Employers are passing more and more healthcare responsibility to their employees; in some cases, this includes a greater share of the financial burden. Likewise, organizations are looking for ways to help employees manage healthcare expenses. There are a number of products for that purpose, and while they're similar, they're not the same.

Health Savings Accounts (HSAs), Health Reimbursement Accounts (HRAs) and Flexible Spending Accounts (FSAs)

With acronyms being used to explain these concepts, it can be difficult for employees to understand the difference between them or even to remember which product they use. It’s important to educate employees so they get the most out of their healthcare spending account, whichever one they choose.

HSA – A Health Savings Account is like 401(k) retirement account for qualified medical expenses. An HSA helps people pay for medical expenses before they hit their deductible. Employers and employees can both contribute money tax-free, and the money can be rolled over from year to year with only a maximum annual accrual. All contributed funds can be invested once a specific minimum is met (determined by the bank).

HSA-compatible health plans don’t include first dollar coverage [except for preventive care], which means employees must meet a deductible before benefits will be paid by a health plan. This deductible is set by the IRS each year; in 2016, high-deductible health plans must have a deductible of at least $1,300 for an individual and $2,600 for a family.

Employees and employers can both contribute funds to build an HSA, and all funds count toward the annual maximum. The employee “owns” the HSA and the money that’s in it.

HSA funds can be spent on qualified medical expenses as outlined by section 213(d) of the IRS tax code, dental, vision, Medicare and long-term care premiums, and COBRA (if unemployed). After age 65, health premiums can also be withdrawn, but are subject to income tax.

Just like a 401(k), the account is portable. If the owner of the HSA changes jobs, the money can still be used for medical expenses, but the employee can no longer contribute to it.

HRA – Health Reimbursement Accounts help employees pay for medical expenses before a deductible is met. But unlike an HSA, employees cannot contribute to an HRA, only employers. The money an employer places in an HRA can be used for medical expenses not covered by a health plan, such as deductibles and copays for qualified medical expenses as outlined by section 213(d) of the IRS tax code, dental, vision, Medicare and long-term care premiums. The associated health plan can have any deductible amount—there are no minimums and the plan does not have to be a high-deductible health plan. Unlike an HSA, an HRA is not portable, and funds can’t be used for non-medical reasons, even with a penalty. Funds also don’t typically earn interest and are not invested.

Employers must be more involved with HRA accounts since they are the only party who can deposit money; they also determine if funds can be rolled over from one year to the next.
FSA – A Flexible Spending Account allows employees to defer part of their income to pay for medical expenses tax free as part of a Section 125 Cafeteria plan. Allowable expenses include those outlined by section 213(d) of the IRS tax code as well as dental and vision expenses. Both employers and employees can contribute to an FSA; however, the amount employees plan to contribute at the beginning of the year can’t be changed mid-year. FSA funds can’t be invested and fees associated with the plan are normally paid by the employer. There are no underlying plan restrictions and these accounts can be maintained alongside traditional health plans. The employer owns the account and is responsible for the management.

Funds in an FSA can be rolled over only if there is a carryover provision; in this case, $500 can be carried to the next year.

With an FSA, individuals must substantiate need for a reimbursement at the time of service by keeping receipts and filling out a form. Some FSAs include “smart” debit cards that automatically pay certain copays and don’t require documentation.

So, which is the best? It depends.

HSAs, HRAs and FSAs serve slightly different purposes and can even co-exist in some circumstances. For example, those enrolled in an HSA can contribute to a limited-used FSA. Those enrolled in an HRA can also contribute to an FSA without limitations.

HSAs work well for employers who don’t want to add to administrative burdens or additional costs. And they’re a great way to give employees a way to offset the costs of qualified high-deductible health plans and save for post-retirement health expenses. However, employers may want to stray from an HSA or refrain from fully funding the account early in the year if there’s high turnover at a company; the money deposited goes with the employee when they leave.

For employees, HSAs provide investment opportunity and are portable; they also encourage consumerism and are cost-effective to administer. But one of the biggest advantages is that the employee doesn’t have to pre-determine expenses since unused funds carry over.

HRAs can work well for an employer that is not offering a qualified high-deductible health plan but wants to promote consumerism while self-funding a portion of the risk. The funds contributed are immediately available and completely funded by the employer, which is an advantage to the employee. However, there is no tax advantage to employees and the fund can’t be transferred.

FSAs are the most appropriate for employers offering traditional health plans. Employees can benefit because they can contribute pre-tax dollars and the funds are immediately available. But the “use it or lose it” provision is a definite disadvantage.

There are pros and cons to all three healthcare spending account types. It’s best to review them carefully to determine which ones will work for your business, and make sure to communicate the funds’ features and restrictions to your employees.

For more information, please call 1.877.426.7779