

Some Health FSAs Are Exempt from HIPAA's Requirements, but Not All

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Many employers have established flexible spending accounts providing for the reimbursement of employee medical or dental expenses ("health FSA"). The Health Insurance Portability and Accountability Act of 1996 (HIPAA) requires "group health plans" to adhere to rules designed to enhance their portability. The portability rules cover issues such as a pre-existing condition limitation, creditable coverage, a certification requirement and special enrollment requirements. Interim regulations were issued in April 1997 to provide guidance to employers and insurers on how the portability provisions of HIPAA were to be implemented. These interim regulations included a broad definition of a "group health plan,"¹ clearly subjecting health FSAs to HIPAA's portability provisions. (See "HIPAA Certificates Required for Cafeteria Plans" in the Summer 1997 *Plan Horizons*).

A technical bulletin² released by the Department of Labor (DOL) on December 29, 1997, was intended to "clarify" the intended scope of HIPAA's portability rules as they apply to health FSAs. The bulletin provides that benefits under certain health FSAs will be exempt from HIPAA's portability requirements if certain conditions are satisfied. If exempt, health FSA coverage would not count as creditable coverage and, therefore, a certificate of creditable coverage would not be required to be issued. Unfortunately, the bulletin does not provide sufficient guidance on the application of HIPAA's portability requirements to health FSAs that are a part of credit-based cafeteria plans.

Conditions for Health FSAs Benefits to be Treated as Excepted Benefits

The December 1997 bulletin provides that benefits under certain health FSAs will be treated as exempt from HIPAA's portability requirements if two conditions are satisfied:

- The maximum annual benefit payable for the employee under the health FSA does not exceed twice the employee's salary reduction election under the FSA for the year (or, if greater, the amount of the employee's salary reduction under the health FSA for the year, plus \$500)
- The employee has other coverage available under the employer's group health plan; and the other coverage is not limited to "excepted benefits"³

For most employers, the second condition is easily satisfied since it merely requires an employer to first provide other group health coverage that would not be treated as an "excepted benefit" in order to qualify its health FSA as an "excepted benefit." The first

¹ T.R. 54.9801-2T defines a "group health plan" to include a plan of or contributed by an employer to provide health care (directly or otherwise) to employees or their families. This broad definition clearly encompasses health FSAs.

² ERISA Technical Release No 97-01.

³ Certain "excepted benefits" are carved out of HIPAA's requirements if the benefits are provided under a separate policy, certificate, or contract of insurance, or are otherwise not an integral part of the group health plan such as: limited scope dental or vision benefits; benefits for long-term care, nursing home care, home health care, community-based care, or any combination thereof; and such other similar, limited benefits as are specified in regulations. See T.R. 54.9804-1T(b)(3); DOL Reg. 2590.732(b)(3).

condition stated above, however, which relates to how health FSAs are funded, may be more problematic for employers.

Funding of Health FSAs: Salary Reduction or Credit-Based Cafeteria Plan

A determination of whether a health FSA will be subject to HIPAA's portability provisions may depend largely upon whether the health FSA is funded by employee salary reduction (with benefits capped by the amount of the salary reduction election) or through a credit-based cafeteria plan. The former will likely satisfy the first condition listed above, while the latter may not.

If a salary reduction FSA has an employer matching contribution feature, it may still be exempt provided the employer matching contribution is less than or equal to the employee salary reduction election. If more than \$500 in employer-provided credits may be directed into a health FSA that is part of a credit-based cafeteria plan, the first condition will not be met unless participants have the choice of cashing out the credits as taxable compensation.⁴

Whether the cashable credits of a credit-based cafeteria plan are treated as employer contributions or salary reduction contributions may determine whether HIPAA will apply. For instance, if the cashable credits are treated as employer contributions, then employees can place more than \$500 per year in credits into their health FSA, thereby violating the first condition set forth in the DOL bulletin, and thus requiring the health FSA to comply with HIPAA's portability requirements. However, if the cashable credits are instead treated as salary reduction contributions (potential taxable compensation) used to purchase health FSA coverage, the first condition would not be violated and the health FSA would be exempt from HIPAA's portability requirements.

Action Plan for Plan Sponsors

Employers who sponsor health FSAs that are subject to HIPAA should consider reviewing their plans to decide whether any design changes may be made to satisfy the exemption requirements as set forth in the December 1997 bulletin. Plan sponsors must be mindful of the fact that if HIPAA applies, health FSA creditable coverage certificates must be issued.

The relief afforded by the technical guidance issued last December is clearly limited in scope. More guidance on how the exemption requirements apply to health FSAs in credit-based cafeteria plans would be welcome. We can only hope that such additional guidance in this area will be forthcoming.

⁴ If the credits cannot be cashed out or if the receipt of the credits as taxable compensation is significantly limited, then HIPAA would apply.