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# All About HSAs

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# HSA Overview

- A Health Savings Account (HSA) is a special account owned by an individual used to pay for current and future medical expenses.
- HSAs are used in conjunction with a “High Deductible Health Plan” (HDHP).
  - Insurance that does not cover first dollar medical expenses (except for preventive care)
  - Can be an HMO, PPO or indemnity plan, as long as it meets the requirements

# HSA Overview

- HSAs were created in Medicare legislation signed into law by President Bush on December 8, 2003
- HSAs modeled after Archer MSAs

# Who Is Eligible for HSAs?

- Any individual that:
  - Is covered by an HDHP
  - Is not covered by other health insurance
  - Is not enrolled in Medicare
  - Can't be claimed as a dependent on someone else's tax return
    - Children cannot establish their own HSAs
    - Spouses can establish their own HSAs, if eligible
- No income limits on who may contribute to an HSA
- No requirement of having earned income to contribute to an HSA

# **Who Is Eligible for HSAs?**

## **What other health coverage is allowed for you to still be eligible for an HSA?**

- specific disease or illness insurance and accident, disability, dental care, vision care and long-term care insurance
- Employee Assistance Programs, disease management program or wellness program
  - These programs must not provide significant benefits in the nature of medical care or treatment
- Drug discount cards
- Eligibility for VA Benefits
  - Unless you have actually received VA health benefits in the last 3 months

# **Who Is Eligible for HSAs?**

**Examples of “1st dollar” medical benefits that make someone ineligible for an HSA:**

- Medicare
  - Tricare Coverage
  - Flexible Spending Arrangements
  - Health Reimbursement Arrangements
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- There are permitted HSA/HRA/FSA combinations

# Who Is Eligible for HSAs?

## Permitted HSA/HRA/FSA combinations:

- “Limited purpose” FSAs and HRAs that restrict reimbursements to certain permitted benefits such as vision, dental, or preventive care benefits
- “Post-deductible” FSAs or HRAs that only provide reimbursement after the minimum annual deductible has been satisfied under the HDHP
- “Retirement” HRAs that only provide reimbursement after an employee retires
- “Suspended” HRAs where the employee has elected to forgo health reimbursements for the coverage period

# What Is a “High Deductible Health Plan” (HDHP)?

- Health insurance plan with minimum deductible of (for 2007):
  - \$1,100 (self-only coverage)
  - \$2,200 (family coverage)
  - These amounts are indexed annually for inflation
- Annual out-of-pocket (including deductibles and co-pays) cannot exceed (for 2007):
  - \$5,500 (self-only coverage)
  - \$11,000 (family coverage)
  - These amounts are indexed annually for inflation

# What is a “High Deductible Health Plan” (HDHP)?

- Reasonable benefit designs not counted toward the out of pocket maximum include:
  - Lifetime limits on benefits
  - Limits to usual, customary and reasonable (UCR) amounts
  - Limits on specific benefits
    - Maximum number of days or visits covered
    - Maximum dollar reimbursements
  - Pre-certification requirements

# **What is a “High Deductible Health Plan” (HDHP)?**

- HDHPs can have:
  - first dollar coverage (no deductible) for preventive care (copays allowed)
  - higher out-of-pocket (copays & coinsurance) for non-network services
- All covered benefits must apply to the plan deductible, including prescription drugs

# What is a “High Deductible Health Plan” (HDHP)?

## Prescription Drugs

- If HDHP provides prescription drug benefit, prescription drug expenses must be subject to the annual deductible or the individual may not contribute to an HSA.

# What is a “High Deductible Health Plan” (HDHP)?

## Preventive Care

- Preventive care generally does not include any service or benefit intended to treat an existing illness, injury or condition.
- Certain drugs and medications can be considered preventive care.
  - Drugs taken by a person who has developed risk factors for a disease that has not yet manifested itself or to prevent reoccurrence of a disease
  - Example: Cholesterol-lowering medication for those with high cholesterol

# What is a “High Deductible Health Plan” (HDHP)?

## Preventive Care

- Safe harbor list of preventive care that HDHP can provide as first-dollar coverage before minimum deductible is satisfied:
  - Periodic health evaluations (e.g., annual physicals)
  - Screening services (e.g., mammograms)
  - Routine pre-natal and well-child care
  - Child and adult immunizations
  - Tobacco cessation programs
  - Obesity weight loss programs
- Can apply co-pays to preventive care services

# HSA Contribution Rules

- Contributions to HSA can be made by the employer or the individual, or both
  - If made by the employer, it is not taxable to the employee (excluded from income and wages)
  - If made by the individual, it is an “above-the-line” deduction
  - Can be made by others on behalf of individual and deducted by the individual
  - Beginning in 2007, individuals can make a one-time transfer from their IRA to an HSA, subject to the contribution limits applicable for the year of the transfer

# HSA Contribution Rules

- For 2007, the maximum amount that can be contributed (and deducted) to an HSA from all sources is:
  - \$2,850 (self-only coverage)
  - \$5,650 (family coverage)
- These amounts are indexed annually.

# HSA Contribution Rules

- For individuals age 55 and older, additional “catch-up” contributions to HSA allowed
  - 2007 - \$800
  - 2008 - \$900
  - 2009 and after - \$1,000
- Contributions must stop once an individual is enrolled in any type of Medicare.

# HSA Contribution Rules

- The total amount of contributions to an HSA are based on the number of months that the individual is covered by an HDHP as of the first day of the month.
  - 3 months of HDHP coverage with an annual high deductible amount of \$1,200 will mean that the maximum contribution will be 3/12ths of \$1,200 or \$300.
  - But see new full contribution rule for 2007
- “Catch-up” contributions must also be pro-rated for number of months eligible.
  - Does not matter when 55<sup>th</sup> birthday falls during year

# HSA Contribution Rules

- Beginning in 2007, a full year's contribution (plus the catch-up, if applicable) may be made to an HSA for someone who first becomes eligible during that year, even if they start in December.
- If someone contributes a full year's contribution but is eligible only part of the year, however, they will be subject to taxes and penalties if they don't remain eligible for 12 months after the year in which they first become eligible.

# HSA Contribution Rules

- Contributions to the HSA in excess of the contribution limits must be withdrawn by the individual or be subject to an excise tax.
  - A pro-rata portion of earnings must be withdrawn also
  - Pay income tax on the withdrawn amount, but no 10% penalty
- If the HSA maximum contribution limit was not reached for the year, any other withdrawal for the year (that is not for qualified medical expenses) will not be considered “excess HSA contributions” and that withdrawal will be subject to both income tax and the 10% penalty.

# **HSA Contribution Rules:** **Employee Contributions**

- Can be made by a salary reduction arrangement through a cafeteria plan (125 plan)
  - Elections to make contributions through a cafeteria plan can change on a month-by-month basis (unlike salary reduction contributions to an FSA)
  - Remember that contributions to the HSA through a cafeteria plan are “pre-tax” and not subject to individual or employment taxes.
  - Employer can automatically make cafeteria plan contributions on individuals’ behalf unless the individual affirmatively elects not to have such contributions made (“negative elections”)

# HSA Contribution Rules: Employer Contributions

- Are always excluded from employees' income (pre-tax)
- Must be “comparable” for all employees participating in the HSA
  - If not comparable, there will be an excise tax equal to 35% of the amount the employer contributed to employees' HSAs
- The self-employed, partners and S-Corporation shareholders are generally not considered employees and cannot receive an employer contribution
  - They can make deductible contributions to the HSA on their own

# HSA Contribution Rules: Employer Contributions

- Comparable contributions are contributions to all HSAs of an employer:
  - which are the same amount
  - or
  - which are the same percentage of the annual deductible
- May count only employees who are “eligible individuals” covered by the employer under the HDHP and who have the “same category of coverage” (i.e., self-only or family).
  - No other classifications of employees are permitted
- Part-time employees can be tested separately.
  - “Part-time” means customarily employed fewer than 30 hours per week
- Employers may contribute more on behalf of nonhighly compensated employees.

Comparability rules do not apply to collectively bargained employees.

# HSA Contribution Rules: Employer Contributions

- Employer matching contributions to the HSA through a cafeteria plan are not subject to the comparability rules
  - But cafeteria plan nondiscrimination rules apply
    - contributions cannot be greater for higher paid employees than they are for lower paid employees
    - contributions that favor lower paid employees are OK
- Employer contributions to an HSA based on an employee's participation in health assessments, disease management program or wellness program do not have to satisfy the comparability rules if the employees are allowed to contribute to the HSA through a cafeteria plan to the HSA
  - Cafeteria plan nondiscrimination rules also apply

# **HSA Contribution Rules:** **Employer Contributions**

## Violations of the Comparability Rules

- Extra contributions to an HSA on account of employees who meet a specified age or qualify for the catch-up contributions
- Contributions based on length of service

# HSA Distributions

- Distribution is tax-free if taken for “qualified medical expenses”.
  - Now includes over-the-counter drugs
- Qualified medical expense must be incurred on or after the HSA was established.
  - If HDHP coverage effective on first day of month, HSA can be established as early as first day of same month
  - If HDHP coverage effective any day other than first day of month, HSA cannot be established until first day of following month

# HSA Distributions

- Tax-free distributions can be taken for qualified medical expenses of:
  - person covered by the high deductible
  - spouse of the individual (even if not covered by the HDHP)
  - any dependent of the individual (even if not covered by the HDHP)

# HSA Distributions

- If distribution is not used for qualified medical expenses
  - Amount of distribution is included in income and
  - 10% additional tax except when taken after:
    - Individual dies or becomes disabled
    - Individual is age 65

# HSA Distributions

- “Qualified medical expenses” do not include other health insurance (including premiums for dental or vision care)
- Exceptions:
  - COBRA continuation coverage
  - Any health plan coverage while receiving unemployment compensation
  - For individuals enrolled in Medicare:
    - Medicare premiums and out-of-pocket expenses (Part A, Part B, Medicare HMOs, prescription drug coverage)
    - employee share of premiums for employer-based coverage
    - Cannot pay Medigap premiums
  - Qualified long-term care insurance premiums

# HSA Distributions

- Should the HSA account holder keep receipts? YES!
  - May need to prove to IRS that distributions from HSA were for medical expenses and not otherwise reimbursed
  - May be required by insurance company to prove that HDHP deductible was met
  - Not all medical expenses paid out of the HSA have to be charged against the deductible (e.g. dental care, vision care)

# HSA Distributions

HSA Distributions can be used to reimburse prior years' expenses as long as they were incurred on or after the date the HSA was established.

- No time limit on when distribution must occur
- Individual must keep records sufficient to prove that:
  - the expenses were incurred,
  - they were not paid for or reimbursed by another source or taken as an itemized deduction

# HSA Distributions

- Mistaken HSA distributions can be returned to the HSA.
  - Clear and convincing evidence must be shown that the distribution was a mistake of fact
  - Must be repaid by April 15 of the year following the year in which the individual knew or should have known the distribution was a mistake

# Treatment of HSAs upon Death

- If the spouse is the beneficiary, the spouse inheriting the HSA is treated as the owner
- To the extent the spouse is not the beneficiary:
  - The account will no longer be treated as an HSA upon the death of the individual
  - The account will become taxable to the decedent in the decedent's final tax return if the estate is the beneficiary, otherwise, it will be taxable to the recipient.
    - Taxable amount will be reduced by any qualified medical expenses incurred by the deceased individual before death and paid by the recipient of the HSA
    - The taxable amount will also be reduced by the amount of estate tax paid due to inclusion of the HSA into the deceased individual's estate

# HSA Accounts

- Accounts are owned by the individual (not an employer). The individual decides:
  - Whether he or she should contribute
  - How much to use for medical expenses
  - Which medical expenses to pay from the account
  - Whether to pay for medical expenses from the account or save the account for future use
  - Which company will hold the account
  - What type of investments to grow account

# HSA Accounts

- Employer cannot restrict
  - What distributions from an HSA are used for
  - Rollovers
- HSA Custodian or Trustee can put reasonable limits on accessing the money in the account
  - Frequency of distributions
  - Size of the distributions

# HSA Accounts

- Who can be an HSA Trustee or Custodian?
  - Banks, credit unions
  - Insurance companies
  - Entities already approved by the IRS to be an IRA or Archer MSA trustee or custodian
  - Other entities can apply to the IRS to be approved as a non-bank trustee or custodian
- IRS has provided model HSA Trustee and Custodian Forms.

# HSA Accounts

- Trustee or custodian fees
  - Can be paid from the assets in the HSA account without being subject to tax or penalty
  - Can be directly paid by the beneficiary without being counted toward the HSA contribution limits

# HSA Accounts

- HSA trustee must report all distributions annually to the individual (Form 1099 SA).
  - Trustee not required to determine whether distributions are used for medical purposes; the individual does that.
  - Individual will report on annual tax return amount of distribution used for qualified medical expenses
- Account holders must file Form 8889 as part of their annual tax return.

# HSA Accounts

- No “use it or lose it rules” like Flexible Spending Arrangements (FSAs).
  - All amounts in the HSA are fully vested
  - Unspent balances in accounts remain in the account until spent
  - Encourages account holders to spend their funds more wisely on their medical care
  - Encourages account holders to shop around for the best value for their health care dollars
- Accounts can grow through investment earnings, just like an IRA.
  - Same investment options and investment limitations as IRAs
  - Same restrictions on self-dealing as with IRAs

# HSA Accounts

- Rollovers from Archer MSAs and other HSAs permitted.
  - Only one rollover per year is permitted
  - The rollover to new HSA must be completed within 60 days
  - These restrictions follow the IRA rollover rules
- Direct trustee to trustee transfers of HSA amounts are not subject to the rollover restrictions.
  - Thus, multiple trustee to trustee transfers are allowed in a single year
  - Both trustees must agree to do the transfer and they are not required to do so
- Direct rollovers from 401(k), 403(b) and 457 plans are not permitted.

# Treasury Assistance

- Web site - [www.treas.gov](http://www.treas.gov) (Click on “Health Savings Accounts”) – contains:
  - All Treasury guidance
  - Frequently asked questions
  - IRS forms and publications
  - HSA statute
  - Examples of tax savings from HSA contributions
  - Links to other useful sites