



LIFESTYLE SPENDING ACCOUNTS: INVEST IN YOUR EMPLOYEES' WELL-BEING

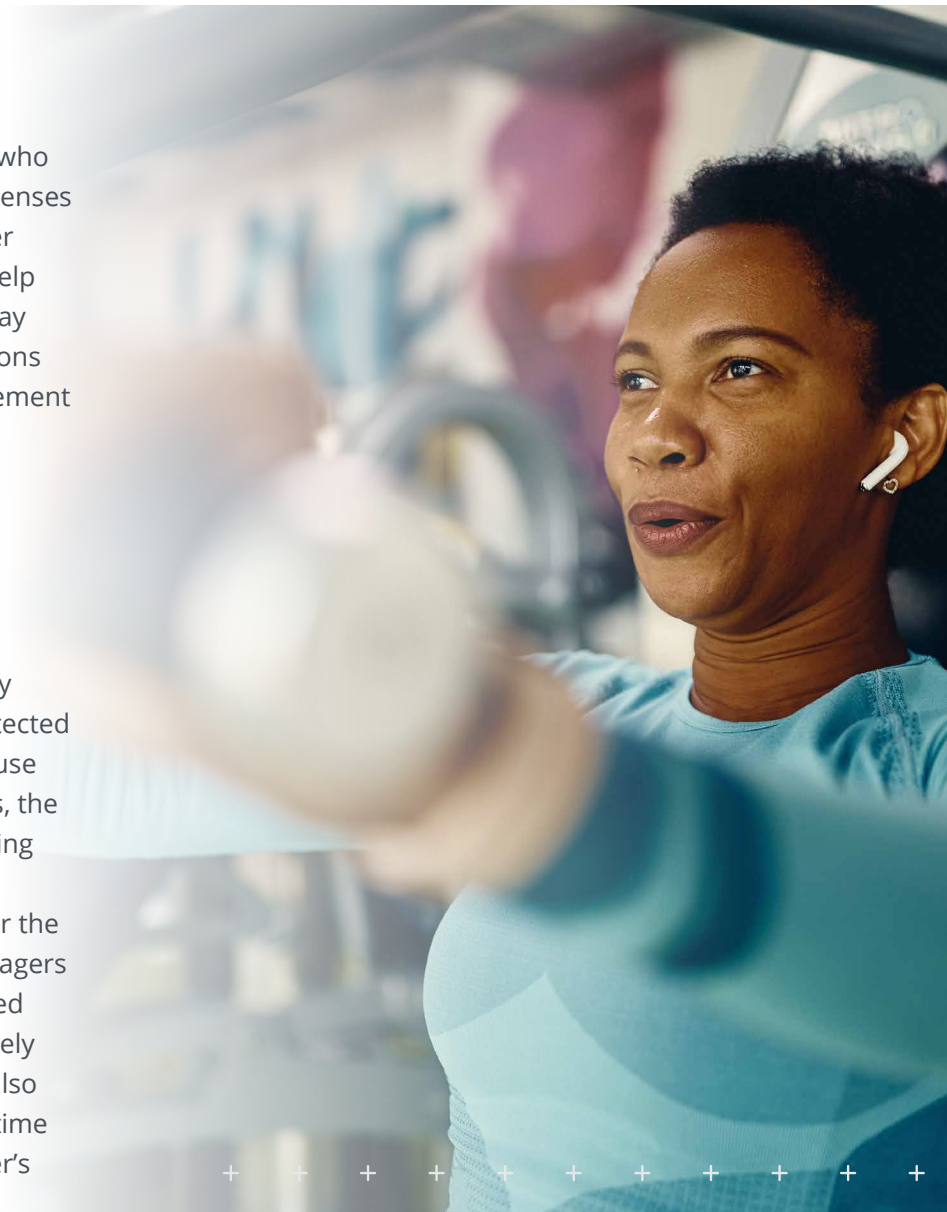
As employers continue to explore different options to attract and retain employees, and to support employee well-being, some employers are choosing to offer Lifestyle Spending Accounts (LSAs). LSAs are accounts that the employer funds to provide taxable reimbursement to employees for a variety of expenses that are not typically covered by traditional benefits. These accounts are also referred to as lifestyle accounts, lifestyle benefits, perk allowances, lifestyle reimbursement accounts, and specialty accounts. LSAs are highly customizable and avoid many of the compliance requirements that apply to other employee benefit offerings.

LSA BENEFIT DESIGN

There is no standard LSA plan design because employers have tons of flexibility to determine who is eligible to participate, funding, and which expenses are reimbursable. Employers can self-administer the LSA, but many employers use a vendor to help administer the LSA, in which case the vendor may impose certain design requirements or restrictions (e.g., regarding eligible expenses and reimbursement substantiation).

ELIGIBILITY TO PARTICIPATE

The employer should offer the LSA uniformly to all employees within the same class to avoid any potential claims of discrimination against a protected class (e.g., gender, age, health status), but because the LSA reimbursement is taxable to employees, the general benefit nondiscrimination rules restricting the ability to favor highly compensated or key employees do not apply. Therefore, eligibility for the LSA could be limited (e.g., available only to managers and executives); however, if the LSA is being used to attract and retain talent, the employer will likely choose to make it available more broadly. It is also a benefit that the employer could offer to part-time employees who are not eligible for the employer's other benefit offerings.



FUNDING

The LSA can be set up as a defined benefit, or even as an earned benefit (e.g., an incentive for participation in a wellness program). The employer can choose how much to contribute without any restrictions because there are no LSA contribution or reimbursement limits. The employer also has lots of flexibility around the timing of the funding. The employer contributions could be made available at the beginning of each year, or the employer could make smaller amounts available throughout the year (e.g., monthly or quarterly). There are no specific requirements or restrictions around carryovers, spenddowns, or run-out periods to submit claims, so the employer can design those as desired as well.

REIMBURSABLE EXPENSES

The list of items that could be reimbursed by an LSA is endless. The LSA could be defined very narrowly to address a particular need or goal (e.g., surrogacy), or it could be defined very broadly to reimburse a long list of items that may support employees' mental, physical, and financial well-being.

Examples of Possible LSA Reimbursable Expenses (Not Exhaustive):

- + Gym memberships or personal training
- + Home gym equipment
- + Nutritional counseling or cooking classes
- + Meditation apps
- + Massage and spa therapy (non-medical)
- + Team league dues or race registration fees
- + Financial planning services or seminars
- + Identity theft services
- + Further education
- + Surrogacy and other infertility treatment
- + Home office equipment
- + Elder care
- + House cleaning services
- + Pet services and supplies

We recommend that only taxable expenses be included as reimbursable expenses. For expenses that could be reimbursed on a tax-favored basis, it would be better to reimburse those expenses elsewhere as permitted by the IRS to reduce income taxes for employees and payroll taxes for employers (e.g., qualifying medical expenses, adoption assistance, educational expenses, qualifying transportation expenses, and daycare expenses).

Avoid Reimbursement of Qualifying Medical Expenses

The LSA should not be designed to provide reimbursement of §213(d) qualifying medical expenses. If the LSA reimburses §213(d) medical expenses, the LSA likely becomes a group health plan subject to ERISA, COBRA, HIPAA, ACA, etc.

The IRS typically imposes specific substantiation requirements for reimbursement on a tax-favored basis, but the same requirements do not apply if the reimbursement is taxable. Therefore, the employer can choose how much documentation (if any) must be provided prior to reimbursement, subject to any vendor limitations.

TAX IMPLICATIONS

In general, the LSA will be taxable to employees (additional income taxes), which will then result in additional payroll taxes for the employer. The LSA is not a tax-advantaged account like FSAs, HRAs or HSAs.

Technically, there is an argument that the full amount made available to the employee via the LSA should be taxable based on the concept of constructive receipt. However, the IRS has not provided definitive guidance addressing how constructive receipt applies to LSAs. It is currently the industry norm only to tax the reimbursed amount. Employers wishing to take a more conservative approach may allow employees to opt out of the LSA before the tax year begins to avoid ambiguity. Others choose to set dollar limits within the LSA for specific purposes (e.g., \$200 for home office, \$500 for gym membership, etc.), which likely exempts them from constructive receipt. Taxing the full amount available would be the more conservative approach.



POTENTIAL ADVANTAGES OF AN LSA

The following are some of the possible advantages of an LSA offering to employees:

- + Alternative to increasing compensation that will not always be fully used by employees.
- + Does not increase employees' base pay, therefore making it easier to adjust or discontinue.
- + Richer benefit offering (more variety) that gives employees more choice.
- + Encourages and supports healthier life choices – e.g., mental, physical, and financial well-being.
- + Offers an alternative benefit to eligible employees not needing the standard benefit offering.
- + Options for employees not eligible for standard benefit offering (e.g., part-time employees).
- + Ability to offer only to a class of employees with violating benefit nondiscrimination rules (if taxable).
- + Limited compliance considerations.

LSAs are a customizable and flexible option that are part of a growing trend allowing employers to offer more employee choice and to support the overall well-being of their employees, including physical, emotional, and financial health.

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