



What are HRAs?

The ever-rising cost of healthcare is a major concern for most employers. In response, the IRS defined the rules for the establishment of Healthcare Reimbursement Accounts (HRAs) in June 2002. Usually coupled with a high deductible healthcare plan, an HRA allows employers the ability to enhance their employee benefit package while still achieving their goals of lowering health insurance costs or maintaining costs at current levels.

What is a Healthcare Reimbursement Account?

HRAs, also referred to as consumer-driven healthcare plans, are employer-funded accounts used to reimburse medical expenses to employees. Similar to a Section 125 Healthcare Flexible Spending Account (FSA), HRAs reimburse medical expenses defined in IRC Section 213 (d) as “medically necessary” including co-pays, deductibles, office visits, vision care expenses, prescriptions and dental expenses. However, unlike Healthcare FSAs, the “use-it-or-lose-it” rule does not apply to the HRA, allowing unused funds to be carried forward (contingent upon the employer’s plan design). These employer-provided funds are untaxed at the employee level and tax deductible at the corporate level.

How does an employer establish a Healthcare Reimbursement Plan?

With an HRA, employers have a variety of plan design options available. Before a plan can be implemented, the employer must decide upon the following features: roll-over options, coordination with their FSA account, determination of funds allocated to each employee, and the time frame in which contributions are accumulated. Once the plan is created and adopted, the employer must distribute a Summary Plan Description (SPD) to all eligible employees.

What Plan Design options are available?

Plan design options are flexible. HRAs may be designed to roll unused balances forward from one year to the next, or to forfeit to the employer at the end of the coverage period. Unlike a Healthcare FSA, the HRA plan does not require employers to advance claim payments to employees prior to the funding of their account. The employer can design the plan so that the funds must have been contributed before they are available to pay for eligible expenses. Following are some typical plan design options:

- **First Dollar or Bridge:** The First Dollar HRA complements a higher-deductible insurance plan. It pays only for deductible items covered by insurance and provides a bridge between out-of-pocket expenses and insurance coverage.
- **Comprehensive:** A comprehensive HRA pays all medical expenses not covered by insurance. These expenses include, but are not limited to: dental and vision expenses, chiropractic services, co-pays, deductibles, and insurance premiums. This plan could be coupled with a high-deductible or limited-coverage insurance arrangement or as a stand-alone employee benefit.
- **Restricted:** A restricted HRA covers a specific group of expenses such as dental or vision. It can also be limited to a single medical expense like prescriptions or insurance premiums.
- **Premium:** The Premium Plan HRA allows employees to pay for employer-provided insurance coverage or individually owned policies for health, disability, or long-term care insurance. The objective of this plan may be to design an HRA program that can accumulate each year and cover retiree benefits.

How does the HRA coordinate with Flexible Spending Accounts?

An employer may offer both an FSA and an HRA. The same expense cannot, however, be reimbursed from both accounts. Special ordering rules can be designed to determine which account the reimbursement should be made from first. Alternatively, FSAs and HRAs can be structured to provide for reimbursement of mutually exclusive types of medical expenses (such as permitting the FSA to cover only vision expenses and permitting the HRA to cover all other forms of medical expense).

What are some advantages of an HRA Plan?

The Employer will realize the following benefits from an HRA Plan:

- A. Combining a higher deductible insurance plan with an HRA plan can lower a company's health insurance costs.
- B. An HRA plan can help lower prescription drug costs.
- C. A company's retiree benefit costs could be capped or reduced.
- D. Administrative costs are tax deductible and can be paid by the employer, employees, or a combination of the two.
- E. Unused employee account balances can be rolled forward each year or forfeited by employees, depending on the benefits strategy.
- F. An HRA complements an FSA plan and enhances FSA participation levels.

Who sponsors an HRA Plan?

Regular corporations, partnerships, S corporations, limited liability companies (LLCs), sole proprietors, professional corporations, and not-for-profits can all save money on taxes by establishing an HRA plan.

While regulations prohibit a sole proprietor, partner, members of an LLC (in most cases), or individuals owning more than 2% of an S corporation from participating in the HRA plan, they may still sponsor a plan and benefit from the savings on payroll taxes. "Employee" shareholders of regular corporations may also participate. An HRA can cover current employees, allow former employees to participate, and permit retirees continued access to unused account funds.

Some key points to remember about HRAs:

- The plan must be in writing and a Summary Plan Description must be distributed to each plan participant.
- COBRA continuation forms should be provided to all terminating participants in the medical reimbursement portion of the plan.
- The plan may not discriminate in favor of highly compensated employees.
- Employers are required to pay eligible medical expenses only to the extent of an individual's account balance.
- Generally, employers maintaining HRA plans that cover more than 100 participants must file an IRS Form 5500 each year.
- An HRA can be restricted to cover only certain benefits, like prescriptions, or co-pays and deductibles.
- Eligible expenses must be incurred during the participant's period of coverage, but may be reimbursed at a future date.
- The HRA cannot be "cashed out" upon an employee's termination or retirement. The fund must always be used for qualified medical expenses.

Healthcare Reimbursement Accounts (HRA) vs.Flexible Spending Accounts (FSA)

	HRA	FSA
Debit Card Access	Yes	Yes
Claims Substantiation	Yes	Yes
Roll Unused Funds to next year	Optional	No
Employer Contributions	Required	Optional
Employee Contributions	No	Yes
Employer Tax Savings	Business Deduction	7.65% on Employee Contributions
Employee Tax Savings	Reimbursements are Tax-Free	Reimbursements are Tax-Free
Plan Document Required	Yes	Yes
Summary Plan Description	Yes	Yes
Account Prefunded by Employer	Not Required	Required
Insurance Premiums Reimbursed from Account	Yes	No
IRS Form 5500 filing	Yes*	Yes*
COBRA Rules apply	Yes	Yes
High Deductible Plan necessary	Any type of health plan arrangement can be offered	Any type of health plan arrangement can be offered
Group size limit	All sizes	All sizes
Account Retained by Employee upon Termination of Employment	No, but terminated employees may be covered by plan	No

*IRS Form 5500 should be filed if group has over 100 participants.