

## Health Reimbursement Accounts (HRAs)

Employers seeking ways to control medical benefit costs may wish to look at HRAs.

*HRAs allow an employer-funded account to reimburse an employee's medical expenses and carry forward unused funds to a subsequent plan year. IRC § 105 sets forth the rules for this device. Reimbursements are tax deductible to the employer and not taxable to the employee.*

### HRAs defined

An HRA is an arrangement that:

- is paid for solely by the employer and not provided pursuant to salary reduction election or otherwise under a 125 cafeteria plan
- reimburses the employee for medical care expenses (as defined by 213(d) of the Internal Revenue Code) incurred by the employee and the employee's spouse and dependents (as defined in 152); and
- provides reimbursements up to a maximum dollar amount for a coverage period and some portion or all of the maximum dollar amount at the end of a coverage period may be carried forward to increase the maximum reimbursement amount in subsequent coverage periods.

### What is really new here?

Employers have long used IRC § 105, which also governs Health Flexible Spending Accounts (FSAs). Formal guidance from the IRS clarifies that the HRA can 1) carry over unused amounts to later years, 2) reimburse health insurance premiums, and 3) continue benefits to former employees and retirees. The “use-it-or-lose-it” rule for FSAs does not apply to HRAs.

### What is the process?

The employer adopts a formal plan and distributes a Summary Plan Description (SPD) to eligible employees. The plan provides each employee with a personal health account for the plan year. Like an FSA, the HRA reimburses certain medical expenses, but with employer dollars that are untaxed to the employee.

As defined in IRC § 213(d) “medically necessary” expenses include co-pays, deductibles, office visits, vision care, most dental procedures, and prescriptions. Expenses related to cosmetic services such as teeth bleaching or facelifts are not eligible. An employer can limit reimbursement to those expenses related to the deductible or permit reimbursement of any qualified medical expenses, even those not covered by the insurance plan.

There is tremendous flexibility in the design and funding of an HRA. For example, the employer may allow the account balance to be used after termination or retirement, fund the annual contribution on a monthly basis or at the beginning of the plan year and use both an HRA and an FSA.

### What happens next?

Employees may request reimbursement for medical expenses at the time services are rendered, accumulate them for reimbursement in the future, or save the account for retiree health benefits. They could use the account as a cushion against catastrophic disease or accident or, if the plan permits, fund health benefits after retirement or pay premiums on long-term care insurance. The money is not forfeited at the end of every year, therefore “rewarding” those who spent their benefit budget wisely.

## Health Reimbursement Accounts (cont.)

### How does the employer benefit?

Employers can reduce costs associated with employee/retiree medical benefits by:

- Shifting a greater portion of the first dollar costs to participants, e.g., through a high deductible health plan or with higher physician or prescription co-payments. This reduces premiums for the insured plan and encourages individual financial responsibility. The HRA would cover a portion of this shift.
- Providing retiree health benefits and/or allowing retirees the opportunity to pay an individual policy premium from the HRA.
- Replacing an underutilized benefit, such as a dental or vision plan, with an HRA.

### Why not increase employee compensation instead?

The downside of a pay increase is tax due from both employer and employee. HRA contributions are not subject to payroll taxes, and generally deductible when paid. For the employee, a qualified reimbursement from an HRA is completely tax-free.

	FSA	HRA
Small and Large Employers, C-Corp Owners	Yes	Yes
Self-employed	No	No
Who "owns" it?	Employee	Employer
How is it funded?	Employee's pre-tax wages	Employer pre-funds or reimburses
Plan Document and SPD	Yes	Yes
Contributions	Er: optional Ee: required	Er: required Ee: none
Employer Tax Savings	Retains salary expense deduction plus 7.65% of employee contribution	Expense deduction for payments
Employee Tax Treatment	Pre-tax contributions, not subject to payroll taxes	Reimbursements not taxed
Employer Pre-funded	Yes	Maybe
Rollover	No	Yes
Insurance Premiums Paid	No	Yes
LTC Premiums Paid	No	Yes
Banking	Employer assets	Employer assets
Convert Account to Taxable Income	No	No
Annual IRS DOL Form 5500 (no tax due)	Yes*	Yes*
COBRA applies	Yes**	Yes
HIPAA Certification Rules	Generally, no**	Yes
HIPAA Privacy Rules?	No	Yes
Is it portable?	No. Individual loses money at termination/retirement	No rollover to new employer. Plan can continue account beyond retirement/termination

\* Special rules apply \*\* Generally, if over 100 participants; Welfare Benefit rules apply  
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