Lesson 7 - Consumer Driven Plans

Lesson 7 Introduction p1 (LHE)

We discussed previously how the history of health insurance in the United States has been a story of steadily climbing costs, and a story of how insurers and other stakeholders have responded to those rising costs.

In this section we'll cover the concept of a consumer driven plan. This term usually refers to health insurance reimbursement accounts designed to work with high deductible health plans.

Note: The high deductible health plans that underlay these types of reimbursement accounts are subject to PPACA.

Lesson 7 Introduction p2 (LHE)

Lesson 7 Learning Objectives

After completing this lesson, you will be able to:

1. List three types of consumer driven health plans.
2. Describe the benefits of Health Savings Accounts
3. List the four requirements an individual must meet to be eligible for a Health Savings Account (HSA).
4. Describe the rules regarding contributions into an HSA.
5. Describe Health Reimbursement Accounts (HRA)
6. Describe Flexible Spending Accounts (FSA).
7. Compare the differences of Health Reimbursement Accounts (HRA) and Flexible Spending Accounts (FSA).
8. List the four major benefits an employer might realize if they choose to insure on a self-funded basis.
Lesson 7 Topic A - Consumer-Driven Health Plans

Lesson 7 Topic A Consumer-Driven Health p1 (LHE)

Consumer-driven health plans originated in the late 1990s to encourage healthcare consumers (insureds and dependents) to shop more carefully for healthcare services.

In return for allowing insureds to establish a health-care financial reserve on a tax-favored basis, the federal government expected health care consumers to negotiate lower healthcare costs, placing pressure on the medical profession to keep costs low.

However, since consumers were inexperienced in negotiating healthcare costs, and did not fully understand the economics of the healthcare system, the results of this strategy had been disappointing. Current events and increased consumer involvement in health care related issues may be changing the situation.

We will study three types of consumer driven health plans:

- Health Savings Accounts (HSA)
- Health Reimbursement Accounts (HRA)
- Flexible Spending Accounts (FSA)

Lesson 7 Topic A Consumer-Driven Health p2 (LHE)

Additional Terms and Concepts

**Qualified medical expenses** - A type of expense that may be reimbursed by a health savings account, flexible spending account or health reimbursement account.

**Tax deferred growth** - Growth in the value of a plan, such as a Health Savings Account is not taxed each year.

**Tax exempt distributions** - A withdrawal from an account that the insured 'never' has to pay tax on, because it meets the criteria determined by the Federal Government as an 'eligible' expense.

**About Terms:** Other important terms will be defined on the topic pages. If you find any terms or concepts that need more explanation, go through the topic once more, and check the glossary. If you still need explanation contact the course mentor.

Lesson 7 Topic A Consumer-Driven Health p3 (LHE)
What is a High Deductible Health Plan (HDHP)?

Regardless of the early poor results, the concept of requiring the healthcare consumer to accept some of the risk of increasing medical costs was established and may yet prove to be successful. For Health Savings Accounts the insured must be covered by a High Deductible Health Plan.

A High Deductible Health Plan is a health plan that meets certain requirements. As an example, for the calendar year 2014 the HDHP must have a deductible of at least $1,250 per single person and $2,500 per family.

Maximum out of pocket expense for a single person is $6,350 and $12,700 for a family. The Federal Government indexes these numbers each year. (http://www.irs.gov)

<table>
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<tr>
<th>Family</th>
<th>Deductible: $2,500</th>
<th>Out of Pocket: $12,700</th>
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<tr>
<td>Single</td>
<td>Deductible: $1,250</td>
<td>Out of Pocket: $6,350</td>
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Lesson 7 Topic A Consumer-Driven Health p4 (LHE)

Health Savings Accounts (HSA)

Learning Objective: Describe the benefits of Health Savings Accounts

Tax-favored monetary contributions are made by or on behalf of eligible individuals (by employee or employer) to an account, and the contributed amounts and interest income can be distributed tax-free for eligible medical expenses. 2014 Max Annual Contribution - HSA

<table>
<thead>
<tr>
<th>Single</th>
<th>$3,300</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family</td>
<td>$6,550</td>
</tr>
<tr>
<td>55+ can deposit additional $1000/yr</td>
<td></td>
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</tbody>
</table>

Oh, man, that means that I am going to have to pay way more than I'm currently paying for my health insurance!

Lester works for a publishing company and this year his employer has announced that the firm is moving to a High Deductible Health plan with the option of contributing to a Health Savings Account.

Hmm, OK I'm listening, but I'm still worried about paying more out of my pocket. I like the idea.
At first the high deductible on the plan is alarming, but once he learns more, he’s interested. For instance, the premium on the HDHP is much lower than his old plan. He decides to open the HSA when his employer informs him that the company will match his contributions up to a certain point.

Large Deductible, but

- Lower Premiums
- No coinsurance
- Plenty of Qualified Expenses
- Ample maximum contributions
- Tax Exempt Savings

And the money that I put in each year that is unused continues to grow in interest and is available next year. I like the sound of that!

He decides to put a certain amount into his HSA each month. Contributions to his HSA decrease his annual tax liability, and the growth of the investment will also be tax exempt.

Whew, what a tough year! But you know what, when I compare what I paid this year (My High Deductible plus my share of the premiums) and compare it to what these medical bills would have cost me last year (My Previous Deductible, + Co-pays, + Coinsurance, + premium) I saved a lot of money this year.

And I didn’t use up all that my employer and I have contributed, so I have money in my account for next year to handle my deductible already. I think I could get used to this!

Even if his family has a bad health year and has to pay out expenses up to the deductible amount, the tax, premium and coinsurance savings still make it a better deal than his old plan would have been under the same circumstances.

Lesson 7 Topic A Consumer-Driven Health p5 (LHE)

Health Savings Accounts - Eligible Individuals

Learning Objective: List the four requirements an individual must meet to be eligible for a Health Savings Account (HSA).

Money not used in an HSA is NOT subject to use it or lose it! It stays in the account and rolls over to be used in future years.

Eligible individuals are persons who:

1. Are covered by a High Deductible Health Plan (HDHP) on the first day of the month.
2. Are not covered by any other health plan that is not a HDHP.
3. Are not entitled to benefits under Medicare.
4. Cannot be claimed as a dependent on another person’s tax return.

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Lesson 7 Topic A Consumer-Driven Health p6 (LHE)

HSA

Learning Objective: Describe the rules regarding contributions into an HSA.

Contributions

Employer Contributions

- Employer contributions are tax-deductible by the employer.
- The contributions are not subject to Social Security taxes.
- Employers who offer a high-deductible plan with HSAs must make comparable contributions for all employees with comparable coverage.

Insured (or account holder) Contributions

Contributions made by the insured are tax deductible. Contributions made by someone other than the insured are deductible by the account holder (except the employer.)

Once an individual is eligible for (and applies for) Part A Medicare OR opts to begin receiving Social Security Retirement benefits, which automatically enrolls them in Part A, no further contributions can be made to an HSA account.

Withdrawals

Qualified Expenses

To be excluded from Federal income tax, funds in an HSA must be used for qualified expenses (examples on page 8 of this section)

Non-Qualified Expenses

Prior to age 65, funds used for non-qualified expenses are subject to income tax and a 20 percent penalty. After 65, income tax only.

Distributions and Investment
• Any amounts not used by year end are not forfeited and they can continue to accumulate tax deferred.
• Distributions because of death or disability of the account holder are not subject to income tax.
• Upon death, HSA ownership may transfer to the spouse on a tax-free basis.

Portability

HSAs are portable: If an employee leaves the company, he or she can continue the plan.

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Lesson 7 Topic A Consumer-Driven Health p7 (LHE)

Health Savings Accounts - Examples of Eligible Expenses

Learning Objective: Describe the rules regarding contributions into an HSA.

- Acupuncture
- Ambulance services
- Artificial limbs
- Chiropractic treatments
- Crutches
- Dental fees
- Doctor’s fees
- Drug addiction recovery
- Drugs (prescription)
- Eyeglasses and examination fees
- Health maintenance organization
- Hospital care
- Laboratory fees
- Nursing home care
- Psychiatric care
- Surgical fees
- Therapy treatments
- Wheelchair
- X-rays

See IRS publication 502 for a full list of eligible expenses.


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Lesson 7 Topic A Consumer-Driven Health p8 (LHE)

Health Reimbursement Accounts (HRA)

Learning Objective: Describe Health Reimbursement Accounts (HRA).

An HRA is funded solely by contributions from an employer to be used for qualified medical expenses on behalf of current, former, or retired employees, including dependents. In addition to supplying the funds, the employer owns the account, maintains control of the funds, and determines the plan design to fit the
individual needs of their employees.

While there is no requirement for an accompanying health insurance plan as there is with an HSA, it would be advisable for the employer to have an HDHP in place to handle any potential catastrophic claim expenses.

If an employer moves from a traditional health insurance plan to an HDHP, the resultant decrease in premium should assist in offsetting the contributions made to the HRA. There is no IRS prescribed maximum contribution limit and the contributions are tax deductible to the employer and are not taxable for the employee.

An employer provides a Health Reimbursement Account for his employees. He provides a High Deductible Health Plan for his employees as well, to handle catastrophic illness, although with an HRA an associated HDHP is not required.

He likes the tax advantage he receives on the contribution amounts. Further, it represents a tax free benefit to his employees. He controls the amounts, whether or not contributions roll over and the range of qualified expenses.

He also likes the flexibility of HRAs. Although he knows what his maximum reimbursement cost will be annually, he only has to pay out what he incurs. In addition to an HRA, he can provide his employees with other health plan options, such as an FSA.

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**Lesson 7 Topic A Consumer-Driven Health p9 (LHE)**

**Flexible Spending Accounts (FSA)**

**Learning Objective: Describe Flexible Spending Accounts (FSA).**

Health care Flexible Spending Accounts are employer-established benefit plans that reimburse employees for specified medical expenses as they are incurred. These accounts are allowed under section 125 of the Internal Revenue Code and are also referred to as "cafeteria plans" or "125 plans." The employee contributes funds to the account through a salary reduction agreement with their employer and is able to withdraw the funds set aside to pay for "eligible medical expenses," as well as dependent expenses such as child and senior daycare, as defined by the employer. Here's an example:

Jennifer is a single mom whose employer offers a Section 125 plan. A total of $1200 is deducted from 24 paychecks in the amount of $50 each to pay for this benefit. This amount is the maximum set by her employer, and it applies to all the employees at Jennifer's company.
Jennifer uses this account to reimburse herself for child care expenses, and with the cost of child care these days, she's not a bit worried that she must "use or lose" all of the $1200 she is able to set aside, before tax, from her wages.

The deduction that happens with each pay check, $50.00, reduces the amount of Jennifer's income that is subject to withholding for Federal and State taxes. So, she realizes the actual tax benefit of participating in this plan each month. From Jennifer's perspective, she gets a discount on her child care costs by participating in the plan.

Lesson 7 Topic A Consumer-Driven Health p10 (LHE)

Contributing to an FSA

Learning Objective: Describe Flexible Spending Accounts (FSA).

Due to the PPACA, there is a statutory maximum contribution limit of $2,500 for healthcare.

Once the employee has set an amount of contribution during the open enrollment period that occurs once each year, the employee is not allowed to change the amount or drop out of the plan during the year unless he or she experiences a change of family or employment status. By law, the employee forfeits any unspent funds in the account at the end of the plan year.

Lesson 7 Topic A Consumer-Driven Health p11 (LHE)

Recap of Consumer-Driven Health Plans

Learning Objective: Compare the differences of Health Reimbursement Accounts (HRA) and Flexible Spending Accounts (FSA).

Eligibility:

HSA:

- Requires an HDHP
- May not be covered by another plan
- May not be entitled to benefits under Medicare
- May not be claimed as a dependent

HRA:
• No requirement for an HDHP
• Employer owns the account and controls the funds

FSA:
• No requirement for HDHP
• Employer establishes benefit plans to reimburse employees

Contributions

HSA:
• Contributions can come from either the Employer, Employee or both. However, they cannot exceed the stated maximum for that year.
• Contributions by employer are not taxable to employee
• Contributions are not subject to use it or lose it; un-used contributions roll over and gain on the account is tax-exempt

HRA:
• Employer makes the contributions
• No IRS prescribed maximum contribution limit
• Contributions are tax-deductible for employer

FSA:
• Employee makes contributions
• Employer sets the maximum annual contribution
• Contributions made through a salary reduction agreement with employer
• Any unused contributions left at the end of the year are forfeited. They are subject to use it or lose it unless the employer opts to amend the plan and allow for some carryover. Effective in 2014 the IRS rules now allow an individual to carry over up to $500 from one year to the next.

Withdrawals

HSA:
• Withdrawals used for qualified medical expenses are not subject to income tax.
• Prior to age 65 withdrawals for non-medical uses are possible but are subject to a 20% penalty plus income tax.
• After age 65, income tax only.
Employees are reimbursed tax free for qualified medical expenses up to a maximum dollar amount for a coverage period. HRA's only reimburse for those items agreed to by the employer which are not covered by the company's selected standard insurance plan.

FSA:

Use it or lose it for qualified medical expenses except for recent IRS ruling cited above.

Please refer to Lesson 7 Topic A Consumer-Driven Health p12-14 (LHE) to complete the Knowledge Checks at this time.