



# HEALTH FSA GUIDE

Paying for health expenses can be stressful, but planning ahead and putting money in a health flexible spending account (FSA) will help you save on taxes while keeping a reserve of money available for health care costs. Although FSAs are a great way to help you pay for medical expenses, they can be confusing if you haven't worked with one before. This guide will walk you through what health FSAs are, what they can pay for and how they work.

## What Are Health FSAs?

An FSA is an employer-sponsored savings account for health care expenses. You are not taxed on the money put into the FSA, and you can then use the account to pay for qualified out-of-pocket health care costs, such as your deductible and copays, but not your premium. However, you cannot stockpile money in the account from year to year, and you will lose leftover money in the account at the end of the plan year unless your employer offers an option that allows for either a short extension or a small carry-over into the next year.

FSAs were created in the 1970s to enable employees to use pre-tax dollars for health care expenses that were not otherwise covered by employer-sponsored health coverage. These accounts gained more popularity in the 2000s, and they underwent a few changes with the Affordable Care Act (ACA), including the addition of an annual contribution limit.

Health FSAs can save you money on taxes while helping you regularly put aside money for health care expenses. If carefully planned, using an FSA for health care costs can be an asset to your family's budget.

## Why Have a Health FSA?

Health FSAs offer an option for setting aside money to use for qualified medical expenses. These accounts offer a convenient way to prepare for out-of-pocket medical expenses while saving on taxes. In addition, you can use your health FSA to pay not only for your medical expenses, but also for the medical expenses of your spouse and dependents.

### Health FSA Advantages

Here are some of the advantages an FSA can provide:

*Tax reductions:* The amount you contribute to a health FSA is not subject to federal income tax or social security (FICA) tax—effectively adjusting your annual taxable salary. The taxes you pay each paycheck and collectively each plan year can be reduced significantly.

- You can withdraw money from your FSA to pay for qualified medical expenses and your withdrawals are not taxed.
- You do not have to report FSA amounts on your income tax return.

*Convenience:* After the initial election at the beginning of the year, your employer will take care of transferring the allotted amount into your FSA through salary deferral.



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*Flexibility:* You can withdraw health FSA funds at any time (for qualified medical expenses), even if the amount has not yet been deposited into the account, as long as the amount is no more than your elected annual deferral amount less any amount already used.

## Is a Health FSA Right for You?

FSAs can save you money because you don't have to pay taxes on the amount deferred to the account. However, using an FSA does require careful planning in order to reap the financial benefits.

When you participate in an FSA, you have to decide at the beginning of the plan year how much to contribute for the year. Because you will generally lose what you don't use by the end of the year, determining how much to defer into an FSA can be challenging. While correctly estimating your health care expenses and using an FSA to pay for those expenses will save you money, incorrectly gauging your health costs could cause you to lose money.

How your employer manages the FSA may also affect how much you will benefit from using an FSA. If the employer provides a grace period or carry-over option (see "Grace periods and carry-overs" section), you will have a little more flexibility when using your FSA funds. The largest downside to using an FSA is that if you overfund your FSA and don't use the amount in there, you will lose what you've saved.

## How Do Health FSAs Work?

At the beginning of the year, you elect the total amount you want to have withdrawn from your paychecks to put into your FSA, and your employer will deposit the money into the account in equal allotments throughout the year. The IRS has outlined rules guiding eligibility, contributions and reimbursements.

### Opening Your FSA

The FSA is sponsored by your employer as one of your employee benefits. You will need to choose how much you want to contribute to your FSA. The amount you elect will be for the entire plan year, and your employer will then deduct the corresponding amount from your paycheck with each pay cycle. This is sometimes referred to as a salary reduction arrangement.

### Contributions

After your initial contribution election, you ordinarily cannot change your election for a plan year during the year.

The amount you choose to transfer into your FSA should be based on the amount of qualifying medical expenses you anticipate your family incurring during the plan year. Start by looking at your family's medical expenses for the past year and then determine whether your family will likely have those same expenses again and whether there will likely be any new expenses. Use this estimate to help you choose what amount you would like to contribute to your FSA, remembering that it is typically best to underestimate by a little than to overestimate and lose that money at the end of the year.

If you have funds in your FSA at the end of the year, you might consider scheduling a checkup, dental cleaning or similar appointment before the end of the year in order to use up the leftover funds before they are lost.

### Using Your Health FSA

When you are paying for a qualified medical expense that you would like to use your FSA funds for, you typically have two choices: using a health payment card or requesting reimbursement.



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## **Health Payment Card**

Some employers may provide you with a health care payment card, which is very similar to a debit or credit card, and you can pay for eligible medical services or products by swiping the card as you would a debit or credit card. The money will then be deducted from your FSA account.

Health care payment cards may be used only on eligible medical expenses that are not reimbursed or covered by another source. Over-the-counter (OTC) medications are only eligible for reimbursement if they are prescribed to you, and you present the prescription at the time of purchase. The only OTC medication that can be reimbursed without a prescription is insulin. Health care payment cards may not be used to cover more than the maximum dollar amount of coverage available in your FSA.

As a general rule, every claim paid with a health care payment card must be reviewed and substantiated. The IRS guidance allows automatic adjudication for certain card transactions, meaning that receipts do not need to be submitted for verification of expenses for which a health care payment card is used. This applies in three situations at medical providers and 90-percent pharmacies (drug stores and pharmacies where at least 90 percent of the store's gross receipts during the prior taxable year consisted of medical expenses):

- When the total cost of the transaction is equal to the standard copayment for the service(s) received
- When the transaction is for recurring expenses that have previously been approved
- When the merchant provides expense verification to the employer when the transaction takes place

## **Reimbursement**

Another way to pay for eligible medical expenses with your FSA funds is to pay out-of-pocket and then submit receipts for reimbursement. Your account will have specific instructions for how to do this. When submitting for reimbursement, you will need your receipts and proof that what you paid for was an eligible medical expense; this is one of the reasons it is important to keep all receipts and related paperwork from your health care provider.

## **Qualified Expenses**

Employees may use their health FSAs to pay for or reimburse themselves for their own eligible medical expenses, as well as their spouses' and dependents' eligible medical expenses. Eligible medical expenses are unreimbursed medical care expenses, as defined under Section 213(d) of the Internal Revenue Code. An employer can more narrowly define the expenses that can be reimbursed from an FSA. Health FSAs cannot be used to pay for non-medical expenses. Your FSA cannot be used to pay for health insurance premiums, long-term care coverage or expenses, or amounts already covered under another health plan. See Appendix for a list of qualified medical expenses.

## **Life Events**

*Employment status changes* – Your employer owns the FSA. Typically, if you leave your job before you've used the FSA funds, the employer will keep the amount left in the account. However, you may be eligible to elect COBRA and continue your FSA until the end of the year.

*Death* – If you die, the contributions to your FSA will stop, but your survivors can file claims until the filing deadline for any remaining eligible expenses that you or your family members incurred.

## **FSA Recordkeeping**

In most cases, you will have to submit receipts and other proof that you purchased an eligible medical service or product in order to receive reimbursement. Make sure you retain all receipts, Explanation of Benefits (EOBs) and other documents to ensure that you have the necessary proof to obtain reimbursement from your FSA.

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## Flexible Spending Account (FSA) Example of tax savings in a year

Flexible spending accounts provide you with an important tax advantage that can help you pay for health care expenses on a pretax basis. As a result of the personal tax savings you incur, your spendable income will increase. The example that follows illustrates how an FSA can save money.

Bob and Jane's combined gross income is \$30,000. They are married and file their income taxes jointly. Since Bob and Jane expect to spend \$2,000 in medical expenses in the next plan year, they decide to direct a total of \$2,000 into their FSAs. (See table)

	Without FSA	With FSA
<b>Gross income</b>	<b>\$30,000</b>	<b>\$30,000</b>
FSA contributions	\$0	-\$2,000
Gross income	\$30,000	\$28,000
<b>Estimated taxes</b>		
Federal	-\$2,550*	-\$1,820*
State	-\$900**	-\$840**
FICA	-\$2,295	-\$1,960
<b>After-tax earnings</b>	<b>\$24,255</b>	<b>\$23,380</b>
Eligible out-of-pocket medical expenses	-\$2,000	\$0
<b>Remaining spendable income</b>	<b>\$22,255</b>	<b>\$23,380</b>
<b>Spendable income increase</b>	<b>--</b>	<b>\$1,125</b>

\* Assumes standard deductions and four exemptions

\*\* Varies, assumes 3 percent

This example is for illustrative purposes only. Every situation varies and it is recommended you consult a tax advisor for all tax advice.

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## Flexible Spending Account Worksheet

When determining how much you would like to contribute to your Flexible Spending Account, you should keep in mind the following:

- In most cases, an employee may not make a mid-year change in the amount he or she has elected to contribute to a Flexible Spending Account.
- Money remaining in a Flexible Spending Account at the end of the plan year must be forfeited. However, up to \$500 of unused funds may be carried over from one year to the next. In addition, any amount that is carried over does not count toward the maximum contribution limit.
- Over-the-counter medicines and drugs (other than insulin) are only reimbursable if accompanied by a prescription.

This worksheet can be used to estimate how much you should elect to contribute to your Flexible Spending Accounts.

<b>Health Flexible Spending Account</b>	
Expenses not covered by insurance may include:	
Deductibles, coinsurance or copayments	\$
Dental care (exams, fillings, crowns)	\$
Hearing care (exams, hearing aids, batteries)	\$
Infertility treatment	\$
Insulin and diabetic supplies	\$
Prescription drugs (e.g., cholesterol medications)	\$
Transportation expenses (to receive medical care)	\$
Vision care (exams, contacts, eyeglasses, laser surgery)	\$
Wheelchairs	\$
<b>Annual Health Flexible Spending Account Election</b>	\$

<b>Dependent Care Flexible Spending Account</b> Annual maximum allowable expense of \$5,000.	\$
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<b>Total pretax contributions to Flexible Spending Accounts:</b>	\$
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## Appendix—Qualified Medical Expenses

The qualified medical expenses that can be reimbursed by an FSA on a tax-free basis are limited to expenses for medical care (as defined in the federal tax code) for the employee and his or her spouse and dependents, to the extent those expenses are not reimbursed by any other health coverage. The federal tax code defines medical care expenses as amounts paid for the diagnosis, cure, mitigation or treatment of a disease, and for treatments affecting any part or function of the body. The expenses must be primarily to alleviate a physical or mental defect or illness.

The products and services listed below are examples of medical expenses that may be eligible for payment under your Flexible Spending Account, when such services are not covered by your health plan. This list is not exhaustive; additional expenses may qualify as medical expenses, and the items listed below are subject to change. Also, your FSA plan may have additional restrictions on the types of expenses it will reimburse. Under a rule that went into effect Jan. 1, 2011, over-the-counter medicine or drug expenses (other than insulin) cannot be reimbursed without a prescription. This rule does not apply to items for medical care that are not medicines or drugs.

- Acupuncture
- Alcoholism treatment
- Ambulance
- Annual physical exam
- Artificial limb
- Artificial teeth
- Bandages
- Birth control pills
- Body scan
- Breast pumps and supplies
- Breast reconstruction surgery following mastectomy for cancer
- Capital expenses (improvements or special equipment installed to a home, if meant to accommodate a disabled condition)
- Car modifications or special equipment installed for a person with a disability
- Chiropractor
- Contact lenses
- Crutches
- Dental treatment (not including teeth whitening)
- Diagnostic devices
- Disabled dependent care expenses (medical care of the disabled dependent)
- Drug addiction treatment
- Eye exam
- Eye glasses

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- Eye surgery
- Fertility enhancement (for example, in vitro fertilization or surgery)
- Guide dog or other service animal
- Hospital services
- Laboratory fees
- Lactation expenses
- Lodging at a hospital or similar institution
- Medical conference expenses, if the conference concerns a chronic illness of yourself, your spouse or your dependent
- Medical information plan
- Medications, if prescribed
- Nursing services
- Operations
- Optometrist
- Osteopath
- Oxygen
- Physical exam
- Pregnancy test kit
- Prosthesis
- Psychiatric care
- Psychoanalysis
- Psychologist
- Sterilization
- Stop-smoking programs
- Surgery
- Special telephone for hearing-impaired individual
- Television for hearing-impaired individuals
- Therapy received as medical treatment
- Transplants
- Transportation for medical care
- Vasectomy
- Vision correction surgery
- Weight-loss program if it is a treatment for a specific disease
- Wheelchair
- X-rays

## Flexible Spending Account Ineligible Expenses

Your health care reimbursement flexible spending account (FSA) lets you pay for medical care expenses not covered by your insurance plan with pre-tax dollars.

The Internal Revenue Service (IRS) defines medical care expenses as amounts paid for the diagnosis, cure or treatment of a disease, and for treatments affecting any part or function of the body.

The included in the following list are examples of products and services that are **NOT eligible for reimbursement** under your FSA, according to the IRS. Typically, expenses for items that promote general health are not eligible expenses.

**Please note that this list is not all-inclusive, and it is subject to change.**

- Babysitting, child care and nursing services for a normal, healthy baby
- Controlled substances
- Cosmetic surgery
- Dancing lessons
- Diapers or diaper service
- Electrolysis or hair removal
- Funeral expenses
- Future medical care (except advance payments for lifetime care, or long-term care)
- Hair transplant
- Health club dues
- Health coverage tax credit
- Household help
- Illegal operations or treatments
- Insurance premiums
- Maternity clothes
- Medication from other countries
- Nonprescription drugs and medicine, except insulin (over-the-counter medicine is eligible for reimbursement with a prescription)
- Nutritional supplements, unless recommended by a medical practitioner as treatment for a specific medical condition
- Personal use items (e.g., toothbrush, toothpaste, dental floss)
- Swimming lessons
- Teeth whitening
- Veterinary fees
- Weight-loss program (unless for a specific disease diagnosed by a physician)



## What is a Dependent Care FSA?

A Dependent Care FSA is an employee benefit that can save you money on your family's child or elder care expenses.

### How will an FSA save me money?

When you enroll in a Dependent Care FSA, the amount you contribute is deducted from your paycheck on a pre-tax basis, meaning you pay less in taxes. Please consult a tax professional for more information.

### Should I enroll?

You should consider enrolling if you and your spouse (if married) work, are looking for work, or attend school on a full-time basis and you:

- Have children under age 13 who attend daycare, before/ after-school care or summer day camp.
- Provide care for any person who is mentally or physically incapable of caring for themselves and the care provided complies with other IRS requirements.

### How much should I contribute to the FSA?

Look at what you typically spend each year on out-of-pocket child or elder care. NOTE: \$5,000 is the annual regulatory maximum per household for Dependent Care FSA contributions.

### What is the use-it-or-lose-it?

Because FSAs have tax benefits, the IRS places guidelines on them. As a general rule, any funds left in your account at the end of the plan year cannot carry into a subsequent year or be used to reimburse you for expenses you incurred after the end of the plan year. So, plan carefully when determining how much to contribute.

### What are some of the eligible expenses?

- Care at licensed nursery schools or child centers.
- Care provided in or outside your home during your working hours.
- Before/after-school care
- Day camps
- Elder care

### How do I use the FSA?

- Pay for an eligible expense out of your pocket.
- Submit a claim form to UMR, along with appropriate documentation.
- UMR processes your request and, if it's eligible, reimburses you by check or direct deposit to your checking or savings account.

### Important Things to Remember About Your Dependent Care Flexible Spending Account

- Unlike the Health Care Flexible Spending Account, only money that has actually been withheld from your paycheck can be reimbursed.
- Dependent Care and Health Care Flexible Spending Accounts are separate and money from one account cannot be reimbursed for expenses incurred under the other account.