Helping Employers Choose Between an FSA and HSA

Reducing the Cost of Employee Benefits

The cost of employee health benefits is rising at an exponential rate. As an employer, you may be searching for ways to control costs – including exploring alternative benefit models or shifting more of the cost burden to your employees in the form of higher deductibles, more limited premium cost-sharing, or reduced coverage. However, cost reduction efforts must be balanced with the need to maintain employee satisfaction, attract, and retain talent. Tax-advantaged benefit accounts represent a compelling way to help offset the increase in your employees' out-of-pocket healthcare responsibilities. Flexible spending accounts (FSAs) and health savings accounts (HSAs) will not only empower your employees to save for the cost of care and better manage their healthcare spending – every dollar that an employee contributes will reduce your payroll tax liability.

Differences Between an FSA and an HSA

What is an FSA?

An FSA can be paired with any health plan and is set up and controlled by the employer. The account can be funded by pre-tax payroll deferment in an amount elected during open enrollment. Participants can then use that money to pay for qualified healthcare expenses throughout the year. FSAs truly are a "spending" account, in that participants are expected to spend the funds by the end of the plan year or forfeit the remaining balance, also known as the use-it-or-lose-it rule. Expenses must be an IRS qualified medical expense to be eligible for payment with the FSA's tax-free dollars.

What is an HSA?

Unlike an FSA, an HSA requires that the insured be covered under a high-deductible health plan (HDHP). It also differs from an FSA because the account is owned by the participant. While most HSA participants enjoy the convenience of account contributions being deducted pre-tax from their paychecks, HSAs may also be funded by their employer or family member (or by the employee on a post-tax basis). The account owner can spend the funds on current eligible expenses or save them for future expenses. Because the account is owned by the individual, the participant is solely responsible for the substantiation of expenses and is not required to send receipts to their employer or administrator.

Criteria	FSA	HSA
OVERVIEW		
General Purpose	Funding predictable healthcare expenses in the current year with pre-tax dollars	Funding a lifetime of healthcare expenses with pre-tax dollars
Account Owner	**Employer** Because the account belongs to you, an employee's participation in the plan ends when employment is terminated	**Employee** The account belongs to the employee, they maintain ownership after they leave your company
Health Plan Pairings	Can be paired with any health plan	Must be paired with a qualified HDHP: • Deductible not less than $1,250 for single or $2,500 for family • Annual out-of-pocket expenses do not exceed $6,350 for single or $12,700 for family
Distribution of Funds	**Eligible Medical Expenses Only** Funds may be used to pay for 213(d) eligible expenses only; cannot access for nonmedical reasons	**Eligible Medical Expenses with Exceptions** Funds are to be used to pay for 213(d) eligible expenses, but may be withdrawn for non-medical expenses with a 10% penalty
Timing of Usage	**Use-it-or-lose-it Rule** Elected contribution amount must be used by the end of plan year or by the end of the grace period for that plan year; unused balance is forfeited	**Funds Are Never Forfeited** Reimbursement can be made for any eligible expense incurred from the HSA established date to the current date; funds do not expire, making an HSA an excellent savings vehicle

Criteria	FSA	HSA
Earnings Investments	No earnings paid	Some HSA offerings provide integrated investment options and/or interest benefits
Tax Savings	**Tax-deductible** Employer contributions are tax-deductible **Tax-free** Employee contributions, made via payroll deduction, are taken out prior to income tax assessment	**Tax-deductible** Employer contributions and contributions made by employees above the line (i.e. from their bank account) are tax-deductible **Tax-free** Employee contributions, made via payroll deduction, are taken out on a pre-tax basis
CONTRIBUTIONS		
Source of Contributions	Employer: optional Payroll deferral: optional From employee bank account: not allowed	Employer: optional Payroll deferral: optional From employee bank account: optional
Contributions	Annual election amount is determined by the participant during open enrollment and deducted evenly per pay period; Changes may only be made due to a qualified life event (marriage, birth, etc.)	Annual election amount is determined by the participant during open enrollment and deducted evenly per pay period; Employees can adjust contributions throughout the year up to IRS limit. Employers may also contribute
Contribution Limit	IRS limit of $2,500	IRS limit of Single: $3,300 / Family: $6,550
Disbursements		
Direct Access to Funds	Pay providers directly via debit card	Pay providers directly via debit card, check, or on the provider's website via ACH
Claims for Reimbursements	Submit a claim for reimbursement with receipts online, by fax, or using the mobile app	There are no claims. Employees pay for eligible expenses directly from the account.
Substantiation Requirement	Receipts and Explanation of Benefits (EOBs) should be kept for all purchases; Your plan administrator may require them for reimbursement	There is no requirement for substantiation. The participant is solely responsible for proper use of funds. Documentation should be kept in case of IRS audit.
Substantiation Requirement	Not permitted	Cash withdrawals are allowed. The cash must be used on an eligible expense or be subject to a 10% penalty. After age 65, cash withdrawals can be made for non-eligible expenses penalty-free but subject to income taxes.

Primary Benefit of Both Plans

Both plans provide advantages for both the employee and the employer:

✠ Tax-free treatment of healthcare expenses

✠ Contributions that are payroll-deferred are not reported as income to the employee, resulting in payroll tax savings for the employer and income tax savings for the employee.

- *Employers can save approximately 7.65%* in reduced payroll taxes on total contributions*
- *Employees making contributions will save between 15-40% by avoiding federal and state income taxes as well as the employee half of payroll taxes.*

**These figures are based on the employer half of FICA and FUTA. The information detailed is for illustrative purposes only and should not substitute for legal or tax advice.*

Which Plan to Choose

FSA

FSAs do not require participation in a high-deductible health plan, so they are most frequently offered in conjunction with traditional health plans. Traditional health plans limit out-of-pocket expenses for participants making it easier for an employee to estimate annual medical expenses by calculating projected copays, deductible amounts, co-insurance, etc. The retention of funds forfeited by participants at the end f the plan year due to the use-it-or-lose-it rule can also be an incentive for employers to offer this type of account.

HSA

Employers who are seeking to minimize the cost of providing health benefits by offering a HDHP will generally offer an HSA. Since compliance requires less paperwork, they can often save on administrative costs. HSAs offer employees a broader value proposition: the ability to pay for current or future expenses without fear of forfeiting dollars, triple tax advantage, investment growth potential, and the option to pay for non-medical expenditures if necessary.

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