

Flexible Spending Accounts for Medical Expenses

Many clergy have asked me about medical reimbursement plans. In response to your questions, I think it might help to explain the difference between two types of tax mechanisms for reimbursement of medical expenses. Please keep in mind Option 1 is considered a salary reduction and should not be included in your 2004 Clergy Budget Compensation Package. The second option would be considered a line-item expense in the church budget.

1. Flexible Spending Account: This is a more formal benefit plan that allows an individual to set aside a portion of pre-tax salary dollars, designated prior to January 1 of each year, to use for medical expenses. Often, FSAs are used to cover deductibles, out-of-pocket expenses, any premium costs not paid by the employer, plus additional medical expenses not otherwise covered under a comprehensive group health plan. Another key feature of FSAs is the "use it or lose it" rule, which requires individuals to forfeit any unspent monies left in the FSA at the end of the year. FSAs are governed by IRS regulations, including non-discrimination rules, which means they need to be offered to all employees who are eligible for participation in health insurance coverage (lay and clergy). FSAs also can be set up to cover certain dependent care expenses. Dependent care FSAs must be maintained separately from medical FSAs, because the tax rules are somewhat different for each type of plan.
2. Reimbursement of Pastor's Medical Expenses: Some local churches, on an informal basis, simply reimburse a pastor for his/her medical expenses, using **budgeted** church monies, not the pastor's salary. This "benefit" is not taxable to the pastor, if done correctly.

This is a very simplified explanation of the two options. The advantage of the FSA is that it uses pre-tax salary dollars and it is available to all employees in all workplace settings (it is not experimental). Option number 2 is probably not available for most pastors, since most local churches probably cannot afford any extra monies out of the budget for payment of medical expenses.

Setting up and administering an FSA plan would be fairly easy for a larger church, which has staff available to take the time needed to develop the plan and monitor it. The implementation and operation of FSAs are governed by detailed IRS regulations.

An FSA plan can be handled internally with simple bookkeeping functions – or it can be established with a complex plan document. Either way, however, compliance with IRS regulations is important. For example, there are regulations about monitoring compliance – someone must know about restrictions on changing the individual's set-aside amount mid-year; someone has to know about and ensure compliance with the "use it or lose it" feature; someone needs to know what to do when the pastor is given a new appointment that requires a June 30 move; etc.

Below are samples that set up each plan. I would encourage each church to consult with the church CPA before establishing one of the plans.

SALARY REDUCTION AGREEMENT
FLEXIBLE SPENDING ACCOUNT

Wishing to maintain a Flexible Spending Account for medical expenses with the _____, the participant agrees to accept a reduction in compensation in the amount indicated below. Said amount will be held in the participant's name until March 31 of the ensuing year in order to provide time within which to submit qualifying medical claims for payment.

FORFEITURE – Any amount remaining in the Medical Reimbursement Account after payment of all timely presented claims for expenses incurred during the applicable period of coverage shall be forfeited.

PAYMENTS – The participant understands that, once funds have been contributed to the Account, they can be withdrawn for the following purposes:

1. Payment or reimbursement of hospital, medical, dental, and optical insurance premiums.
2. Reimbursement of deductible payments made by participant or dependents.
3. Reimbursement of co-payments made by participant or dependents.
4. Payments for well-baby care and immunizations.

DEPENDENT SALARY REDUCTION AGREEMENTS – It is understood that dependents who have similar salary reduction agreements cannot submit claims for reimbursement on the same medical costs regardless of place of employment.

TERMS OF AGREEMENT – Having read and accepted the provision of this salary

Reduction Agreement, I agree to a salary reduction of: \$ _____ for the period beginning _____ 20____, through _____, 20____.

This agreement signed on _____, 20____.

Participant _____

Approved _____

SAMPLE MEDICAL EXPENSE REIMBURSEMENT PLAN

1. BENEFITS

The Church shall reimburse all eligible employees for expenses incurred by themselves, and their dependents, as defined in IRC S152, as amended, for medical care, as defined in IRC S213(e), as amended, subject to the conditions and limitations as hereinafter set forth. It is the intention of the Church that the benefits payable to eligible employees hereunder shall be excluded from their gross income pursuant to IRC S105, as amended.

2. ELIGIBILITY

All church employees employed on a full time basis at the date of inception of this Plan, including those who may be absent due to illness or injury on said date, are eligible employees under the Plan. A corporate employee shall be considered employed on a full time basis if said employee customarily works at least seven months in each year and twenty hours in each week. Any person hereafter becoming an employee of the Church, employed on a full time basis shall be eligible under this Plan. All other employees shall become eligible to participate in this Plan after _____ years of continuous service.

3. LIMITATIONS

(a) The Church shall reimburse any eligible employee no more than \$ _____ in any fiscal year for medical expenses.

(b) Reimbursement or payment provided under this Plan shall be made by the Church only in the event and to the extent that such reimbursement or payment is not provided under any insurance policy(ies), whether owned by the Church or the employee, or under any other health and accident or wage continuation plan. In the event that there is such an insurance policy or plan in effect, providing for reimbursement in whole or in part, then to the extent of the coverage under such policy or plan, the Church shall be relieved of any and all liability hereunder.

4. SUBMISSION OF PROOF

Any eligible employee applying for reimbursement under this Plan shall submit to the Church, at least quarterly, all bills for medical care, including premium notices for accident or health insurance, for verification by the Church prior to payment. Failure to comply herewith, may at the discretion of the Church, terminate such eligible employee's right to said reimbursement.

5. DISCONTINUATION

This Plan shall be subject to termination at any time by vote of the board of directors of the Church; provided, however, that medical care expenses incurred prior to such termination shall be reimbursed or paid in accordance with the terms of this Plan.

6. DETERMINATION

The President shall determine all questions arising from the administration and interpretation of the Plan except where reimbursement is claimed by the president. In such case, determinations shall be made by the board of directors.