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What’s Best, FSA or HSA?

Many employers offer health flexible spending accounts (FSAs) and health savings accounts (HSAs) as part of their employee benefits packages. Both plans allow you to set aside money to pay medical expenses with pre-tax dollars, providing a significant tax benefit. But which is the better option?

Although FSAs are only available through an employer, you may be able to open an HSA on your own if you have an HSA-eligible health plan through work, your spouse's employer, private insurance, or the insurance marketplace.

How Health Flexible Spending Accounts Work - A Health Flexible Spending Account (FSA, also called 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 they aren’t required to. With an FSA, you submit a claim to the FSA (through your employer) with proof of the medical expense and a statement that it hasn't been covered by your plan. Then, you’ll get reimbursed for your costs.

To learn more about FSAs, contact your employer for details about your company’s FSA, including how to sign up. Facts about Health Flexible Spending Accounts (FSA):

- The amount you can put into an FSA for 2023 is limited to $3,050 per employer. If you’re married, your spouse can put up to $3,050 in an FSA with their employer too. The amount is indexed for inflation each year.

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. Reimbursements for insulin are allowed without a prescription.
- FSAs may also be used to cover costs of medical equipment like crutches, supplies such as bandages, and diagnostic devices like blood sugar test kits.
- You generally must use the money in an FSA within the plan year. But your employer may offer one of 2 options:
  - It can provide a "grace period" of up to 2-½ extra months to use the money in your FSA.
  - It can allow you to carry over up to $610 per year (the 2023 inflation adjusted amount) to use in the following year.

Your employer doesn't have to offer these options. If it does, it can be either one of these options, but not both.

Don't put more money in an FSA than you think you'll spend within a year on things like copayments, coinsurance, drugs, and other allowed health care costs.

Health Savings Account (HSA) - Is a type of savings account that lets you set aside money on a pre-tax basis to pay for qualified medical expenses. By using untaxed dollars in a Health Savings Account (HSA) to pay for deductibles, copayments, coinsurance, and some other expenses, you may be able to lower your overall health care costs. HSA funds generally may not be used to pay premiums.

While you can use the funds in an HSA at any time to pay for qualified medical expenses, you may contribute to an HSA only if you have a High Deductible Health Plan (HDHP) — generally a health plan (including a Marketplace plan) that only covers preventive services before the deductible. For plan year 2022, the minimum deductible for an HDHP is $1,500 for an individual and $3,000 for a family. When you view plans in the Marketplace, you can see if they're "HSA-eligible."

For 2023, if you have an HDHP, you can contribute up to $3,850 for self-only coverage and up to $7,750 for family coverage into an HSA. HSA funds roll over year to year if you don't spend them. An HSA may earn interest or other earnings, which are not taxable if used for qualified medical expenses. Some health insurance companies offer HSAs for their HDHPs. Check with your company. You can also open an HSA through some banks and other financial institutions.

Establishing and contributing to an HSA can be more than just a way for individuals to save taxes and gain control over their medical care expenditures. It can also be a retirement vehicle, especially for taxpayers who are maxed out on their other retirement plan options or who can't contribute to an IRA because of the income limitations. There is no requirement that medical expenses must be paid or reimbursed from the HSA, so a taxpayer can maximize tax-free growth in the account by using funds from other sources to pay routine medical costs. Later, distributions can be used tax-free to pay post-retirement medical expenses. Or, if used for non-medical purposes, an individual aged 65 or older will pay income tax, but not a penalty, on the distribution. Unlike IRAs, no minimum distributions are required to be made from HSAs at any specific age.

FSA and HSA COMPARISONS		
DIFFERENCES	**FSA**	**HSA**
Funds not used for medical purposes carry over year to year	Limited	Yes
Contributions are pre-tax	Yes	Yes
Contributions may be tax deductible	---	Yes
You must have high deductible medical insurance to qualify	No	Yes
The plan is only available through an employer	Yes	No
Funds can be invested for tax-free growth	No	Yes
Can be used as a retirement vehicle	No	Yes
Plan belongs to employer	Yes	No

As you can see an HSA allows larger contributions and retirement options but requires high deductible medical insurance to qualify. While an FSA is only available if your employer offers an FSA as an employee benefit, but only has limited carryover of unused funds.
If you have further questions related to HSAs and FSAs, please give this office a call.

Employee or Independent Contractor – A Primer for Employers and Employees

It is not uncommon for employers to misclassify employees as independent contractors, either to intentionally avoid their withholding and tax responsibilities or because they are not aware of the laws regarding the issue. Misclassifying a worker can have significant ramifications for both the employer and the worker in terms of how much each pays in income, Social Security, and Medicare taxes, among others. Worker misclassification is a perennial issue for the Internal Revenue Service and state taxing authorities due to the

perception that many employers are not properly classifying their workers. This article looks at several issues regarding this matter.

The general distinction, of course, is that an employee is an individual who works under the direction and control of an employer, and an independent contractor is a business owner or contractor who provides services to others.

Whether an individual is an employee or an independent contractor is governed by both federal law and state law. It has always been a complicated issue at both the federal and state levels, and the state and federal guidelines often differ. However, because of the significant payroll tax revenues involved, the states are generally more aggressive in classifying workers as employees.

To determine whether a worker is an independent contractor or an employee, the IRS examines the relationship between the worker and the business and considers all evidence regarding control and independence. This evidence falls into the following three categories:

(1) Behavioral control covers whether the business has the right to direct or control how the work is done through instructions, training, or other means. Employees are generally given instructions on when and where to work, what tools to use, where to purchase supplies, what order to follow, and so on.

(2) Financial control covers whether the business has the right to control the financial and business aspects of the worker’s job. This includes the extent to which the worker has unreimbursed business expenses; the extent of his or her investment in the facilities being used; the extent to which his or her services are made available to the relevant market; how he or she is paid; and the extent to which he or she can realize a profit or incur a loss.

(3) Type of relationship includes any written contracts that describe the relationship the parties intended to create; the extent to which the worker is available to perform services for other, similar businesses; whether the business provides the worker with employee-type benefits, such as insurance, a retirement plan, vacation pay, or sick pay; the permanency of the relationship; and the extent to which the worker’s services are a key aspect of the company’s regular business.

If the business has the right to not only control or direct what is to be done but also how it is to be done, then the workers are most likely employees. On the other hand, if the company can direct or control only the result of the work done, and not the means and methods of accomplishing the result, then the workers are probably independent contractors.

One situation for which there is no uncertainty as to classification relates to a partner in a partnership. The IRS has long held that a bona fide member of a partnership is not an employee of the partnership, and a partner who devotes time and energy to conducting the partnership's trade or business, or who provides services to the partnership as an independent contractor, is considered self-employed and is not an employee.

The obvious advantages for a business to treat an individual as an independent contractor is to avoid paying minimum wages, overtime, payroll taxes, worker’s compensation insurance, unemployment tax, Social Security and Medicare contributions, health benefits, paid leave, 401(k) contributions, and unpaid leave under the Federal Family and Medical Leave Act.

Workers also have some tax-related benefits to being considered independent contractors, such as the ability to deduct certain business expenses that are not available to employees, the eligibility to set up their own retirement plans, and the fact that they are not subject to withholding. Of course, many workers want to be considered employees so they can get the benefits available to employees, such as vacation pay, overtime pay, and health insurance coverage.

A business that misclassifies an employee can be held liable for employment taxes for that worker, as well as owe various penalties, and if the employer willfully misclassified the individual, additional penalties apply and possibly prison time. More penalties could be piled on by the state where the business operates and the misclassified employee could be entitled to back wages for overtime, mandated work breaks, retirement benefits, and more. Misclassifying a worker can be very costly to the employer.

The IRS offers an optional Voluntary Classification Settlement Program that gives businesses an opportunity to reclassify their workers as employees for future employment tax purposes, and offers partial relief from federal employment taxes for eligible businesses who agree to prospectively treat their workers as employees. Businesses must meet certain eligibility requirements and apply by filing Form 8952, Application for Voluntary Classification Settlement Program (VCSP), and enter into a closing agreement with the IRS.

If you have questions about worker status as an employee or independent contractor, please contact this office for assistance.

The contents of this newsletter are intended to convey general information only and not to provide accounting or tax advice or opinions. The content should not be construed as, and should not be relied upon for, accounting or tax advice in any particular circumstance or fact situation. We recommend you contact us to discuss the application to any specific situation.

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