Comparing MSAs, HSAs, HRAs and FSAs: Which Approach is Best?

Employers are increasingly looking to consumer-driven health plans to help soften the blow of continually rising health care costs. Depending on the model, these plans typically include Health Reimbursement Arrangements (HRAs), Flexible Spending Accounts (FSAs), Health Savings Accounts (HSAs) and Medical Savings Accounts (MSAs). Some plans allow employees to use these accounts to pay for medical expenses that are not covered by insurance, while employers use others to provide employees with a fixed dollar amount with which they can purchase health care services or a health insurance policy on the open market. This article provides some basic information about the similarities and differences between HRAs, FSAs, HSAs and MSAs.

Medical Savings Accounts
The original consumer-driven health plan, the Archer MSA, was an account that allowed year-to-year rollovers and was designed to be combined with a high-deductible health insurance policy. The high-deductible policy protected the insured from catastrophic loss, such as a prolonged illness or hospitalization. The savings account was controlled by the individual, and was intended to pay for routine health care services.

MSAs contained restrictions that reduced their practicality and appeal to employers and employees. For example, tax-free MSAs were only available to the self-employed and the employees of small businesses (under 50 employees). Large and medium-sized employers and employees of companies that did not provide health insurance were not eligible for an Archer MSA. The employer and employee could not both contribute to the employee's MSA in the same year. While MSA accounts already established may continue to be used and receive contributions, no new accounts may be established.

Consumer-driven health plans help soften the blow of continually rising health care costs. These plans are Health Reimbursement Arrangements (HRAs), Flexible Spending Accounts (FSAs), Health Savings Accounts (HSAs) and Medical Savings Accounts (MSAs).

Health Savings Accounts
The Medicare Prescription Drug, Improvement and Modernization Act of 2003 established a tax-favored health savings account (HSA). HSAs are established by an individual, including the self-employed, or it may be employer-sponsored. Unlike MSAs, the employer and employee can contribute to the HSA in the same year, subject to annual limits.

Like the MSA, the high-deductible health plan is designed to protect the individual against catastrophic loss, but allows the individual to roll over unspent funds in the HSA from year to year. Since the HSA is a tax-exempt trust owned by the individual, the may keep
Flexible Spending Accounts
In 1986, the Internal Revenue Code Section 125 introduced the flexible spending account. FSAs provide a means for employees to considerably reduce their income tax liability through salary reduction. Employees can contribute a portion of their own salary to an account designated to pay for health care expenses. These pretax contributions are exempt from income and payroll taxes.

Several inherent design flaws have resulted in low participation in FSAs. The tax code requires that only employers may set up these accounts for their employees, leaving self-employed individuals and millions of other employees unable to set up their own accounts. In addition, the FSA has a use-it-or-lose-it provision. Employees are required to elect a specific amount of salary deduction at the beginning of the year, and then must use every dollar in the account by the end of that year. Because annual medical expenses are hard to predict, employees often overfund the accounts and then spend unnecessarily at the end of the year to avoid forfeiting the money in their accounts.

In 2005, the IRS announced that cafeteria plans could be amended to allow participants to access unused amounts remaining in an FSA at the end of the plan year to pay for expenses incurred during a grace period of up to two and a half months after the end of the plan year. It is important to note that when a plan with a general purpose health FSA provides a grace period, participants will not be eligible to contribute to an HSA until the first day of the first month following the end of the grace period, unless the employee has a zero balance in the FSA at the end of the plan year, or if a qualified HSA distribution of the entire remaining balance is made as of the end of the plan year.

Critics of FSAs also note that they are difficult and confusing to set up and administer, causing many small and midsize employers without adequate resources to forego their use. In addition, filing claims for reimbursement can sometimes be difficult and time-consuming for the employee.

Health Reimbursement Arrangements
Funds within a Health Reimbursement Arrangement (HRA) may be rolled over from year to year. HRAs allow employees to use employer contributions only for medical expenses or to pay health insurance premiums.

Unlike FSAs, unused HRA balances may accumulate from year to year, thus providing a personal stake for the consumer in the financial outcome of his or her health care spending decisions.

Because HRAs are group health plans, they are subject to laws such as HIPAA and COBRA. If an employee leaves an employer, he may continue to access unused funds within the HRA by electing COBRA. Under COBRA, the employer may also be required to continue its contributions during the COBRA coverage period. The requirement to continue contributions and comply with HIPAA is a deterrent for employers HRA.

Deciding on the Right Approach
Introducing consumerism into your health plan requires an evaluation of the benefits and disadvantages of HSAs, FSAs and HRAs. No one solution is right for every employer. In light of the complexities of choosing the right consumer-driven health plan, many employers continue to take a wait-and-see approach.

If your organization is considering implementing a consumer-driven health plan, your COPIC Financial Services representative can help you decide which plan is best for you.

A chart comparing the tax-advantaged accounts discussed in this article follows below.
<table>
<thead>
<tr>
<th><strong>Comparison of Tax-Advantaged Accounts</strong></th>
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<tbody>
<tr>
<td><strong>Name of account</strong></td>
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<tr>
<td>Health Savings Account</td>
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<tr>
<td><strong>Who owns the account?</strong></td>
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<tr>
<td><strong>Who may fund the account?</strong></td>
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<tr>
<td>Employee can contribute pre-tax dollars through Section 125 plan</td>
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<td><strong>What plans may be offered with the tax-advantaged account?</strong></td>
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<td><strong>Is there a limit on the amount that can be contributed per year?</strong></td>
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<td><strong>Does the uniform coverage rule apply?</strong></td>
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</table>

*Self-employed individuals, including partners, and more than 2% shareholders in a subchapter S-corporation cannot contribute.

**For 2010/2011 calendar years. ***For 2012 calendar years. ****For 2011 calendar years.
## Comparison of Tax-Advantaged Accounts

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<tr>
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<th>HSA</th>
<th>MSA</th>
<th>HRA</th>
<th>FSA</th>
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<tr>
<td><strong>Can unused funds be rolled over from year to year?</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes, subject to COBRA</td>
<td>No, but in some cases employee may elect COBRA through end of plan year. Unused amounts in FSA may be used for expenses incurred during grace period of two and one half months after end of plan year.</td>
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</tbody>
</table>
| **What expenses are eligible for reimbursement?** | Section 213(d) medical expenses  
- Effective 12/31/10, OTC medicine or drug expenses cannot be reimbursed unless they are prescribed or are insulin.  
- COBRA premiums  
- QLTC premiums  
- Health premiums while receiving unemployment benefits  
  - If Medicare eligible due to age, health insurance premiums except medical supplement policies  | Section 213(d) medical expenses  
- Effective 12/31/10, OTC medicine or drug expenses cannot be reimbursed unless they are prescribed or are insulin.  
- COBRA premiums  
- QLTC premiums  
- Health premiums while receiving unemployment benefits | Section 213(d) medical expenses  
- Effective 12/31/10, OTC medicine or drug expenses cannot be reimbursed unless they are prescribed or are insulin.  
- Health insurance premiums for current employees, retirees, and qualified beneficiaries, and QLTC premiums  
  - Employer can define “eligible medical expenses” | Section 213(d) medical expenses  
- Effective 12/31/10, OTC medicine or drug expenses cannot be reimbursed unless they are prescribed or are insulin.  
- Expenses for insurance premiums are not reimbursable  
  - Employer can define “eligible medical expenses” |
| **Must claims submitted for reimbursement be substantiated?** | No                   | Yes                  | Yes                      | Yes                                      |
| **May account reimburse non-medical expenses?** | Yes, but taxed as income and 20% penalty**** (no penalty if distributed after death, disability, or eligible for Medicare) | Yes, but taxed as income and 20% penalty****; no penalty if after age 65 | No                                       | No                                        |
| **Is interest earned on the tax-advantaged account?** | Yes, accrues tax-free | Yes, accrues tax-free | Yes, paid to the employer | No                                        |

****For any non-medical distribution before January 1, 2011, the HSA penalty was 10% and the MSA penalty was 15%.