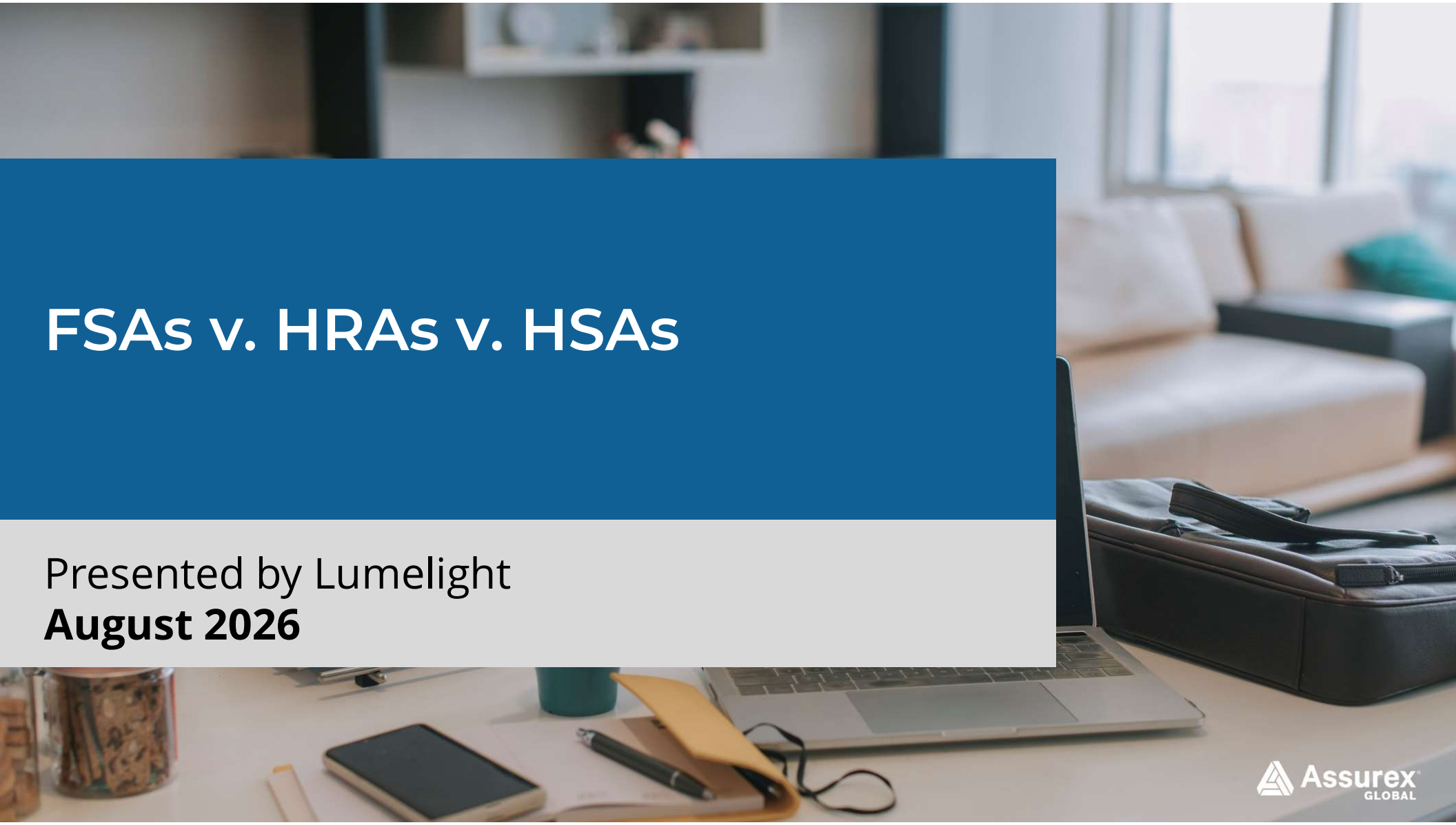

FSAs v. HRAs v. HSAs

Presented by Lumelight
August 2026

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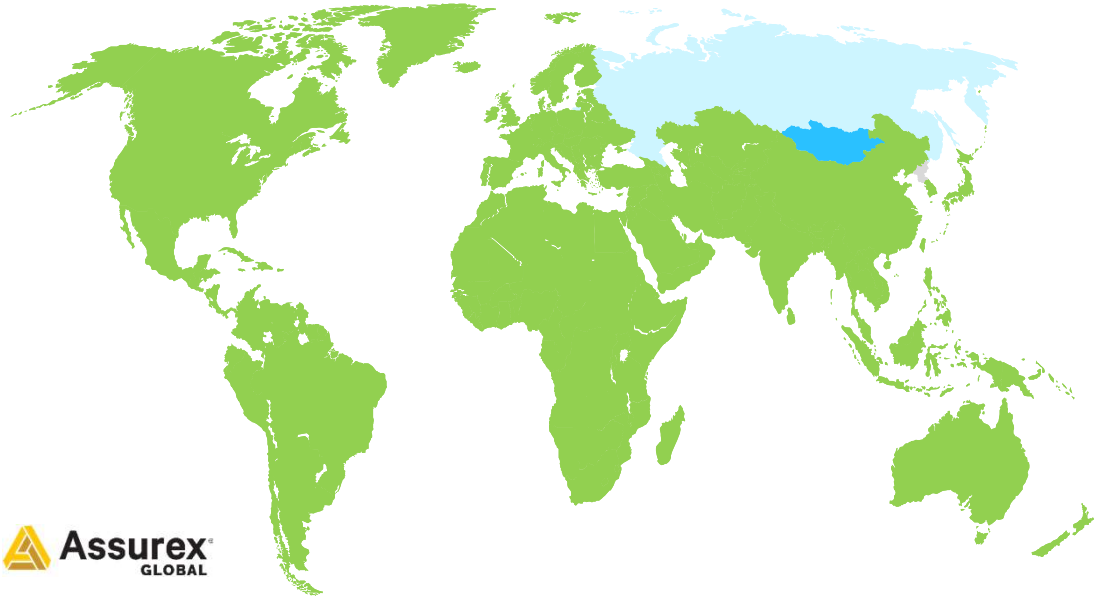

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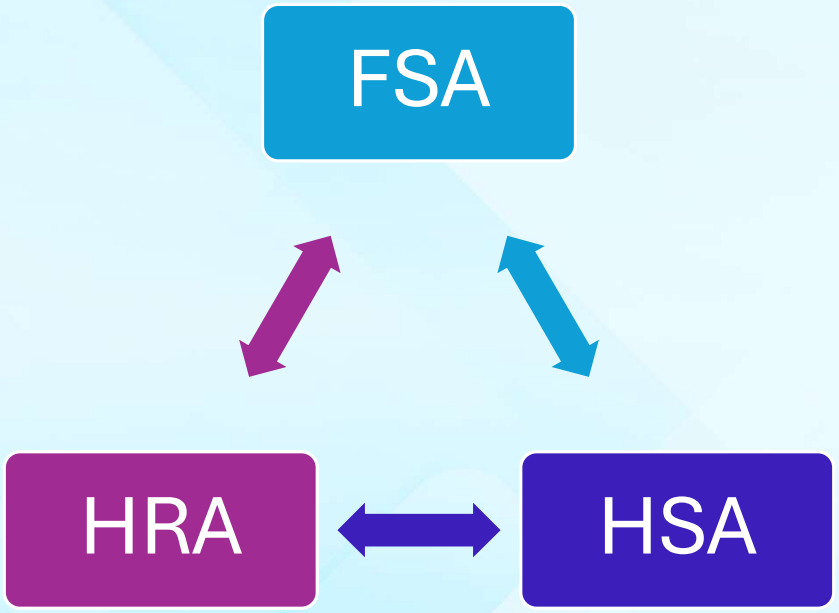
Health FSAs – HRAs - HSAs

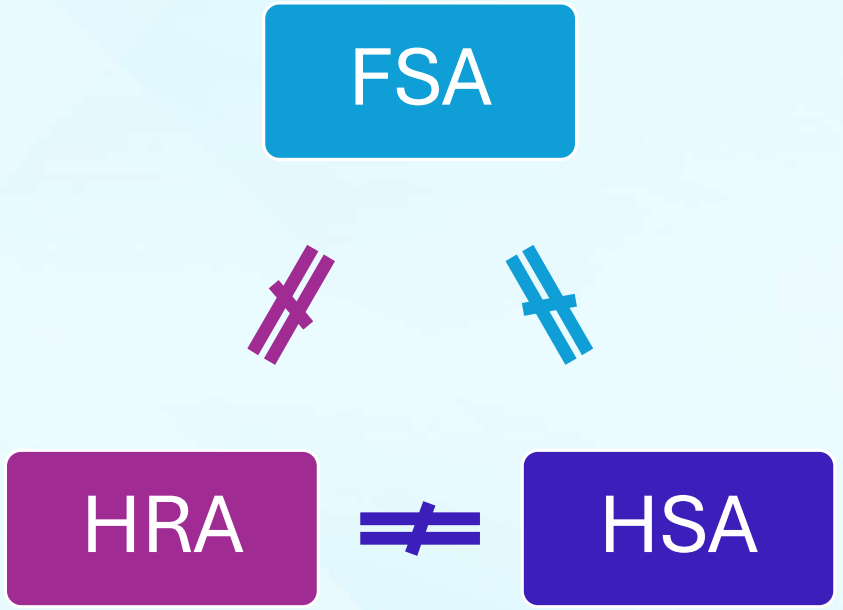


Account based plans

- Specified amount of money allocated to individual employee which that employee can use to pay their and their family's medical expenses.
- Once available balance is spent, no further benefits available unless/until account funds are replenished by employer and/or employee.
- Accounts are not always actual accounts with real funds in them; often they are simply bookkeeping or data base entries.

Health FSAs – HRAs - HSAs

- But how similar are they really?
  - Different tax code sections
  - Each best suited to certain specific circumstances
  - Different sources of funding
  - Different ownership rules
  - Different contribution limits
  - Varying degrees of design flexibility
- More different than they are similar which means rules and intuitions that apply to one often do not apply to the others.



Health FSA

- Tax code §105 and §125
- Small accounts, usually funded by employee pretax payroll contributions
- Primarily intended to help cover relatively low cost medical expenses like copays, deductibles, uninsured dental and vision expenses, and certain over the counter drugs and medical items
- All claims must be adjudicated by someone other than employee; employer typically hires TPA to administer the plan
- Limited flexibility in plan design

HRA

- Tax code §105
- Medium size accounts. Must be funded exclusively by employer contributions
- Typically intended primarily to either:
  - Cover copays, deductibles, and other out of pocket costs on major medical plan; or
  - Provide supplemental coverage, e.g. fertility expenses, GLP1s and other specialty drugs, expenses incurred when using preferred providers; etc.
- All claims must be adjudicated by someone other than employee; typically employer hires TPA to administer the plan.
- Significant flexibility in plan design

HSA

- Tax code §223
- No max account balance so accounts can get quite large over time; can be funded with both employer and employee contributions.
- Typically intended to help cover copays, deductibles, and other out of pocket costs on the major medical plan plus accumulate balances over time to fund future medical expenses
- Employee adjudicates all claims subject to review by IRS.
- No flexibility in plan design.

FSAs

Unique Rules and Plan Design Features

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Uniform Coverage & Use It Or Lose It

FSA

Uniform coverage.

- Employee has access to full amount of annual election at any time during the year regardless of amount of payroll contributions.
- If employee receives reimbursements in excess of contributions and then leaves FSA, e.g. termination of employment, employer experiences a loss.
- Employer may **not** recover the difference or take other steps to eliminate this risk of loss – IRS says this is an essential feature of Health FSA.

Use it or lose it.

- Funds not used by end of plan year are forfeited. Excess funds may not be returned to individual employees or cashed out.
- Unused funds can be used to
  - Offset losses under uniform coverage
  - Fund plan expenses, e.g. TPA fees.
  - Distributed as cash, employer contributions, or reduction of employee contributions but only on a uniform basis to all current or prior plan year participants.
- Two limited exceptions:
  - Grace period. Employee can use left over funds to cover expenses incurred in first 2.5 months of next plan year.
  - Carryover. Limited carryover of unused funds to next plan year ($680 2026).

Contributions & Distributions

FSA

Contributions

- $3400 per employee per employer per year.
- Employer contributions do not count towards this limit but employer contributions are limited by excepted benefit requirements (see below).

Distributions

- Usually any §213(d) medical expenses but can be restricted, usually to make HSA compatible
  - Limited purpose FSA – dental and vision expenses only
  - Post-deductible FSA – FSA reimbursement only available after employee has incurred medical expenses at least equal to minimum required HDHP deductible
- TPAs also often have list of expenses they will never reimburse because too hard to adjudicate.
- Can reimburse expenses of employee, spouse, tax dependents and children
  - Child's expenses can be reimbursed to a) age 26; b) end of month child turns age 26; or c) end of year child turns age 26, depending on FSA plan design
- Most owners are not eligible to participate in Health FSA (other than C-corp owners and less than 2% owners of S-corps)

Midyear Election Changes

FSA

FSA part of §125 plan so election change rules apply

Annual election must be made in advance and can only be changed midyear upon occurrence of election change event.

Fewer FSA election change events than pretax election change events

- Not every event that allows a pretax election change allows an FSA election change.

FSA change (i.e. either increasing/adding election or decreasing/dropping election) must be consistent with the event

Midyear FSA election changes raise difficult questions about how to apply annual limit before and after the election change event and how payroll deductions are changed to reflect new annual elections.

Health FSAs are health plans that can be continued during FMLA leave but employee can also choose to suspend FSA during FMLA leave.

For nonFMLA leave, question is whether the employee remains eligible for coverage during the leave

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Nondiscrimination Testing (NDT)

FSA

- Health FSAs are subject to both §125 NDT (as part of the cafeteria plan) and §105(h) NDT (as a self-funded health plan).
- FSAs that are uniformly available with no employer contributions rarely have NDT issues.
- Most common NDT violation is different waiting periods for different groups.
  - E.g. Managers can join FSA date of hire, all other employees are first of month after 60 days.
- If Health FSA fails NDT, highly compensated individuals (highest paid 25% of all employees) lose some or all of the tax break from the FSA.

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Excepted Benefit

FSA

Typically want FSA to qualify as an excepted benefit to take advantage of special COBRA rules and avoid ACA violations, e.g. preventive care mandate.

To be an excepted benefit:

1) Only employees eligible for major medical plan can participate in Health FSA. Don't have to aenroll in major medical, just have to be eligible.

2) Employer FSA contribution cannot exceed greater of a) $500; or b) amount of the employee's annual election, i.e. a match. *This effectively caps employer contributions at same level as employee contributions ($3400 for 2026)*

Special COBRA rules for excepted benefit Health FSAs

- COBRA only has to be offered on accounts that are underspent at time of COBRA qualifying event.
- No carryover, underspent is intuitive – amounts of claims paid less than amount collected through payroll deductions
- With carryover must use the more technical definition of underspent – calculate remaining annual election available; calculate amount of COBRA premium that can be charged for rest of the year; if remaining annual election > COBRA premiums for remainder of year, account is underspent
- COBRA only has to be offered through the end of the current FSA plan year, not 18 / 36 months

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Debit Cards

FSA

- All debit card charges must be substantiated
- Some charges can be auto-substantiated
- Other charges require additional documentations to verify charges are eligible medical expenses.
- If employee fails to provide documentation, TPA must initiate “pay and chase” process.
  - Series of steps mandated by IRS to substantiate claim or recover unsubstantiated claims, e.g. shutting off card; sending repayment demands; offsetting against other claims; etc.
- Final steps of “pay and chase” can only be carried out by employer.
  - Deduct unsubstantiated claims from paychecks if allowed by state law – usually not allowed
  - Treat unsubstantiated claims and send to collections or, if small enough, write off the debt and report unsubstantiated claims on employees’ current W-2s.

HRAs

Unique Rules and Plan Design Features

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Integration

HRA

- HRAs generally cannot be offered on a stand-alone basis.
- HRA must be integrated with another health plan, i.e. employee and family members must be enrolled in another health plan in addition to HRA
  - Does not have to be employer's own health plan, can be health plan of employee's spouse, e.g. Spousal Incentive HRA (SIHRA)
  - ICHRAs (Individual Coverage HRA) integrate with individual plans or Medicare.
  - Medicare HRAs can integrate with Medicare but only allowed for employers with less than 20 employees.
  - Integration not required for limited purpose HRAs (dental and vision expenses only); excepted benefit HRAs; Qualified Small Employer HRAs; retiree HRAs; and spend down HRAs

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Employer Funding & Account Ownership

HRA

Employer funding

- HRA must be funded exclusively with employer funds
- Prohibits both direct and indirect employee funding.
  - E.g. Employer offers single HDHP with two different HRAs at different funding levels. Employees who choose larger HRA are charged a higher employee contribution. Impermissible indirect employee funding because larger employee contribution can only be traced to larger HRA contribution since HDHP for both HRAs is the same.
  - Mandatory contribution of unused vacation, sick, PTO to HRA allowed if employees have no opportunity to receive unused paid time off as cash or carry over unused time to next year.
  - COBRA premiums are not considered

Account ownership

- HRA is owned by employer.
- Not portable and no cash out at termination of employment or any other time.
- Access to HRA can only continue after termination by electing COBRA or if employer offers a spend down feature.

Plan Design

HRA

- Employer has considerable discretion when it comes to plan design
  - Eligible expenses (but must always be §213(d) medical expenses)
  - Amount of annual benefit
  - Timing of contributions (annual lump sum, quarterly, monthly per pay period, etc.)
  - Allow carryover or not including limits on amount of carryover and/or maximum balance
  - No uniform coverage rule – employees can be limited to spending funds in account
  - Order in which HRA pays, e.g. HRA pays deductible expenses first; employees pay deductible expenses before HRA kicks in; deductible expenses split 50/50 with employee and HRA
- Eligible participants
  - Employees, spouses, children under age 26 and tax dependents
  - Domestic partners can participate but employee must be taxed on value of the coverage

COBRA

HRA

- All HRAs are subject to COBRA
  - Can offer HRA on same terms as active employees
    - E.g. Active employee are automatically enrolled in HRA when they elect major medical and cannot elect major medical without HRA
    - Same restrictions can be imposed on COBRA qualified beneficiaries
  - Can calculate separate COBRA premium for HRA and add to COBRA premiums for accompanying HDHP.
    - Similar rules to calculating COBRA premium for self-funded major medical plans, i.e. based on expected HRA utilization, not max HRA benefit

Nondiscrimination Testing (NDT)

HRA

- HRAs are subject to §105(h) NDT (as a self-funded health plan).
- HRA eligibility or benefits rule that favor Highly Compensated Individuals (HCIs) are problematic.
  - HCIs are highest paid 25% of all employees, i.e. every employer's workforce consists of at least 25% HCIs.
- If HRA fails NDT, highly compensated individuals (highest paid 25% of all employees) lose some or all of the tax break from the HRA.
- Different waiting periods on HRA is an automatic NDT violation resulting in taxation to HCIs who benefit from shorter waiting period.

HSAs

Unique Rules and Plan Design Features

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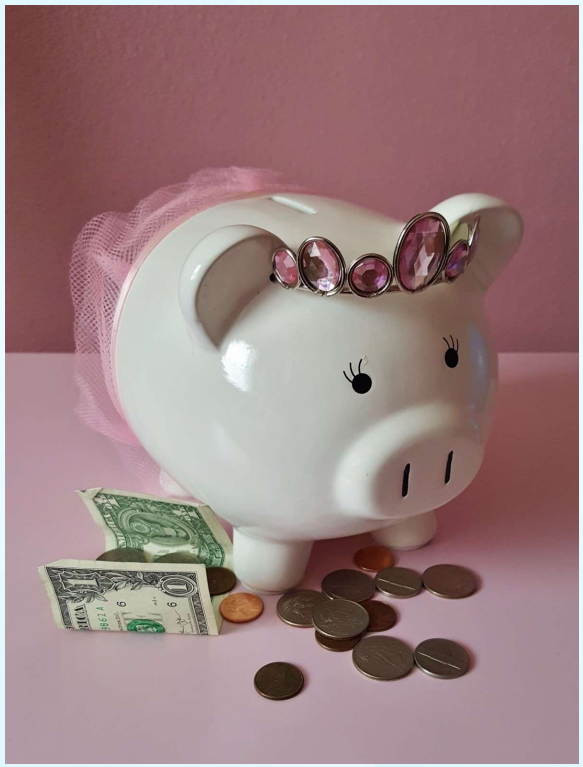
Account Ownership

HSA

- Accounts are owned by employees.
  - Fully portable at termination employment.
  - Once funds contributed to HSA, they are non-forfeitable; difficult for employer to recoup even erroneous contributions.
  - Accounts are held solely in the name of the employee / HSA account holder.
    - There is no such thing as a joint HSA account.
  - Eligibility to contribute to HSA and amount that can be contributed determined solely by coverage and age of the HSA account holder
    - Makes no difference if other family members are HSA eligible or not.
    - Exception: If either spouse has family HDHP coverage, spouses may contribute up to the maximum family contribution limit divided between their HSAs as they see fit.



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HSA Eligibility

HSA

In order to make or receive HSA contributions employee must be 1) enrolled in HDHP coverage; and 2) not enrolled in nonHDHP coverage.

HSA eligibility is determined monthly based on coverage in effect on the first day of each calendar month.

Max annual HSA contribution limit is number of months the employee is HSA eligible times the max annual contribution limit for the type of HDHP coverage (single v. family) in effect each such month.

If employee is eligible for catch-up contributions (age 55+) this must be prorated as well based on months of HSA eligibility

HSA Eligibility (continued)

HSA

- NonHDHP coverage
  - Spouse's employer's nonHDHP plan
  - Medicare / Medicaid / Tricare
  - General purpose FSA (employee or spouse)
  - HRAs
  - Add on benefits that pay medical expenses before minimum required HDHP deductible has been met
    - Fertility plans
    - Preferred provider programs
    - International / specialty drug programs

- Types of coverage that are OK
  - Dental and vision plans
  - Accident and disability plans
  - Most indemnity plans (hospital, critical illness)
  - Limited purpose FSA
  - Post-deductible HRA
  - Telemedicine plans
  - Some direct primary care plans

Employer's responsibility.

- Employer can only make or allow HSA contribution through payroll if it was reasonable to believe employee was entitled to such contribution at time it was made.
- Employer must monitor coverage on internal plans and max annual contribution limit
- Not required to monitor external coverage or prorated contribution limits., as long as employer does not have actual knowledge of external disqualifying coverage.

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Contributions & Distributions

HSA

Contributions

- Both employers and employees can contribute to HSA. All contributions count toward max annual contribution limit ($4400 single / $8750 family / $1000 catch up – 2026).
- Contributed funds are non-forfeitable. Employer may be able to recover contributions made due to certain eligibility and administrative mistakes but must be accepted by HSA trustee.
- If employee contributes more than max annual contribution limit, employee will own income and excise taxes on excess contributions. Excise taxes, but not income taxes, can be avoided with corrective withdrawal before April 15 of following year. Not an ordinary withdrawal – must work with HAS trustee to code withdrawal correctly.
- Employees must be allowed to change HSA contributions once per month, even if contributions are being made pretax through cafeteria plan, i.e. not subject to midyear election change rules.
- Owners can participate but cannot make contributions through pretax payroll deductions.

Distributions

- Funds can be used tax-free to pay medical expenses of employee, their spouse and their tax dependents.
- Cannot use funds tax-free for medical expenses of children who are not tax dependents, even if enrolled in the employee's HDHP
- Cannot use funds tax-free for medical expenses of domestic partner who are not tax dependents, even if enrolled in the employee's HDHP.
- All §213(d) medical expenses eligible for reimbursements except insurance premiums.
- Funds can be used for non-medical expenses but employee will owe incomes taxes plus penalties (until age 65) on such withdrawals

HSA

Miscellaneous

COBRA

- HSAs are portable but are not subject to COBRA
- Employer does not have to continue employer HSA contributions to COBRA participants

FMLA

- HSAs are not health plans subject to FMLA benefit continuation rules
- Employer does not have to continue employer HSA contributions to employees on FMLA leave, unless they do so for employees on other types of leave

Discrimination

- If employer HSA contributions are made **outside** cafeteria plan, must pass HSA comparability tests.
- But as long as employees can make their own pretax HSA contributions employer contributions are deemed to be **inside** cafeteria plan
- Employer need only pass §125 NDT taking into account employer and employee HSA contributions.

Miscellaneous

Unique Rules and Plan Design Features

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Other Miscellaneous Rules and Plan Design Features

ERISA

- Health FSAs and HRAs are ERISA group health plans
- Need summary plan descriptions; subject to 5500 filing if large enough; usually included in wrap documents
- HSAs are not ERISA plans

HIPAA Privacy and Security

- Health FSAs and HRAs are subject to HIPAA privacy and security rules unless self-administered and less than 50 participants
- HSAs are not subject to HIPAA Privacy

PCORI Fees

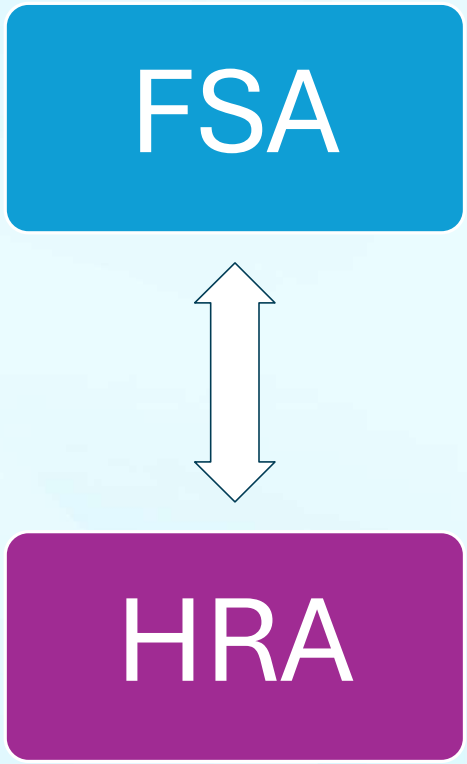
- HRAs must pay PCORI fees
- Health FSAs (as long as they are an excepted benefit) and HSAs do not

ACA reporting

- HRAs are generally subject to ACA §6055 reporting (exception for certain integrated HRAs) on Form 1095B or 1095C
- Health FSAs and HSAs are not

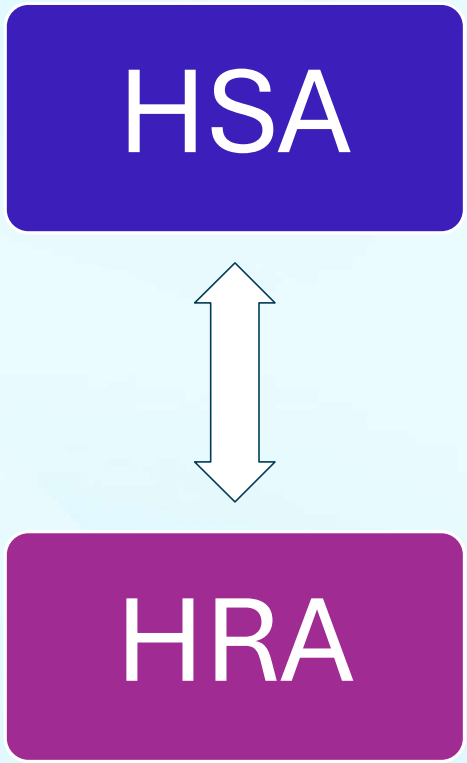
Interactions

- Can an employee have both an FSA and an HRA?
  - Yes but HRA must specify order of payment, i.e. does HRA pay before FSA or vice-versa
  - No double dipping (reimbursing same expense from both accounts)



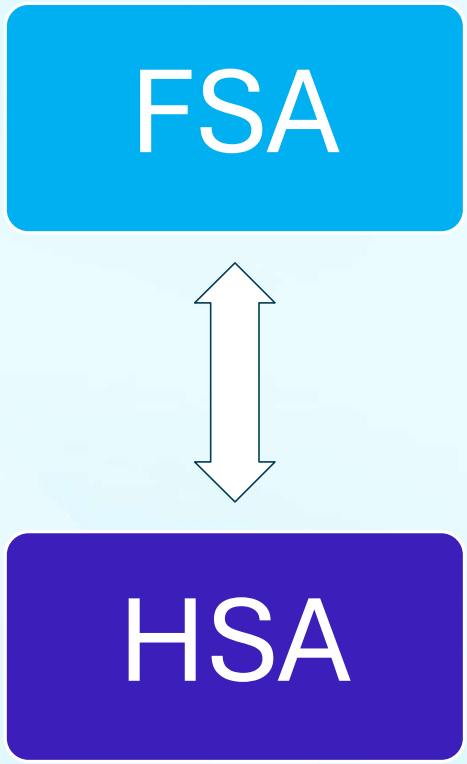
Interactions

- Can an employee have an HSA and an HRA?
  - Yes as long as the HRA is limited purpose and/or post-deductible.
  - No double dipping (reimbursing same expense from both accounts)



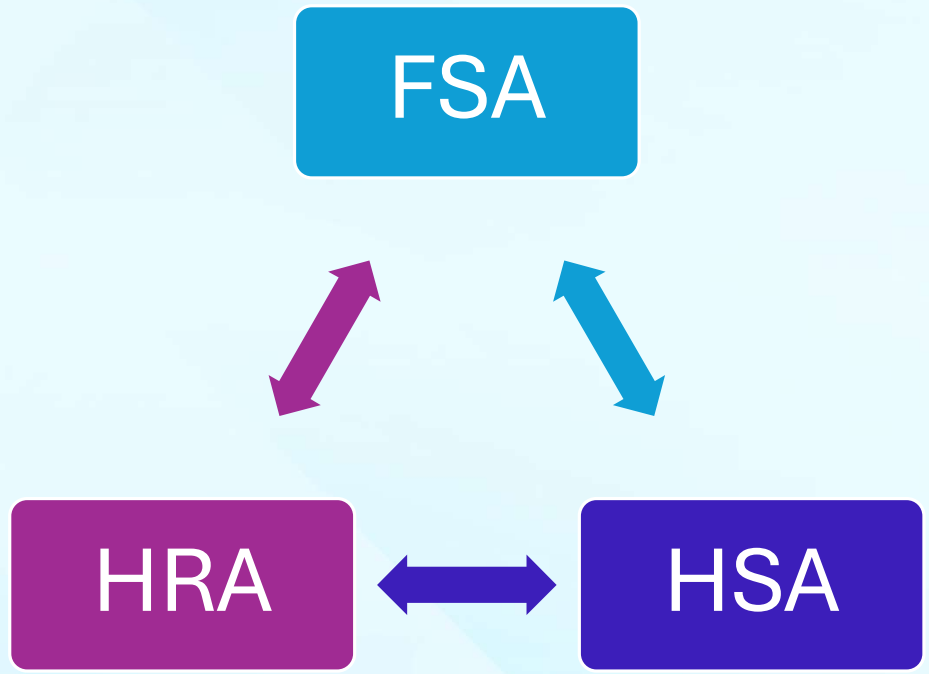
Interactions

- Can an employee have an FSA and HSA?
  - Yes but unless FSA is limited purpose and/or post-deductible, employee will not be eligible to make or receive HSA contributions.
  - General purpose FSA is **not** automatically cancelled just because employee enrolls in HSA plan
  - Do **not** assume employee can drop general purpose FSA just because employee enrolls in HSA plan midyear – usually they cannot
  - Rather FSA will disqualify employee from making and receiving HSA contributions until end of FSA plan year, even if FSA balance drops to $0
    - Can you convert general purpose Health FSA to limited purpose FSA?
  - Grace period / carryover from general purpose FSA will make employee HSA ineligible for first three months of / entire next plan year, respectively
    - Different options available to fix this problem but must be specified in plan docs – they are not automatic



How do FSAs, HRAs and HSAs interact with each other?

- Can an employee have an FSA, HRA and HSA?
  - Yes as long as both Health FSA and HRA are limited purpose and/or post-deductible
  - No double dipping (reimbursing same expense from more than one account)
  - All the other rules discussed in prior slides must be obeyed as well.



Questions

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Webinar Wrap-Up

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