



**Flexible Spending Accounts (FSA)  
2012**

Flexible spending accounts (Section 125 plans) provide a vehicle for funding health care and dependent care expenses in the context of an employee benefit program. If the employer requires employee premium contributions, a flexible spending account should be offered to employees. A number of expenses can be paid for through such accounts. In the context of health care expenses, this may include dental services, hospital services, insurance premiums, prescription drugs, dental services, travel expenses to receive medical care, and vision care, to name a few. Qualified medical expenses are updated each year in IRS publication 502; IRS publication 503 details expenses that are qualified annually for dependent care expense reimbursement.

FSA funding occurs through the employer or the employee. In the case of the former, employers contribute a uniform amount to employees' accounts. In the case of the latter, a salary reduction agreement is negotiated. In both cases, however, the decision to set a contribution or salary reduction amount is implemented once a year, though changes during the year are possible under certain federal rules. The potential tax savings for individuals are largely dependent upon income level (Tables 1 and 2).

*Table 1: Support Staff Member, Married, Filing Single*

|                             | With FSA   | W/o FSA    |
|-----------------------------|------------|------------|
| Annual salary               | \$ 20,000  | \$ 20,000  |
| Standard deduction          | \$ (5,350) | \$ (5,350) |
| Exemptions (1)              | \$ (3,400) | \$ (3,400) |
| Pre-tax contribution to FSA | \$ (1,000) |            |
| Taxable income              | \$ 10,250  | \$ 11,250  |
| Federal income taxes        | \$ (1,146) | \$ (1,296) |
| After-tax expenses          |            | \$ (1,000) |
| Disposable income           | \$ 9,104   | \$ 8,954   |
|                             | \$ 150     |            |

*Table 2: Certified Staff Member, Married, Filing Single*

|                             | With FSA   | W/o FSA    |
|-----------------------------|------------|------------|
| Annual salary               | \$ 50,000  | \$ 50,000  |
| Standard deduction          | \$ (5,350) | \$ (5,350) |
| Exemptions (1)              | \$ (3,400) | \$ (3,400) |
| Pre-tax contribution to FSA | \$ (1,000) |            |
| Taxable income              | \$ 40,250  | \$ 41,250  |
| Federal income taxes        | \$ (6,486) | \$ (6,736) |
| After-tax expenses          |            | \$ (1,000) |
| Disposable income           | \$ 33,764  | \$ 33,514  |
|                             | \$ 250     |            |

*This example is intended for illustration purposes only, and assumes the 2007 federal tax rates identified by the Internal Revenue Service listed in IRS Publication 919 (Rev. March 2007). Actual savings depends upon the tax situation and health spending of each individual. Please consult a tax professional for more information on the tax implications of flexible spending accounts.*

Though benefit periods typically last twelve months, the annual amount must be available throughout each day in the plan year. This means that expenses are reimbursed as they are submitted no matter how much has actually accrued at any point during the benefit coverage period. Employee claims for reimbursement must occur during the 12-month period of coverage, and must be used only for qualifying expenses. While historically any money left over

in the account must be forfeited to the employer, recent changes in the law allow for an additional 2 ½ month grace period *upon employer election*. FSA medical accounts have no prescribed limits in 2012, but are generally set at \$1,000 - \$3,000. Beginning in 2013, FSA medical accounts will be limited to \$2,500 per year (indexed for inflation) by virtue of the Affordable Care Act (federal health care reform). In 2012, FSA dependent account limits are \$5,000 for a single taxpayer or a married couple filing jointly (the maximum includes the amounts in the spending accounts of both spouses, if applicable); it is \$2,500 for a married person filing separately. Other limitations apply; see IRS Publications 502, 503 and 969 (see the IRS website at <http://www.irs.gov/publications/index.html>).

FSA plans are negotiated with employers and implemented with the assistance of a third-party to the collective bargaining agreement, typically an insurance company. The administration of the plan typically requires employees to file a claim for reimbursement with the company through a claim form. Account balances are kept by the company, with account balance communications made to employees on a regular basis in order to avoid the forfeiture of unused funds.

According to SERB's annual health insurance survey data, on January 1, 2012 73% of school district and educational service centers offered a flexible spending account to employees; 69% offered a medical and dental account, and 61% offered a child and dependent care account. In terms of coverage, 69% offered flexible spending accounts on a 12-month term, while 31% offered coverage for 14 ½ months. In terms of employer contributions, 11% of employers contributed to employee accounts. Median reported contribution levels in 2011<sup>1</sup> were \$400 for single and \$600 for family contracts.

In 2010, federal health care reform legislation restricted the use of flexible spending account funds for medicines and drugs. Specifically, FSA plans now only cover or reimburse medicines and drugs if the drug: 1) requires a prescription, 2) is available without a prescription (i.e., over the counter [OTC]) but the individual obtains a prescription for it, or 3) is insulin. A prescription is defined as "any written or electronic order that meets the legal requirements of a prescription in the state in which the medical expense is incurred and is issued by an individual who is legally authorized." The new rule applies to OTC drugs purchased on or after January 1, 2011.

This document is for general education purposes only, and does not constitute legal or tax advice; such assistance should be sought from an attorney or accountant. Questions regarding FSA plans should be directed to OEA Research Division.

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<sup>1</sup> Employer contributions are from SERB's 2011 Health Insurance Survey; SERB did not collect this information in 2012.