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[Home](#) > [Publications](#) > [ABA Health eSource](#) > [2016-2017](#) > [July 2017](#) > [Are Concierge Physician Fees Payable Tax-Free from Health Savings Accounts and Reimbursable Health Flexible Spending Accounts?](#)

Are Concierge Physician Fees Payable Tax-Free from Health Savings Accounts and Reimbursable Health Flexible Spending Accounts?

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I. What is Concierge Medicine?

Concierge medicine has emerged as a trend since the 1990s.¹

Patients of concierge practices receive greater access to their physicians, personalized healthcare, preventive services, and wellness education. The concierge business model offers patients perks like quick responses from a physician, 24-hour access, answers to questions and treatment via e-mail, appointments without wait time, and even house calls. Because of the greater time and attention dedicated to each patient, concierge physicians typically have smaller patient rosters than physicians in conventional practices.

II. What are Health Flexible Spending Accounts (FSAs)?

A Health Flexible Spending Account or Flexible Spending Arrangement (FSA) is an employer-sponsored benefit program that allows employees and eligible family members to receive tax-free reimbursement of qualified medical expenses.² The employee, the employer, or both may contribute to the employee's FSA.⁴ Contributions are withheld from the employee's paycheck on a pre-tax basis.³ Thus, the contributions are not subject to payroll and income tax withholding and are effectively tax-free. FSA funds cannot be used for anything other than qualified medical expenses that have not been reimbursed by insurance or other benefit plans.⁵

To offer FSAs as a benefit, an employer must establish a cafeteria plan.⁶ Congress subjected cafeteria plans to a use-or-lose rule, which prohibits the deferral of compensation in the form of employee benefits.⁷ This rule requires that contributions remaining unused as of the end of the plan year be forfeited.⁸ The Treasury Department and the Internal Revenue Service (IRS), however, have modified this use-or-lose rule by adopting a grace period rule. A cafeteria plan may permit the use of up to \$500 of any remaining balance to pay expenses incurred during a grace period of up to two months and 15 days

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after the plan year ends (March 15th for calendar-year plans).⁹ Hence, remaining balances are forgone unless used by the end of the year or any grace period, depending on the plan.¹⁰

III. What are Health Savings Accounts (HSAs)?

A Health Savings Account (HSA) is a medical savings account established as a tax-exempt trust for the payment of qualified medical expenses of its beneficiary and eligible family members.¹¹ Only qualified medical expenses that are not covered by insurance or other benefit plans may be paid or reimbursed with tax-free HSA funds.¹² Use of HSA funds for anything other than qualified medical expenses results in inclusion of these amounts in the beneficiary's taxable income and triggers an additional tax of 20 percent.¹³ HSAs are available only to individuals covered by high deductible health plans.¹⁴ Individuals can establish either self-sponsored HSAs on their own or employer-sponsored HSAs under an employer's cafeteria plan. The employee, the employer, or both may contribute to an employer-sponsored HSA.¹⁵ Employees contribute through salary withholdings on a pre-tax basis or may deduct HSA contributions made with after tax funds on their tax returns.¹⁶ No use-or-lose rule applies to HSAs, and beneficiaries can carry forward remaining balances to the following year and from one year to another during the beneficiary's lifetime.

IV. Consumer Healthcare Responsibility Trends

Consumer payment responsibility, including copayments, deductibles, coinsurance and balance billing is on the rise.¹⁷ HSAs and FSAs are part of this growing trend toward greater consumer healthcare responsibility.¹⁸ As consumer payment responsibility and out-of-pocket payments increase, consumers are demanding greater transparency from their healthcare providers and payors and the industry has been shifting to a more consumer-centric service model.¹⁹

V. Qualification for Reimbursement

Whether a concierge fee is eligible for tax-free coverage depends on whether the fee: (1) meets the definition of a qualified expense for "medical care" under the Internal Revenue Code (the Code) and (2) is a permitted expense under the employer's cafeteria plan. While FSAs must meet both conditions, HSAs must meet only the tax law requirement. As a practical matter, a concierge fee may be covered only to the extent an HSA or FSA has been funded adequately.

VI. Reimbursement of Expenses for Medical Care

A) Qualified Medical Care

HSAs and FSAs may cover qualified expenses paid for medical care unless such amounts have been compensated by insurance or other benefit plans.²⁰ Under the Code, medical care includes "the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body."²¹ Associated expenses must be incurred primarily for medical purposes.²² The inquiry centers on the nature of the services received. While neither FSAs nor HSAs can be used to cover health

insurance premiums,²³ both may offset deductibles, copayments and other medical, dental and vision expenses. The tax law recognizes the following as qualified "medical care": annual physical exams, eye exams, lab work, diagnostic tests, preventive dental treatments, vaccines, and X-rays. Personal expenses – such as medically recommended household help, maternity clothes, purely cosmetic procedures, and health club dues – do not qualify as expenses for medical care.

B) Characterization of Concierge Physician Fees

While the business model may vary, concierge physicians typically charge a concierge fee ranging from a small monthly membership fee to annual retainers in the thousands. Ordinarily, concierge subscription fees and retainers are charged for access and convenience, regardless of whether medical services are provided. Yet concierge fees may cover routine medical services, and additional fees may accompany medical services provided à la carte.

The nature of the service determines whether a concierge fee is a qualified expense for "medical care" and eligible for reimbursement. Only the portion of the fee, which is associated with the medical service and not otherwise covered by insurance, is eligible for coverage. If the fee is only for non-medical services or the right to preferred access to concierge medical care, then the fee is not a qualified medical expense.

Concierge physician fees encompass the following categories:

1. Access fees. In this case, the patient subscribes to a concierge physician practice solely for preferred access to medical care. When medical services are provided, additional fees would apply. While the subscription portion of the fee is paid for preferred access and is ineligible, any amount paid for medical care would be treated as a qualified medical expense.
2. Retainer fees. These are charges for special treatment and perks, including 24-hour availability of a physician, special waiting rooms, newsletters with wellness recommendations, minimal or no wait time when scheduling appointments, longer and more comprehensive appointments and house calls. Retainer fees are billed annually and apply whether or not medical services are provided. These fees are paid for non-medical services and convenience and so are not qualified medical expenses.
3. Membership fees. Similar to retainer fees, these fees cover special treatment and perks and are payable whether or not medical services are provided. Unlike retainer fees, membership fees may offset part of the cost of medical services. Membership fees are billed monthly, in addition to copayments, deductibles, and other charges for office visits. These fees are similar to insurance premiums in that they are paid to cover contingent future expenses, and insurance premiums cannot be covered with HSA or FSA funds.²⁴ Therefore, neither can be membership fees.
4. Fees for diagnostics, prevention and annual physicals. These fees normally qualify as expenses for medical care and may be paid in advance, on an annual basis, or when the services are actually received. Annual physical exams qualify as medical care, and certain diagnostic and preventive medical services qualify, as well.²⁵ If the fees are paid in advance, they may become reimbursable once the physical or other medical services have been performed because that is when the medical character of the expenses is established.²⁶

C) Documenting Concierge Fees for Medical Care

The patient must have supporting documents to prove that medical services

were received and payment was made for an eligible medical expense. Ideally, the concierge physician practice would provide details on the fee and indicate whether the patient has received medical services or merely convenience, concierge access, and non-medical services. In addition to the patient's name and dollar amounts, itemized billing statements should indicate the type of expense and the date of service.

VII. IRS's Silence

The IRS has not issued interpretive guidance on the eligibility of concierge fees as medical expenses. In an IRS Information Letter, which is only advisory and with no binding effect, the IRS faced the issue of whether a concierge fee was reimbursable from a Medical Reimbursement Account or Healthcare Reimbursement Arrangement (MRA), which is very similar to an FSA.²⁷ The patient paid an annual medical concierge fee for "access to physicians, a comprehensive annual physical, minimum half hour doctor visits, and access to dietitians and exercise therapists."²⁸ Whether intentionally or not, the IRS did not address the issue of whether the fee would qualify as an expense for medical care. Instead, the IRS letter outlined the tax rules and alluded to an MRA plan's discretion to set its own rules to determine which expenses are reimbursable and which ones are excluded from coverage.²⁹

VIII. Restricting Eligibility of Medical Expenses

All medical expenses under section 213(d) are eligible for payment or reimbursement from HSA funds, and employers cannot restrict the eligibility of medical expenses under an HSA. However, even if an expense qualifies as for "medical care," the tax law does not require FSA plans to reimburse it and the plan terms control.³⁰ Employers have discretion to limit reimbursement to only a subset of eligible medical expenses listed in the plan and exclude others, whether or not these expenses would otherwise qualify under the Code.³¹

IX. Deductibility on Form 1040, Schedule A

If the fees are for qualified medical services under section 213(d) of the Code, but are not eligible for coverage under the terms of the FSA, patients may still be able to deduct them on their tax returns (IRS Form 1040) as an itemized deduction on Schedule A.³² Only qualified medical expenses, which are not reimbursed from health insurance, can be deducted. This applies regardless of whether the insurance payment was received directly or made on the patient's behalf to the medical provider. Regrettably, one can never deduct all of one's medical expenses because the deduction is limited to only the amount that exceeds 10 percent of adjusted gross income (AGI) or 7.5 percent of AGI for individuals born before January 2, 1952.

X. Additional Qualification Details

A) Who qualifies as a recipient of medical care?

The recipient of medical care may be the beneficiary (HSA) or participant (FSA), her or his spouse, or a dependent (as determined for tax purposes).³³ FSAs also include adult children under age 27.³⁴

B) When can an eligible medical expense be incurred?

The expense must be incurred: (1) for an HSA, after the HSA is established and during the patient's tax year, which usually is the calendar year, and (2) for an FSA, during the patient's tax year, in which the FSA's plan year or any grace period ends.³⁵

Example: If Noelle's tax year is the calendar year (ending in December), and she incurs medical expenses in October 2016, these expenses will be deductible: (1) in 2016 if Noelle has an HSA and (2) in 2017 if Noelle has an FSA with a plan year ending in December 2016 and a grace period ending February 2017 (in Noelle's 2017 tax year).

C) When can the expense be reimbursed?

The expense can be reimbursed only after the medical services have been provided.³⁶ If the fee was paid in advance, the fee cannot be reimbursed until after the services have been delivered.³⁷

XI. Illustrations

The following examples provide additional guidance as to when concierge physician fees may be covered with HSA or FSA funds and/or deducted on one's tax return.

Example 1: Arthur pays an annual fee of \$1,200 for concierge medical care. Arthur does not use any medical visits or services this year, and the fee of \$1,200 is solely for concierge access. Because no medical services are received, the fee is neither reimbursable nor deductible under the Code.

Example 2: Peter pays an annual fee of \$1,200 for concierge medical care. Peter receives a comprehensive annual physical upon enrollment. This visit is billed as a physical for \$1,200, and the fee includes concierge access. Because it is an expense incurred for medical services, the entire fee of \$1,200 is eligible for reimbursement or deduction under the Code.

If Peter receives no reimbursement because of the restrictions of his FSA and itemizes his deductions, he can deduct on Schedule A at least a portion of the \$1,200 fee, to the extent that his AGI does not exceed \$12,000 (only the amount over 10 percent of AGI is deductible).

Example 3: Vanessa pays an annual concierge fee of \$1,200 for concierge medical care. Vanessa does not receive a comprehensive annual physical upon enrollment. Instead, the billing statement indicates a fee of \$1,200 for both concierge access and a contingent annual physical to be performed in the future. Because no medical services are received, the fee is neither reimbursable nor deductible under the Code.

Example 4: George pays an annual fee of \$1,200 for concierge medical care. George visits with his physician once every quarter. The first quarter, he visits for an annual physical exam and then for three follow-up consultations, one in each of the remaining three quarters. These four visits for medical services are billed against the annual fee at \$400 for the physical and \$200 for each consultation. A total of \$1,000 (\$400 plus three times \$200) is eligible for reimbursement or deduction under the Code. The remaining \$200 (\$1,200 minus \$1,000) is neither reimbursable nor deductible under the Code.

If George receives no reimbursement because of the terms of his FSA and

itemizes his deductions, he can deduct a portion of the \$1,000 fees on Schedule A, to the extent that his AGI does not exceed \$10,000 (only the amount over 10 percent of AGI is deductible).

Example 5: Diana pays an annual fee of \$1,200 for concierge medical care. Diana visits with her physician once every quarter. The first quarter, she visits for an annual exam and then for three follow-up consultations, one in each of the remaining three quarters. None of these visits is billed against the annual fee. Instead, each visit is billed at an additional cost of \$400 for the physical and \$200 for each consultation. While the annual fee of \$1,200 is ineligible for reimbursement or deduction under the Code, the fees for the medical services of \$1,000 (\$400 plus three times \$200) are eligible.

If Diana receives no reimbursement because of the terms of her FSA and itemizes her deductions, she can deduct on Schedule A at least a portion of the \$1,000 fees, to the extent that her AGI does not exceed \$10,000 (only the amount over 10 percent of AGI is deductible).

XII. Conclusion

As concierge medicine becomes more popular and the trend to greater consumer healthcare responsibility leads to the greater use of HSAs and FSAs, understanding these rules to ensure compliance is essential.

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¹ David P. Paul, III & Michaeline Skiba, *Concierge Medicine: A Viable Business Model for (Some) Physicians of the Future?*, Health Care Mgr., vol. 35, Jan.-Mar. 2016, at 3, available at <https://www.ncbi.nlm.nih.gov/pubmed/27892907> (last accessed July 10, 2017); Priyanka Dayal McCluskey, *How these doctors bypass insurance companies*, Boston Globe, Apr. 20, 2016, available at <https://www.bostonglobe.com/business/2016/04/19/primarycare/KWhFenipdotfHFN0ZZZhrN/story.html> (last accessed July 10, 2017).

² See Internal Revenue Code (Code) §§ 105(b), 106(c)(2). Throughout this article, FSA refers specifically to a health FSA.

³ See Code § 125(j)(3).

⁴ See Prop. Treas. Reg. § 1.125-1(r). An employer's, like an employee's, contributions are in the form of salary reductions. The rationale is that the employee elects to receive tax-free contributions in lieu of taxable compensation.

- 5 See Code §§ 105(b), 105(f), 106(a). Employers realize benefits from cafeteria plans in the form of savings from payroll taxes and deductions of set-up costs and contributions as business expenses. See Code §§ 162, 3121(a)(5)(G), 3306(b)(5)(G). When offering FSAs, employers cannot discriminate in favor of highly compensated employees. See Code §§ 105(h), 125.
- 6 Individuals may establish FSAs only under an employer-sponsored cafeteria plan. A cafeteria plan allows the participating employees to choose among two or more benefits, consisting of cash and at least one qualified benefit. See Code § 125(d)(1). Employees electing to receive cash, which is a taxable benefit, must include it in gross income. Qualified benefits, on the other hand, are not taxable. A qualified benefit is a benefit that Congress designated expressly as excludable from gross income under the Code. See Code § 125(f)(1). Examples of qualified benefits offered through cafeteria plans are employer-provided health plans, which include FSAs and HSAs. See Prop. Treas. Reg. § 1.125-5(h).
- 7 See Code § 125(d)(2)(A); Prop. Treas. Reg. § 1.125-5; I.R.S. Notice 2013-71, 2013-47 I.R.B. 532.
- 8 See Prop. Treas. Reg. §§ 1.125-1(c)(7)(C), -1(o), -5(c).
- 9 See Prop. Treas. Reg. § 1.125-1(e); Notice 2005-42, 2005-1 C.B. 1204.
- 10 Employers may offer cafeteria plan terms that are less permissive than what the tax law permits. For example, an employer may limit the amount of unused benefits and contributions available during the grace period. See Prop. Treas. Reg. § 1.125-1(q).
- 11 See Code § 223(d)(1), (e)(1).
- 12 See Code §§ 223(d)(2), (f)(1), (f)(2).
- 13 See Code § 223(f)(4)(A). No additional tax or inclusion of the reimbursed amounts in taxable income would result if the beneficiary becomes disabled or eligible for Medicare (at age 65) or upon the beneficiary's death. Code § 223(f)(4)(B), (C).
- 14 See Code § 223(c)(1). To be eligible, beneficiaries must not have other health coverage, must not be enrolled in Medicare, and cannot be claimed as a dependent for tax purposes. See Code §§ 223(b)(6), (b)(7), (c)(1)(A)(ii).
- 15 See Code § 106(a), (d).
- 16 See Code § 125(f), 223(a). HSA contributions are deductible on IRS Form 1040, line 25.
- 17 See InstaMed, *Trends in Healthcare Payments Fifth Annual Report: 2014*, May 2015, available at <https://www.instamed.com/wp-content/uploads/Trends-in-Healthcare-Payments-Annual-Report-2014.pdf> (last accessed July 10, 2017) (hereinafter "InstaMed's Report").
- 18 See Gentry Pool, *Keeping up with the Joneses: Employer Trends in HRA, FSA, & HSA*, Benefits Pro, Jul. 11, 2016, available at <http://www.benefitspro.com/2016/07/11/keeping-up-with-the-joneses-employer-trends-in-hra> (last accessed July 10, 2017).

- 19 See InstaMed's Report.
- 20 See Code §§ 105(b), (f); 223(d)(2)(A). Expenses fully reimbursed with FSA funds cannot be also reimbursed with HSA funds and vice versa. See Code §§ 105(b), (f); 223(d)(2)(A). When offering FSAs, employers cannot discriminate in favor of highly compensated employees. See Code §§ 105(h), 125.
- 21 Code § 213(d)(1)(A); Treas. Reg. § 1.213-1(e). For eligibility of common expenses for medical care under § 213(d), see IRS Pub. 502, "Medical and Dental Expenses," *available at* <https://www.irs.gov/pub/irs-pdf/p502.pdf>.
- 22 See *id.*
- 23 HSAs allow for an exception for the following health insurance premiums: qualified long-term care, COBRA healthcare continuation coverage, and healthcare coverage while an individual is receiving unemployment compensation. See I.R.S. Notice 2004-2, 2004-1 C.B. 269, Q & A-33 (27).
- 24 See *id.* and *supra* text accompanying note 23.
- 25 See discussion *supra* Part V.A.
- 26 Only amounts paid for expenses incurred for qualified medical care are not subject to tax. See Treas. Reg. § 1.213-1(e)(1)(i). ("Deductions for expenditures for medical care allowable under section 213 *will be confined strictly to expenses incurred. . .*") (emphasis added). FSA funds may not reimburse medical expenses unless the expenses are actually incurred for medical care. See Treas. Reg. § 1.105-2. HSA funds may reimburse non-medical expenses outside of limited circumstances, but become subject to tax. See *supra* Part III and note 13 for further details.
- 27 I.R.S. Letter 2011-0027 (Mar. 25, 2011). An MRA is an employer-sponsored medical reimbursement benefit, and section 105 of the Code governs both MRAs and FSAs. Employees may carry forward balances remaining at year-end. While FSAs may be funded by employees, only employers may contribute to MRAs. The employer has the flexibility to determine which expenses and services to cover, the maximum contribution amounts, and how to treat balances remaining at year-end.
- 28 *Id.*
- 29 *Id.* ("In general, expenses that are reimbursable from an MRA must be both expenses paid during the taxable year for medical care and *expenses that the MRA decides to reimburse*. The Internal Revenue Code defines medical care as amounts paid for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body. *An MRA can limit payment or reimbursement to only certain expenses. Each plan can have its own rules as to what it chooses to reimburse and can disallow an expense even if it otherwise fits the definition of a medical care expense.*") (emphasis added.)
- 30 For example, a cafeteria plan may provide that an FSA may exclude reimbursement of over-the-counter medicines. See Rev. Rul. 2003-102, 2003-2 C.B. 559.
- 31 FSA plan documents must identify the expenses that the plan would reimburse. *Cf.* I.R.S. Letter 2011-

0055 (June 24, 2011).

- 32 See Itemized deductions, Form 1040, line 40, *available at* <https://www.irs.gov/pub/irs-pdf/f1040.pdf> (last accessed July 10, 2017) and Medical and dental expenses, Schedule A, lines 1-5, *available at* <https://www.irs.gov/pub/irs-pdf/f1040sa.pdf> (last accessed July 10, 2017).
- 33 See Code §§ 105(b), 223(d)(2)(A). The Code defines the term “dependent.” Code § 152. For FSA and HSA purposes, a “dependent” is determined without regard to subsections (b)(1), (b)(2), and (d)(1) (B).
- 34 See Code § 105(b).
- 35 See Code § 213(a) (medical expense deduction). For HSAs, medical expenses incurred before the HSA is established do not qualify. See Code § 223(d)(2)(A). For FSAs, medical expenses incurred before or after the plan year, aside from any grace period, are ineligible for reimbursement. See Code § 125(b) (3) and seediscussion *supra* Part II.
- 36 See *supra* Part V.B.4.
- 37 See *supra* note 26 and accompanying text.