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Consumer-Driven Health Plans Under the New Reform Law

The Patient Protection and Affordable Care Act (PPACA) imposes a number of new rules and restrictions on consumer-driven health plans (CDHP) such as health savings accounts (HSAs), health flexible spending accounts (health FSAs) and health reimbursement arrangements (HRAs). This issue of *Healthcare Re-Forum* provides a brief overview of these arrangements and the PPACA provisions that affect them.

Overview: HSAs, Health FSAs, HRAs and Related "Insurance" Arrangements

HSAs are individual accounts that pay routine healthcare expenses directly. An HSA is designed to function with (and can only accept contributions when paired with) a high-deductible health insurance plan (HDHP), which protects the individual from catastrophic medical expenses. This system of healthcare is referred to as "consumer-driven healthcare" because non-catastrophic medical expenses can be paid using a consumer-controlled account. Health FSAs and HRAs are similar to HSAs, but are not directly established by an individual. However, all three types of arrangements give employees and employers the opportunity to pay for covered medical expenses on a pre-tax basis, while encouraging enrolled individuals to become actively involved in making their own healthcare decisions.

HSA Paired with an HDHP[1]

- An HSA is used for general medical expenses; an HDHP protects against catastrophic medical bills
- An HDHP is purchased by either an individual or an employer (as a group health plan)
- An HSA is owned by the individual, even when an employer sponsors the HDHP
- Individuals may make annual contributions up to a pre-determined limit; employers may also contribute under limited circumstances
- Individuals may withdraw funds tax-free to pay for qualified medical expenses until reaching the HDHP deductible
- Funds remaining at the end of each year grow on a tax-deferred basis
- Individuals cannot have access to other forms of medical insurance including certain health FSAs and HRAs (subject to limited exceptions)

Health FSA

- An FSA is an employer-sponsored, employee-funded healthcare spending account
- Employees elect pre-tax contributions to pay for qualified medical expenses not otherwise covered by their health plan
- Funds remaining at the end of each year may not be rolled over into the next year
- Can be used in conjunction with other types of insurance plans, as a component of a cafeteria plan (Internal Revenue Code Section 125) or as stand-alone vehicles (there are some restrictions on types of health FSAs that can be used if a person contributes to an HSA)

HRA

- An HRA is an employer-sponsored, employer-funded healthcare spending account
- Provides covered employees with benefits through individual accounts to help meet annual deductibles or pay for other qualified medical expenses
- Employer determines the amount of money set aside; employees cannot contribute

[1]Archer Medical Savings Accounts (Archer MSAs) are the precursor to HSAs and operate very similarly. Effective January 1, 2008, new Archer MSAs may not be established; however, contributions to and distributions from Archer MSAs established prior to that date may continue.

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- Employer determines if funds remaining at the end of each year may be carried over or must be forfeited
- Can be used in conjunction with any type of health plan offered by the employer, including an HDHP, or as stand-alone vehicles (there are some restrictions on the types of HRAs that can be used if a person also contributes to an HSA)
- May not be offered as a component of a cafeteria plan (Internal Revenue Code Section 125)

Reform Provisions Affecting HSAs, Health FSAs, HRAs and Archer MSAs

- Effective January 1, 2011, the PPACA limits the types of medical expenses that can be paid for by an HSA or an Archer MSA and reimbursed under a health FSA or HRA. Over-the-counter medications no longer qualify as eligible medical expenses for HSA and Archer MSA distribution or health FSA and HRA reimbursement, other than two exceptions:
  1. Over-the-counter insulin
  2. Over-the-counter items prescribed by a physician
- The PPACA also requires employers to provide information on the aggregate cost of an individual's employer-sponsored health coverage for the previous year on the individual's W-2. This requirement is effective for tax years starting on or after January 1, 2011. Contributions to a health FSA are not included as part of the aggregate cost of an individual's employer-sponsored health coverage. The existing W-2 reporting requirement for an employer's contributions to an individual's HSA or Archer MSA remains unchanged under the PPACA.
- Effective January 1, 2011, there is an increase in the tax penalty on distributions from HSAs and Archer MSAs that are not used for qualified medical expenses. The current 10 percent tax on non-qualified distributions from HSAs and 15 percent tax on non-qualified distributions from Archer MSAs will both increase to 20 percent.
- Effective January 1, 2013, PPACA imposes a new $2,500 annual limit on the contribution an employee can make to a health FSA. The new limit will be indexed to inflation for future years.
- Effective January 1, 2018, an excise tax of 40 percent will be levied on employer-sponsored coverage that has an aggregate actuarial value in excess of $10,200 for single coverage and $27,500 for family coverage (indexed annually). This is the so-called "Cadillac Tax." Employer-sponsored coverage includes the value of the employer's contributions to an employee's HSA or Archer MSA and the cost of coverage (as defined in the Internal Revenue Code) provided under a health FSA or HRA. The tax will be imposed on coverage providers, which can include insurers, employers and plan administrators, depending on the funding arrangement for the coverage.

Other Points to Note:

- HDHPs in existence on or before March 23, 2010, must observe the rules established for grandfathered plans if they seek to maintain their grandfathered status for plan years beginning on or after September 23, 2010.
- Annual or lifetime limit restrictions do not apply to HSAs, health FSAs, HRAs or Archer MSAs that are integrated with a group health plan that otherwise complies with the annual and lifetime limit prohibition. These limits also do not apply to retiree-only HRAs, though the status of stand-alone HRAs is unclear. The Department of Health and Human Services is requesting comments on the application of annual limit restrictions to stand-alone HRAs that are not retiree-only HRAs.

This article is not intended to provide tax or legal advice. As always, it is important for employers to consult with a tax and/or legal advisor when evaluating the effect of the PPACA provisions reviewed above.

Future Topics:

- Healthcare Reform and Self-Insured Plans
- New Cafeteria Plan Requirements
- Medical Loss Ratios