What’s the Difference Between HRA and FSA?

Most healthcare plan participants are all too familiar with the fact that not all expenses are covered by their group health insurance. This can be the cause of much frustration and stress, but it’s also the reason Health Reimbursement Arrangements (HRA) and Flexible Spending Accounts (FSAs) exist. Both are supplemental health plans offered by an employer to cover the costs that group health coverage will not. Employers who want to look after the wellbeing of their employees can choose to offer these plans, but it’s important to know the difference between them and which is appropriate for your organization.

An HRA is an employer-owned account that can be paired with any type of health plan. Employers make the plan contributions and funds can be used to pay for qualified healthcare expenses. Contributions can be written off for the employer and can be used tax-free for the plan participants. Employers determine contribution amounts and eligible expenses that best fit the needs of their workforce. Unused HRA funds can be carried over to the next plan year, up to the rollover amount determined by the employer, which provides an incentive not to spend the full amount.

Medical and Limited Purpose FSAs are part of the IRS Section 125, also known as a cafeteria plan. Dependent Care FSAs are sanctioned under Section 129 of the IRS Code. While HRAs are employer funded, FSAs can be both employee and employer funded. Contributions can be made tax-free for both employers and employees.

FSAs exist in three different varieties: Medical FSA (FSA), Dependent Care FSA (DCFSA), and Limited Purpose FSA (LPFSA).

Medical FSA

Funds can be used for Insurance deductibles, copayments and coinsurance, prescriptions, dental or vision expenses, OTC medicine & menstrual products (eligible under the CARES Act of 2020). Employees may contribute up to $2,750 in 2021. Employers have the option to allow up to $550 of unused funds to be rolled over into the next plan year, or set up a grace period when the plan year ends to use the remaining funds past the deadline. The $550 maximum rollover amount was increased for plan year that ended in 2020 or 2021 to an unlimited amount.

Dependent Care FSA

Funds can be used for certain expenses related to caring for dependents including child care for children under the age of 13, though funds may also be used for a dependent of any age who is physically or mentally incapable of self-care. The usual contribution limits in 2021 were $5,000 for married couples filing jointly and $2,500 for single filers. Thanks to the American Rescue Plan, those caps were raised to $10,500 for married couples and $5,250 for singles for the calendar year of 2021 only.

Limited Purpose FSA

Limited Purpose FSAs were designed to be compatible with Health Savings Accounts (HSA). Participants who elect an LPFSA can use funds for dental, vision OTC and post-deductible expenses with pretax funds while remaining eligible for an HSA. HSAs require participants to have a high-deductible health plan (HDHP) and exclude participation in both an HSA and Medical FSA. LPFSAs offer a great way for employees to get tax savings on certain expenses while still contributing to and HSA.

Both HRAs and FSAs have their own merits and can work together, or separately, to provide exceptional value for your employees when designed correctly. For more information on regulations and the specifics governing each plan, visit our Regulations page.

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