Provided by Clarke & Company Benefits, LLC

Changes to Health Accounts

The Affordable Care Act (ACA) makes some significant changes to health flexible spending accounts (health FSAs), health reimbursement arrangements (HRAs) and health savings accounts (HSAs). These changes:

- Limit reimbursements on over-the-counter (OTC) medications;
- Limit salary reduction contributions to health FSAs; and
- Increase the tax on withdrawals from HSAs and Archer medical savings accounts (MSAs) that are not used for medical expenses.

In addition, the ACA includes reforms that limit the availability of HRAs and health FSAs beginning in 2014, which prohibit most stand-alone HRAs and health FSAs that do not qualify as "excepted benefits." Notably, the Departments have explicitly stated that **HRAs cannot be used to purchase individual market health coverage for employees**.

LINKS AND RESOURCES

- On Sept. 13, 2013, the Internal Revenue Service (IRS) and Department of Labor (DOL) issued IRS Notice 2013-54 and DOL Technical Release (T.R.) 2013-03 to address how the ACA's reforms apply to HRAs and health FSAs.
- Final regulations published on Nov. 18, 2015, extend this guidance to other types of account-based plans (including health FSAs) and confirms that an HRA cannot be used to purchase individual market coverage.

HIGHLIGHTS

LIMIT ON OTC MEDICATIONS

The ACA limits reimbursements for OTC drugs from certain health accounts to only those purchased with a prescription (except insulin).

CHANGES FOR 2014 AND AFTER

Under the ACA, beginning in 2014:

- Most stand-alone HRAs and health FSAs are prohibited; and
- HRAs cannot be used to purchase individual market health coverage for employees.

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LIMIT ON REIMBURSEMENT OF OVER-THE-COUNTER MEDICATIONS

The ACA revised the definition of "qualified medical expenses" for purposes of reimbursement from health FSAs and HRAs, and distributions from Archer MSAs and HSAs. The revised definition is consistent with the definition used for the itemized tax deduction.

Under the ACA definition, "qualified medical expenses" include amounts paid for medicines or drugs only if the medicine or drug is a prescribed drug (regardless of whether the drug is available without a prescription) or is insulin. This means that health FSAs and HRAs **may not reimburse the cost of OTC medications that do not have a prescription**.

Also, distributions from Archer MSAs and HSAs used to pay for OTC medications without a prescription will be taxable and subject to penalties. However, amounts paid for OTC medicine with a prescription still qualify as "qualified medical expenses."

The ACA's limit on OTC medications for health FSAs and HRAs took effect for:

- Expenses incurred after Dec. 31, 2010, for health FSAs and HRAs; and
- Medicines and drugs purchased after Dec. 31, 2010, for HSAs and Archer MSAs.

LIMIT ON HEALTH FSA CONTRIBUTIONS

The ACA imposes a dollar limit on employees' salary reduction contributions to a health FSA offered under a Section 125 cafeteria plan. This limit first took effect for plan years beginning on or after Jan. 1, 2013, and was initially set at $2,500. For years after 2013, the dollar limit is indexed for cost-of-living adjustments.

The health FSA limit stayed at $2,500 for 2014. However, on Oct. 30, 2014, the IRS increased the health FSA limit to **$2,550**, effective for plan years beginning on or after Jan. 1, 2015. On Oct. 21, 2015, IRS Revenue Procedure 2015-53 announced that the health FSA limit will remain at **$2,550** for plan years beginning on or after Jan. 1, 2016. On Oct. 25, 2016, IRS Revenue Procedure 2016-55 increased the health FSA limit to **$2,600** for 2017. The health FSA limit will potentially be further increased for cost-of-living adjustments for later years.

An employer may impose its own dollar limit on employees' salary reduction contributions to a health FSA, as long as the employer's limit does not exceed the ACA's maximum limit in effect for the plan year. Also, in connection with the ACA's limit on salary reduction contributions, the IRS released Notice 2013-71 to relax the "use-or-lose" rule for health FSAs. Under the relaxed rule, employers may allow participants to **carry over up to $500 in unused funds** into the next year. This modification applies only if the plan does not also incorporate the grace period rule, and is available beginning with the health FSA's 2013 plan year.

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INCREASED TAX ON WITHDRAWALS FROM HSAS AND ARCHER MSAS

Participants in HSAs and Archer MSAs may withdraw funds from those accounts either to pay for qualified medical expenses or to use for other purposes. However, only withdrawals used to pay for qualified medical expenses are tax-free. If the funds are used for other purposes, the withdrawal becomes taxable and subject to penalties.

The ACA increased the additional tax on HSA distributions prior to age 65 that are not used for qualified medical expenses from 10 to **20 percent**. The additional tax for Archer MSA distributions not used for qualified medical expenses increased from 15 to **20 percent**. These increased taxes apply to distributions made after Dec. 31, 2010.

CHANGES FOR 2014

The ACA requires non-grandfathered group health plans to cover certain preventive care services without imposing any cost-sharing. Also, for plan years beginning on or after Jan. 1, 2014, the ACA prohibits group health plans from placing annual dollar limits on coverage of essential health benefits.

IRS Notice 2013-54 and DOL T.R. 2013-03 address how the ACA's reforms apply to HRAs and health FSAs, and applies for plan years beginning on or after **Jan. 1, 2014**, but can be applied for all prior periods.

HRAs

Effective for plan years beginning on or after Jan. 1, 2014, whether an HRA will be permitted mainly depends on whether the HRA is integrated with other group health coverage or a stand-alone HRA.

INTEGRATED HRAS	VS.	STAND-ALONE HRAS
An HRA that is integrated with a group health plan will comply with the ACA's annual limit prohibition and preventive care reforms if the group health plan with which the HRA is integrated complies with the ACA requirements. Thus, integrated HRAs are still allowed after 2014.		Stand-alone HRAs cannot satisfy the ACA's annual limit and preventive care reforms on their own and, thus, are no longer available.

The Departments' guidance includes two ways for an HRA to be considered integrated with another group health plan. The Departments' final regulations extend this guidance to other types of account-based plans (including health FSAs) and confirms that an HRA used to purchase coverage on the individual market cannot be integrated with that individual market coverage. Thus, HRAs cannot be used to purchase health coverage on the individual market for employees.

In addition, retiree-only HRAs are exempt from the ACA's market reforms. These types of stand-alone HRAs continue to be available for 2014 and later years. Based on a proposed rule from Dec. 20, 2013, limited-scope vision or dental HRAs that qualify as excepted benefits are also available after 2014.

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Health FSAs

Employee benefits that qualify as excepted benefits are not subject to the ACA's market reforms, including the ACA's prohibition on annual limits and preventive care coverage requirement. The Departments' guidance indicates that health FSAs that do not qualify as excepted benefits are generally prohibited beginning in 2014.

Health FSAs qualify as excepted benefits if they satisfy the **availability** AND **maximum benefit** requirements. To satisfy the availability requirement, other non-excepted group health plan coverage (for example, coverage under a major medical group health plan) must be made available for the year to the class of participants by reason of their employment. To satisfy the maximum benefit requirement, the maximum benefit payable under the health FSA to any participant for a year cannot exceed the greater of:

- Two times the participant's salary reduction election under the health FSA for the year; or
- The amount of the participant's salary reduction election for the health FSA for the year, plus $500.

For example, a health FSA with a one-to-one employer match ($700 employee, $700 employer) would satisfy the maximum benefit requirement. Also, a health FSA with an employer contribution of $500 or less would satisfy the maximum benefit requirement.

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