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Harmony Wealth Strategies
BUILDING AND SAFEGUARDING YOUR FINANCIAL WORLD

Health Reimbursement Arrangements

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What is a health reimbursement arrangement (HRA)?

A health reimbursement arrangement (HRA) is an employer-sponsored health-care option that allows employees to pay for medical costs using a pool of employer-provided funds. HRAs reimburse employees for qualified medical expenses they've incurred, up to a maximum amount per coverage period.

Why do employers establish HRAs?

HRAs are typically established to meet the needs of both employers and employees. Employers may establish HRAs to provide better health-care coverage for employees or to contain health-care costs. In some cases, HRAs serve as primary health insurance programs. Most commonly, employers offer HRAs in conjunction with high-deductible medical or accident insurance plans. Employees who pay deductibles or other costs not covered by the high-deductible plan are reimbursed for these costs from their employer's HRA. In both cases, the employer saves money on health insurance premiums.

What are the advantages of HRAs?

To employers:

- Employers can make compensation packages more attractive by offering HRAs.
- Employers can contain health-care costs by offering HRAs in conjunction with high-deductible major medical plans.

To employees:

- HRAs are funded solely by employers. An HRA cannot be funded by a salary-reduction election either directly or indirectly through a cafeteria plan.
- HRAs can be used to pay for health insurance premiums (e.g., major medical plans), as well as services typically not covered by health plans (e.g., eyeglasses or alternative medicines).
- HRA reimbursements are generally excludable from the employee's gross income, provided the reimbursements are for qualified medical expenses as defined by the tax code.
- HRAs can allow participants to carry over any unused amounts into the next year.
- HRAs may continue to reimburse former or retired employees for medical expenses.

What are the disadvantages of HRAs?

To employers:

- Employers offering HRAs must pay administrative costs to make sure they comply with complex legal and tax requirements.
- Employers must pay the full cost of funding the plan.

To employees:

- Employees will face increased paperwork, since they must submit receipts or other documentation in order to be reimbursed for qualified health-care expenses.
- Employees may shoulder more of the cost of health care with an HRA than they would with a traditional group health plan.

How are HRAs different from flexible spending accounts?

Although HRAs and flexible spending accounts (FSAs) share certain attributes, they are significantly different. FSAs require employees to make pre-tax contributions to an account, while HRAs prohibit this; only employers can make contributions to an HRA. In fact, if it appears that an employee's salary has been reduced to offset the cost of the HRA, the status of the arrangement could be jeopardized. HRA funds can only be used to reimburse employees for qualified medical expenses, whereas certain types of FSAs can be used for benefits other than health care.

Another important difference is that FSAs renew annually with a "use-it-or-lose-it" clause. If an employee has a remaining balance, those funds are given to the employer to pay administrative costs associated with the plan. HRAs, however, allow employees to carry over unused funds from year to year.

Tip: *In late 2013, the IRS issued Notice 2013-71, which modified the Section 125 (cafeteria) "use it or lose it" rule for health-care FSAs to allow these plans to permit up to $500 of unused amounts to be carried over to the following plan year. Plan participants can then use these funds to reimburse qualified expenses incurred during that following year. Note that any plans adopting the carryover provision cannot also permit a grace period. Plans must be amended to both add the carryover provision and omit the grace period, if one applies. The $500 carryover is in addition to the maximum $2,700 (2019 limit) employees can set aside for qualified medical expenses. Note that employers can choose to impose lower limits.*

Tip: *An employer may offer both a health FSA and an HRA. But if coverage is provided under an HRA and a health FSA for the same health-care expenses, HRA funds must be exhausted before reimbursements can be made from the FSA, unless the HRA plan document specifies that coverage under the HRA is available only after expenses exceeding the dollar amount of the FSA have been paid.*

How are HRAs different from health savings accounts?

Health savings accounts (HSAs) allow employees to save tax-deductible money for routine medical care. Because they share many of the same features and benefits, HRAs and HSAs may be easily confused, but they differ in many respects. Here are some of the significant differences between them:

- HSAs must be established in conjunction with high-deductible health plans; no such requirement applies to HRAs
- HSAs may be established by individuals and employers; HRAs may only be established by employers
- HSAs allow both individual and employer contributions; HRAs are funded solely by employer contributions
- HSAs are owned by individuals and are portable; HRAs are owned by employers and are not portable
- HSA funds can be invested and earn interest; HRA funds cannot

Caution: *If you are currently covered under an HRA, you may be eligible to establish an HSA only in limited circumstances.*

Tip: *An individual can roll over funds in an existing Archer MSA to an HSA.*

Tip: *HSAs have largely replaced standard (non-Medicare) Archer MSAs. However, eligible individuals can still be covered by existing Archer MSA accounts created prior to 2008.*

Tax considerations

If an HRA is considered an employer-sponsored accident or health plan under IRS rules, reimbursements for health-care expenses (including health insurance premiums) are generally excludable from the employee's gross income. But to be considered excludable, the reimbursements must be for health-care expenses incurred by individuals covered by the HRA. These individuals may include:

- Current employees
- Former employees (including retired employees), whether or not they elect COBRA continuation coverage
- Spouses and dependents of employees and former employees
- Spouses and dependents of deceased employees

Caution: *HRAs may only reimburse qualified expenses that are substantiated and that occur after the date an employee first enrolled in the HRA.*

HRAs must comply with other complex IRS regulations. For more information, consult a tax advisor or the IRS website.

Impact of health-care reform

Health-care reform legislation passed in 2010 includes a change in the definition of "qualified medical expenses" that impacts reimbursements and withdrawals under all types of tax advantaged health-care accounts (i.e., FSAs, HRAs, HSAs, and Archer

MSAs). As of 2011, expenses incurred for over-the-counter (OTC) medications were no longer eligible for reimbursement from FSAs and HRAs, or count as qualified expenses for purposes of HSAs and Archer MSAs. However, OTC medicines prescribed by a physician and insulin are still considered qualifying expenses.

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