employer began an HRA program to complement a new high-deductible health plan. The health plan for single coverage has a deductible of $1,500 and the HRA provides $500 per year for everyone selecting this coverage. The health plan for family coverage has a deductible of $2,400 and the HRA provides $800 per year.

Jill decides to continue to pay her out-of-pocket medical expenses through her Section 125 health FSA. The health FSA still affords a substantial tax savings on her unreimbursed medical expenses, and she would like her HRA account to accumulate enough cash to eventually cover the entire deductible. She can accomplish her goal in three years and retain this "cushion" for an unexpected illness, accident or when she launches that future family.

Bill works for the same company, but his goals are different. He has a wife and two small children and needs help with his current medical expenses. Bill knows he will spend approximately $100 per month just for prescriptions and doctor visits for the family. Bill decides to elect $1,000 to his health FSA account and utilize the HRA for unexpected expenses. Bill has effectively eliminated his risk of loss in his FSA plan. After all, his known expenses are at least $1,200. What happens if his family experiences unexpected medical expenses during the year? No problem, the HRA is there to pay for qualified medical expenses above the $1,000 health FSA election.

Employers Take Advantage of HRAs

The rising cost of healthcare is a concern for most employers. With the addition of an HRA, employers can enhance their benefit package while still achieving their overall corporate goals of controlling benefit costs.

Let's look at four great plan designs employing an HRA approach.

Bridge Plan. The bridge HRA plan pays only for deductible items covered by insurance and provides a "bridge" between out-of-pocket expenses and insurance coverage.

The employer knows that by implementing a higher deductible health plan, the premiums will decrease. However, employee satisfaction may erode, causing turnover and higher recruiting and training costs. The implementation of an HRA will turn the tide in this employer's favor.

To quote one insurance agent, "I would rather have commission on the lower premiums than no commission because the client either decided to drop the plan altogether or go to another agent."

By making one-third to one-half of the deductible increase available to employees each year through an HRA, employees have more control over medical expenses and less risk of paying deductibles.

Comprehensive Plan. The comprehensive HRA plan pays all medical expenses not covered by insurance. These expenses include, but are not limited to, dental and vision fees, chiropractic services, co-pays, deductibles and insurance premiums.

This plan could be coupled with a higher-deductible or limited-coverage insurance arrangement or as an additional employee benefit.

Limited Plan. A limited HRA covers only a group of expenses such as dental or vision. It can also be restricted to a single medical expense, like prescriptions.

What better vehicle does an employer have these days to explore the advantages of self-insuring? Start out with an HRA limited to dental expenses. No premiums for the employees or employer, and the employee just acquired a great new benefit.

Insurance-Only Plan. The insurance-only plan HRA allows employees to pay for employer-provided insurance coverage or individually owned policies for health, disability or long term care insurance. This plan objective may be to design an HRA program that can accumulate each year and covers retiree benefits. Employees may utilize their HRAs for current premium expenses or to build up their accounts to pay healthcare premiums, long term care insurance premiums and medical expenses during retirement.

For example, an employer could design a plan that allows unused contributions to roll forward each year. Then at retirement, the employee could be given a choice to use the balance to purchase long term care insurance or forfeit the account balance.

Benefit costs are capped for current employees, and the employer won't have to provide additional funds for employees at retirement time.

Tax Planning for Small Employers

For many family owned or closely held businesses, the majority of the employees are owners. Even if all employees must be covered by HRAs, that may be a small price to pay so that the corporation can get more benefits to the owners.

Retiree coverage is one plan design option. The company could write their HRA plan to cover those reaching retirement age, but not those who terminate prior to retirement. In today's mode of frequent job changes, employee-owners would most likely stay until retirement, while few other employees would.

Retiree benefits could even be used for

long term care insurance purchased after retirement. The HRA account would build during employment, and then the accumulated balance could be used to purchase long term care insurance at, or close to, retirement.

HRAs enhance FSAs for the employee and the employer. One plan design doesn't usually fit everyone's need; that's why Section 125 cafeteria plans have become such a popular benefits tool. Now, with the addition of an HRA, employers have more choice in how much to spend on benefits and how the benefits are delivered to their employees.

Employees have been asking for more choice and employers need a break on benefit expenses. With an HRA, employees get more choice and a greater say in how their benefit dollars are spent. They have become the employer's partner. An HRA is a great way to meet employees' needs and boost the employer's benefit package.

One simple plan, and the paybacks are lofty for employers and employees. The employer is managing healthcare costs and employees are given more choice. It's a win/win situation.

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