FSA and HSA Changes Nothing to Sneeze At

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Many employees take advantage of Flexible Spending Accounts (FSAs) or Health Savings Accounts (HSAs) that allow them to set aside pre-tax money for certain defined medical expenses. These accounts can lower employee's income subject to taxation, and result in the employee paying less income tax.

As a parent, as well as an attorney, I see two changes to current FSA and HSA regulations imposed by the Healthcare and Education Reconciliation Act of 2010 (Reconciliation Act P.L. 101-152) that could really affect families.

1. Starting January 1, 2011 is that over-the-counter (OTC) medications cannot be paid for with FSA or HSA funds. I am used to buying pain relievers, first aid supplies (including the biggest line-item for parents of young children: Band-Aids), cough, cold and allergy medicine, vitamins and the like with FSA funds. Under the new regulations, I cannot do this unless I get a doctor's prescription for an over-the-counter medication.

My pediatrician is concerned about her patients with allergies and similar chronic conditions, who are often required to try OTC medications first before insurance will pay for a prescription medication. I'm not sure if I would spend the time and money for a doctor's visit to get a prescription for an OTC remedy, or if I would just get used to paying for it the regular way. I suppose, like anything, it will be an analysis of time vs. money. The more I spend on OTC allergy medications the more likely I would be to get the prescription, if that's even possible.

One explanation for this change is that people without HSAs or FSAs are currently not allowed to deduct the cost of over-the-counter medications on their taxes, but people with these employee benefits are able to pay for over-the-counter medications with pre-tax dollars. The Health Care Bill simply brings these two types of taxpayers to common ground. Another interpretation is that our government is merely raising taxes on American families.

2. Starting in 2013, each employee will be limited to contributing $2,500 to the FSA. There has never been a regulatory limit for contributions to an FSA, but some employers limit contributions to $4,000 or $5,000. Families with special needs children and those with chronic medical conditions could see a huge difference in their tax bill because of this cap. Certain education costs/tuition for special needs children are eligible to be paid through an FSA, and $2,500 is a drop in the bucket compared to the actual costs.

Again, opinions differ as to how many families take advantage of this tax benefit and what the impact of this change will be. If it is your family, however, that can no longer pay for special needs education or out-of-pocket medical costs with pre-tax dollars, the impact will be significant. This could put more people in HSAs instead of FSAs.

Employers offering these benefits should consult with their attorneys and other advisors so they can be prepared to properly advise employees.