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HRAs reduce health premiums for employers, employees alike

By Debra Hicks

Companies are continually looking for ways to reduce their health care cost for employees.

Small businesses are the backbone of our economy and many can no longer afford to keep up with the current trend of double digit rate increases in their group health insurance plans. With average family premiums now exceeding $10,000 per year, and expected to blow past $12,000 in 2006, many employers have no choice but to reduce benefits, increase employee contributions or terminate their group coverage in order to avoid business failure!

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Within the past few years, a new strategy called a Health Reimbursement Arrangement (HRA) has been created under which companies set aside a fixed dollar amount for each employee.

The HRA is likely to be as significant in the evolution of employee benefits as the 1978 laws that enabled Cafeteria Plans (section 125) and 401(k) plans. Employers may use HRA plans to reimburse employees tax-free for medical expenses, including insurance premiums.

Employers may set up health reimbursement arrangements (HRAs) to allow employees to be reimbursed for medical expenses without any cost to them. The company sets up accounts for each employee and contributes a flat dollar amount. The employee is not taxed on employer contributions.

Similarly, when the employee uses the funds in his/her account to cover their medical costs, the employee is not taxed on withdrawals. There is no dollar limit on employer contributions on the employees' behalf, nor on amounts that they can withdraw tax free for medical expenses, including premiums on individual policies!

While the HSA offer employers and employees attractive tax breaks, they are required to be linked to a specific "HSA Qualified" high-deductible plan and control of the assets are turned over to the employee account holders. An HRA can be offered with any type of health coverage (including individual policies) and the employer retains control over the HRA assets. The Internal Revenue Service gave birth to the HRA in 2002 by issuing a revenue ruling that permitted HRA holders to roll over account funds from year to year without including the rolled over assets in taxable income.

HSAs were the buzz for 2004 and 2005, but the jury is still out. Many who bought the HSAs when they came out thought it was a great concept but are not funding the account so they are not receiving the tax benefit this type of plan offers.

Employer contributions are optional on an HSA but are mandatory for an HRA. The employee does not contribute anything. The employee receives reimbursements tax-free for any qualified medical expense, including doctor visits, dental, vision, long term care, etc. The "use it or lose it" rule is also eliminated because the employer can fund at will or as needed.

This type of set-up (using a third party administrator) enables the employer to potentially cut his health insurance expenditures in half while still providing superior benefits for his employees. An employee can purchase an individual policy for himself and/or his family at a much lower cost. His out of pocket expenses may be eliminated totally by the employer's tax-free reimbursement policy.

The average individual (non-group) policy sold in 2005 cost less than half the cost of a comparable employer-sponsored group plan. Employers will love this because the tax-free premium reimbursement on an individual policy will be much less than the premiums on the former group plan.

Many small business owners weekly are amazed at the extreme differences in cost between group and individual coverage. The thought process in the business world is that group coverage is less expensive than individual, when in reality, it is the other way around. Comparable individual health insurance is much less expensive than a group policy.

Employer group health insurance will continue to decline and become virtually extinct over the next decade. It will be replaced by individual health insurance purchased by employees that are reimbursed with tax-free dollars. What the industry refers to as "Consumer Driven" will be the dominant health plan.

This is a win-win for both the employee and employer. The employer will save up to 50 percent or more on health care costs, receive the same tax advantages and the employee gets tax-free reimbursement of medical expenses and has an insurance plan that is affordable, portable, permanent and safe.

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