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in conjunction with United Benefit Advisors

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**Health Savings Accounts:
Employer Rights and Responsibilities**

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Agenda

- ▶ HSAs 101
- ▶ Survey Data on HSAs and HRAs
- ▶ Tax Code Constraints and Requirements
- ▶ Comparison to Other CDHPs
- ▶ Simplifying HSA Administration



What is an HSA?

- ▶ “Health Savings Accounts” were created by the Medicare Modernization Act of 2003, effective as of January 1, 2004
- ▶ Something of a cross between a flexible spending account (“FSA”) and an individual retirement account (“IRA”):
 - Designed for the payment of medical expenses, **but**
 - “Owned” by the employee, who exercises sole control over the use of the HSA’s assets and may take the HSA to another employer

HSA Tax Advantages

- ▶ **Contributions** to an HSA are pre-tax (up to specified dollar amount per year)
- ▶ **Earnings** within the HSA are tax-free
- ▶ **Withdrawals** are tax-free if made to reimburse medical expenses



Key Tax Rules

- ▶ To be HSA-eligible, an employee must
 - Be covered under a “high-deductible health plan” (“HDHP”), **and**
 - Not have any “disqualifying coverage”
- ▶ 2012 limits on annual HSA contributions:
 - \$3,100 single
 - \$6,250 family
 - \$1,000 catch-up (if 55 or older)
- ▶ Employer contributions must be “comparable” for all employees (unless made through a cafeteria plan)



ERISA Treatment of HSAs

- ▶ HSAs are generally exempt from ERISA's requirements – even if an employer makes contributions (DOL Field Assistance Bulletins 2004-1, 2006-2)
- ▶ This goes beyond ERISA's exemption for IRAs, which does not apply if an employer contributes
- ▶ However, the **Tax Code's** “prohibited transaction rules” still apply to HSAs, meaning that employee contributions must be promptly deposited into the HSA's custodial account

HSA Versus an HRA

- ▶ “Health Reimbursement Accounts” (“HRAs”) are simply a variation on a standard self-funded employer health plan
- ▶ Subject to the same tax rules as any employer-sponsored indemnity medical plan (rules outlined in IRS Revenue Ruling 2002-41 and Notice 2002-45)
- ▶ Need not be either funded or portable (and generally are not)

HSA Versus an FSA

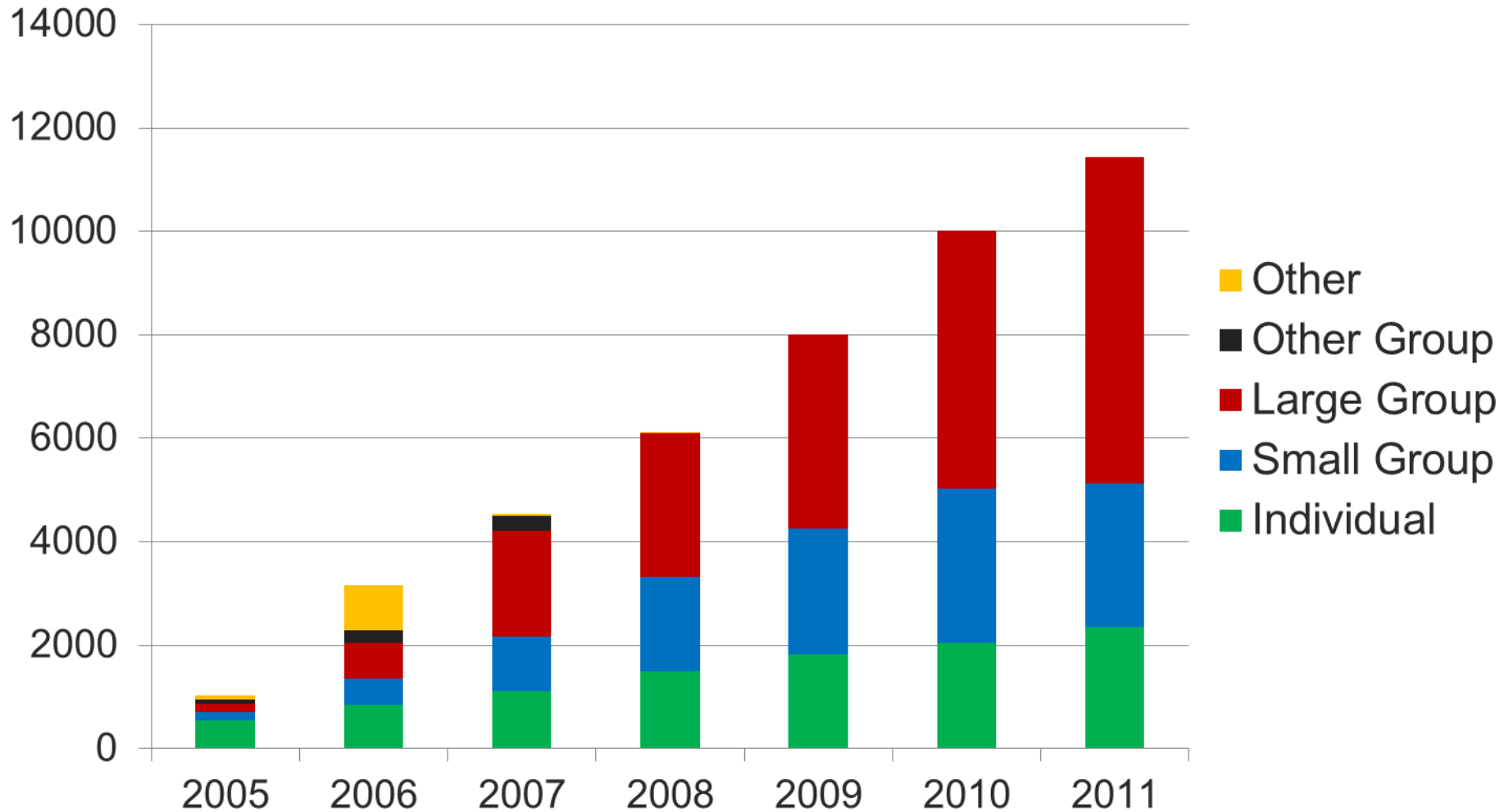
- ▶ “Flexible Spending Accounts” (“FSAs”) are a special type of employer health plan, almost always associated with a Section 125 cafeteria plan
- ▶ May accept either employer or (pre-tax) employee contributions
- ▶ Subject to both “uniform coverage” and “use-it-or-lose-it” rules (unlike HSAs)

HSA Versus an Archer MSA

- ▶ “Archer Medical Savings Accounts” (“MSAs”) predate HSAs
 - Limited to small employers (<50 employees) and self-employed individuals
 - May no longer establish an MSA (unless employed by an employer that had one as of 12-31-07)
 - Tax rules are similar – though not identical – to those that apply to HSAs

Growth of HSAs (in 000's)

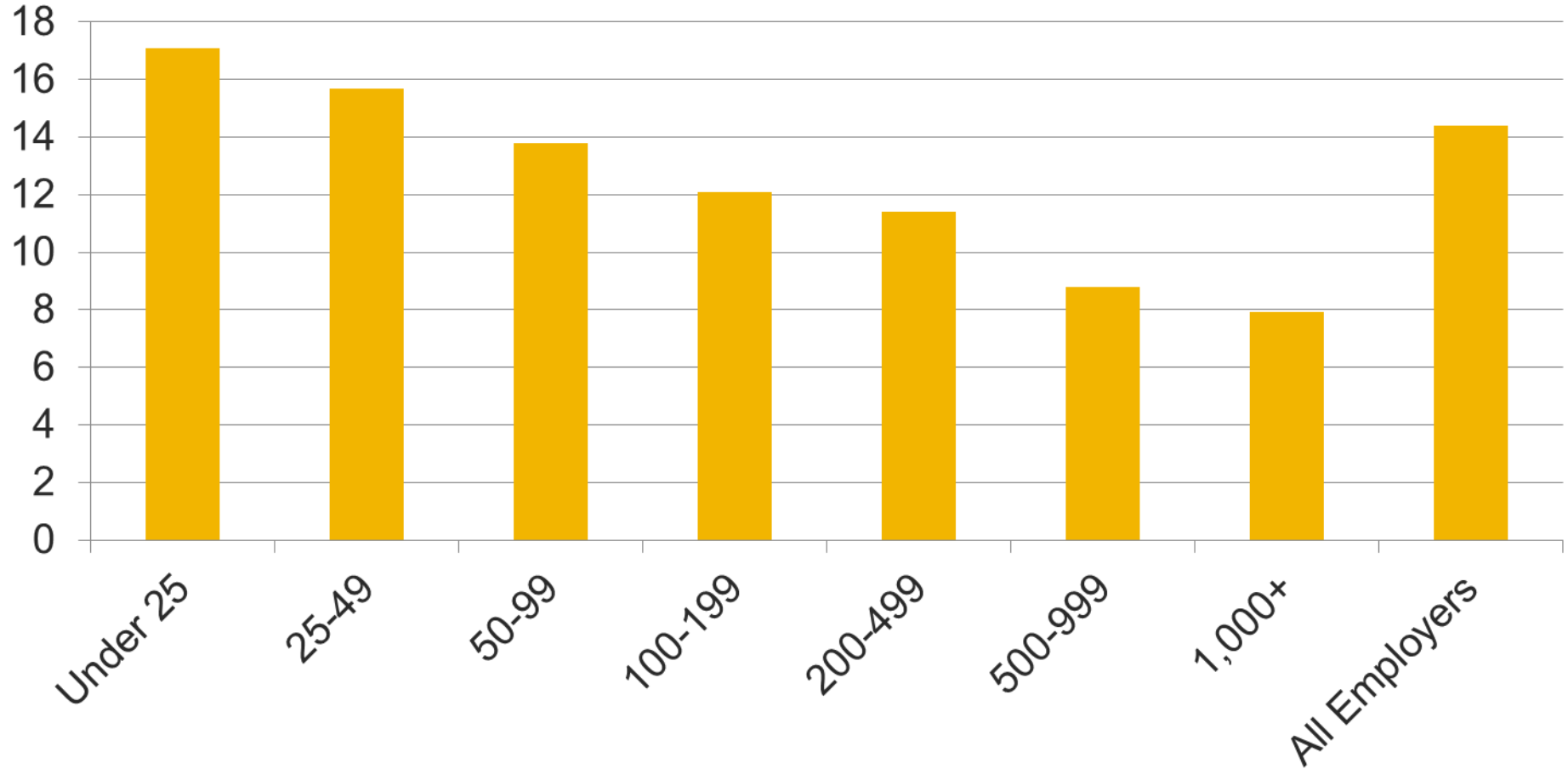
(Per AHIP Center for Policy and Research, 2005-2011 HSA/HDHP Census Reports)



% of Employers Offering HSAs

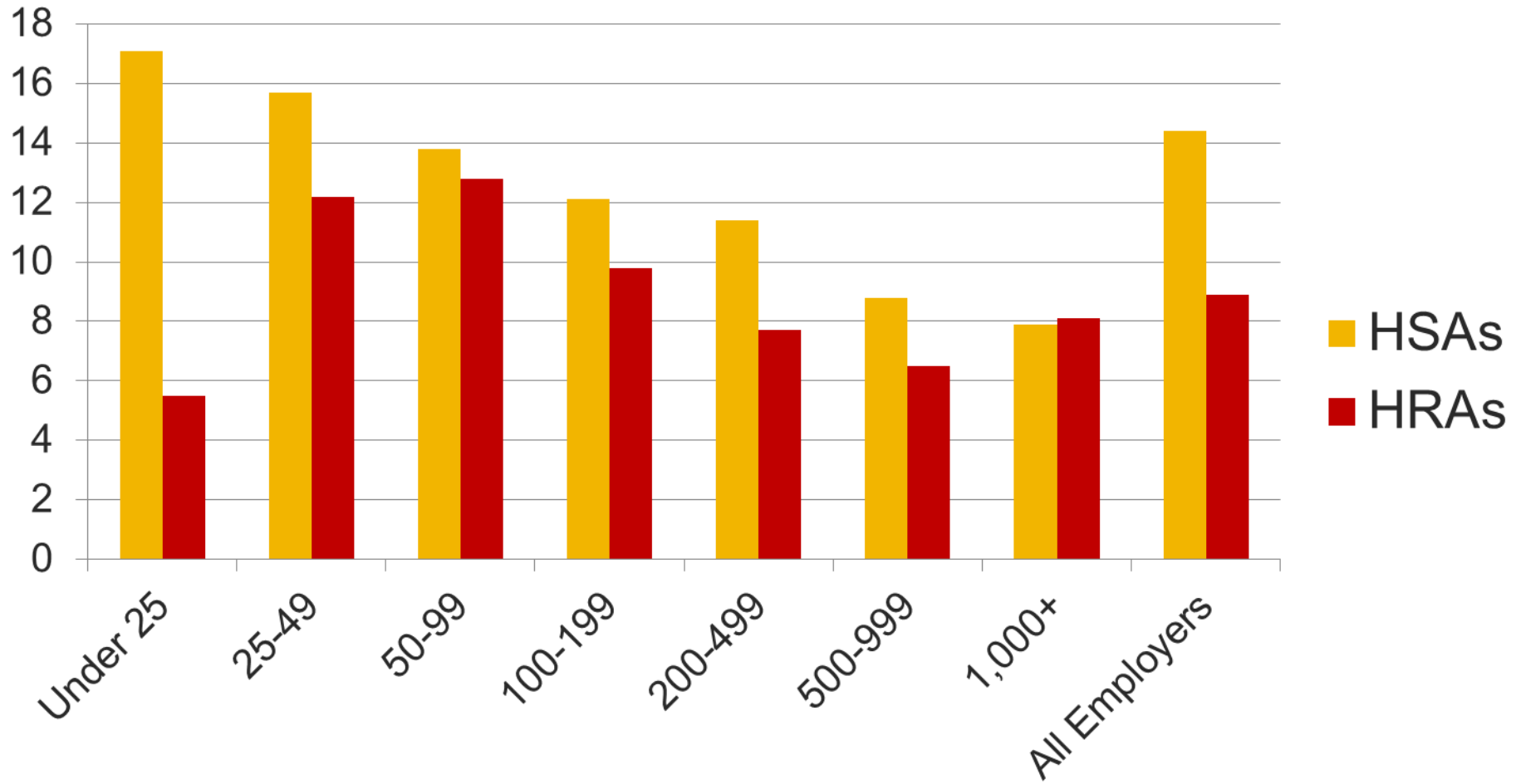
(Per 2011 United Benefit Advisors Health Plan Survey)

By Number of Employees



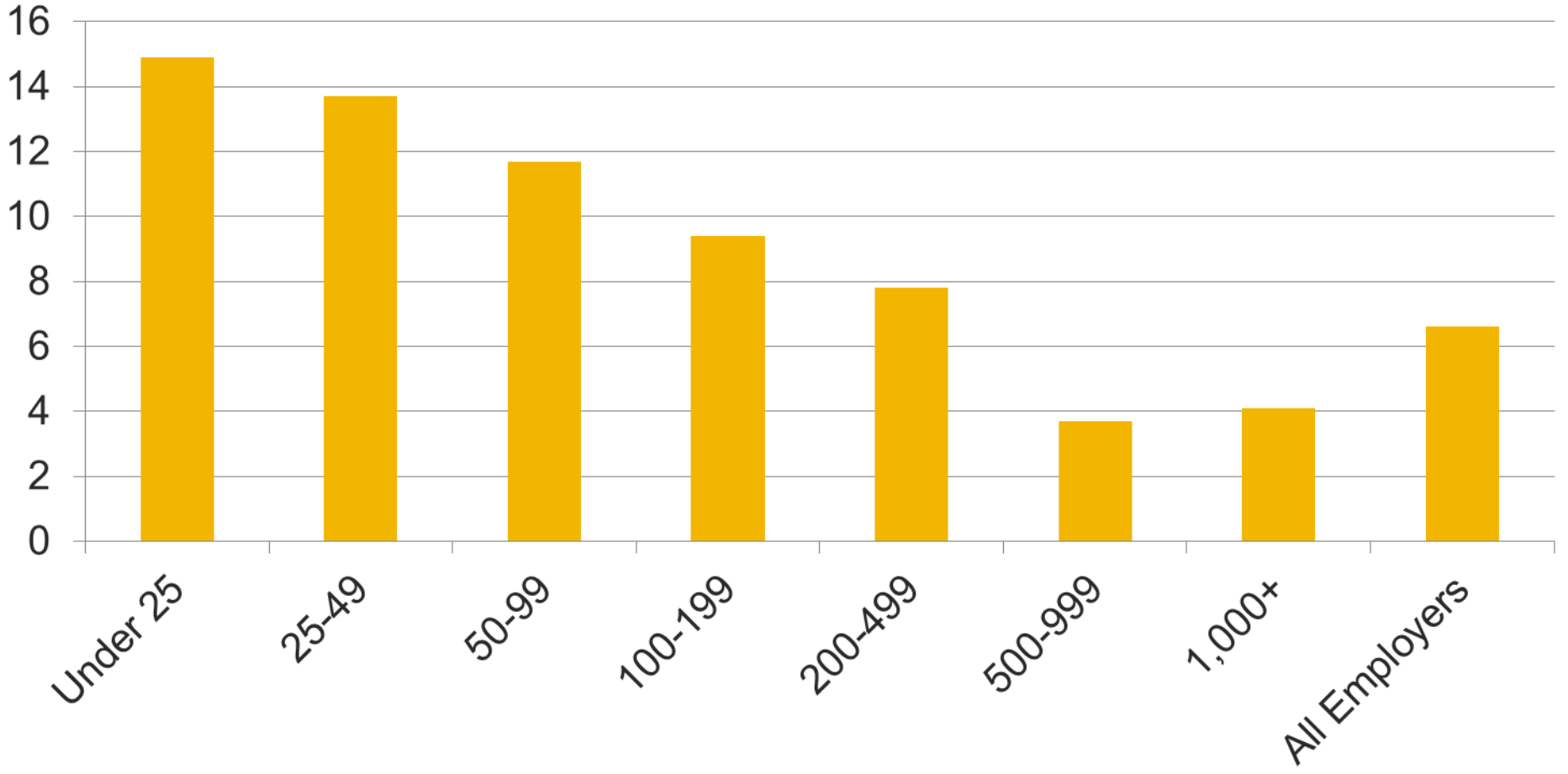
% of Employers Offering . . .

(By Number of Employees)



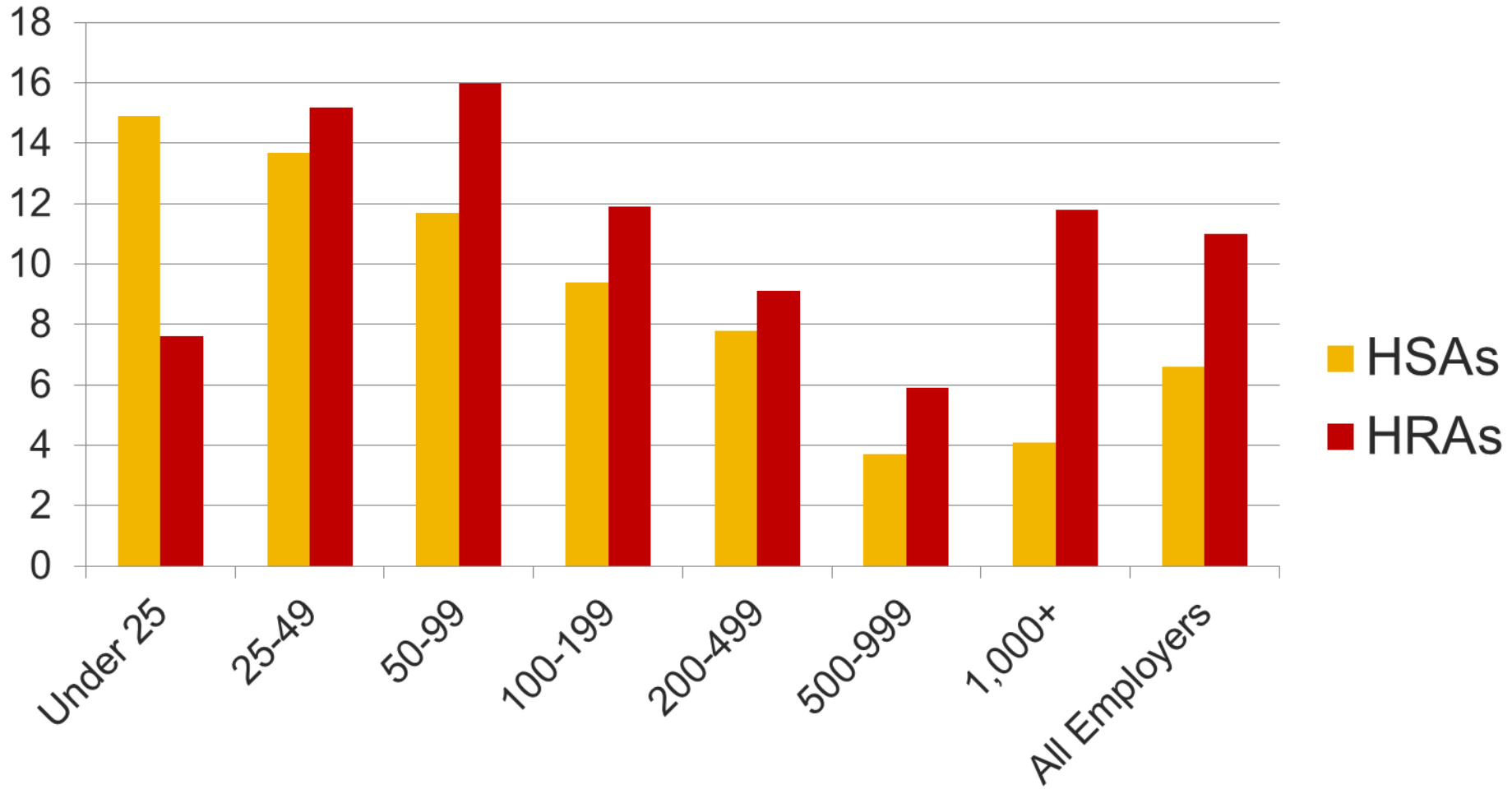
% of Employees Enrolled in HSA

By Number of Employees



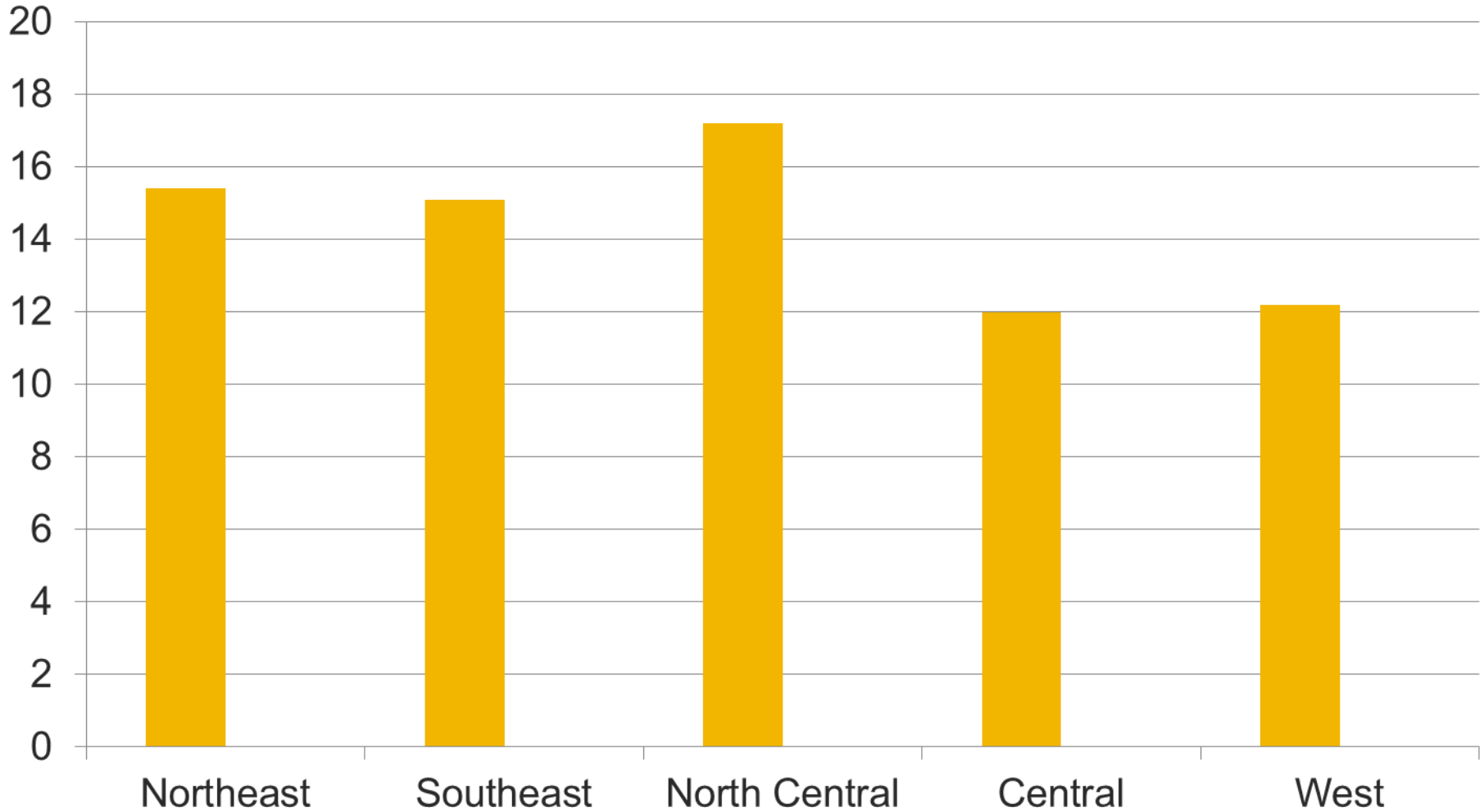
% of Employees Enrolled . . .

(By Number of Employees)



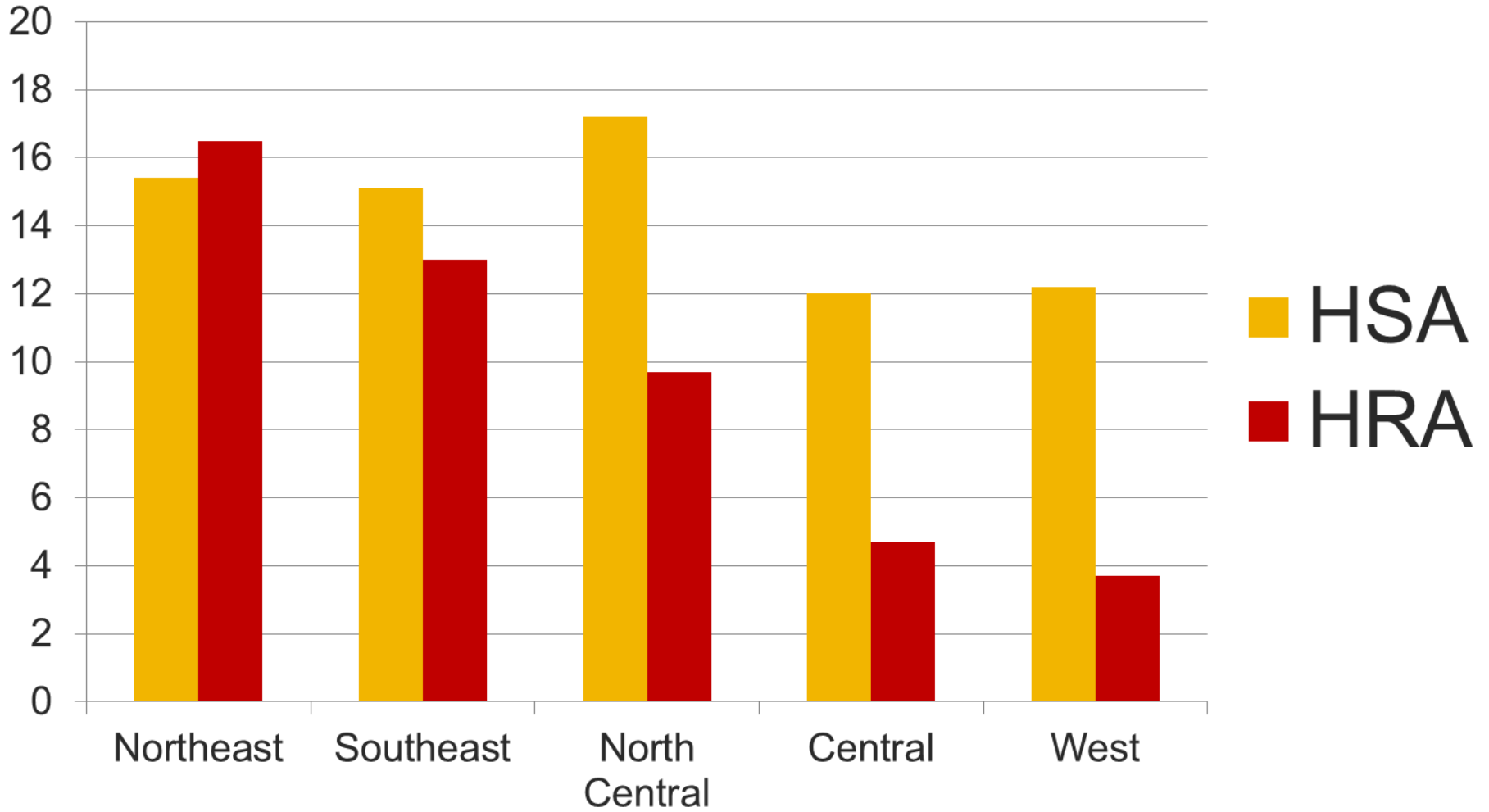
% of Employers Offering HSAs

(By Geographic Region)



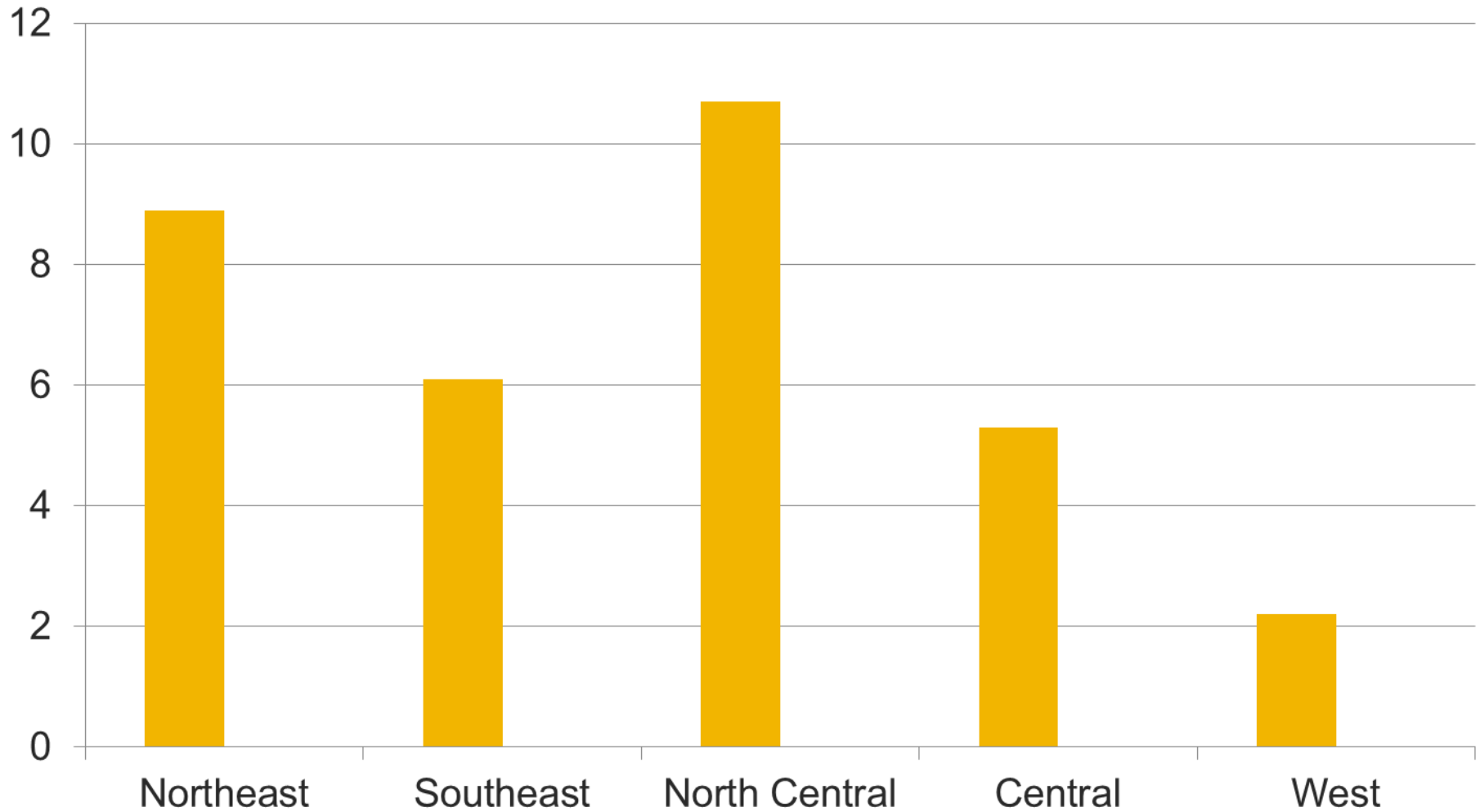
% of Employers Offering . . .

(By Geographic Region)



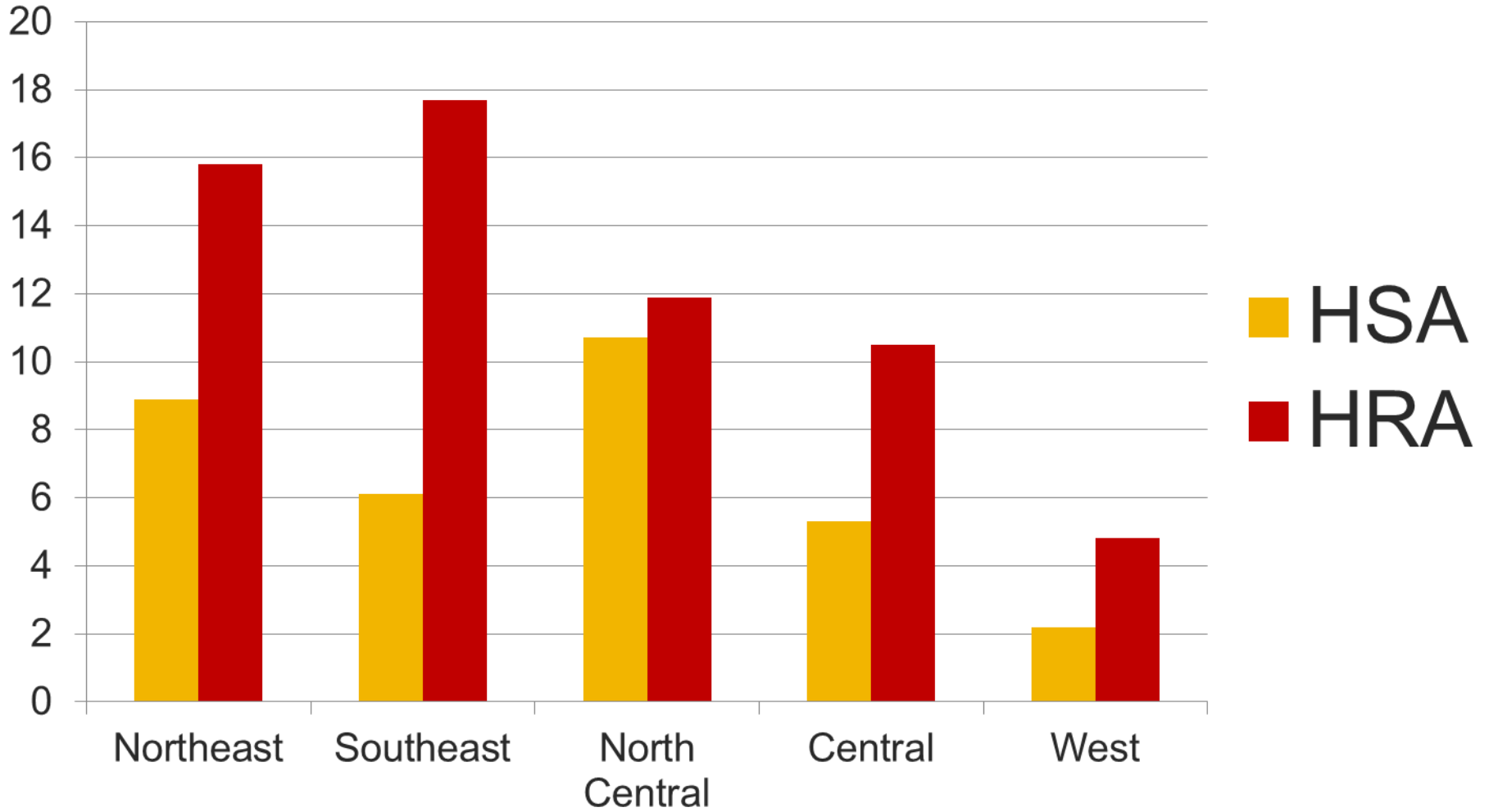
% of Employees Enrolled in HSAs

(By Geographic Region)

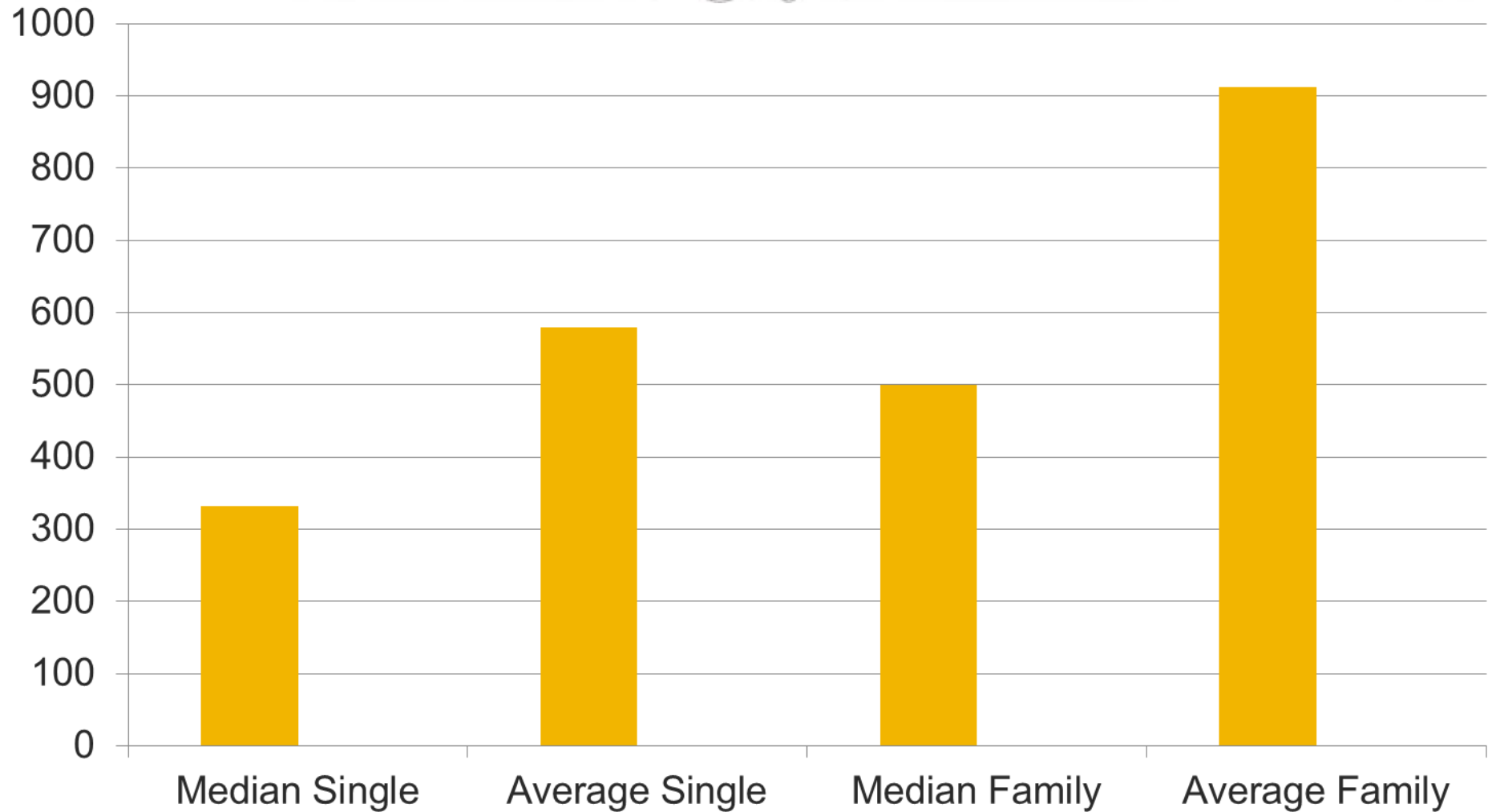


% of Employees Enrolled . . .

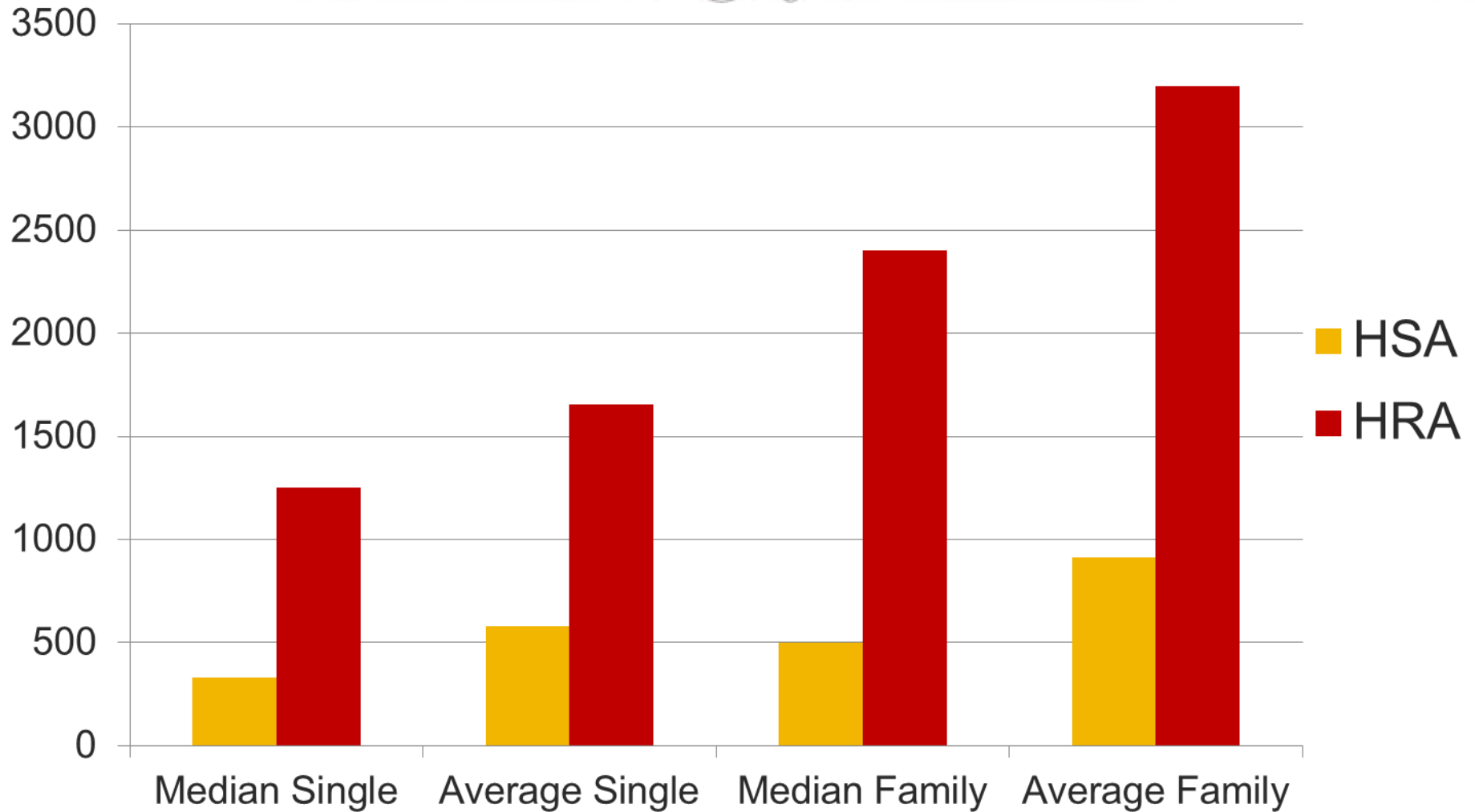
(By Geographic Region)



Annual Employer Contributions to HSAs

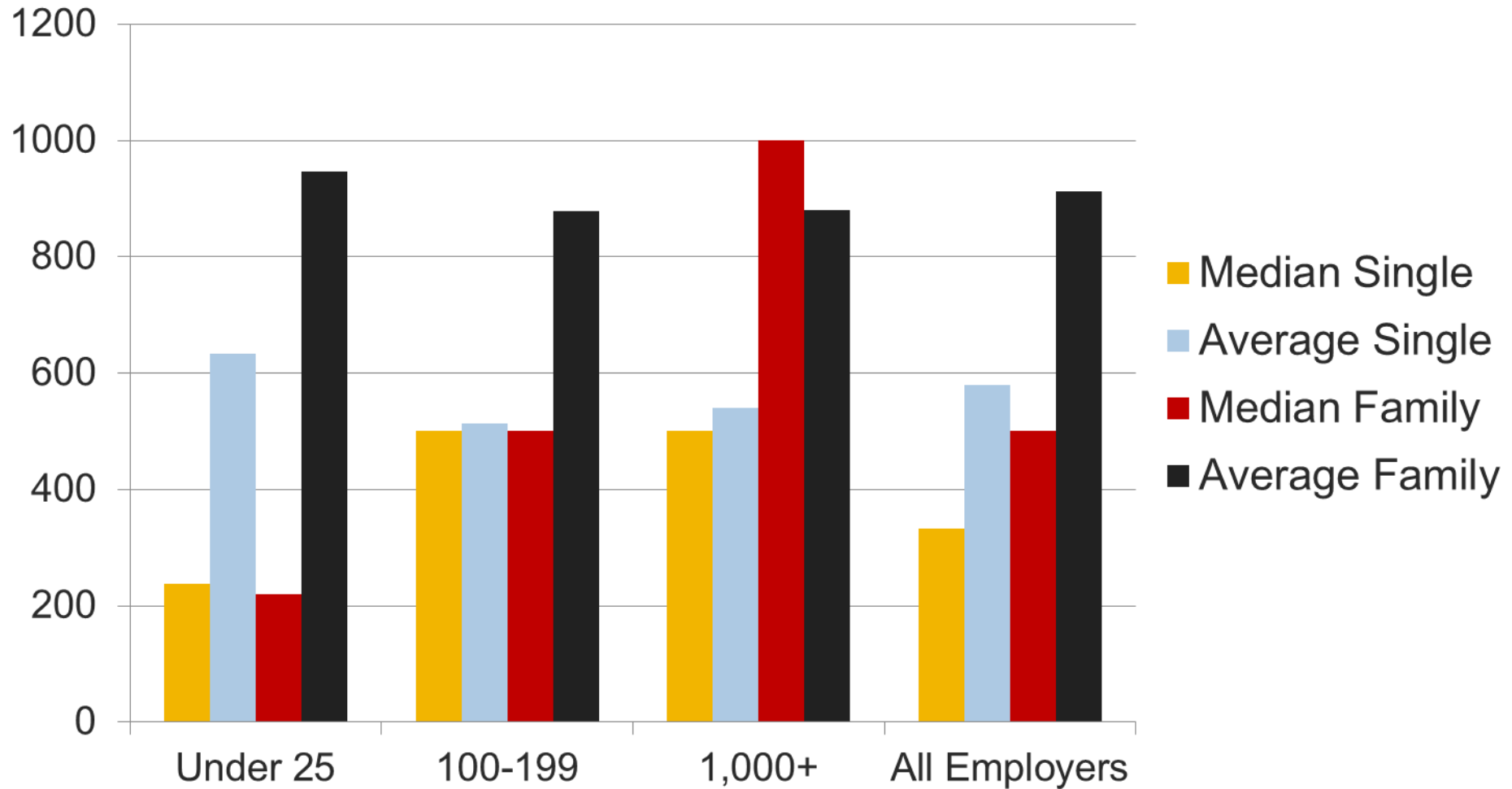


Annual Employer Contributions



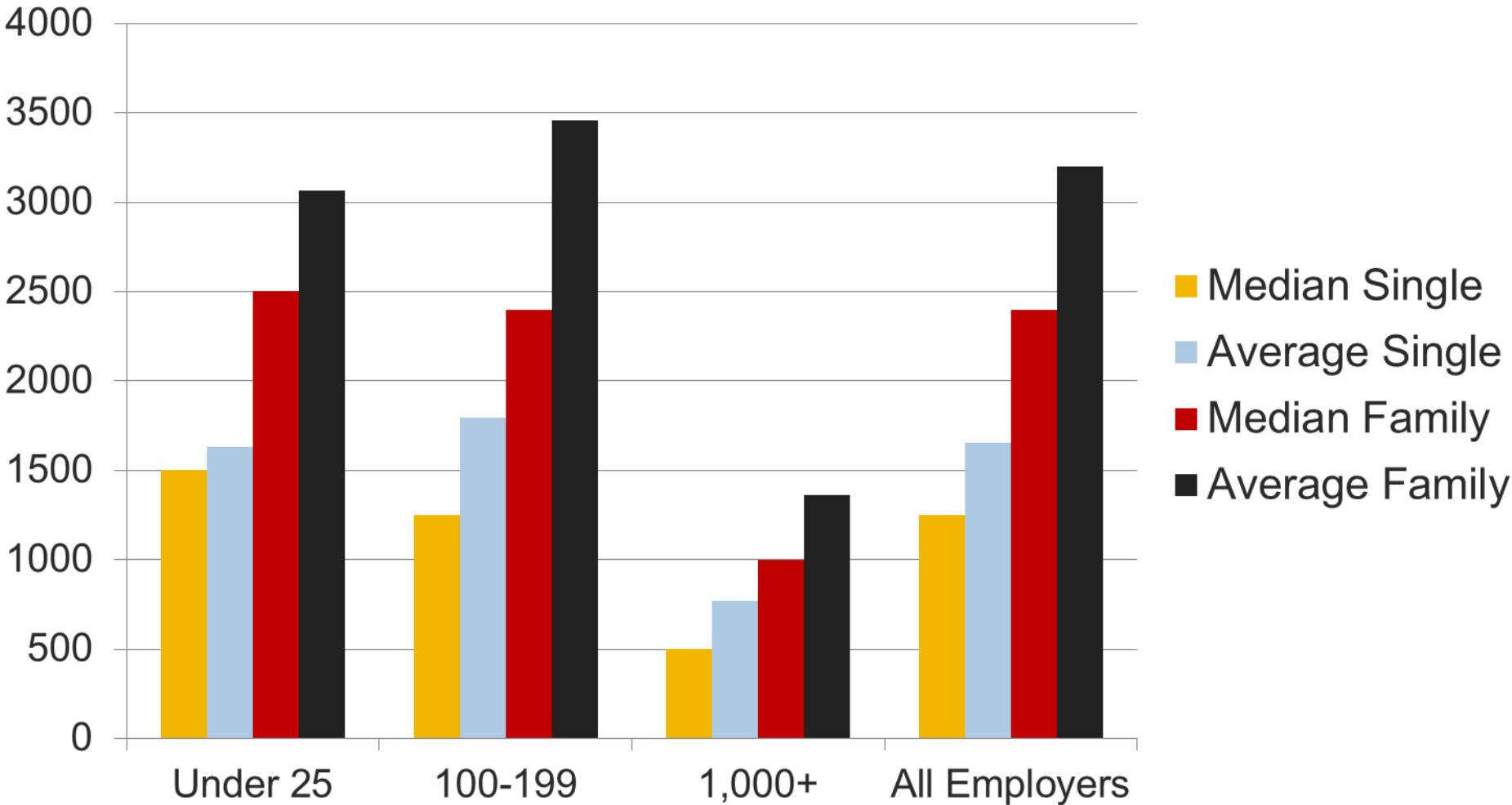
Employer HSA Contributions

(By Number of Employees)



Employer HRA Contributions

(By Number of Employees)



HSA Eligibility

- ▶ Any individual with qualifying HDHP coverage, so long as he or she has no other disqualifying health coverage
- ▶ Need not be an employee (so includes partners, 2% S corporation shareholders, and sole proprietors)
- ▶ Two groups of individuals who are ineligible for HSA contributions:
 - Those who can be claimed as tax dependents
 - Those who are entitled to Medicare



Who is a Tax Dependent?

- ▶ The taxpayer's child and under age 19 at the end of the tax year;
- ▶ The taxpayer's child, a student, and under age 24 at the end of the tax year; or
- ▶ A member of the taxpayer's household for whom the taxpayer provided over half of the support for the year and whose gross income does not exceed the personal exemption amount



Employer Verification Requirements

- ▶ Employers that contribute to an employee's HSA are responsible for determining only:
 - Whether the employee is covered under an HDHP or any low-deductible health plan (including health FSAs and HRAs) sponsored by that employer, and
 - The employee's age (for catch-up contributions)



Eligibility Determined Monthly

- ▶ Contributions may be made only for months in which the individual meets all the eligibility requirements, including having HDHP coverage as of the *first* day of the month
- ▶ “Full-contribution rule” (discussed later) applies to individuals who are eligible on December 1, allowing them to make a full year’s worth of contributions

Contributions Made While Ineligible – Consequences

- ▶ Contributions are not deductible from gross income;
- ▶ Contributions made by the individual's employer are not excludable from the individual's gross income; and
- ▶ *All* contributions to the HSA with respect to the period of ineligibility (and earnings thereon) are excess contributions, subject to a 6% excise tax



Required HDHP Coverage

- ▶ High Deductible Health Plan (“HDHP”) is a health plan that
 - Meets the statutory requirements for annual deductibles and out-of-pocket expenses, and
 - Provides “significant benefits”
- ▶ HDHP may be either self-funded or fully insured
- ▶ HDHP **may** make available discounted prices before the plan’s deductible is satisfied

Self-Only HDHP Coverage

- ▶ Coverage for only one individual who is HSA eligible
- ▶ Annual deductible of at least \$1,200 for 2011 (unchanged for 2012)
- ▶ Sum of the plan's annual deductible and other out-of-pocket expenses (other than premiums) may not exceed \$5,950 for 2011 (\$6,050 for 2012)



Family HDHP Coverage



- ▶ Any coverage other than self-only coverage
 - May include coverage of a non-tax dependent domestic partner
- ▶ Annual deductible of at least \$2,400 for 2011 (unchanged for 2012)
- ▶ Sum of the plan's annual deductible and other out-of-pocket expenses (other than premiums) may not exceed \$11,900 for 2011 (\$12,100 for 2012)

“Disqualifying Coverage”

- ▶ Any health plan that provides coverage below the statutory minimum HDHP deductible. This includes, e.g.:

- Participation in an HRA or health FSA – **unless** the HRA or FSA
 - Reimburses only dental and vision expenses, or
 - Covers only post-deductible medical expenses
- On-site wellness clinic (unless employees are charged for each visit)



Permitted Non-HDHP Coverage

- ▶ Preventive care;
- ▶ “Permitted insurance”;
- ▶ “Permitted coverage”; or
- ▶ Coverage with a deductible that equals or exceeds the statutory minimum annual HDHP deductible



Example

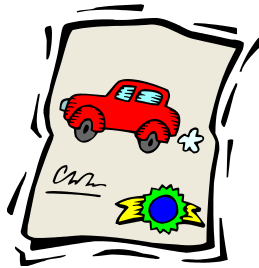


Marilyn has self-only HDHP coverage with a deductible of \$1,200. Additionally, she has self-only health plan coverage with a \$1,500 deductible.

Marilyn is an HSA-eligible individual despite her non-HDHP coverage, because this non-HDHP coverage has a deductible (i.e., \$1,500) that is equal to or greater than the statutory minimum annual deductible for self-only HDHP coverage for 2011 (i.e., \$1,200).

“Permitted Insurance”

- ▶ Insurance in which substantially all of the coverage relates to:



- Liabilities incurred under workers' compensation laws;
 - Tort liabilities;
 - Liabilities relating to ownership or use of property (e.g., homeowners or auto insurance); or
 - Similar liabilities
- ▶ Insurance for a specified disease or illness (e.g., cancer insurance); and
 - ▶ Insurance that pays a fixed amount per day (or other period) of hospitalization (e.g., hospital indemnity insurance)

“Permitted Coverage”

▶ Includes coverage for:

- Accidents,
- Disability,
- Dental care,
- Vision care, or
- Long-term care



▶ For example, an automobile personal injury protection policy should be permissible even if some medical expenses are covered

Limited-Purpose FSAs and HRAs

- ▶ Permissible to maintain an HRA or health FSA that pays or reimburses only permitted coverage, permitted insurance, or preventive care – without regard to the HDHP deductible
 - For example, an HRA that covers vision, dental, and preventive care expenses on a first-dollar basis
- ▶ Cannot reimburse OTC drugs, except in limited cases where such coverage qualifies as permitted coverage



Example

For the 2011 plan year, Bill elects self-only HDHP coverage under his employer's major medical plan and is otherwise HSA eligible. He is also covered under his employer's limited-purpose health FSA, which reimburses only vision and non-cosmetic dental expenses. Is Bill still HSA eligible?

Yes. Because the health FSA is a limited-purpose health FSA, his FSA coverage will not interfere with his HSA eligibility.

HSA Contribution Limits

Maximum HSA Contribution	2011	2012
Individual	\$3,050	\$3,100
Family	\$6,150	\$6,250

Maximum Catch-up Contribution*	2011	2012
Individual/Family	\$1,000	\$1,000

*For HSA-eligible individuals who will attain age 55 by the end of the taxable year

Contributions

- ▶ All HSA contributions (other than rollover contributions) must be made in cash
- ▶ All regular HSA contributions made by or on behalf of an eligible individual are aggregated for purposes of applying the annual contribution limit
- ▶ The same annual contribution limit applies regardless of who makes the contribution



Contribution Limits Calculated on Monthly Basis

- ▶ Contributions may not exceed the sum of the “monthly limitations” for all months within the individual’s taxable year in which he or she actually is – or, under the full-contribution rule, is treated as – an eligible individual
- ▶ An individual who ceases to be an eligible individual during a year may still contribute to his or her HSA for the months he or she was an eligible individual
- ▶ Contributions must be made by the date for filing federal income tax return (without extensions)



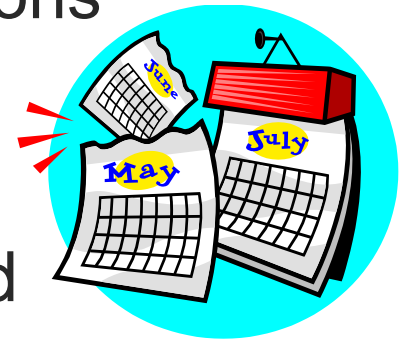
Example

Sharon, age 40, has self-only HDHP coverage and is an HSA-eligible individual for the first four months of 2011. (The statutory maximum HSA contribution for an individual with self-only HDHP coverage for 2011 is \$3,050.)

Sharon has until April 16, 2012 (the due date for filing her 2011 federal income tax return, without extensions) to contribute up to \$1,016.67 ($4/12 \times \$3,050$) to her HSA.

Full-Contribution Rule

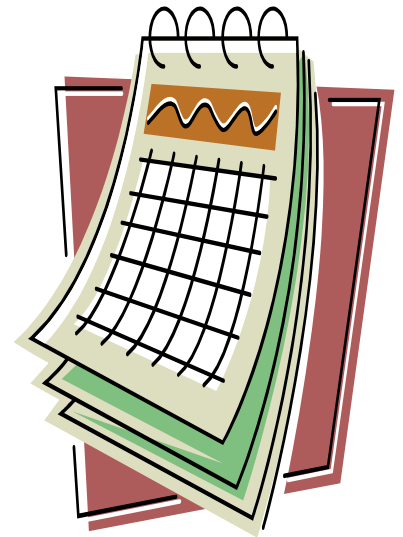
- ▶ Allows a full year's worth of HSA contributions for someone who is HSA eligible for only a portion of the year
- ▶ Applies to individual who becomes covered under an HDHP in a month other than January and who is an HSA-eligible individual on December 1st of the year
- ▶ Must remain HSA eligible during a 13-month "testing period" to avoid adverse tax consequences (i.e., through December 31 of the following year)



Example

Larry, age 43, enrolls in family HDHP coverage on December 1, 2011, and is otherwise HSA-eligible on that date. He is not HSA-eligible in any other month of 2011.

Larry's contribution limit is \$6,150, but he must remain HSA-eligible through December 31, 2012, to avoid adverse tax consequences.



13-Month Testing Period

- ▶ Relevant in the following three circumstances:
 - Full-Contribution Rule (described above)
 - Qualified HSA Distributions (described below)
 - Qualified HSA Funding Distributions (described below)
- ▶ Must remain HSA eligible (unless due to death or disability) during the entire 13-month testing period
- ▶ May change HDHP coverage level (i.e., from self-only to family, or vice versa)

13-Month Testing Period

- ▶ Tax consequences of losing HSA-eligibility during testing period:
 - Additional contributions made under full-contribution rule (i.e., amount contributed under full-contribution rule minus amount that **could** have been contributed under general monthly contribution rule) will be includible in individual's gross income; and
 - 10% additional tax applies to includible amount



Special Rule for Married Individuals

- ▶ If **either** spouse has family coverage, then **both** spouses are treated as having that family coverage
- ▶ HSA contribution limit calculated under this “Special Rule” is a joint limit, to be divided equally between the married couple, if both are HSA eligible (unless they agree on a different division)
- ▶ Applies even if one spouse has family HDHP coverage and the other has self-only HDHP coverage



Example

In 2011, Kevin (age 56) and Brenda (age 53) are married and both have family coverage under separate HDHPs. They will be able to contribute up to the annual statutory maximum (\$6,150 for 2011). They have not made any special agreement as to the division of their combined HSA limit.

Consequently, Kevin may contribute \$4,075 to his HSA (half of the \$6,150 statutory maximum plus an additional \$1,000 catch-up contribution) and Brenda may contribute \$3,075 to her HSA.

HSA Limit When Only One Spouse Is HSA-Eligible

- ▶ An otherwise HSA-eligible individual whose spouse has family non-HDHP coverage is not disqualified from contributing to an HSA so long as the otherwise eligible individual is not covered by the spouse's family non-HDHP coverage; and
- ▶ An individual with no coverage cannot establish or contribute to an HSA simply because the individual's spouse has family HDHP coverage if that coverage does not cover the individual

Example 1

In 2011, Deborah and Ray are married and have two children. Deborah has family HDHP coverage with a \$5,000 deductible that covers Deborah and one of the children. Deborah, age 35, otherwise meets the requirements for being an eligible individual for HSA purposes.

Ray has family non-HDHP coverage that covers Ray and the other child. Deborah may contribute up to \$6,150 to her HSA. Ray is not eligible to make an HSA contribution.

Example 2

In 2011, Doug and Carrie, each age 40, are married and have two children. Doug has family HDHP coverage with a \$4,000 deductible that covers Doug and both children, and he is otherwise HSA-eligible. Carrie is not covered under Doug's family HDHP coverage and has no other health coverage.

Doug may contribute up to \$6,150 to his HSA. Carrie is not eligible to make an HSA contribution.

Employer HSA Contributions

- ▶ Excludable from employees' gross income
- ▶ Not subject to FICA or FUTA withholding
- ▶ Contributions made outside cafeteria plan are subject to 35% excise tax, unless contributions satisfy "comparability" rules
- ▶ Contributions made between January 1 and the date for filing the employee's federal income tax return (without extensions) may be allocated to the prior taxable year



Contributions Must Be Non-Forfeitable

- ▶ Cannot be subject to a vesting schedule, and no portion may be returned to the employer if the employee terminates employment mid-year
- ▶ Regardless of whether contributions were made by the individual, his or her employer, or any other person
- ▶ Limited exception for contributions made on behalf of employee who was **never** HSA eligible (but not after eligibility ended)



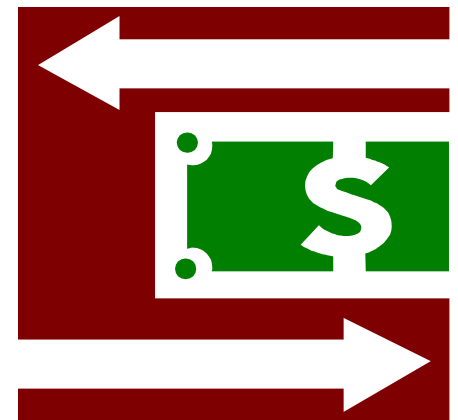
Excess Contributions

- ▶ Contributions are not deductible to the extent they
 - Exceed an individual's maximum contribution limit, or
 - Are made by or on behalf of an individual who is not HSA-eligible
- ▶ Excise tax of 6% is imposed on the HSA holder for all excess contributions (whether contributed by the account holder, the employer, or someone else)



Permitted Rollovers / Transfers

- ▶ Rollovers and transfers from other HSAs and Archer MSAs;
- ▶ Rollovers of “qualified HSA distributions” from health FSAs and HRAs; and
- ▶ Transfers of “qualified HSA funding distributions” from IRAs and Roth IRAs



Rollovers and Transfers from HSAs and Archer MSAs

▶ Rollovers

- Within 60 days after the distribution is received
- Only once every 12 months

▶ Trustee-to-Trustee Transfers

- Unlimited in number

▶ Rollovers and Transfers

- Not subject to the annual contribution limitations
- Need not be in cash (e.g., mutual fund shares)



Qualified HSA Distributions from Health FSAs and HRAs

- ▶ Permissible only from December 20, 2006, to ***December 31, 2011***
- ▶ Only one qualified HSA distribution allowed per HRA or health FSA
- ▶ Limited to the lesser of the balance in the FSA or HRA on September 21, 2006, or the balance as of the date of the distribution
- ▶ Does not count against either the general HSA contribution limit or the catch-up contribution limit for the year for which the contribution is made

Qualified HSA Funding Distributions from IRAs

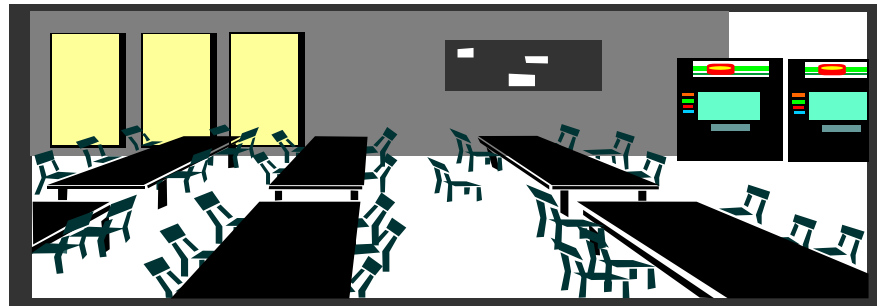
- ▶ HSA-eligible individual may irrevocably elect to make a once-in-a-lifetime, tax-free, direct trustee-to-trustee transfer of a qualified HSA funding distribution from his or her traditional or Roth IRA into his or her HSA
- ▶ **Does** count against the general HSA contribution limit and any catch-up contribution limit for the year in which they are contributed to the HSA

Comparability Rules

- ▶ An employer that contributes to its employees' HSAs outside of a cafeteria plan will be subject to an excise tax equal to 35% of all of its contributions for a calendar year **unless** it makes “comparable” contributions for all comparable participating employees for each coverage period during that year
- ▶ To be comparable, the contributions must be either the same dollar amount or the same percentage of the HDHP deductible

Avoiding the 35% Excise Tax

- ▶ Two easy ways to avoid the 35% excise tax:
 - Make employer HSA contributions through a Code § 125 cafeteria plan; **or**



- Make the same employer HSA contributions, outside of a cafeteria plan, for all HSA-eligible employees

Distributions

- ▶ The Tax Code provisions governing HSAs contain no restrictions on when HSA distributions may be obtained
- ▶ The account holder is entitled to distributions for any purpose
- ▶ Only the account holder may determine how HSA distributions will be used



Distributions

- ▶ Distributions are generally excluded from gross income to the extent they offset unreimbursed medical expenses of the HSA account holder, or his or her spouse or tax dependents
- ▶ Balances are non-forfeitable and automatically carry forward from year to year for future medical expenses



Qualified Medical Expenses

- ▶ Generally, do not include payments of health insurance premiums or contributions for self-funded health coverage, except as follows:
 - Continuation coverage under federal law (e.g., COBRA or USERRA);
 - Qualified long-term care insurance;
 - Health coverage while the individual (i.e., the HSA holder, spouse, or dependent) is receiving unemployment compensation; or
 - Any deductible health insurance (e.g., retiree medical coverage) other than a Medicare supplemental policy for HSA holders age 65 or over (whether or not they are entitled to Medicare)

PPACA and Distributions

- ▶ Effective January 1, 2011, HSAs can no longer be used to buy medicine or drugs (other than insulin) without a doctor's prescription
- ▶ The new restrictions do not apply to other over-the-counter items, such as equipment, supplies, and medical devices, including items such as crutches, bandages, blood-sugar test kits, and eyeglasses



Timing of Distributions

- ▶ No time limit on when they must occur
- ▶ May relate back to eligible expenses incurred many years before
- If being taken on a tax-free basis, however, the HSA holder must keep records sufficient to prove that the expense was:
 - a qualified medical expense;
 - not previously paid or reimbursed by another source; and
 - not taken as an itemized income tax deduction in any prior taxable year



Example

Valerie, an HSA account holder, contributes \$5,000 per year to her HSA from 2006 until 2015. As of January 1, 2016, this \$50,000 in deposits has resulted (with investment earnings) in an account balance of \$65,000. Valerie has also incurred or paid \$4,000 in qualified medical expenses each year (for a total of \$40,000) and has adequate documentation substantiating those expenses, but she elected to pay them with non-HSA funds to allow the HSA to increase in value.

On January 1, 2016, she withdraws \$40,000 from her HSA and uses the money to buy a car. Valerie can treat the \$40,000 as a tax-free distribution if she can substantiate that the expenses were qualified medical expenses, were incurred after her HSA was established, were not paid or reimbursed by any other source, and were not taken as an itemized deduction in any prior taxable year.

Distributions for Non-Medical Expenses

- ▶ Included in gross income and generally subject to an additional 20% tax penalty
 - PPACA increased the additional tax on withdrawals from 10% to 20%, effective as of January 1, 2011
 - The additional tax does not apply in certain situations – such as payments made after death, disability, or attaining age 65, or for “rollovers” meeting certain statutory requirements



Employer Reporting Obligations

- ▶ Must report all employer HSA contributions in Box 12 of Form W-2, using code W
 - Note: These employer contributions include pre-tax employee contributions made through a cafeteria plan
- ▶ Employer contributions to an HSA that are not excludable from the income of the employee must also be reported in Boxes 1, 3, and 5 of Form W-2

PPACA and Employer Reporting Obligations

- ▶ HSA contributions are not subject to health coverage cost reporting on Form W-2
- ▶ The cost of an employer's HDHP, however, will have to be reported beginning with the 2012 Forms W-2 (to be provided to employees in January of 2013)



Comparison of CDHPs

	HSA	HRA	FSA
HDHP Required?	Yes	No	No
Contribution Limits?	Yes	No	No (until 2013)
Nondiscrimination Rules for Employer Contributions?	Yes; must be “comparable” (or made via §125 plan)	Yes; subject to §105(h) rules	Yes; subject to both §105(h) and §125 rules
Pre-Tax Employee Contributions?	Yes (via §125 plan or tax deduction)	No (employer contributions only)	Yes (via §125 plan)
Contributions Subject to FICA?	No	No	No
May Employer Limit Use of Funds?	No	Yes	Yes
ERISA Applies?	Generally, no	Yes	Yes

Comparison of CDHPs

	HSA	HRA	FSA
Carryovers Allowed?	Yes	Yes	No (other than 2 ½ month grace period)
Incoming Rollovers Allowed?	Yes	No	No
Trustee / Custodian Required?	Yes	No	No
Portable to New Employer?	Yes	No	No
May Pay Long-Term Care Premiums?	Yes	Yes (but perhaps not LTC <i>services</i>)	No
May Pay COBRA Premiums?	Yes	Yes	No
May Pay Health Insurance Premiums?	Only in limited circumstances	Yes	No

Comparison of CDHPs

	HSA	HRA	FSA
May Pay Medicare Premiums?	Yes	Yes	No
May Pay Medigap Premiums?	No	Yes	No
Claim Substantiation Required?	Yes (by account holder)	Yes	Yes
Independent Adjudication Required?	No	Yes	Yes
Distributions Subject to 20% Penalty Tax?	Yes (if not for medical expenses)	No	No
Contributions Subject to 6% Excise Tax?	Yes (if over annual limit)	No	No
Debit Cards Allowed?	Yes	Yes	Yes

Comparison of CDHPs

	HSA	HRA	FSA
12-Month Coverage Period Required?	No (<i>must</i> allow monthly elections)	No	Yes
COBRA Applies?	No	Yes	Yes (though limited)
Employer Involvement Required?	No	Yes	Yes
Plan Document Required?	No	Yes	Yes
HIPAA Portability and Nondiscrimination?	No	Yes	Generally, no
HIPAA Privacy?	Unclear	Yes	Yes
Medicare Part D Creditable Coverage Notices?	No	Yes	No

Simplifying HSA Administration



- ▶ Consider other alternatives. Will an HRA or FSA achieve the same goals?
- ▶ Eliminate competing CDHPs, such as FSAs and HRAs – at least for employees who elect the HSA option.
- ▶ If an HRA or FSA will be retained, amend them to be limited-purpose or post-deductible

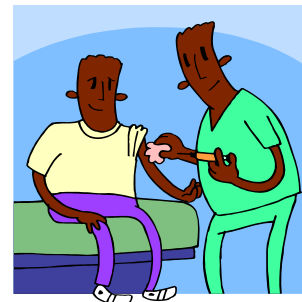
Simplifying HSA Administration



- ▶ Make any employer contributions through a cafeteria plan (thereby avoiding the “comparability” rules)
- ▶ Make employer contributions only to HSAs established with a particular trustee or custodian
- ▶ At least restrict employees’ choices to a limited number of HSA providers

Simplifying HSA Administration

- ▶ Choose an HSA provider that offers electronic payment cards (debit, credit, or stored-value cards), to facilitate employee access to their HSA funds
- ▶ Establish a reasonable charge for access to any on-site clinic





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