USE IT OR

LOSE IT!

FLEXIBLE SPENDING ACCOUNTS FOR FEDS

BY DAVID TOBENKIN

The 2018 Federal Benefits Open Season is nearly here. Most federal employees probably know that means it is time to check whether their Federal Employees Health Benefit (FEHB) Program health insurance plan is the best for their needs and to also check whether enrolling in a second federal benefits program, the Federal Employees Dental and Vision Insurance Program (FEDVIP), makes sense. But there is a third benefit federal employees should be evaluating each Open Season and may not be: the Federal Flexible Spending Account Program (FSAFEDS), a federal benefits program that can reduce tax bills by using pretax dollars to pay for health and dependent care out-of-pocket expenses.

FSAFEDS accounts, all of which are available only to active federal employees to cover expenses for themselves and their dependents, can provide as much as $10,300 of extra cash (assuming both you and your spouse elect the maximum coverage) for health and dependent care expenses. However, these programs require careful planning and affirmative actions each year by federal employees to participate, reap the savings, and avoid potentially losing money through overestimating health or dependent care costs or by failing to timely file claims under the program.

FSAFEDS 101

FSAFEDS accounts reimburse employees for eligible health care and dependent care expenses using tax-free money set aside from their federal salaries.

"For someone in the 22 percent tax bracket who contributes $1,000 to a flexible spending account, it works out to $295 in tax savings," says Shawn Steel, CFP, JD, a financial planner and attorney at Reston, VA-based financial advising firm ClearLogic Financial, Inc.

How does it work? Let's say you make, and pay taxes on, $1,000 per pay period. If you put $50 per pay date in an flexible spending account (FSA), then you would only pay taxes on $950. Over one year, that would add up to $1,300 (26 pay periods x $50) in accumulated FSAFEDS funds that you could spend on eligible expenses that, but for the program, would instead have been taxed and that also would have increased your overall amount of taxable income. An example provided by FSAFEDS Administrator WageWorks, Inc. shows that a federal employee earning $60,000 with a 30 percent estimated tax rate contributing the maximum $2,650 to a Health Care FSA would end up with take-home pay that was $795 higher.

There are three types of FSAFEDS accounts: the Health Care Flexible Spending Account (FSA), the Limited Expense Health Care FSA, and the Dependent Care FSA. These accounts cover eligible expenses incurred by the employee and anyone the employee can claim as a dependent on a tax return. Each is discussed below.

Health Care Flexible Spending Accounts

Health Care FSAs reimburse eligible health care expenses incurred by you, your spouse and your children through the calendar year they turn 26. It reimburses the part of the expense not covered or reimbursed by FEHB, FEDVIP, or any other insurance coverage. Individual employees can save up to $2,650 per year (with possible incremental increases year to year as determined by the IRS) with a household limit of $5,300 per year. Eligibility for the program includes federal employees who are eligible for the FEHB, whether you're enrolled in FEHB or not.

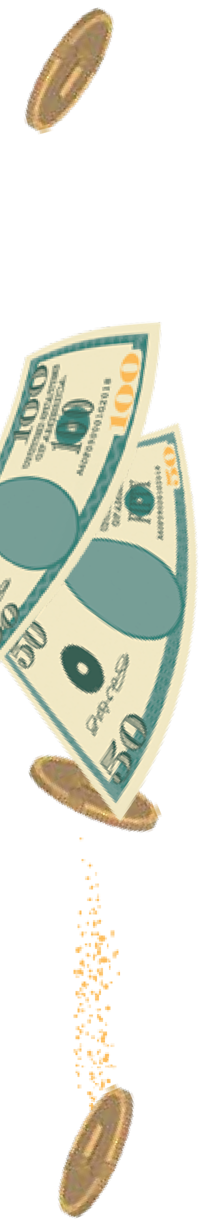
Types of covered expenses include those for prescriptions and doctor's office visit co-pays, as well as:

- Hospital coinsurance
- Ambulance services
- Physical therapy
- Eye exams
- Prescription glasses
- Prescription sunglasses
- Contact lenses
- Vision correction surgery
- Dental exams and cleanings
- Orthodontia and braces
- Fertility treatments
- Massage therapy
- Sunscreen
- First aid supplies
- Hand sanitizer
- Mileage to/from provider

What expenses are not covered or reimbursed by FEHB but would be by a Health Care FSA? Those could include the $20 or $30 co-pay you may pay for each routine office visit, your overall deductible costs before FEHB coverage kicks in, and the 20 or 30 percent co-pay you may pay under your plan even when it does cover the procedure. There are some limits: cosmetic surgery is generally not covered unless associated with a related medical issue, like illness or trauma; experimental medical treatments are evaluated on a case-by-case basis; and alternative treatments abroad may not be covered. An FSAFEDS list provides exact benefits: www.fsafeds.com/support/eligibleexpenses. Looking at the partial list of eligible expenses above, it is easy to see that even a family with only moderate health issues and strong insurance coverage could rack up significant covered costs.

Health Care FSAs cannot be combined with Health Savings Accounts (HSAs), another tax advantaged insurance benefit discussed below.

Limited Expense Health Care Flexible Spending Accounts



Limited Expense Health Care FSAs, which can only be used by those enrolled in or covered by a High Deductible Health Plan with an HSA, reimburse only eligible dental and vision expenses incurred by you, your spouse and your children through the calendar year they turn 26. Like the Health Care FSAs, Limited Expense Health Care FSA accounts reimburse the part of the expense not covered or reimbursed by FEHB, FEDVIP or any other insurance coverage. Again, money is withdrawn from salaries and can be used for dental and vision expenses.

Examples of eligible expenses include:

- Contact lenses, solutions, cleaners and cases
- Eyeglasses, refractions and vision correction procedures
- Crowns, fillings, dental cleanings and orthodontics

The same $2,650 individual and $5,300 household cap as for Health Care FSA applies to this type of account.

DEPENDENT CARE FLEXIBLE SPENDING ACCOUNTS

The Dependent Care FSA account reimburses eligible nonmedical day care and elder care for your children under age 13 and any dependents on your federal tax return who are incapable of self-care and live with you for at least half of the year. Examples of eligible expenses include day care, summer day camp, baby sitters, before- and after-school care, and adult day-care expenses. This program allows use of pretax withdrawals from savings of $2,500 per individual or $5,000 per household. These accounts may be used in conjunction with an HSA.

You may contribute a minimum annual election of $100 per individual or household for any of the three types of FSA accounts. Notably, individuals or households can max out both Dependent Care FSAs and Limited Expense Health Care or Health Care FSAs in the same year. Thus, a pair of married Feds filing jointly maxing out the programs could allocate $5,300 to fund a Health Care FSA and $5,000 in a Dependent Care FSA, for a total of $10,300.

EMPLOYEE ACTION AND PLANNING REQUIRED!

Beyond simply knowing to consider them as an Open Season option, all three FSAFEDS accounts share some key aspects that employees need to consider.

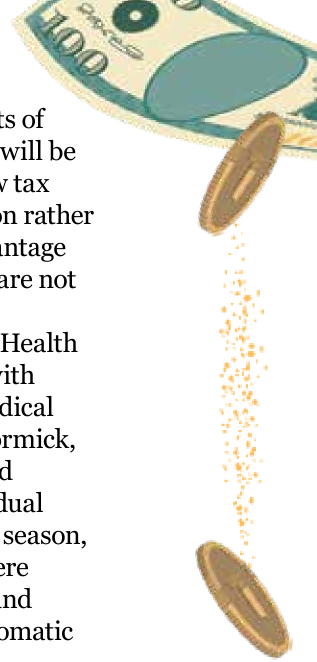
They all require affirmative efforts by federal employees to enroll in the program each year, to incur expenses and submit claims by a deadline, and to have enough in claims to recover payments into the program. Federal employees' existing FEHB insurance coverage defaults to their coverage in the next year if they take no action during Open Season. Not so for FSAFEDS: if you fail to register for one or more FSAFEDS accounts for the following year during Open Season, even if you participated in the year that is ending, you will not be able to participate in the new year's program.

And if you register for FSAFEDS and fail to submit claims by the deadline, or have eligible expenses less than the amount you contributed, you will lose all unclaimed Dependent Care FSA contributions and all but $500 of Limited Expense Health Care and Health Care FSA contributions (with up to $500 rolled over to the next year, contingent upon reenrollment in the following year's plan). Health Care and Limited Expense Health Care FSA expenses must be incurred within the calendar year of coverage (January 1 – December 31 of any year). For Dependent Care FSAs, participants have an additional 2½ months past the end of the calendar year (March 15) to incur expenses toward their balance. You must submit claims and receipts for all eligible expenses by April 30th of the following plan year.

In addition to enrolling during Open Season, newly hired and newly eligible employees, including those who experience an FSAFEDS qualifying life event (QLE), can enroll within 60 days of becoming eligible, but no later than October 1.

NOT FULLY USED

Having been first launched in 2003, total FSAFEDS enrollment in 2018 was 444,000 unique participants with more than 500,000 accounts (the account total is due to some participants having a health care account as well as a dependent care account), according to WageWorks, the organization that administers the program. Still, that represents less than a quarter of the 2 million federal civilian



employees, suggesting that many who would likely benefit from the program are not participating. (A few federal agencies, such as the Office of Thrift Supervision and the Federal Reserve System, do not participate in FSAFEDS.)

"We've seen growth in the use of the program year to year, but we would love to see more growth," says Dale Miller, Senior Vice President, Service & Operations, at WageWorks. "The responsibility is on us to make sure we promote the features and benefits and help employees make informed decisions based upon their individual situations. I think there is a misconception that FSAFEDS is difficult to use, but we have ensured that they can use their channel of choice to enroll in the program and file claims, including a mobile app, paperless reimbursement, fax and mail. We try to make it as user-friendly as possible and help them know the time frames and actions they need to take to participate in the program."

FSAFEDS 202

The program continues to evolve. Last year, 2017, was the first year the United States Postal Service participated in the FSAFEDS program, according to WageWorks.

There could be more interest in FSAs after the passage of last year's landmark tax legislation, the Tax Cuts and Jobs Act, as the tax benefits of FSAFEDS accounts are available even if, as will be the case for many individuals under the new tax law, they elect to take the standard deduction rather than itemize. Individuals can also take advantage of the FSAFEDS accounts if their expenses are not high enough to itemize, notes Steel.

Health Care FSAs and Limited Expense Health Care FSAs can also help some individuals with cash flow issues by essentially financing medical expenses without interest, notes Wan McCormick, CFP, a financial planner at Fairfax, VA-based Reliable Alliance Financial. Thus, an individual commit to contributing $1,000 for the 2019 season, can withdraw full $1,000 immediately if there is a big medical bill at the start of the year, and provide repayment through subsequent automatic reimbursement from payroll deductions.

As concerns the Dependent Care FSA, Steel says that there are some trade-offs with a federal tax credit for a non-FSAFEDS dependent-care tax credit for dependents, the Child and Dependent Care Tax Credit, that may determine whether using the Dependent Care FSA is advisable.

"A dependent care flexible spending account reduces the Child and Dependent Care Tax Credit, but the FSA is generally the better option for people in the 22 percent and *(Continued on p. 54)*

HEALTH SAVINGS ACCOUNTS (HSA)

In considering Health Care FSAs, it is worth keeping in mind the rival benefits and limitations of Health Savings Accounts (HSAs), given Health Care FSAs cannot be used with HSAs.

Like Health Care FSAs, HSAs also allow use of pretax dollars to set up accounts to pay for medical expenses. HSA holders may contribute up to $3,450 for an individual and $6,900 for a family per year. Employees taking advantage of HSAs are also eligible for catch-up contributions at or after age 55 of an additional $1,000 more per year, until enrolled in Medicare.

Perhaps most notably, accrued amounts in these accounts can be rolled over from year to year, be carried into retirement, and be used as investment vehicles. (The ability to contribute more money into them, however, ends when one is entitled to receive Medicare, turns age 65, or begins taking Social Security, unless they delay Medicare enrollment.) Under federal rules, a portion of high-deductible premiums are passed through to HSA accounts, thereby helping to fund the accounts. After age 65, amounts in HSAs can be used for nonmedical expenses without payments, just payment of applicable taxes, notes Wan McCormick, CFP, a financial planner at Fairfax, VA-based Reliable Alliance Financial.

Funds in HSAs can be invested in mutual funds, just as you would a standard retirement plan like the Thrift Savings Plan. Be aware that you take the risk of such investments, just as you would with a fund in a 401(k) plan. In retirement, you can use the money in your health savings account even if you switch from a high-deductible plan to Medicare. They can also be used to cover expenses Health Care FSAs cannot, such as Medicare premiums and long-term care insurance premiums and expenses, notes Jody L. Dietel, ACFCI, CAS, chief compliance officer at WageWorks, which also administers HSA programs for some clients.

Using HSAs, you can reimburse yourself for qualified medical expenses from a previous year as long as they were incurred after your health savings account was established. Stated another way, if your expenses in the prior year exceeded your contributions, you can use contributions in the following year to reimburse yourself for the prior year's expenses. This could actually provide a source of income that can be tapped at an opportune time, notes Shawn Steel, CFP, JD, a financial planner and attorney at Reston, VA-based financial advising firm ClearLogic Financial, Inc.

The major limitation is one must be enrolled in one of a small number of high-deductible health plans. Details of the 2018 Federal Benefits Open Season plans for have not been stated yet, but a description of high-deductible plans available in the current year that is ending is posted here: www.opm.gov/healthcare-insurance/healthcare/health-savings-accounts/hdhp_benefits-hsanetamounts.pdf

A key consideration is whether the high-deductible plan covers the doctors and medical expenses that you are likely to need and/or whether the HSA can make up any additional costs. There is also a risk comfort level, notes Steel.

"With high deductibles, you may have to pay for substantial medical expenses before health care coverage kicks in," Steel notes. "There is also likely more paperwork, including a requirement to file a form with the IRS each year." Steel notes HSAs can be particularly beneficial for those who commence them early, as there are more years to accumulate benefits.

The table on p. 53 compares some of the different attributes of the HSAs and Health Care FSAs for federal employees and retirees.

ATTRIBUTE	HSA	HEALTH CARE FSA
ELIGIBILITY	Available to federal to employees and retirees	Available to federal employees to cover eligible expenses for themselves and eligible dependents, not retirees
RELATIONSHIP TO HEALTH INSURANCE	Can only be used with FEHB high-deductible health plan, of which there are only a limited number. Plan does not pay out benefits until you reach the higher deductible, however you can use HSA funds to pay those expenses	Can be used with any non-high-deductible FEHB health plan.
CONTRIBUTION MINIMUM AND MAXIMUM	No minimum contribution. Maximum contribution of $3,450 for an individual and $6,900 for a family. Additional $1,000 catch-up contributions are available for individuals aged 55 or older.	$100 minimum. Individual employees can save up to $2,650 per year (with possible incremental increases year to year as determined by the IRS) with a household limit of $5,300 per year
CHANGES TO CONTRIBUTION	Can change contribution level throughout the year.	One-time election each Open Season, save for certain extraordinary events
DURATION	Account rolls over year to year. Can keep unlimited accumulated amount in account.	Account only lasts one year, except for $500 that can be rolled over if covered employee reenrolls.
TAX BENEFITS	Pretax contribution, withdrawals not taxed, earnings on money invested not taxed	Pretax contribution, withdrawals not taxed
INVESTMENT BENEFITS	Can be invested into other funds just like 401k. Earnings are not taxed if used for eligible medical expenses.	Cannot be invested
RETIREMENT OR CHANGE JOBS	Can be rolled into retirement and is not affected by federal service separation.	Cannot be carried into retirement or to a new, non-federal job.
FEES	Some HSAs have fees, depending upon the plan.	No fees.
PENALTIES	20 percent penalty if withdraw money for nonmedical expenses before age 65. After age 65, can withdraw for any purpose without penalty, but must pay taxes upon it.	N/A
USE OR LOSE?	No, money automatically rolls over	Up to $500 rolls over if you reenroll; any additional, unused amounts are forfeited.
OBLIGATIONS TO THE IRS?	Yes, you must file IRS Form 8889 with your tax return each year. Must keep documentation for medical expenses, in case there is an audit.	No.

(Continued from p. 51) over tax bracket," Steel says. "However, for people in the 12 percent or less tax bracket, forgoing the FSA may produce more tax savings and avoid the cash-flow strain from paying for day care and FSA contributions at the same time." Steel recommends asking a CPA or tax preparer which option is best for you.

However, there are also income requirements that apply to the Dependent Care FSA, including, notably, that if you are married, your contributions are limited to the lesser of your salary or your spouse's salary. For example, if you earn $60,000/year and your spouse earns $2,000, your dependent care contribution is limited to $2,000.

NAVIGATING PROGRAM CAPS

Knowing how much to allocate to FSA programs is critical. Usually, dependent care costs are fairly easy to estimate and, in many cases, will lead employees to want to contribute the maximum to the programs. Families where both spouses work 40 or 50 hours per week and need full-time nanny, day care or preschool coverage for the work week will, for example, easily reach up to $5,000 in eligible costs in regions with significant labor costs over a few months. In addition, there is an increasing number of federal employees who must help cover the costs of caring for aging parents, according to a recent Office of Personnel Management (OPM) Federal Work-Life Survey report.

Contributing the right amount to Health Care and Limited Expense Health Care FSAs present a more challenging consideration. Steel recommends analyzing both recurring health care costs and one-time events that are likely to fall within the coverage year.

With some planning, the almost-certain need for some such coverage can be worked out. This is likely the case in particular for procedures that are very expensive, have relatively less insurance coverage, or are under high deductibles, and for individuals holding less generous health-insurance plans where participant costs will be higher. Prescriptions and physical therapy following a planned major operation are other areas where the needs and non-insurance-covered expenses are often foreseeable. In addition, determining out-of-pocket costs for a surgical procedure to be performed the following year can help determine out-of-pocket expenses. Also, significantly, Health Care FSAs cover fertility treatments, an area with limited or no coverage under many health plans. Calculators on the FSAFEDS website can help estimate costs.

MAKING YOUR CLAIM AND REIMBURSEMENT

You must submit claims and receipts for all FSA eligible expenses by April 30 of the following plan year. There are numerous options for submitting your claims to FSAFEDS, such as a mobile app, online, fax/mail or paperless reimbursement, through which claims are automatically sent to FSAFEDS from your FEHB and/or FEDVIP carrier. Reimbursements are made via Electronic Funds Transfer (EFT) to a designated checking or savings account.

- For Health Care FSA and Limited Expense Health Care FSA, if you are enrolled in a FEHB and/or FEDVIP plan that automatically sends eligible medical, dental and vision expenses to FSAFEDS, you have the option of choosing how to be reimbursed for these claims:
- Auto Reimbursement – Automatically reimbursed for eligible out-of-pocket HCFSA expenses based on the claim information received from your plan.
- Pick and Process – Claims received from participating FEHB or FEDVIP plans are loaded into your account. You select which expenses you want processed for reimbursement and when to process them.
- You can upload your claim information online through the secure web site.
- The mobile app provides a convenient option for submitting claims. You simply upload the receipt and enter key data and submit.
- There is also the option to fax or mail using a claim form with the appropriate documentation.

And just what happens to any forfeited dollars for FSAFEDS participants who do not make timely claims or who make insufficient claims? Since 2013, OPM has been leveraging forfeited dollars to offset the administrative costs to participating agencies. By using those funds to cover a portion of the administrative fee, agencies have realized significant annual savings related to the FSAFEDS program, according to WageWorks.

This year's Open Season window is Nov. 12 – Dec. 10, 2018.

To enroll or get more information, go to www.FSAFEDS.com or call 1-877- FSAFEDS (372-3337), TTY: 1-866-353- 8058 Benefits Counselors are available Monday through Friday 9:00 a.m. to 9:00 p.m. ET, excluding holidays, to answer any questions.

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