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Individual Health Savings Accounts

INITIAL CONSIDERATION

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ISSUE STATEMENT

There is a gap in healthcare coverage for public safety employees from the time of retirement to when Medicare coverage begins.

OVERVIEW

Health insurance premiums have increased rapidly over the recent past, growing a cumulative 138% between 1999 and 2010 and outpacing cumulative wage growth of 42% over the same period.[1] Therefore, it's important for members to begin saving for healthcare costs in retirement, now.

LEOFF Plan 2 members have the opportunity to take a normal retirement at age fifty-three, or take an early retirement at age fifty. Some members have access to retiree medical plans sponsored by the Public Employees' Benefits Board (PEBB), however many local employers do not participate in PEBB plans, and retiree medical coverage can be hard to find and expensive especially before reaching Medicare eligibility at age sixty-five.

SB 6071 (Appendix A) was introduced in the 2015 session to help ensure access to retiree medical coverage for LEOFF Plan 2 members through the use of appropriate tax-authorized spending accounts or Voluntary Employee Benefit Accounts. These accounts would allow employees to contribute income now to help pay for their future medical premiums. As allowed by the IRS, these accounts may also allow employer contributions if bargained for at the local level. This bill did not receive a hearing.

BACKGROUND & POLICY ISSUES

There are different accounts available to help pay for post-retirement healthcare costs. A few of those options are:

[1] Kaiser Family Foundation/Health Research and Educational Trust, Employer Health Benefits 2010 Annual Survey.

Voluntary Employees' Beneficiary Association (VEBA)

A VEBA is a tax-free post-retirement medical expense account used by retirees and their eligible dependents to pay for eligible medical expenses. The plan is funded by the amount of unused sick leave that an employee has at the time of retirement, which is contributed by the employer into the plan. The benefit of this plan is the amount of sick leave left at retirement is paid out in full to the plan and is not subject to tax, which would reduce the amount one would receive.

VEBA plans are considered welfare benefit plans under federal tax law and are tax-exempt under Section 501(c)(9) of the Internal Revenue Code. Contributions to a VEBA are therefore tax-deductible and the funds grow tax-deferred. There are no tax penalties for early distributions from the VEBA, and assets are protected from creditors.

The primary benefit of a VEBA is the tax savings on the initial deposit of funds into the account. Many individuals withdraw their VEBA funds very quickly to cover medical expenses. Others may wish to save the account for future use, and invest for long term growth.

If upon a members death there are unused funds in the VEBA, and the member is survived by their legal spouse or dependent children (or other dependents as defined by the IRS), they will be able to use the remaining funds in the account for their eligible health care expenses. If a member has no surviving spouse or dependent(s), any remaining funds will be forfeited and redistributed pro rata among the remaining participants.

Health Savings Account (HSA)

HSA's were created in 2003 so that individuals covered by high-deductible health plans could receive tax-preferred treatment of money saved for medical expenses. An HSA may be funded by both employer and employee contributions, within IRS established limits, to finance health care costs. The contributions are invested over time and can be used to pay for qualified medical expenses, which include most medical care such as dental, vision and over-the-counter drugs. This was enacted as part of the Medicare Prescription Drug Improvement and Modernization Act of 2003 and the rules are found in Section 223 of the Internal Revenue Code. Contribution limits for 2016 are relatively high, $3,350 for an individual or $6,750 for family coverage, but can be used for healthcare costs at any time, they are not restricted to only paying healthcare in retirement.

Savings can be used tax-free preretirement for qualified medical expenses for yourself, spouse or dependents, even if they are not covered under the high-deductible plan. Otherwise savings are tax-deferred until withdrawal. At 65 years old, you will avoid a 20 percent penalty even if not used for medical expenses. The increased flexibility over IRAs, 401(k)s and other retirement savings accounts is leading many private employers across the country to opt into creating these accounts for their employees.

Advantages

- Contributions can come from various sources, including you, your employer, a relative and anyone else who wants to add to your HSA.
- Contributions made through payroll deposits (through your employer) are typically made with pre-tax dollars, which means they are not subject to federal income taxes. Your employer can also make contributions on your behalf, and the contribution is not included in your gross income.
- Contributions made with after-tax dollars can be deducted from your gross income on your tax return, which means you may owe less tax at the end of the year.
- Withdrawals from your HSA are not subject to federal (or in most cases, state) income taxes if they are used for qualified medical expenses.
- Any interest or other earnings on the assets in the account are tax free.
- If you have money left in your HSA at the end of the year, it rolls over to the next year.
- The money in your HSA remains available for future qualified medical expenses even if you change health insurance plans, change employers or retire. Funds left in your account continue to grow tax fee.

Disadvantages

- Even though you are paying less in premiums each month, it can be difficult – even with money in an HSA – to come up with the cash to meet a high deductible.
- Your healthcare costs could exceed what you had planned for, and you may not have enough money saved in your HSA to cover expenses.
- You may be reluctant to seek healthcare when you need it because you don't want to use the money in your HSA account.
- If you withdraw funds for non-qualified expenses before you turn 65, you'll owe taxes on the money plus a 20% penalty. After age 65, you'll owe taxes but not the penalty.
- You have to keep your receipts to prove that withdrawals were used for qualified health expenses.

Flexible Spending Account (FSA)

If you have a health plan through your employer, aka a cafeteria plan, you can use a Flexible Spending Account (FSA) to pay for copayments, deductibles, some drugs, and some other health care costs.

An FSA, also known as a flexible spending arrangement, is a special account you put money into that you use to pay for certain out-of-pocket health care costs. You don’t pay taxes on this money. This means you’ll save an amount equal to the taxes you would have paid on the money you set aside.

Employers may make contributions to your FSA, but aren't required to. A few fast facts about FSAs:

- FSAs are limited to $2,550 per year per employer. If you're married, your spouse can put up to $2,550 in an FSA with their employer too.
- You can use funds in your FSA to pay for certain medical and dental expenses for you, your spouse if you're married, and your dependents.
    - You can spend FSA funds to pay deductibles and copayments, but not for insurance premiums.
    - You can spend FSA funds on prescription medications, as well as over-the-counter medicines with a doctor's prescription.
    - FSAs may also be used to cover costs of medical equipment like crutches, supplies like bandages, and diagnostic devices like blood sugar test kits.

You generally must use the money in an FSA within the plan year. At the end of the year, you lose any money left over in your FSA, so it's important to plan carefully and not put more money in your FSA than you think you'll spend within a year on things like copayments, coinsurance, drugs, and other allowed health care costs.

Comparison						
	Source of Funds	**Annual limits**	**Use it or lose it?**	**When can $ be used?**	**Tax free contributions?**	**Tax-free withdrawal?**
VEBA	Unused sick leave	None	No	Post-retirement	Yes	Yes
HSA	Any type of contributions	$3350-single $6750 -family	No	Any time	Yes	Yes
FSA	Any type of contributions	$2250	Yes	Within 1 calendar year of deposit	Yes	Yes

SUPPORTING INFORMATION

Appendix A: SB 6071

S-1426.1

SENATE BILL 6071

State of Washington 64th Legislature 2015 Regular Session

By Senators Hobbs and Conway

Read first time 02/25/15. Referred to Committee on Ways & Means.

AN ACT Relating to authorizing benefit funding accounts for members of the law enforcement officers' and firefighters' retirement system plan 2; amending RCW 41.04.208 and 41.26.740; adding a new section to chapter 41.26 RCW; and creating a new section.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** (1) Public safety employees, such as firefighters, police officers, and corrections officers, participate in the law enforcement officers' and firefighters' retirement system plan 2 and have the opportunity to retire at age fifty-three or take an early retirement at age fifty. Many members of the law enforcement officers' and firefighters' retirement system plan 2 have access to the retiree medical plans sponsored by the public employees' benefits board, however many local employers do not participate in the medical program, and retiree medical coverage can be hard to find and expensive especially before reaching medicare eligibility generally at age sixty-five.

(2) It is the intent of the legislature to help ensure access to retiree medical coverage for the public safety employees listed in subsection (1) of this section, especially for the nonmedicare retirees, and to assist employees in planning for their retirement and future medical benefit needs through the use of appropriate tax-

authorized spending accounts that will allow employees to voluntarily contribute to their benefit accounts to help pay for their future medical premiums. As allowed by the internal revenue service, the accounts may also allow employer contributions as bargained locally.

Sec. 2. RCW 41.04.208 and 2004 c 173 s 1 are each amended to read as follows:

(1) Unless the context clearly requires otherwise, the definitions in this subsection apply throughout this section.

(a) "Disabled employee" means a person eligible to receive a disability retirement allowance from the Washington law enforcement officers' and firefighters' retirement system plan 2 and the public employees' retirement system.

(b) "Health plan" means a contract, policy, fund, trust, or other program established jointly or individually by a county, municipality, or other political subdivision of the state that provides for all or a part of hospitalization or medical aid for its employees and their dependents under RCW 41.04.180.

(c) "Retired employee" means a public employee meeting the retirement eligibility, years of service requirements, and other criteria of the Washington law enforcement officers' and firefighters' retirement system plan 2 and the public employees' retirement system.

(2) A county, municipality, or other political subdivision that provides a health plan for its employees shall permit retired and disabled employees and their dependents to continue participation in a plan subject to the exceptions, limitations, and conditions set forth in this section. However, this section does not apply to a county, municipality, or other political subdivision participating in an insurance program administered under chapter 41.05 RCW if retired and disabled employees and their dependents of the participating county, municipality, or other political subdivision are covered under an insurance program administered under chapter 41.05 RCW. Nothing in this subsection or chapter 319, Laws of 2002 precludes the local government employer from offering retired or disabled employees a health plan with a benefit structure, copayment, deductible, coinsurance, lifetime benefit maximum, and other plan features which differ from those offered through a health plan provided to active employees. Further, nothing in this subsection precludes a local government employer from joining with other public agency employers,

including interjurisdictional benefit pools and multi-employer associations or consortiums, to fulfill its obligations under chapter 319, Laws of 2002.

(3) A county, municipality, or other political subdivision has full authority to require a person who requests continued participation in a health plan under subsection (2) of this section to pay the full cost of such participation, including any amounts necessary for administration. However, this subsection does not require an employer who is currently paying for all or part of a health plan for its retired and disabled employees to discontinue those payments.

(4) Payments for continued participation in a former employer's health plan may be assigned to the underwriter of the health plan from public pension benefits or may be paid to the former employer, as determined by the former employer, so that an underwriter of the health plan that is an insurance company, health care service contractor, or health maintenance organization is not required to accept individual payments from persons continuing participation in the employer's health plan.

(5) After an initial open enrollment period of ninety days after January 1, 2003, an employer may not be required to permit a person to continue participation in the health plan if the person is responsible for a lapse in coverage under the plan. In addition, an employer may not be required to permit a person to continue participation in the employer's health plan if the employer offered continued participation in a health plan that meets the requirements of chapter 319, Laws of 2002.

(6) If a person continuing participation in the former employer's health plan has medical coverage available through another employer, the medical coverage of the other employer is the primary coverage for purposes of coordination of benefits as provided for in the former employer's health plan.

(7) If a person's continued participation in a health plan was permitted because of the person's relationship to a retired or disabled employee of the employer providing the health plan and the retired or disabled employee dies, then that person is permitted to continue participation in the health plan for a period of not more than six months after the death of the retired or disabled employee. However, the employer providing the health plan may permit continued participation beyond that time period.

(8) An employer may offer one or more health plans different from that provided for active employees and designed to meet the needs of persons requesting continued participation in the employer's health plan. An employer, in designing or offering continued participation in a health plan, may utilize terms or conditions necessary to administer the plan to the extent the terms and conditions do not conflict with this section.

(9) If an employer changes the underwriter of a health plan, the replaced underwriter has no further responsibility or obligation to persons who continued participation in a health plan of the replaced underwriter. However, the employer shall permit those persons to participate in any new health plan.

(10) The benefits granted under this section are not considered a matter of contractual right. Should the legislature, a county, municipality, or other political subdivision of the state revoke or change any benefits granted under this section, an affected person is not entitled to receive the benefits as a matter of contractual right.

(11) This section does not affect any health plan contained in a collective bargaining agreement in existence as of January 1, 2003. However, any plan contained in future collective bargaining agreements shall conform to this section. In addition, this section does not affect any health plan contract or policy in existence as of January 1, 2003. However, any renewal of the contract or policy shall conform to this section.

(12) Counties, municipalities, and other political subdivisions that make a documented good faith effort to comply with the provisions of subsections (2) through (11) of this section and are unable to provide access to a fully insured group health benefit plan are discharged from any obligations under subsections (2) through (11) of this section but shall assist disabled employees and retired employees in applying for health insurance. Assistance may include developing and distributing standardized information on the availability and cost of individual health benefit plans, application packages, and health benefit fairs.

(13) The office of the insurance commissioner shall make available to counties, municipalities, and other political subdivisions information regarding individual health benefit plans, including a list of carriers offering individual coverage, the rates charged, and how to apply for coverage.

(14) Counties, municipalities, and other political subdivisions that employ public safety employees participating in the law enforcement officers' and firefighters' system plan 2 must set up tax appropriate flexible spending accounts or voluntary employee benefit accounts that allow employees to contribute and accrue savings for retiree medical premiums. The tax accounts must be consistent with existing state law, the internal revenue code, and the regulations adopted by the internal revenue service. To the extent allowed by the internal revenue code, accounts may be authorized to accept contributions from employers.

NEW SECTION. **Sec. 3.** A new section is added to chapter 41.26 RCW to read as follows:

(1) The department, in consultation with the law enforcement officers' and firefighters' retirement system plan 2 board, shall assist employers of law enforcement officers and firefighters in the formulation and adoption of a plan, policies, and procedures designed to guide, direct, and administer the voluntary employee benefit account established in RCW 41.04.208 for public safety employees. The program and plan documents must be developed in consultation with the employers of law enforcement officers and firefighters.

(2) A plan document describing the requirements shall be adopted and administered by the department and be available as a template for local employers. The department shall represent the state in all matters concerning the administration of the plan. The state may engage the services of a professional consultant or administrator on a contractual basis to serve as an agent to assist or perform the administrative functions necessary in carrying out the purposes necessary to establish the voluntary employee benefit account or alternative internal revenue service authorized spending account.

Sec. 4. RCW 41.26.740 and 2003 c 92 s 7 are each amended to read as follows:

(1) All expenses of the department and the office of the state actuary related to the implementation of chapter 2, Laws of 2003 shall be reimbursed from the law enforcement officers' and firefighters' retirement system expense fund under RCW 39.34.130.

(2) All expenses of the department and the office of the state actuary related to the implementation of the accounts required in sections 2 and 3 of this act shall be reimbursed from the law

enforcement officers' and firefighters' retirement system expense fund under RCW 39.34.130.

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LEOFF
Plan 2 Retirement Board

Individual Health Savings Accounts

INITIAL CONSIDERATION

SEPTEMBER 21, 2016

ISSUE

- There is a gap in healthcare coverage for public safety employees from the time of retirement to when Medicare coverage begins

OVERVIEW

- **Health insurance premiums have increased rapidly over the recent past**
  - Growing a cumulative 138% between 1999 and 2010
  - Outpacing cumulative wage growth of 42% over the same period
- **It's important for members to begin saving for retiree health costs**

OVERVIEW

- **SB 6071**
  - Introduced in the 2015 session to help ensure access to retiree medical coverage for LEOFF Plan 2 members through the use of appropriate tax-authorized spending accounts or voluntary employee benefit accounts
  - These accounts would allow employees to contribute income now to help pay for their future medical premiums

BACKGROUND

- **There are different accounts currently available to help pay for post-retirement healthcare costs**
  - Voluntary Employees' Beneficiary Association (VEBA)
  - Health Savings Account (HSA)
  - Flexible Spending Account (FSA)

VEBA

- **Voluntary Employees' Beneficiary Association**
  - Funded by the amount of unused sick leave that an employee has at the time of retirement
  - The amount of sick leave is paid out in full to the plan and is not subject to tax
  - Able to pass on any remaining funds in the account to eligible dependents
  - Funds are forfeited if no eligible participant exists

HSA

- **Health Savings Account**
  - Tax favored savings account
    - Must be covered by a “high deductible health plan”
  - May be funded by both employer and employee contributions
  - Contributions are invested over time and can be used to pay for qualified medical expenses
  - Contribution limits
    - $3350 for an individual
    - $6750 for family coverage

HSA

- **Advantages**
  - Others can contribute to your HSA
  - Pre-tax contributions
  - Tax-deductible contributions
  - Tax-free withdrawals
  - Earnings are tax-free
  - Funds roll over
  - Portable
  - Convenient

HSA

- **Disadvantages**
  - High deductible plan requirement
  - Unexpected healthcare costs
  - Pressure to save
  - Taxes and Penalties
  - Recordkeeping
  - Fees

FSA

- **Flexible Spending Account**
  - Health plan must be through your employer
  - Pay for out of pocket health care costs
  - Tax free
  - $2550 limit per year, per employer
  - Funds can be spent on you, your spouse, or your dependents
    - Pays for deductibles and co-pays
    - Doesn’t pay for medical premiums

FSA

- **Flexible Spending Account**
  - Can be used to pay for prescriptions and medical equipment
  - Money must be used within the plan year
    - Money doesn't roll over into next year
    - Don't put more money into an FSA than you think you'll spend

COMPARISON

	Source of Funds	Annual limits	Use it or lose it?	When can $ be used?	Tax free contributions?	Tax-free withdrawal?
VEBA	Unused sick leave	None	No	Post-retirement	Yes	Yes
HSA	Any type of contributions	$3350- single $6750 - family	No	Any time	Yes	Yes
FSA	Any type of contributions	$2250	Yes	Within the plan year	Yes	Yes

QUESTIONS?

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