Benefits Toolkit:

Employer's Guide to HSAs, FSAs and HRAs

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Introduction

Employees have many choices when selecting their employer-provided benefits, but most hinge on their financial and health care needs. Amid economic turmoil and rising health care costs, workers are looking for guidance now more than ever to maximize every hard-earned dollar. Fortunately, employers are uniquely poised to provide their employees with the benefits and financial education they want.

Savings accounts can round out a top-tier benefits package. Such accounts help employees save on health-related costs and taxes and are also valuable to employers. Three standard tax-free savings accounts that employees can use to pay for qualified medical expenses include health savings accounts (HSAs), flexible spending accounts (FSAs) and health reimbursement accounts (HRAs). Such savings accounts can help employers save on health care expenses while offering employees options to use pre-tax dollars for eligible medical, dental and vision costs.

These types of savings accounts can fit into employers' larger picture of expanded financial wellness support. Today's workers want and need guidance and resources to help stretch their health care dollars. And when employees experience lower financial stress, employers may see greater employee productivity and morale and lower absenteeism. As many employers still face employee attraction and retention challenges across American workplaces, comprehensive benefits offerings can help secure talent, making it a win-win for employers.

This Benefits Toolkit analyzes savings accounts, specifically HSAs, FSAs and HRAs, and their importance to employees and organizations. Additionally, it explores the benefits of savings accounts and employer tips to increase utilization. Please note that the various considerations and strategies outlined within this toolkit are merely suggestions and are not intended to be exhaustive. Employers should consult legal counsel before making any changes to benefits packages.

Why Health Care Accounts Matter

Benefits packages matter now more than ever, and savings accounts are often key offerings. Moreover, financial matters are a leading cause of employee stress and a major distraction at work. Employers can alleviate some of that stress to help employees focus better on the job. As a result, the workforce could experience higher engagement, increased productivity, fewer absences, and improved health and well-being.

Savvy employers are focusing on revamping or expanding current benefits to compete in the tight race for workers, and valuable savings tools are critical. This section explores the reasons why savings accounts matter to employees and employers alike.

Inflation

The U.S. inflation rate has reached its highest level in four decades, and Americans shouldn't plan on seeing relief any time soon. Inflation has led to significant price increases across many everyday consumer goods. As employees face increased financial difficulty, many employers are trying to help. While every employer may take a different approach to address inflation and its impact on their employees, many are reevaluating their benefits and building meaningful packages to help mitigate the effects employees face.

Only 4 in 10 Americans could cover a $1,000 emergency expense with their savings accounts, according to a Bankrate survey.

Unfortunately, many employees are unprepared for an extended economic downturn or recession and may not have enough money saved to cover emergency expenses. As a result, employees are quick to use money held in their retirement plans to pay for those unexpected expenses—or make short-term financial decisions that may have a negative long-term impact.

With savings stretched thin and a potential recession on the horizon, employees need guidance on prioritizing spending and paying bills. With savings accounts, employers have a unique opportunity to help employees avoid making poor financial decisions at the expense of their overall financial well-being.

Health Literacy and Medical Debt

More than 1 in 3 Americans have difficulty with everyday health tasks, such as reading a prescription drug label or making an educated health care decision, according to the U.S. Department of Education's National Assessment of Adult Literacy (NAAL). Low health literacy often results in higher utilization of essential and expensive health care services, such as emergency care and inpatient visits, which can add up quickly. Consequently, the NAAL estimates that low health literacy costs the United States up to $236 billion every year. Employers can promote employee engagement in health care decision-making by offering educational resources alongside valuable savings accounts. Not only does offering savings accounts help employees save for and cover qualified medical expenses, but employers can also help increase their workers' health literacy by explaining how accounts work and ways to maximize their dollars. The overall goal is to help make employees better health care consumers in an effort to offset unnecessary medical debt. In turn, improved health literacy of employees could lead to better business outcomes, such as higher employee productivity and lower health care costs.

The Kaiser Family Foundation estimates that 100 million adults—about 4 in 10 adults—have medical or dental debt. Many expect repaying the debt to take years, and about 1 in 5 say they do not expect to ever pay it all off.

Furthermore, medical debt is a specific concern and challenge for many people. According to the White House, medical debt is the largest source of debt in collections. Medical debt is not just a financial issue, as it can have adverse health effects. Research revealed that almost half of individuals with medical debt intentionally avoid seeking health care. Low health literacy and medical debt have many people floundering through their health care decisions and bills. Today's workers need health care guidance, and employers are poised to offer such direction and resources.

Attraction and Retention

The labor market was tight in 2022 and shows no signs of stopping in 2023. Labor metrics indicate that even though the market has slightly improved from last year, it remains a tight market. It's a safe bet that employers will continue struggling to compete for top talent in 2023.

Several terms have been coined to describe employment practices and behaviors over the past couple of years, such as "quick quitting," "quiet quitting" and "the Great Resignation." Undoubtedly, employers' expectations and workers' desires and must-haves have changed throughout this time, and workplaces have been perpetually impacted. Now, many organizations anticipate entering the Great Rebalance, which implies a rebalancing of the employer-employee relationship. Workers are returning to more typical career security and leverage levels following a highly worker-friendly market. As employers continue to compete for top talent, comprehensive and fulfilling benefits packages—including savings accounts—will play a critical role.

Understanding Savings and Spending Accounts

In an effort to respond to the rising costs of health care, many employers are offering tax-favored accounts, such as HSAs, FSAs and HRAs. It's important to keep in mind that the IRS generally regulates these benefits and sets rules and annual limits. This section provides an overview of HSAs, FSAs and HRAs, including employee eligibility and contribution limits, and why they are useful for both employees and employers.

HSA

HSAs can be a powerful tax savings tool. An HSA is a tax-exempt trust or custodial account established to pay qualified medical expenses. To contribute to an HSA, employees must be enrolled in a high deductible health plan (HDHP).

Employee Eligibility

To be eligible to contribute to an HSA, an individual must be covered by a qualifying HDHP. In addition, the individual cannot be covered by any other health coverage (with some narrow exceptions), enrolled in Medicare or be eligible to be claimed as a dependent on another person's tax return.

An individual may contribute to an HSA in any month in which they are covered under an HDHP on the first day of the month.

Contributions

Both employers and employees can make HSA contributions. In general, HSA contributions made by an eligible individual are tax-deductible, and employer HSA contributions made on behalf of an eligible employee are excluded from the employee's gross income. Interest and other earnings on HSA contributions accumulate tax-free. Amounts distributed from an HSA for qualified medical expenses are also generally tax-free. Keep in mind that some states define income differently than the IRS. As a result, HSAs that are tax-exempt at the federal level may not be tax-exempt at the state level.

In 2023, eligible individuals may contribute up to $3,850 for single coverage and $7,750 for family coverage into an HSA. In 2024, the amount increases to $4,150 for individual coverage and $8,300 for family coverage. Individuals age 55 or older by the end of the tax year are permitted to make "catch-up contributions" and can contribute up to an additional $1,000 annually.

HSA contributions do not have to be made in equal amounts each month. An eligible individual can contribute a lump sum or in any amount or frequency they wish. All funds in an HSA roll over to the following year.

Eligible Expenses

An HSA may reimburse qualified medical expenses incurred by the account beneficiary and their spouse and dependents. Visit the IRS' website for a complete list of qualified medical expenses.

In addition to qualified medical expenses, the Consolidated Omnibus Budget Reconciliation Act (COBRA) premiums and qualified long-term care premiums may be reimbursed from an HSA.

Why an HSA?

HSAs can be helpful for saving for current and future health care expenses—as long as the rules are followed. They provide triple tax benefits through tax-free contributions—interest, other earnings and eligible distributions are all tax-free. Funds in this type of account roll over from year to year, even if the individual is no longer eligible to contribute to the account. Additionally, an HSA is portable, meaning if an individual changes jobs, medical coverage or has other life changes, they can still use accumulated HSA funds. HSA funds are also an inheritable asset.

While the savings benefits are evident for employees, HSAs can also save employers money. Since employees own their HSA accounts, they're responsible for managing their funds—unlike with FSAs and HRAs—leaving employers with fewer administrative expenses. In addition, organizations are eligible for a tax deduction for any contributions they make to employees' HSA accounts, making it even easier to incentivize these plans.

FSA

An FSA is an account in an employee's name that reimburses the employee for qualified health care or dependent care expenses, helping reduce out-of-pocket expenses. It allows an employee to fund qualified expenses with pre-tax dollars deducted from the employee's paychecks. The employee can receive cash reimbursement up to the account's total value for covered expenses incurred during the benefit plan year and any applicable grace period.

There are two types of FSAs: health care accounts and dependent care accounts. A dependent care FSA is also called a dependent care assistance plan (DCAP).

An employee can elect to have both accounts and contribute separate pre-tax dollars. These accounts are kept separate, so an employee couldn't be reimbursed for dependent care expenses from their health care account.

Employee Eligibility

Unlike an HSA, employees do not need to be covered by an HDHP to participate in an FSA. They can be offered with any other type of health plan.

Contributions

Both employers and employees can make health FSA contributions. Employees may contribute pre-tax dollars to their health FSAs through a Section 125 plan (or cafeteria plan). Also, employers do not pay Federal Insurance Contributions Act (FICA) or unemployment taxes on employees' health FSA contributions.

Often, employers will set a maximum annual amount that employees may contribute to their health FSAs. Effective for plan years beginning on or after Jan. 1, 2013, the Affordable Care Act (ACA) limits employees' pre-tax health FSA contributions each year. Employers may continue to impose limits on employee health FSA contributions as long as the employer's limit does not exceed the ACA's maximum limit. Employers can set up employees with an FSA, and contributions are taken out of each paycheck—before taxes—in equal installments throughout the plan year. These dollars are then placed into employees' FSA.

In 2023, employees can contribute up to an annual maximum of $3,050 to a health FSA. If an employee is married, their spouse can put up to $3,050 in an FSA with their employer.

The DCAP maximum for 2023 is not subject to inflation, remaining at $2,500 for those married and filing separately and $5,000 for those who are single or married and filing jointly.

FSAs employ a "use-it-or-lose-it" model. If there are unused FSA funds at the end of the year (or after the grace period), the employee forfeits those funds. This dollar amount is adjusted for inflation, and $610 is the limit on FSA carryovers for plan years beginning in 2023. It should be noted that any amount carried over does not count toward the maximum contribution limit.

Grace Period

As an optional plan design feature, FSAs may incorporate a grace period after the end of the plan year. The grace period is an exception to the general use-it-or-lose-it rule by allowing plan participants to incur eligible expenses for a period after the plan year ends. IRS guidance provides that FSAs may "include a grace period of up to the fifteenth day of the third month immediately following the end of each plan year." In other words, employers may add up to a 2.5-month grace period to the end of their FSA's plan year. For example, an FSA with a plan year ending on Dec. 31, 2023, may incorporate a grace period that allows plan participants to continue to incur expenses through March 15, 2024. If an employer decides to add a grace period to its FSA, it must amend the plan documents to describe the grace period.

Eligible Expenses

Funds from a health FSA can help pay for copays, deductibles, prescription drugs, medical equipment and other qualified medical expenses. Qualifying medical expenses are unreimbursed medical care expenses, as defined under Section 213(d) of the Internal Revenue Code. Visit the IRS' website for a full list of qualified expenses.

A DCAP can be used to pay for the care of dependent children under the age of 13 by a babysitter, day care center, or a before- or after-school program. Care for a disabled spouse, parent or child older than age 12 is also eligible for reimbursement. For more information about dependent care expenses, visit the IRS' website.

Why an FSA?

FSAs benefit employees with out-of-pocket medical, dental, vision, hearing or dependent care expenses beyond an insurance plan. Employees need to determine their annual election amount at open enrollment time, so it's a good idea to consider medical needs for the year before choosing a contribution amount. FSAs can help employees save money by using tax-free funds to pay for qualified expenses while saving on taxes since FSA contributions decrease their taxable income. This flexible account allows employees to withdraw funds at any time when used for qualified expenses.

FSAs also benefit employers. The cost of FSAs to employers is relatively minimal and often offset by the tax savings an employer receives since the employee payroll deductions are taken pre-tax. An FSA is a top benefit to consider when making total rewards decisions since the account gives employees a tangible way to reduce out-of-pocket expenses for themselves and their dependents. Also, there are minimal expenses for the employer to provide the benefit when tax savings are considered. Ultimately, FSAs directly benefit employees while also being a cost-effective offering for employers.

HRA

An HRA is an employer-sponsored arrangement that reimburses employees on a tax-free basis for their eligible medical expenses. Unlike an HSA, employees do not need to participate in an HDHP to be eligible for an HRA. However, it is common for HRAs to be paired with an HDHP to maximize savings and increase employee awareness of medical spending.

Unlike the other accounts discussed in this section, HRAs are entirely funded by employer contributions.

Employee Eligibility

If an employer offers an HRA, they will establish eligibility rules, a maximum reimbursement amount and a list of eligible expenses. This account can either be offered to any eligible employee or only certain types of employees (e.g., full-time, part-time or seasonal status, salaried or hourly workers and work locations). HRAs may reimburse employees for their eligible medical expenses as well as their enrolled spouses' and dependents' eligible medical expenses.

Additionally, employers have considerable design flexibility with respect to their HRAs, including establishing the maximum reimbursement amount under the HRA. This limit may vary for different

groups of employees, although employers are generally prohibited from basing contributions on an employee's age, length of service or compensation.

Contributions

Employer contributions are generally tax-deductible and excluded from an employee's gross income. Unlike HSAs and health FSAs, employees cannot contribute to an HRA. Most employers with HRAs create notional, or unfunded, accounts for each participating employee and reimburse eligible medical expenses up to each employee's HRA balance. Employers may link HRA contributions with employee behavior, such as participating in a wellness program. After incurring medical expenses, employees submit claims to the HRA administrator for reimbursement.

Eligible Expenses

Eligible medical expenses are unreimbursed medical care expenses, as defined under Section 213(d) of the Internal Revenue Code, which broadly defines "medical care" to include amounts paid "for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body."

The following are examples of common medical care expenses that an HRA may reimburse:

Drugs and medicine
(including over-the-counter drugs without a prescription)

Orthodontia

Drug addiction treatment

Eye exams, eyeglasses, contact lenses or vision correction surgery

Deductibles, copayments and coinsurance
(if the underlying expense is for medical care)

Dental exams and procedures

Hearing exams and hearing aids

Fertility treatments

Durable medical equipment (e.g., crutches)

Genetic testing or counseling
(to the extent the testing is done to diagnose a medical condition or to determine possible defects)

Menstrual care products

An employer can more narrowly define the expenses that can be reimbursed from its HRA. Unlike HSAs, HRAs cannot be used to pay for nonmedical expenses.

Why an HRA?

Since HRAs are employer-funded, being able to use the funds for qualified medical expenses reduces the amount employees spend on health care. Most importantly, an HRA may be attractive to employees because it removes any financial burden they may face in making contributions.

HRAs can significantly benefit employers. HRAs offer employers more control over the account than they would have over FSAs or HSAs. It's important to remember that employers get to choose which employee classes and types of medical expenses to cover and can even decide whether to allow balance carryovers. Moreover, an HRA can be a valuable recruiting and retention tool since it's an employer-provided account and fund for employees. As with any benefits offering, HRA design choices should be reviewed by the employer's advisors to ensure compliance with legal requirements.

Workplace Considerations

While many employers offer savings and spending accounts as part of their benefits packages, there are nuances to take into account and tips to increase employee engagement and utilization of accounts. This section explores key considerations for employers looking to offer HSAs, FSAs and HRAs as part of their employee benefits packages.

Employee Engagement and Utilization

Meaningful and comprehensive benefits can help promote employee engagement from the start. Suppose employees have a robust benefits package available to them. In that case, they are more likely to actively make plan decisions and be interested in learning more to fully take advantage of available benefits, perks and resources. When done correctly, employee engagement results in benefits utilization.

The following are strategies to increase employee engagement and utilization with employer-offered spending and savings accounts:

- **Empower employees through education.** One of the first steps in helping engage employees in their benefits selection is education. Employers have a unique opportunity to provide data and information to help employees understand the savings potential of leveraging HSAs, FSAs and HRAs, if available. General financial wellness education is in demand from today's workers, so employers can use this to help employees better understand their finances and offer solutions to save money, afford health care expenses and stretch their hard-earned dollars further.
- **Leverage providers' tools.** When available, lean on available information and tools offered by benefits providers. Oftentimes, resources are already available for employees, so use them as is or inquire about ways to customize tools based on the organization. For example, a calculator tool could help employees better understand how much to contribute and make the most out of their accounts. Also, younger generations generally prefer to use online technology to access their health care and make decisions. Knowledge of this consumption habit can be used to increase engagement.
- **Communicate via multiple channels.** Repetition is effective. Multichannel communication is necessary for employee engagement and information retention. Communications should be simple and offer various ways for employees to learn about their benefits. Reminders can go a long way as well for important decision-making deadlines.
- **Incentivize behaviors.** As with any workplace initiative or program, employees sometimes need encouragement to participate in all potential benefits offerings. Employers should consider if incentives fit into plans. For example, they could offer seed money or matching contributions in HSAs to help encourage employees to participate and contribute money.

Common Pitfalls to Avoid

Conversely, there are also common challenges employers may face when they offer HSAs, FSAs and HRAs. Consider the following pitfalls related to accounts to avoid:

- **Administration**—Certain accounts, such as HRAs and FSAs, will require higher levels of administration, so it's important for employers to consider that and have a plan in place so administration doesn't get in the way of employees utilizing the accounts. Generally, the more benefits an employer offers, the more administrative overhead costs. Sometimes employers opt to outsource with a third-party administrator who can take some of the responsibility.
- **Legal compliance**—Employers may struggle with rules related to contributions, eligibility and unused funds. One-on-one benefit review during open enrollment could help catch such mistakes. Furthermore, offering any type of employee benefit raises concerns regarding legal compliance. Mistakes could result in lawsuits, regulatory fines and related legal fees. Employers should consult legal counsel before making any benefits changes, including the design, structure, implementation and administration of offerings.

Regardless of which account or arrangement is being offered, employers should carefully review their options and decide on benefits that are best for their organization and workers. HSAs, FSAs and HRAs might not be the right choice for every company, so it's essential to carefully consider whether these benefits are a great offering for employees or potentially an unnecessary burden on the employer.

Summary

Benefits packages matter more than ever in today's tight competition for talent. Financial issues are a leading cause of employee stress and a significant distraction at work, as many workers struggle with medical debt and rising inflation. Employers have a great opportunity to alleviate many of these concerns by offering employee benefits that can help stretch health care dollars and providing the education and guidance many workers desperately want and need.

HSAs, FSAs and HRAs are three common accounts in which employers can offer employees more options to use pre-tax dollars for eligible medical, dental and vision costs while saving on health care expenses. These accounts have proven to be popular offerings due to various benefits to both employees and employers. When workers are better health care consumers, they will not only be healthier and experience lower costs, but employers will see the trickle effect as well.

Benefits options can be overwhelming for employees and employers alike, but our team can partner with you to develop and maintain a competitive benefits package. Contact Davevic Benefit Consultants, Inc. to further discuss savings accounts and other employee benefits at your organization.