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# What Reform's Squeeze May Mean for Flex Benefits

*By Rich Glass, JD*

Last summer, water balloons were plentiful at my house. One aspect of water balloons is that they generally stay the same size: Squeeze one end, and the other end expands.

The same holds true for employer-sponsored flexible benefits. As health reform continues to be hotly debated, a prevailing view is that flexible benefits would be squeezed, perhaps out of existence, by some of the measures already passed by the House and Senate. Like the water balloon, though, the squeeze may expand into other opportunities for those who regularly toil in Code Sections 105 and 125 (see App. A of the *Handbook* for both).

In light of the Jan. 19, 2010, special election results in Massachusetts, it is unlikely that the full reform agenda will be passed. However, four major components of health care reform that pose a threat to flexible benefits could still find their way into a less comprehensive law:

- An annual limit on health flexible spending account (FSA) reimbursements (for example, \$2,500) that would be indexed for inflation.
- The elimination of over-the-counter drugs from tax-free reimbursement under a health FSA, health savings account (HSA) or health reimbursement arrangement (HRA) (See ¶311 and ¶292, respectively, for more on HSAs and HRAs.)
- An increase in the HSA excise tax from 10 percent to 20 percent when HSA funds are used for non-medical reasons.
- A "Cadillac Tax" on high-cost coverage (including flexible benefits) for insurance carriers and self-insured employers, indexed for inflation plus one percentage point, and adjusted for several categories like retiree status, high-risk professions and high health care cost states.

The Cadillac Tax, in particular, could cause some employers with health insurance to drop or minimize flexible benefits. If you are like me, reviewing these features of health care reform increases the stress level and pulse rate. Before that happens, let me inject four deep breaths of air.

First, as of this writing, the Cadillac Tax would not take effect until January 2013 at the earliest. That provides plan sponsors plenty of time to alter benefit designs to come below the thresholds. Second, many health FSA participants, especially first-time entrants, make annual elections below \$2,500 because they cannot spare \$208.33 per month from the paychecks, even if it is on a pre-tax basis. Third, many non-prescription drug items (for example, insulin, bandages, diagnostic items and medical equipment) would still be reimbursable. Finally, there is always time for another law to tweak and change unpopular provisions, especially if the makeup of Congress shifts radically after the 2010 mid-term elections.

That addresses the "squeeze" side of the health reform balloon. Where are some areas that flexible benefits might expand in the next several years? Let me inject four rays of sunshine on an otherwise cloudy outlook, if health care reform passes in its current form.

First, the Cadillac Tax would inject a higher level of analysis into benefits delivery. Employers will pay more attention to the value of benefits options and insurance riders in finding the optimal amount of coverage that falls below the Cadillac Tax threshold. This could usher in a new era of innovation and critical thinking when it comes to employer-sponsored health coverage. Employers will have a few years to put on their creative thinking caps before the Cadillac Tax takes effect. You might see more employers getting more serious about wellness and preventive care, two programs that show promising results in holding down claims costs.

**See *Flex Benefits*, p. 5**

# Questions and Answers

For each newsletter, we gather some of the questions we have received from subscribers and other sources, and provide the responses in the hope that readers who face similar circumstances may find them instructive. We already have provided answers to subscribers who submitted the questions; their names are omitted here.

If you would like to submit questions, please see the bottom of this article.

***Q. My question deals with FSA credit cards for flex money. Company X issues FSA credit cards to employees, and also issues cards in the dependents' (of the employees) names. The question is if there is anything in the IRS regulations that allows employers to send out two cards [to] just the employees (not including the dependents). I am also curious about the dependents' cards, if they should have anything else on the cards other than their name.***

**A.** There is no restriction on issuing multiple cards to a spouse and/or dependents as long as purchases would be considered medical care under Code Section 213(d).

For example, an FSA can issue someone two cards, one for the employee and one for the employee's spouse. Every FSA card must contain the required statements in Treas. Reg. §1.125-6(d).

***Q. I know that a hearing aid and its batteries are reimbursable under a flexible spending account, but is the factory repair of a hearing aid reimbursable?***

**A.** This would likely require a note explaining it is medically necessary for the person. Is the factory repair more necessary than getting a new hearing aid? Answering such a question could increase the likelihood of reimbursement.

***Q. When someone has to pay for their "medical records," would this be eligible through a FSA? We are thinking no, but just wanted to be sure. In this particular case, the person was transferring to a different doctor.***

See Q&A, p. 6

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Second, many employers will look for cheaper major medical coverage in order to avoid the Cadillac Tax. High-deductible health plans (HDHPs, see ¶142, ¶143 and ¶145) will be an increasingly attractive option. In November 2009, the Employee Benefit Research Institute reported that employee eligibility for consumer-driven health plans (defined as either an HRA or HSA-eligible HDHP) increased from 33 percent in 2006 to 39 percent in 2009. Resistance to HDHPs appears to be waning in the hard reality of ever-increasing premiums for traditional health insurance.

Third, HSAs do not appear headed for extinction quite yet. In fact, one view of the HSA excise tax increase is that more HSA participants would result in more HSA excise tax revenues, which would help pay for health care reform. Even without health care reform, HSAs are becoming more popular. A Celent study published in June 2009 showed some startling HSA statistics. From 2008 to 2009, survey respondents reported a 46.1 percent increase in HSAs. More remarkably, HSA account balances increased by 62.6 percent. Remember this as well. Missing from all current versions of health care reform is a hotly debated topic in 2008: HSA substantiation. The increase in the excise tax may also discourage non-medical expenditures.

Fourth, HRAs may get an added boost. The San Francisco Health Care Security Ordinance mandated minimal health care coverage for many northern California employers. Litigation has failed to overturn this ordinance. In response, HRAs continue to be an attractive solution for complying with the law. HRAs are more flexible than health FSAs in that they can pay for insurance premiums and more flexible than HSAs in that they do not require coverage under an HDHP. By law, they are totally employer-funded so employees do not automatically view them as another employer attempt to shift health-related costs. The search for lower-cost coverage may end at HRAs for many.

In summary, a constructive way for employers to look at health care reform is simply that it could be worse and it is not all bad.

Health reform merely signifies the next great benefits challenge. Before I get too carried away with the upbeat perspective, I should acknowledge that the positive consequences of health care reform described above may never happen. They are largely dependent on attitudinal changes. And who can reasonably predict future attitudes?

After all, water balloons do burst from time to time. 🏠

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