Provided by: Heim, Young & Associates, Inc.

Flexible Spending Accounts

Flexible spending accounts (FSAs) provide you with an important tax advantage that can help you pay health care and dependent care expenses on a pretax basis. By anticipating your family's health care and dependent care costs for the next plan year, you can lower your taxable income.

The Internal Revenue Service (IRS) set up FSAs as a means to provide a tax break to employees and their employers. As an employee, you agree to set aside a portion of your pretax salary in an account, and that money is deducted from your paycheck over the course of the year. The amount you contribute to the FSA is not subject to social security (FICA), federal, state or local income taxes, which effectively adjusts your annual taxable salary. The taxes you pay each paycheck and collectively each plan year can be reduced significantly, depending on your tax bracket. As a result of the personal tax savings you incur, your spendable income will increase. For example, if you contribute $2,500 to an FSA throughout the year and your effective federal and state tax rate is a combined 20 percent, using an FSA would save you $500.

The Health Care Reimbursement FSA

The health care reimbursement FSA lets you pay for certain IRS-approved medical care expenses not covered by your insurance plan with pretax dollars. For example, cash that you now spend on deductibles, copayments or other out-of-pocket medical expenses can instead be placed in the health care reimbursement FSA pretax. The annual maximum contribution to the health care reimbursement FSA for 2016 is $2,550.

How Much Should I Contribute?

If you have records from the previous year, they can be a great starting point for determining how much to anticipate spending. Here are some common expenses to anticipate:

- Deductibles
- Co-payments
- Prescription drugs
- Child care expenses
- Eye glasses and contacts
- Braces or dentures
- Fees paid to hospitals and doctors

And many more

Eligible Expenses

Eligible health care expenses for the health care reimbursement FSA include more than just your deductible and copayments. You can also reimburse items such as prescription drugs, dental expenses, eye glasses and contacts, certain medical equipment and many more items. For more information about eligible medical expenses, please refer to IRS Publication 502,

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Medical and Dental Expenses, available at www.irs.gov/publications/p502/index.html.

Claims for over-the-counter medication or drug expenses (other than insulin) can only be reimbursed if the patient has a prescription. This rule does not apply to items for medical care that are not considered medication or drugs. Equipment such as crutches, supplies such as bandages and diagnostic devices such as blood sugar test kits do qualify for reimbursement without a prescription.

The Dependent Care FSA

A dependent care FSA lets you use pretax dollars toward qualified dependent care. The annual maximum amount you may contribute is $5,000 (or $2,500 if married and filing separately) per calendar year.

If you elect to contribute to a dependent care FSA, you may be reimbursed for:

- The cost of child or adult dependent care
- The cost for an individual to provide care either in or out of your house
- Nursery schools and preschools (excluding kindergarten)

Eligible Expenses

In order for dependent care services to be eligible, they must be for the care of a tax-dependent child under age 13 who lives with you, or a tax-dependent parent, spouse or child who lives with you and is incapable of caring for themself. The care must be necessary to allow you and your spouse (if applicable) to go to work. Care must be given during normal working hours (instances such as Saturday night babysitting do not qualify) and cannot be provided by another of your dependents.

The “Use it or Lose it” Rule

Flexible spending accounts certainly have their benefits, but there is one very important potential downfall to using an FSA: Remaining funds that are not used at the end of a plan year are lost to the employee. This is often referred to as the “use it or lose it” rule. In November 2013, the IRS added a carryover feature to the rule, which allows plan members to carry up to $500 of unused funds from the previous plan year to the next year. This feature only applies to health care FSAs, not to dependent care FSAs, and this feature may not be used in conjunction with the “grace period” feature that some FSAs offer, which allows plan members to use the previous year’s funds for up to two and a half months in the next plan year. Plan sponsors will have to choose which of these features will be more beneficial to their participants, and plan members will only have access to the feature that is chosen.

Is The FSA Program Right for Me?

It’s easy to determine if an FSA will save you money. At enrollment time, you will need to determine your annual election amount. Estimate the expenses that you know will occur during the year. These include out-of-pocket expenses for yourself and anyone claimed as a dependent on your taxes. If you had $100 or more in recurring or predictable expenses, an FSA can help you stretch your dollars.

How do the Accounts Work?

If you decide to enroll in one or both of the accounts, your contributions are taken out of each paycheck—before taxes—in equal installments throughout the plan year. These dollars are then placed into your FSA. When you have an eligible health care or dependent care expense, you must submit a claim form along with an itemized receipt to be reimbursed from your account.

The health care reimbursement FSA will reimburse you for the full amount of your annual election (less any reimbursement already received), at any time during the plan year, regardless of the amount actually in your account. The dependent care FSA will only reimburse you for the amount that is in your account at the time you make a claim. ■