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HSA vs. FSA vs. HRA

Employers are increasingly looking to consumer-driven health plans to help soften the blow of continually rising health care costs. Depending on the model, consumer-driven health plans typically include health reimbursement arrangements (HRAs), flexible spending accounts (FSAs) or health savings accounts (HSAs).

Consumer-driven health plans generally increase employees' stake in their own health care costs. In most cases, a consumer-driven health plan covers a wide range of medical expenses, but also includes more cost-sharing for participants (for example, higher deductibles). Some plans incorporate an HRA, health FSA or HSA to help employees pay for their out-of-pocket medical expenses on a tax-free basis. This article provides some basic information about the similarities and differences between HSAs, FSAs and HRAs.

HEALTH SAVINGS ACCOUNTS (HSAs)

Due to their tax-favored status, HSAs have strict rules regarding eligibility and contributions. To make or receive HSA contributions, individuals must meet the following qualifications:

+ Be covered by a high deductible health plan (HDHP)
+ Not have any other health coverage (with some exceptions)
+ Not be claimed as a dependent on another person's tax return
+ Not be covered by Medicare

The employer and employee can contribute to the HSA in the same year, subject to annual limits. Employers may allow employees to make pre-tax salary reduction contributions to fund their HSAs. Individuals may roll over unspent funds in the HSA from year to year. Since the HSA is a tax-exempt account owned by the employee, he or she may keep the account upon termination of employment or retirement.

HEALTH FLEXIBLE SPENDING ACCOUNTS (FSAs)

Health FSAs provide a means for employees to reduce their income tax liability through salary reduction. Employees can contribute a portion of their own salary to an account designated to pay for health care expenses. These pre-tax contributions are exempt from income and payroll taxes. The Affordable Care Act (ACA) limits employee's pre-tax contributions to their health FSAs to $3,050 (adjusted for inflation for future plan years).

There are some strict design requirements for health FSAs that have negatively impacted their popularity. While any individual who satisfies the HSA eligibility criteria can make HSA contributions, only employees can participate in a health FSA. This means that, while self-employed individuals can establish health FSAs for their employees, they cannot set up their own accounts.

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In addition, FSAs have a "use-it-or-lose-it" provision.* In general, employees are required to elect a specific amount of salary reduction at the beginning of the year, and then must use every dollar in the account by the end of that year. Because annual medical expenses are hard to predict, employees often overfund the accounts and then spend unnecessarily at the end of the year to avoid forfeiting the money in their accounts.

To help avoid this problem, the IRS allows health FSAs to incorporate either a grace period or carry-over feature. Health FSAs with a grace period allow participants to access unused amounts remaining in an FSA at the end of the plan year to pay for expenses incurred during a grace period of up to two and a half months after the end of the plan year. Alternatively, health FSAs may allow participants to carry over up to $610* of unused funds remaining at the end of a plan year to be used for qualified medical expenses incurred during the following plan year.

Health FSAs are also subject to a uniform coverage rule, which requires the health FSA to operate like an insurance plan, with the employer assuming the risk of loss. Under this rule, an employee's maximum reimbursement amount for a year must be available at any time during the coverage period, even if a reimbursement would exceed the year-to-date contributions to the employee's FSA.

Health FSAs are group health plans that are subject to laws such as the ACA, the Health Insurance Portability and Accountability Act (HIPAA) and the Consolidated Omnibus Budget Reconciliation Act (COBRA).

HEALTH REIMBURSEMENT ARRANGEMENTS (HRAs)

HRAs allow employees to use employer contributions to pay for (or reimburse) eligible medical care expenses. HRAs can only be funded with employer money; employees cannot make contributions to their HRAs. Unlike health FSAs, unused HRA balances may accumulate from year to year.

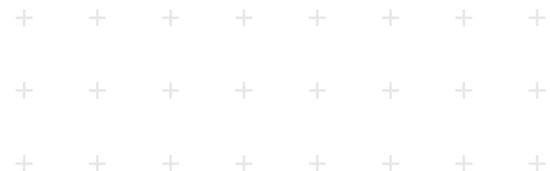
There is no specified cap on the amount an employer is allowed to contribute to an HRA. Also, an HRA is not subject to the uniform coverage rule that applies to health FSAs. However, like health FSAs, only employees can participate in an HRA, which means that self-employed individuals cannot participate in an HRA on a tax-favored basis.

Like health FSAs, HRAs are group health plans that are subject to laws such as HIPAA and COBRA. Under the ACA, most HRAs must be "integrated" with another group health plan to satisfy certain market reforms.

DECIDING ON THE RIGHT APPROACH

Introducing consumerism into your health plan requires an evaluation of the benefits and disadvantages of HSAs, FSAs and HRAs. No one solution is right for every employer. If your organization is considering implementing a consumer-driven health plan, we can help you decide which plan is best for you.

A chart comparing the tax-advantaged accounts discussed in this article follows on the next page.



Comparison of Tax-advantaged Accounts

	HSA	FSA	HRA
Type of account	Health Savings Account	Health Flexible Spending Account	Health Reimbursement Arrangement**
Who owns the account?	Individual/employee	Employer	Employer
Who may fund the account?	Anyone can make contributions to an individual's HSA, including employer and/or employee.	Employer and/or employee	Employer
What plans must be offered with the account?	A high deductible health plan (HDHP) that satisfies minimum annual deductible and maximum annual out-of-pocket expense requirements.	Most health FSAs must qualify as excepted benefits to satisfy ACA reforms. To qualify as an excepted benefit, the FSA must meet a maximum benefit requirement and other group health plan coverage must be offered by the employer.	An employer must offer a health plan and the HRA must be considered integrated with group health plan coverage.
Is there an annual contribution limit?	$3,850 Ind; $7,750 Family (2023) Catch-up contributions: $1,000/year– age 55 by end of tax year	For 2023, employees may not elect to contribute more than $3,050 per year.	No, there is no IRS prescribed limit.
Can unused funds be rolled over from year to year?	Yes	No, with two exceptions. A health FSA may include a grace period of 2-1/2 months* after end of plan year or it may allow employees to carry over up to $610* in unused funds into the next plan year.	Yes
What expenses are eligible for reimbursement?	Section 213(d) medical expenses, including: + COBRA premiums + QLTC premiums + Health premiums while receiving unemployment benefits + If Medicare eligible due to age, health insurance premiums except medical supplement policies	+ Section 213(d) medical expenses + Expenses for insurance premiums are not reimbursable + Employer can define "eligible medical expenses"	+ Section 213(d) medical expenses + Effective for 2014 plan years, cannot reimburse health insurance premiums for individual coverage + Employer can define "eligible medical expenses"

	HSA	FSA	HRA
Must claims be substantiated?	No	Yes	Yes
May the account reimburse non-medical expenses?	Yes, but taxed as income and 20% penalty (no penalty if distributed after death, disability, or age 65).	No	No
Does the uniform coverage rule apply?	No	Yes	No

* Due to the COVID-19 pandemic, Notice 2021-15 from the IRS provides flexibility to employers offering FSAs or dependent care assistance programs. The Consolidated Appropriations Act of 2021, signed into law on Dec. 27, 2020, also provides similar flexibility for these arrangements in 2021 and 2022.

These flexibilities allow employers to:

+ Provide flexibility for the carry-over of unused amounts from the 2020 and 2021 plan years.
+ Provide flexibility to extend the permissible period for incurring claims for plan years ending in 2020 and 2021, allowing employers to extend the grace period to 12 months.
+ Provide flexibility to adopt a special rule regarding post-termination reimbursements from health FSAs, which allows employers to permit employees who cease plan participation during 2020 or 2021 to continue to receive reimbursements from unused amounts through the end of the plan year in which their participation ended.
+ Provide flexibility for a special claims period and carry-over rule for dependent care assistance programs when a dependent "ages out" during the COVID-19 public health emergency. For purposes of determining dependent care assistance that may be paid or reimbursed, the maximum age is increased from 13 to 14 years of age.
+ Allow certain mid-year election changes for health FSAs and dependent care assistance programs for plan years ending in 2021.

** For purposes of this comparison chart, an HRA refers to a traditional HRA that is properly integrated with a group health plan. It does not include retiree-only HRAs, qualified small employer HRAs, individual coverage HRAs or excepted benefit HRAs.