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The Healthcare Spending Account Alternative

By: Robert J. Crowder

Healthcare Spending Accounts (HCSAs) have become a popular alternative to traditional **group health** and dental plans. They are practical, affordable, flexible, and a cost-effective way to meet the changing needs of many employers and diverse needs of their employees.

Many employers are considering HCSAs as an alternative when reviewing or initiating their employee **benefits plan**. It is important to take the time to understand the ins and outs of HCSAs to determine if they are an appropriate solution.

How HCSAs Work

Healthcare Spending Accounts are pre-determined amounts of money provided to employees at the beginning of each benefit year for coverage of their medical and dental expenses.

This amount is held in trust and claims are submitted by employees and reimbursed in a similar fashion to a traditional benefits plan. Eligible expenses are reimbursed at 100 per cent up to the total dollar amount available in the HCSA. A Healthcare Spending Account can replace or exist alongside traditional medical and dental coverage.

These accounts ensure controlled benefit costs for the employer and complete claim flexibility for the employees.

At the beginning of each benefit year, the plan sponsor determines the amount of HCSA dollars available in each employee's individual account (normally by class of employee). For example, executives could receive \$5,000 per year and all other employees \$1,000 per year.

Employees and their families can then claim from these accounts to cover Canada Revenue Agency (CRA) approved health and dental expenses, which they encounter throughout the benefit year. This allows flexibility for employees to claim the expenses which are unique to their own families, rather than restricting them to the dollar limits and specific expenses an employer may set out in a traditional benefits plan. One employee can replace his glasses and another can pay for their children's orthodontics.

Under the Income Tax Act, any item that qualifies for the Medical Tax Credit is eligible for coverage through an HCSA. Often this definition of eligible expenses is broader than that of a traditional employee benefits plan, allowing for additional flexibility for employees and executives in particular.

Tax Advantages

Healthcare Spending Accounts provide a way for plan sponsors to deliver benefits to their employees using pre-tax dollars. As with a traditional employee benefits plan, an HCSA is a private health services plan. The plan cost is a tax-deductible business expense and the benefits are received tax-free. This can be a significant advantage for owners, executives, and key employees as they can pay for significant medical and dental expenses with corporate dollars in the most tax effective way possible.

To be considered a tax-deductible expense to the plan sponsor, an HCSA must be a preset limit which is 100 per cent employer funded. The funds cannot be used to purchase additional insurance such as life insurance. The amount of reimbursement is limited to the amount allocated to the account by the employer and to the eligible expenses defined in the Income Tax Act. Funding Under the terms of the Income Tax Act, to qualify as a tax-deductible expense to the company, HCSAs must be fully funded by the employer. These amounts can be billed on a monthly basis, rather than requiring a large lump sum payment at the beginning of the benefit

year. This budgeted approach is particularly effective for small companies that require predictable expenses each month. In some instances, such as with an executive HCSA, annual contributions may be billed at a specified date each calendar year.

Employee expenditures may not exceed the HCSA maximum set by the plan sponsor. Employer costs will not exceed the total employee HCSA amounts, plus administration costs and taxes. There is no increase in HCSA contributions annually unless the employer chooses to change the total HCSA dollar amounts available to the employees which means no 'surprises' at renewal time. The employer retains complete control over the cost of the plan.

Unspent Funds

As there may be employees who spend their entire available balance in a short period of time, there will also be employees who incur no medical or dental expenses in a given year and have funds remaining in their accounts.

Through a Balance Carry Forward arrangement, if an employee has a remaining balance at the end of the year, the funds may be carried forward and added to the next year. If at the end of that year they have not spent the carry forward funds, the remaining amount would be returned to the employer. This allows the employee to plan and budget for large expenditures, such as orthodontic expenses, over a two-year period. Once an employee has exhausted their full balance, any additional expenses they may have cannot be carried forward to the next year under the income tax guidelines.

Expense Carry Forward or No Carry Forward arrangements require that any unspent HCSA funds are returned to the employer at the end of each year. Some employers may choose to make further arrangements for the unspent funds outside of the benefit plan once returned, such as contributions to group RRSPs. This can be dealt with in conjunction with the employer's financial advisor or accountant, ensuring that employees without claims don't lose out.

Employers should expect that employees might claim their full balance each year. Employees are aware of their balance on an ongoing basis which can encourage 'using up' credits available to them. In some cases, employees who would normally be restricted by the limits in a traditional plan (\$200 for vision care) may spend more as their entire claim would be eligible (\$400 pair of glasses). Overall, however, employees are limited to their annual balance, which encourages them not to spend it all at once as they may need the credits later in the year.

HCSA And Insurance

Healthcare Spending Accounts provide no 'insurance' coverage. They are strictly a reimbursement plan. Traditional insurance products – group life insurance, accidental death and dismemberment insurance, critical illness insurance, and out-of-country emergency medical coverage – can be added to an HCSA plan to round out an employer sponsored benefit plan offering. Many employers also add stop loss insurance protection to insure medical expenses that exceed a certain pre-determined threshold. This helps plan sponsors protect employees and their families from unexpected catastrophic medical expenses such as high cost prescription drugs or extended hospital stays, that may occur in a given year.

HCSAs can be added to a 'stripped down' traditional core health and dental plan. For example, an employer may offer an 80 per cent drug plan and an 80 per cent basic dental plan and a top-up HCSA. This type of plan design can reduce the annual renewal crunch for the employer, while empowering the employee to spend wisely on other health and dental related expenses. HCSAs can also be added to traditional plans for an executive class of employees as an added benefit.

Administration, Reporting, And Privacy Legislation

HCSAs are a straightforward plan design which may seem simple enough for an employer to administer within their own office. A capable human resources person could manage accepting receipts from employees and issuing a cheque to reimburse these expenses.

So why have a professional administrator provide these services?

First and foremost, with professional administration the employee can be assured of complete privacy regarding the types of claims they submit. Under the Personal Information Protection and Electronic Documents Act, employers are not permitted access to

information regarding the nature of drugs or medical services claimed by employees and their families. Professional administration by a third-party ensures privacy and removes the possibility of either discriminatory or preferential treatment of employees, even inadvertently.

Secondly, the professional administrator is able to dedicate the time required to be certain that only eligible claims are paid, that benefit maximums are adhered to, and that annual accounting for carry forward balances is maintained. A professional administrator can also provide reports tracking overall usage of the plan and funding status, enabling the employer to review spending and providing a solid foundation on which to base future plan changes. Administration, claims adjudication, and claims payment can be very time-consuming. Outsourcing to a professional administrator, rather than diverting internal resources away from the employer's core business, allows the employer to ensure his staffing resources benefit his business directly.

Finally, the employer is able to take advantage of 'one-stop shopping.' A professional administrator can manage not only the HCSAs, but the insured benefits as well. The employer gains the expertise of professional consultants in obtaining quotes for any additional insurance the employer wishes to include in their benefits plan offering. Many administrators also offer the convenience of a single bill for the entire benefits plan each month, rather than the employer managing relationships with several insurers, resulting in reduced administration for the employer's HR department, while maintaining a high level of service for employees.

Healthcare Spending Accounts provide employers with complete control over claims costs each year because the employees can only claim up to their individual maximums. Funds that are not used for claims within the specified time period remain the property of the plan sponsor and will be returned to them. For employers looking for creative ways to control their health and dental expenditures, Healthcare Spending Accounts can be an ideal solution. ■

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