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HSAs and Their Tricky Rules

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Health Savings Account (HSA)

What is an HSA?

Tax-exempt trust or custodial account owned by the individual

What is it for?

May be used for eligible medical expenses of the individual, spouse and dependents

Are there any special requirements?

Must be covered by a high deductible health plan (HDHP) as defined by law

Potential ACA Penalties (Taxes)

WHO IS ELIGIBLE TO ESTABLISH AN HSA?

Anyone who is:

- Covered by an HDHP
- Not ***enrolled*** in Medicare
  - Watch out for retroactive enrollment due to events like the start of Social Security distributions
- Not covered under other non-HDHP insurance or health plan
- Not a tax dependent of another individual

Other health insurance or group health plans do not include separate dental plans, separate vision plans, specific disease or illness insurance, accident and disability insurance and long-term care insurance.

High Deductible Health Plan

HDHP

Self-Only Coverage

For 2022, self-only HDHP coverage must have an annual deductible of $1,400 and an out-of-pocket maximum of no more than $7,050

Family Coverage

For 2022, family HDHP coverage must have an annual deductible of $2,800 and an out-of-pocket maximum of no more than $14,100

- Don’t forget to embed ACA out-of-pocket maximum of $8,700 for individuals covered under a family plan

ACA Impact on HSAs

HSA QUALIFIED HDHP OUT-OF-POCKET MAXIMUM INTERACTION WITH THE ACA'S OUT-OF-POCKET MAXIMUM

HSA qualified HDHP out-of-pocket maximums for 2022

- Self-Only Coverage = $7,050
- Family Coverage = $14,100

ACA out-of-pocket maximums for 2022

- Self-Only Coverage = $8,700
- Family Coverage = $17,400

HHS final rule states that the annual limitation on cost-sharing for self-only coverage applies to all individuals regardless of whether the individual is **covered by a self-only plan** or is covered by a plan that is other than self-only

An individual's cost-sharing for essential health benefits may never exceed the self-only annual limitation on cost-sharing

Mandatory embedding of the ACA's out-of-pocket maximum for family HDHP

Under a Family HDHP, no single individual can incur a MOOP greater than $8,700 because of the ACA limits

High Deductible Health Plan

HDHP

Self-Only Coverage

Maximum contribution of 2022 = $3,650

“Catch-Up” Contributions

Age 55 and older
by the end of the tax year = $1,000

Family Coverage

Maximum contribution of 2022 = $7,300

Source of Contributions

Employer, or employee, or both
(or anyone else)

Special Contribution Rule

LAST “MONTH” RULE

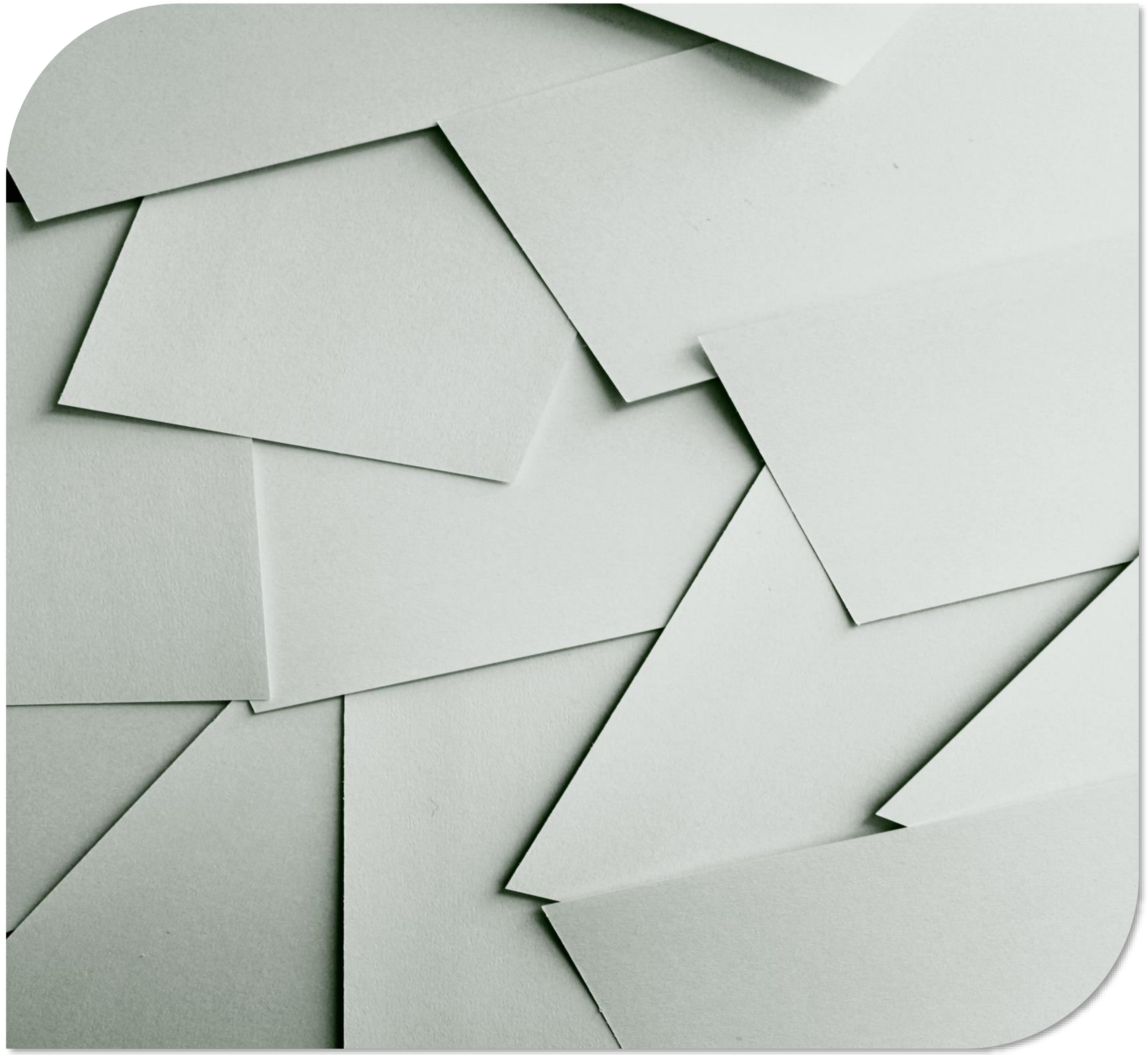
> “
>
> An individual may contribute the entire annual limit when first eligible for an HSA as long as you are eligible on the first day of the last month of the tax year (December 1 for most of us)

- This also applies when an employee switches from individual to family coverage
- If the employee is enrolled in the family tier as of December 1 of the applicable year and remains HSA eligible until December 31 of the following year, the individual is eligible to contribute up to the family maximum for the applicable year
- However, if you join mid-year and contribute the maximum amount to your HSA, you must remain eligible for at least 12 months after the last day of the last month of that tax year (December 31 for most taxpayers), or you will be subject to taxes and penalties on the amount you contributed.

Multiple HSAs in the Family

- If both spouses of a married couple are HSA eligible, and either spouse is covered by family HDHP coverage (other than self-only coverage), then both are treated as having family HDHP coverage and split the family maximum contribution between them
  - They can allocate contributions between them
  - Catch-up contributions are allocated separately to each spouse and one spouse cannot take advantage of the other spouse’s catch-up contribution

- This rule does not apply to adult dependents and domestic partners
  - They can generally contribute the full amount allowed for family coverage into their own HSA



HSA Funds

HSA funds may be invested and can grow on a “tax-qualified” basis

- Funds can roll over from year-to-year and you keep the money even if you change jobs
- Investment options often include a minimum amount

Claims are “Self-adjudicated”

- Save your receipt in case of an IRS audit

HSA funds may be used for “qualified” out-of-pocket medical expenses (generally not medical premiums)

- Code 213(d) – medical expenses incurred by the employee, spouse and/or dependents
- Dependent is a child to age 19 or age 23 who is a full-time student Note: This is different from the medial plan coverage definition of dependent

HSA Distribution Rules

TAX QUALIFIED

- If taken for qualified medical expenses
  - If non-qualified expenses, income tax and 20% penalty apply
- May only be used for expenses incurred on or after the date the HSA was established
- May use funds for expenses incurred in a prior year if the HSA was in existence on or after the date the expense was incurred

Distributions for non-qualified expenses for age 65 or older: ordinary income tax will apply but the 20% penalty does not apply.

Qualified Medical Expenses

EXAMPLES

- Most medical care that is subject to your deductible
  - Copays
  - Coinsurance
  - Doctor visits
  - Inpatient or outpatient treatment

- Prescription and OTC drugs
- Insulin (with or without a prescription)
- Dental and vision care
- Select insurance premiums:
  - COBRA
  - Qualified long-term care insurance
  - Health insurance premiums paid while receiving unemployment benefits
  - Health insurance after you turn 65 except for a Medicare supplemental policy

Non-Qualified Medical Expenses

EXAMPLES

- Insurance premiums (other than the exceptions listed on the previous slide)
- Surgery purely for cosmetic reasons
- Expenses covered by another insurance plan
- General health items such as tissues, toiletries and hand sanitizer

Interaction of Health FSAs with HSAs

HEALTH FLEXIBLE SPENDING ARRANGEMENT (HEALTH FSA)

- A general purpose health FSA will reimburse all otherwise unreimbursed, out-of-pocket 213(d) (medical) expenses (except for individual premiums)
- Because it provides for reimbursement of medical expenses before the minimum HDHP deductible has been satisfied, the health FSA is disqualifying coverage for HSA purposes
- Typically, the health FSA will provide for reimbursement for spouse and dependent medical expenses
    - This means an employee's spouse would not be eligible for an HSA even if his or her employer provides a qualifying HDHP

Interaction of Health FSAs with HSAs

DESIGNING AN HSA COMPATIBLE HEALTH FSA

Limited Purpose Health FSA

Provides reimbursement for dental and vision expenses only

Post-Deductible Health FSA

Provides reimbursement after the minimum annual deductible has been satisfied

- The health FSA could reference the HDHP deductible or could be designed to pay after the minimum statutory deductible is satisfied

Health FSA Grace Period Impact on HSAs

HEALTH FLEXIBLE SPENDING ARRANGEMENT (HEALTH FSA)

- The health FSA may a have grace period of up to 75 days following the end of the plan year
- Claims incurred during the grace period may be reimbursed from the prior plan year funds (if available)
- For a calendar-year health FSA: If the health FSA is “general purpose”, the covered individual will not be HSA-eligible until April 1 (assuming the grace period is the full 75 days) if there are any funds remaining in the FSA as determined on a cash accounting basis
  - If there’s a $0 balance on the last day of the plan year, the grace period will not impact HSA contribution eligibility
  - Because the health FSA provides coverage before the minimum HDHP deductible has been satisfied and the individual must be HSA-eligible on the first day of the month

The individual could contribute 9/12ths of the annual maximum – unless the individual follows the “last month” rule.

Health FSA Grace Period Impact on HSAs

DESIGNING AN HSA COMPLIANT GRACE PERIOD

- The plan may be amended (before the end of the plan year) to provide a mandatory limited purpose health FSA where only dental and vision care expenses incurred during the grace period will be reimbursed
  - This must apply to all health FSA participants, not only those enrolling into the HDHP

- Other options like automatic termination of health FSA participation?

Health FSA Carryover Impact on HSAs

HEALTH FLEXIBLE SPENDING ARRANGEMENT (HEALTH FSA)

The health FSA may include carryover of up to $570 (indexed for inflation) into the next plan year

- The carryover amount is applied for the entire plan year

If the health FSA is "general purpose" (will reimburse all otherwise unreimbursed out-of-pocket-medical expenses), the covered individual will not be HSA-eligible for the entire plan year

- Because the health FSA provides coverage before the minimum HDHP deductible has been satisfied

Some employers allow participants to waive their carryover to avoid this issue

The health FSA may also be amended (before the end of the plan year) to provide conversion of carryover funds into a limited purpose health FSA

- Unlike the health FSA grace period, the carryover provision can provide the participant a choice of whether to carryover into a limited purpose health FSA or a general purpose health FSA
- Also, the plan may provide that the carryover is automatically credited to a limited purpose health FSA if the individual elects the HDHP
  - The health FSA may be amended (before the end of the plan year) to permit participants to suspend or waive carryover

Interaction of HRAs with HSAs

HEALTH REIMBURSEMENT ARRANGEMENT (HRA)

A health reimbursement arrangement (HRA) provides for reimbursement of 213(d) (medical) expenses

- 100% employer dollars
- Claims are typically paid from the employer's general assets

If the HRA is "general purpose" (will reimburse all otherwise unreimbursed out-of-pocket-medical expenses), the covered individual will not be HSA-eligible for the entire plan year

- Because the health HRA provides coverage before the minimum HDHP deductible has been satisfied

Interaction between HRAs and HSAs

DESIGNING AN HSA COMPATIBLE HRA

Limited Purpose HRA

Provides reimbursement for dental and vision expenses only

Post-Deductible Health HRA

Provides reimbursement after the minimum annual deductible has been satisfied

- The HRA could reference the HDHP deductible or could be designed to pay after the minimum statutory deductible is satisfied

Retirement HRA

Provides reimbursement after the individual has retired and is no longer contributing to an HSA

Other Coverage Issues

Telemedicine

If an individual can receive significant medical benefits with no-cost, the availability of telemedicine “visits” will disqualify the individual from contributing to an HSA

- The telemedicine coverage provides/pays for services received before the minimum HDHP deductible has been met

On-site Medical Clinics

If an individual can receive medical benefits with no-cost the on-site medical clinic office availability will disqualify the individual from contributing to an HSA

EAPs

Similar to telemedicine, if an individual can receive significant medical benefits with no-cost, the availability of the EAP will disqualify the individual from contributing to an HSA

Interaction of HSAs with Cafeteria Plans

EMPLOYEE HSA CONTRIBUTIONS

May be made pre-tax through the employer's cafeteria plan

- This must be listed as an available benefit (pre-tax HSA contributions) in the cafeteria plan documents

If employee contributions are made through operation of the cafeteria plan, employer contributions are considered to be through operation of the cafeteria plan

- This avoids the HSA comparable contribution rules (next slide)

Employees must be allowed to change their elections on a monthly basis without a corresponding change in status

- This must be listed as a status change in the cafeteria plan documents

Interaction of HSAs with Cafeteria Plans

COMPARABLE CONTRIBUTION RULE

- Comparable contribution rules require employer contributions to be the same for comparable participating employees (based on HDHP coverage tier)
- Employer contribution for next-higher tier must be at least equal to employer contribution for lower tier

Example: Employer contributes $500 to all participants with single-only coverage and $1,000 to all participants with other than single-only coverage

- May differentiate based on the following classifications only:
  - Current active employees vs. former employees
  - Non-union employees vs. employees in collective bargaining unit
  - Full-time vs. part-time employees
- This prevents the employer from making matching contributions based on the employee's elections
- As previously noted, allowing employees to make their contributions through operation of the cafeteria plan will avoid the comparable contribution rules

Mid-Year Change from Family to Single HDHP

WHAT IS THE MAXIMUM ANNUAL CONTRIBUTION?

Family coverage from January – September

and then changed to single the calculation is (2022 amounts):*

9/12 x $7,300 = $5,475
(rounded to nearest dollar)

3/12 x $3,650 = $912.50
(rounded to nearest dollar)

Maximum Contribution Limit
$5,475 + $912.50 = $6,387.50

*Don't forget the full contribution rule for changes from single coverage to family coverage

HSA Corrections

MISTAKES HAPPEN

What happens when ineligible contributions are made to an HSA?

- It appears the IRS differentiates between those that were never eligible and those that lose eligibility

For those that were never eligible:

- No deductions for individual contributions
- No tax exclusions for employer contributions
- Corrections required for income reporting and tax withholding
- Employer contributions can be recovered

For those that lose eligibility:

- Curative distribution can be used if excess contribution and net income attributable to an excess contribution are distributed before the account holder's federal income tax return filing deadline
  - One issue: Employers generally must rely on employees to refund an employer's excess contribution because the contributions are nonforfeitable

HSA Corrections

MISTAKES HAPPEN

What about contributions in excess of the statutory maximum or contributions made due to an administrative error?

- Curative distribution can be used if excess contribution and net income attributable to an excess contribution are distributed before the account holder's federal income tax return filing deadline

- If the employer made the excess contribution or a contribution as a result of an administrative error, the employer may seek to recoup the erroneous contributions

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