Consumer-Directed Benefits Accounts

Fact Sheet

Overview
Almost 35 years ago, Congress created Section 125 of the Internal Revenue Code, which enabled employers to offer a range of benefits to middle-class Americans through “cafeteria plans.” These plans allow employees to pay for benefits on a pre-tax basis, which lowers payroll taxes for employers and employees.

Cafeteria plans enable middle-class Americans get the health care services they need and value the most and set aside funds in self-directed accounts for medical, child/dependent care, and work-related transportation and parking expenses.

Flexible Spending Arrangement (FSA)
- An estimated 35 million Americans rely on FSAs to get health care services they need.¹
- Participants allocate dollars before taxes for predictable medical expenses into their health FSA. This annual election is most commonly deducted evenly out of each paycheck on a pre-tax basis.
- Unused funds in the FSA are forfeited to the employer at the end of the year.
- Common uses for FSAs are employee out-of-pocket costs (including dental, vision, prescription, and office visit copays) and services often not covered by insurance, such as orthodontia, medical devices, and autism treatments.
- There are more than 32,000 over-the-counter health care items and numerous health care services you can pay for with tax-free FSA money.²

Health Reimbursement Arrangement (HRA)
- HRAs are self-insured, defined contribution health care plans that decrease the overall cost of employer provided health coverage by reducing insurance premiums and giving employees greater control of their health care expenses through a consumer-directed account.
- This type of plan is established and completely funded by the employer. The employer determines a specified amount (defined contribution) to give employees to help them cover out-of-pocket medical expenses.
  - The employer determines what will and will not be reimbursable under the plan, subject to IRC Section 213(d).
- HRAs may be paired with any type of health plan.
- Unlike the health FSA, there is no “use it or lose it” rule governing HRAs. Based on each employer’s plan design, unused funds can carry over to the following plan year.
- In 2011, HRAs were offered by 20 percent of companies with another 5 percent expected to offer one in 2012.³
- In 2011, eight percent of workers with employer-sponsored health benefits were enrolled in a HRA with a combined high-deductible health insurance policy.⁴

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¹ Extrapolated from U.S. Census Bureau statistics on number of employed, number of employers who offer FSAs, average enrollment statistics, and Visa research (conducted by C+R Research, July 2012)
² SIGIS: Special Interest Group for IIAS Standards, List, September 1, 2012
⁴ The Kaiser Family Foundation and Health Research and Education Trust, Employer Health Benefits, 2011 Annual Survey
Health Savings Account (HSA)

- HSAs are vehicles that enable participants to save and invest funds to be used for health care expenses
  - Employers and/or participants can contribute money on a pre-tax basis.
  - Funds accumulated in the HSA can be invested; investment income and gains are non-taxable as long as the funds are used for approved health care expenses.
- HSAs must be paired with a qualified high-deductible health plan; by contrast FSAs and HRAs may be used with any type of health plan coverage.
- HSA funds used for health care expenses are non-taxable; however, funds used for any purpose beyond health care are subject to a 20 percent excise tax.
- Because the individual participant has full ownership and control of the account, it is completely portable and can be established either inside an employer plan or independent of the plan.
- As of January 2012, 13.5 million Americans enrolled in HSA plans, an 18 percent increase from 2011 and a two-fold increase since 2008.5
- HSAs are gaining ground: 41 percent of U.S. companies offered an HSA in 2011, with another 12 percent expected to do so in 2012.6

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<tr>
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<th>Health FSA</th>
<th>HRA</th>
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<tr>
<td><strong>Employee Contributions</strong></td>
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<td>X</td>
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<tr>
<td><strong>Employer Contributions</strong></td>
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<tr>
<td><strong>Health Plan Restrictions</strong></td>
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<td><strong>Ownership of Funds</strong></td>
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<td>Individual</td>
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<tr>
<td><strong>Investment of Balance</strong></td>
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<tr>
<td><strong>Tax Treatment</strong></td>
<td>Contributions</td>
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<td></td>
<td>Reimbursements (Health Care Use)</td>
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<td>Non-Taxable</td>
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<td></td>
<td>Reimbursements (Non-Health Care)</td>
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<tr>
<td><strong>Investment Gain</strong></td>
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<tr>
<td><strong>Require Independent Substantiation for Reimbursements</strong></td>
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<td><strong>Carry-over of Unused Funds at Year End</strong></td>
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<td>Employer Option</td>
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<td><strong>Portable/Spend Down Balance</strong></td>
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<td></td>
<td>In some cases</td>
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<tr>
<td><strong>Allows Use of Debit Card</strong></td>
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</tbody>
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Dependent Care FSA

- A dependent care FSA can be used to pay for employment-related dependent care expenses for your dependent children or with pre-tax dollars.
  - Day care is one of the single largest expenses for a family with children or with an incapacitated family member (e.g., an elderly parent).
- The day care expenses must be incurred to allow the employee to work, look for work, or be a full-time student (for at least five calendar months during the tax year), and the care must be for dependent children under the age 13 who lives with you for more than half the year or your spouse or other qualifying dependent who is physically or mentally incapable of self-care and lives with you for more than half the year.
- The care provider can be a licensed day care facility or a private individual. All reimbursements are subject to independent substantiation.
  - Before and after-school care

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5 America’s Health Insurance Plans, Center for Policy and Research, “January 2012 Census Shows 13.5 Million People Covered by Health Savings Account/High-Deductible Health Plans (HSA/HDHPs),” May 2012
- Preschool or nursery school
- Extended day programs
- Au pair services (amounts paid for the actual care of the dependent)
- Baby sitter (in or out of your home)
- Nanny services (amounts paid for the actual care of the dependent)
- Summer day camp for your qualifying child under the age of 13
- Elder day care for a qualifying individual

- The statutory limit of $5,000 a year for dependent care FSA elections falls well below the national average for day in almost every part of the country, and the limit of $5,000 has not been increased for inflation in over 20 years.
  - The average annual cost for center-based care for an infant was higher than a year’s in-state tuition and related fees at a four-year public college in 35 states and the District of Columbia.\(^7\)
  - The annual cost of infant care increased roughly 2 percent last year and ranged from about $4,600 in Mississippi to $15,000 in Massachusetts. Meanwhile, the cost of providing care for a four-year-old increased by more than 4 percent and ranged between $3,900 a year in Mississippi to almost $11,700 a year in Massachusetts.\(^8\)
  - In almost half of all states, the cost of center-based care for one child exceeded annual median rent payments. And when two children are factored in, the costs exceeded rent payments in all 50 states.\(^9\).

Transit and Parking Benefits
- A Transportation Fringe Benefits Plan enables employees to use pre-tax dollars to pay for work-related parking and commuting costs.
  - Americans took 10.4 billion rides on public transportation in 2011—a billion more than they took in 2000.\(^10\)
  - The number of regular commuters on transit rise from 5.98 million in 2004 to 7.21 million in 2008—and the percentage of commuters using transit as their primary means of transportation to work increase from 4.57 percent to 5.01 percent during that same time period.\(^11\)
- In 2009, Congress brought parity to employer-provided transit benefits by increasing the limit from $120 per month to $230 per month—the same amount for parking benefits.
- The parity transit benefit expired in December 2011.

Over-the-Counter (OTC) Medicines and Drug Limitations
- OTC medicines cans only be reimbursed from an FSA, HRA, or HSA with a prescription, a change that went into effect January 1, 2011.
- The use of OTC medicine is estimated to save the system $102 billion a year, in part through a decreased need for office visits and diagnostic tests. This includes about $25 billion in savings from using lower-cost medicines instead of drugs that are kept behind the pharmacy counter.\(^12\)
- A coalition that includes the American Medical Association, AARP, the Consumer Healthcare Products Association, the National Association of Manufacturers and the U.S. Chamber of Commerce supports repealing the reform law provision that went into effect January 1, 2011. Limiting tax-preferred coverage of medications that can be purchased over the counter has increased costs and impeded patient care, the groups say.\(^13\)

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\(^7\) Child Care Aware® of America “Parents and the High Cost of Child Care,” August 2012
\(^8\) Child Care Aware® of America “Parents and the High Cost of Child Care,” August 2012
\(^9\) Child Care Aware® of America “Parents and the High Cost of Child Care,” August 2012
\(^10\) American Public Transportation Association (APTA) Report, June 4, 2012
\(^12\) Consumer Healthcare Products Association “The Value of OTC Medicine to the United States,” January 2012
\(^13\) 2012 American Medical Association “Doctors pressured to write prescriptions for OTC drugs,” May 7, 2012