

Funded HRAs can provide tax-free solution

THE GROWING COST OF POST-EMPLOYMENT HEALTHCARE FOR GOVERNMENTAL EMPLOYEES

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It's no secret. Public retirees everywhere are struggling to cope with soaring healthcare costs. As insurance premiums and other health-related costs consume larger and larger portions of monthly pensions, many retirees seek to become re-employed in order to make ends meet. Meanwhile, an alarming number of employees eligible to retire cite the cost of health insurance as the reason they are job-locked and can't afford to stop working.

These individuals sadly admit they wish they would have begun planning long ago to better prepare themselves for the significant amount of out-of-pocket healthcare costs they're facing today. These expenses can include premiums for medical, dental, vision and long-term care coverage; Medicare Part B, Medicare Part D and Medicare supplement plan premiums; deductibles; copays for office visits and prescription drugs; and the cost of certain over-the-counter medications.

GASB 45 DEADLINES APPROACH

Benefit changes inevitable for governmental retirees

GASB 45, a new accounting standard issued by the Governmental Accounting Standards Board being phased in over the next three years, requires public agencies to account for the cost of retiree medical and other post-employment benefits (OPEB) over the working lifetime of their employees rather than using the more common "pay-as-you-go" system. This will necessitate significant changes in the accounting methods currently used by most governmental entities when reporting OPEB liabilities. The magnitude of this change is not yet fully realized by many governmental employers and could result in huge financial dilemmas that may require legislative action authorizing new funding alternatives, the reduction or elimination of promised benefits, cost-shifting to active employees and retirees and other drastic measures yet to be determined.

To define an employer's estimated accrued liability under the new GASB accounting standard, certain actuarial calculations must be performed and, in many cases, the results are astronomical! Employers hit hardest will be those promising current employees a defined benefit form of retiree healthcare. Many employers, particularly those struggling to cope with defined benefit obligations, will begin looking for creative ways to set aside funds to offset accruing OPEB liabilities.

GASB 45 will almost inevitably force governmental employers to seek defined contribution alternatives to replace current defined benefit forms of retiree healthcare promises.

START PREPARING NOW

Begin pre-funding post-employment healthcare costs

Employers and employees everywhere are quick to recognize that the time to prepare for the growing cost of post-employment healthcare is right now. The question is, how?

Health savings accounts (HSAs) must be coupled with a high deductible health plan. IRC Section 125 flexible spending accounts (FSAs) provide significant tax advantages and have become quite common for predictable qualified expenses in a given plan year, but fall far short of meeting future funding needs because of their “use-it-or-lose-it” caveat.

So, is there some sort of tax-advantaged vehicle designed to pre-fund medical, dental, vision and other health-related costs beyond the current year and into retirement? If so, can it provide the same tax advantages as an FSA, but allow a carryover of unused amounts that can be used even after separating employment? Can such a plan help improve an employer’s bottom line when implementing GASB 45’s new accounting standard? The answer to all of these questions is, yes!

FUNDED HRAs PROVIDE TAX-FREE SOLUTION

Win-win for employees and employers

Defined by IRS Notice 2002-45, a health reimbursement arrangement (HRA) is funded by an employer for the purpose of reimbursing or paying qualified out-of-pocket healthcare costs and premiums on behalf of employees/retirees, spouses and qualified IRS dependents. Plan assets (employer contributions) are typically held in an IRC Section 501(c)(9) voluntary employees’ beneficiary association (VEBA) or Section 115 integral part trust. All HRA contributions, investment earnings and withdrawals for qualified expenses are tax-free to both the employee and employer.

Looming deadlines for GASB 45 compliance have fueled an explosive interest in funded HRAs among governmental employers. It is likely a funded HRA will quickly become the plan of choice for governmental employers looking for a sensible retiree health benefit solution that will help them define and contain the costs of such benefits. Many governmental employers may attempt to amend or change defined retiree health benefit promises to current employees and retirees and seek to offer a defined contribution alternative, in the form of a funded HRA, to new employees.

While the main objective of a funded HRA is to begin pre-funding post-employment healthcare costs, funds can be used to provide in-service and/or post-separation benefits depending on the employer’s plan design. Unused account balances carry over from year to year and employees and employers both save all applicable payroll taxes. All of these features combined make HRAs a win-win for everyone. So, what’s the catch?

IRS RULES

Not a deterring factor

IRS rules require compliance with three basic conditions. First, HRA funds can only be withdrawn to reimburse or pay qualified out-of-pocket healthcare expenses and insurance premiums as defined by IRC Section 213(d). This is not typically viewed as a negative condition since healthcare expenses are the reason funds are contributed to an HRA plan in the first place. Second, IRS rules do not permit individually-elected contributions; participation is mandatory for all employee group members defined as eligible. While the knee-jerk reaction to this provision may be unfavorable, experience shows it is not a deterring factor. Third, contributions may not discriminate in favor of highly compensated employees. Contrary to what one might expect, even entry level employees are often anxious to participate in an HRA program once educated with regard to the growing need and tremendous tax advantages of such a plan.

COMMON FUNDING SOURCES

Employers can actually save money

Employers and employee groups alike (i.e. collective bargaining units, non-represented staff, etc.) recognize the growing need for an HRA and are developing creative HRA funding methods at a record-setting pace all over the country. Common HRA funding sources include lump sum cash-outs (i.e. sick leave, vacation, etc.), unused monthly benefit dollars, mandatory group salary reductions (no individual elections permitted), longevity incentives, merit pay and other employer discretionary contributions provided by collective bargaining agreements, other written agreements or employer policy. By redirecting existing forms of compensation to a funded HRA in lieu of a taxable wage benefit, employers and employees both can avoid all applicable payroll taxes.

In addition, a funded “employer” HRA account could provide a unique solution to employers struggling to improve their bottom line after applying OPEB liabilities to their balance sheets. A funded employer HRA account could be set up and administered much the same as funded employee HRA accounts discussed earlier, but with the express purpose of directly offsetting the employer’s OPEB liability and providing the employer control over the investment and use of the account to meet its OPEB funding goals.

TURN-KEY HRA PROGRAMS AVAILABLE

Employers don’t have to reinvent the wheel

Fortunately, employers don’t have to wrestle with designing and implementing their own HRA plan without help. Turn-key HRA programs are available to governmental employers from several national plan providers, but be careful! Some of these plan designs have almost no longevity and even operate under flawed or much too aggressive interpretations of important IRS rules and guidelines. Aggressive or questionable plan features are not necessary for the successful operation of an HRA program, and could result in serious ramifications such as the plan losing its tax exempt status making contributions taxable.

When looking at various HRA plan offerings, employers should seek well-established, time-tested plan designs that minimize employer responsibility and risk. A properly

structured HRA plan can effectively meet employer goals and objectives and provide employees with a valuable addition to their benefits package, creating a win-win benefit for both employers and employees.

HRAs GET WELL-DESERVED ATTENTION

Positive trend across country

Using an HRA as an innovative tool to pre-fund increasing post-employment healthcare costs is gaining momentum on both sides of the table. Employers and unions alike are exploring HRA funding concepts. Why? Because they recognize that in today's world, an HRA is a timely and essential cost-saving benefit worthy of their immediate attention.

Contact your human resources department, employee benefits administrator, union leadership and benefits advisory committees today and encourage them to learn more about how an HRA should be an integral part of every employee benefits package.

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HRA Consultants, a Division of VEBA Service Group, LLC (VSG) has more than 20 years of experience serving HRA and other similar programs using tax-exempt employee benefit trusts. VSG has developed customized, cost-effective health reimbursement programs serving more than 60,000 public employees from over 600 governmental employers in several states.

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