



Overview of an FSA Plan

A Flexible Spending Arrangement (FSA) is an employer sponsored benefit that allows both the employees and the employer to save money on insurance premiums and out-of-pocket medical and dependent care expenses. The plan operates on a plan year basis established by the employer.

Self Administration vs. TPA

Many employers struggle with whether to self administer an FSA or employ a Third Party Administrator (TPA). Ninety-nine percent of existing FSA plans are administered by third party organizations; however, some employers choose to administer the plan internally. Before making this decision, the employer should review all the issues regarding self-administration:

1. The employer will be responsible for maintaining the bookkeeping and accounting duties of an IRS governed plan. This means the employer will need to hire dedicated persons specifically for these tasks or the employer will need to add these tasks to an employee's current work load.
2. Employees will be required to send personal health information to a co-worker.
3. The employer/plan administrator will need to be educated in the area of HIPAA, ERISA, COBRA and IRS and Department of Treasury regulations and attend continuing education.
4. The employer will need to oversee various compliance issues such as plan document authoring, form 5500 filing and nondiscrimination testing.

Looking for a TPA?

Most employers will rely on their employee benefits insurance broker or consultant for recommendations on good TPAs. A good TPA has a proven track record of customer service, expertise in compliance matters and delivers features that enhance the participant experience.

A Pre-Tax Benefit

Under a Section 125 Plan, the IRS allows employers to deduct an employee's group insurance premium and FSA deductions on a pre-tax basis. This means that the employee does not pay federal income tax or FICA tax (social security and Medicare) on these deductions. In most states, employees are also exempt from paying state income tax. Employers benefit because they do not pay the matching FICA tax on the employee deductions. Since the employees have a lower adjusted gross income, an employer may also realize savings through lower workers compensation premiums.

The Actual Accounts

There are three components to an FSA plan, a health care FSA, dependent care FSA and the premium only plan (POP) component. Under the health or dependent care FSA, the employee has to make an annual pledge or election each year. The POP component of the plan is typically designed so that the employees are automatically enrolled to have their insurance premiums deducted pre-tax.

Health Care FSA (HCFSA)

The health care FSA is a pre-funded arrangement that allows employees to set aside money from their paycheck for the reimbursement of out-of-pocket health care expenses. Qualified health care expenses are defined by IRS Section 213(d) and include almost all medical, dental, vision, Rx and over-the-counter expenses. Items and procedures that are cosmetic or for one's general well-being are not covered under the plan. As a pre-funded arrangement, an employee has full access to their annual pledge on the first day of the plan year.

COBRA and FSAs

Most health care FSAs are considered *excepted* benefits under HIPAA. HIPAA excepted benefits provide special limited COBRA obligations — specifically only certain employees must be offered COBRA and the duration of COBRA coverage is shorter.

- Only employees with an under-spent benefit at the time of termination must be offered COBRA continuation rights.
- The coverage period for COBRA continuation ends at the end of the plan year. Employees do not have re-enrollment rights for the next year.

Day Care FSA (DCFSA)

Employees can set aside money from their paycheck for the reimbursement of their day care expenses for qualifying individuals. Unlike the health care FSA, the day care FSA is not a prefunded account, but more like a traditional bank account. The day care FSA has a set limit of \$5,000 per taxable year and is an alternative to the child tax credit. Employees considering a day care FSA should consult a tax advisor to determine if it is a better option than the child tax credit. There are various online calculators that can help employees make this decision as well.

Plan Design Choices

FSA plans are governed by section 125 of the IRS tax code and department of treasury regulations. Within the framework of the regulations, employers have some flexibility in designing their plan so long as the terms of the plan are applied uniformly to the employees. Here are some of the various aspects of a plan's design that are determined by the employer.

- The health care FSA limit
- Adding the 2 ½ month grace period
- The FSA plan year
- The claims run-out period
- Offering a debit card
- Pre-tax insurance premiums

Tax Illustrations

The following examples illustrate the savings for the employer that sponsors an FSA plan. These examples are for illustrative purposes only and should not be considered tax advice. The FSA participation rates are derived from a sampling of 100 existing clients to determine an average participation rate and average election amounts for the plan. The examples below do not include any estimates for pre-tax insurance premiums.

Employer A

25 Employees
6 HCFSA Participants
1 DCFSA Participant

\$11,667 of Employee
Deductions

\$893 of Tax Savings

Employer B

100 Employees
26 HCFSA Participants
4 DCFSA Participants

\$49,378 of Employee
Deductions

\$3,777 of Tax Savings

Current statistics show that 26% of employees participate in the HCFSA with an average annual election of \$1,355. Participation in the DCFSA is at 4% with an annual election of \$3,537.

The employer's FICA savings is 7.65% of the employees' deductions. In some states, employers may save money through a lower wage base for the calculation of Workers Compensation premiums.

Compliance

FSA plans are regulated by the IRS and the Department of Treasury and are considered a group health plan. As a result, they are subject to specific rules to ensure that the plan meets regulatory standards. There are three (3) main areas of compliance for an FSA plan — the form 5500 filing, nondiscrimination testing and the plan document and summary plan description (SPD) requirement.

The Form 5500 filing is a requirement for plans with over 100 HCFSA participants at the start of the plan year.

Nondiscrimination testing (NDT) is required for all plans to ensure that the plan does not favor highly compensated employees or key employees. Although the testing is not filed with any agency, the burden is on the employer to ensure that the plan will pass the testing requirements.

A written plan documents is required. This document governs the terms and conditions of the plan. The plan document should be updated or amended each year to account for changes in plan design. The SPD is a "layman's" version of the plan document and is provided to the plan participants during the enrollment period.

Call to Action

For more information on FSA plans or to find out how Flex-Plan Services can help your company implement a plan, please contact the sales department at (800) 669-3539 or email us at sales@flex-plan.com.

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