Benefit Comply
Employee Benefit Compliance Support

Health Savings Account (HSA) Guide

A practical guide to understanding HSAs

Version 5

January 2020

Table of Contents

OVERVIEW 3

HSA ELIGIBILITY 4

HSA CONTRIBUTIONS 8

HSA DISTRIBUTIONS (REIMBURSEMENTS) 13

MISCELLANEOUS 16

APPENDIX A – HDHP REQUIREMENTS AND CONTRIBUTION LIMITS 17

APPENDIX B – CONTRIBUTION LIMIT EXAMPLES 18

APPENDIX C – SPECIAL RULE FOR MARRIED INDIVIDUALS 19

APPENDIX D: COMPARISON OF HRAS, HEALTH FSAS, AND HSAS 20

APPENDIX E – ADDITIONAL RESOURCES 21

While every effort has been taken in compiling this information to ensure that its contents are totally accurate, neither the publisher nor the author can accept any liability whatsoever for any inaccuracies or changed circumstances of any information herein or for the consequences of any reliance placed upon it. This publication is distributed on the understanding that the publisher is not engaged in rendering legal, accounting or other professional advice or services. Readers should always and without exception seek professional advice before entering into any commitments.

© 2020 Benefit Comply, LLC

OVERVIEW

With the number of individuals enrolled in high deductible health plans (HDHPs) growing, and health care costs continuing to rise, health savings accounts (HSAs) provide an option for reimbursement of medical expenses on a tax-favored basis without some of the restrictions and risk that accompany a health reimbursement account (HRA) or health flexible spending account (FSA). An important difference is that HSAs are individually owned accounts that will stay with the account holder and are not tied to employment or to a particular employer.

There are specific rules about who is eligible to contribute to an HSA; how much may be contributed to an HSA; and which medical expenses are reimbursable by the HSA, and a failure comply with such requirements could result in the loss of the tax-favored treatment and potentially in excise taxes.

Although in most cases there is no specific penalty for an employer who chooses to facilitate HSA contributions or who chooses to make employer HSA contributions, if the HSA rules are not followed by individuals (rather, the individual would be responsible for any owed taxes), the reality is that employees look to their employers to help them navigate such requirements. Therefore, it is important that employers help educate employees about HSA requirements if the employer is choosing to offer qualifying HDHP coverage or to facilitate HSA contributions, perhaps even asking employees to certify that they meet the criteria to be an eligible individual for HSA purposes. In addition, employers should be careful when evaluating various plan offerings and how they may affect HSA-eligibility.

© 2020 Benefit Comply LLC

HSA Eligibility

Only eligible individuals can make contributions to their HSA account. To be eligible to contribute to an HSA, an individual:

- Must be enrolled in a qualifying high-deductible health plan (HDHP);
- May not have any other “disqualifying coverage”; and
- Cannot be claimed as a tax dependent by another individual.

Eligibility for an HDHP is different from eligibility to contribute to an HSA. Eligibility for the HDHP will depend upon the plan eligibility rules set by the employer and/or insurance carrier (e.g., averaging 30 or more hours of service per week), whereas eligibility to contribute to an HSA is determined by federal laws and regulations. Therefore, while an individual must be enrolled in a qualifying HDHP to be eligible to contribute to an HSA, an individual who is ineligible to contribute to an HSA could still enroll in HDHP coverage so long as the plan eligibility requirements are met.

Qualifying High Deductible Health Plan (HDHP)

A qualifying HDHP must meet minimum deductible and maximum out-of-pocket (OOP) requirements.

- *2020 Minimum deductible*
    - Single (individual) – $1,400; Other than single (family) – $2,800
    - Embedded individual deductible, if any, cannot be less than $2,800

- *2020 Maximum out-of-pocket*
    - Single (individual) – $6,900; Other than single (family) – $13,800
    - Must have an embedded individual OOP maximum of $8,150 or less

See chart of requirements for 2014–2020 in Appendix A.

Embedded Individual Deductible

If the HDHP plan design includes an embedded individual deductible, the embedded individual deductible must be at least the amount of the required minimum family deductible ($2,800 in 2020) in order to ensure that the HDHP does not begin paying before the minimum family deductible has been satisfied. See guidance from IRS Notice 2004-2 (Q&A #3). This is also addressed in IRS publication 969.

> ***EXAMPLE 1***: Family HDHP has a $5,000 deductible and an embedded individual deductible of $2,500.
>
> *This is NOT a qualifying HDHP because the embedded individual deductible is less than $2,800.*
>
> ***EXAMPLE 2***: Family HDHP has a family deductible of $6,000 and an embedded individual deductible of $3,000.
>
> *This is a qualifying HDHP because the embedded individual deductible is more than $2,800.*

Coordination of OOP Maximum with ACA Requirements

The ACA's maximum OOP on essential health benefits requires that any individual who meets the ACA individual OOP maximum in expenses be reimbursed at 100% (an embedded individual OOP maximum). For 2020, an individual enrolled in family HDHP coverage must have all expenses reimbursed at 100% once the individual incurs $8,150 in medical expenses, even if the HDHP OOP maximum is higher.

> ***EXAMPLE 1***: Family HDHP has a $5,000 deductible and maximum OOP of $10,000. Covered individuals are subject to plan copays and coinsurance once the deductible is met until $10,000 in medical expenses has been incurred by one or all covered individuals.
>
> *This is a qualifying HDHP, but would violate ACA requirements because a single individual may have to incur up to $10,000 (> $8,150) in medical expenses before receiving 100% plan coverage.*
>
> ***EXAMPLE 2***: Family HDHP has a $6,000 deductible and maximum OOP of $12,000 ($6,000 embedded individual OOP maximum). Covered individuals are subject to plan copays and coinsurance once the deductible is met until $12,000 in medical expenses has been incurred by the family, or any covered individual alone incurs $6,000 in medical expenses.
>
> *This is a qualifying HDHP and would meet ACA requirements because a single individual would receive 100% plan coverage once $6,000 (< $8,150) of medical expenses is incurred.*

Disqualifying Coverage

Most medical coverage available to an individual prior to meeting the statutory HDHP deductible ($1,400/$2,800 in 2020) will cause HSA ineligibility. However, there is an exception for preventive coverage, as well as for permitted insurance and permitted coverage. Individuals who have such coverage prior to meeting the minimum statutory HDHP deductible remain eligible to contribute to an HSA.

- Permitted insurance includes:
  - 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., homeowner or auto insurance); or similar liabilities as specified by the IRS;
  - 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.
- Preventive coverage includes preventive services described in IRS Notice 2004-23 (https://www.irs.gov/pub/irs-drop/n-04-23.pdf) and items considered to be preventive care and required to be covered with no cost-sharing under the ACA (PHSA §2713). Preventive coverage generally does not include any service or benefit intended to treat an existing illness, injury, or condition. However, in an effort to encourage treatment for some chronic illnesses, IRS guidance expanded the definition of preventive coverage to also include the medical care services and items listed in IRS Notice 2019-45 (https://www.irs.gov/pub/irs-drop/n-19-45.pdf).

In general, only coverage available to the individual affects HSA eligibility. If the spouse or dependents have disqualifying coverage (other than a general-purpose health FSA or HRA), that does not affect the individual's ability to maintain and contribute to an HSA. For example, if an employee enrolls in family HDHP coverage and the spouse is enrolled in non-HDHP coverage or Medicare, the employee is still eligible to contribute to an HSA so long as the employee doesn't have any disqualifying coverage.

© 2020 Benefit Comply LLC

Permissible Coverage	Impermissible Coverage
Limited-purpose or post-deductible health FSA	Medical plans with a deductible or OOP maximum less than the HSA statutory minimums
Limited-purpose or post-deductible HRA	General-purpose health FSAs
Specific disease or hospital indemnity policy	HRAs reimbursing claims below the HDHP statutory minimum deductible
Employee Assistance Programs (EAPS), so long as they do not provide significant medical care	Medicare, Tricare, and Medicaid coverage
Wellness programs, so long as they do not provide significant medical care	Indian Health Service
VA coverage for individuals with a disability rating	VA coverage
	On-site clinics providing significant medical care if participants are not required to pay fair market value for the services
	Executive reimbursement plans (unless limited solely to coverage for annual physicals)

****There is little to no guidance in regard to telemedicine services and concierge (direct primary care) services. Until further guidance is available, the conservative approach is to assume that such coverage would cause HSA ineligibility unless the individual is required to pay fair market value for the services.*

Employee Assistance Program (EAP) or Wellness Program

Most employee assistance programs (EAPs) and wellness programs will not prevent HSA eligibility so long as they don't provide significant benefits in the nature of medical care or treatment. Screening and preventive care are not considered significant medical care.

Indian Health Service (IHS)

An individual who has received medical services from an IHS facility during the previous three months will be ineligible to make HSA contributions unless the medical services qualified as permitted coverage (e.g., dental and vision care) or preventive care (e.g., well-baby visits and immunizations). If an individual has not received disqualifying services in the previous three months, the individual will be HSA eligible. So, for example, if an individual is enrolled in a qualifying HDHP for all of 2020, but used IHS services in mid-April 2020 (causing HSA ineligibility for May, June, and July 2020) and therefore was eligible to contribute to an HSA nine months out of the year, the individual could contribute 9/12 of the annual maximum contribution amount for 2020.

Veterans Affairs (VA) coverage

An individual with a disability rating from the VA may make HSA contributions, regardless of whether VA medical benefits have been received. However, individuals who don't have a disability rating from the VA are ineligible to contribute to an HSA if medical benefits have been received from the VA during the previous three months. If an individual has not received disqualifying services in the previous three months, the individual will be HSA eligible. So, for example, if the individual without a disability rating is enrolled in a qualifying HDHP for all of 2020, but used VA services once in mid-January 2020 (causing HSA ineligibility for February, March, and April 2020) and therefore was eligible to contribute to an HSA nine months out of the year, the individual could contribute 9/12 of the annual maximum contribution amount for 2020.

© 2020 Benefit Comply LLC

Health Flexible Spending Account (FSA)

Participation in a general-purpose health FSA disqualifies an individual from contributing to an HSA. A health FSA is typically available to reimburse expenses of the employee, spouse, and tax dependents, and therefore, in contrast to the general rule that a spouse's disqualifying coverage doesn't affect an individual's HSA eligibility, a spouse's participation in a general-purposes health FSA will cause both spouses to be ineligible to contribute to an HSA.

Employees who participate in a health FSA will not be eligible to contribute to an HSA until the end of the health FSA plan year, regardless of whether the health FSA funds have been used or exhausted prior to the end of the plan year. Grace-period or carryover provisions may further extend ineligibility if funds roll over into the new plan year.

- Health FSA with a Grace Period:
    - If the participant has a zero balance at the end of the plan year, the individual is eligible to contribute to the HSA following the end of the health FSA plan year.
    - If the participant has an unused year-end balance, the grace period extends the participant's period of HSA ineligibility through the end of the grace period (typically 2½ months), unless the employer makes the grace period limited-purpose. If this is done, it must be applied on a uniform basis for all participants (i.e., participants could not be given a choice between a limited-purpose or general-purpose grace period).

- Health FSA with a Carryover (up to $500):
    - If the participant has a zero balance at the end of the plan year, the individual is eligible to contribute to the HSA following the end of the health FSA plan year.
    - If the participant has an unused year-end balance, the individual is ineligible for HSA contributions for the entire next health FSA plan year (because the $500 can be used any time during the year), unless the employer allows participants to waive the carryover or make the carryover limited-purpose. Unlike the grace period, the employer is allowed to design the carryover to be converted to limited-purpose for those who enroll in the HDHP and remain general-purpose for the other participants.

Additional information may be found in IRS Chief Counsel Advice 201413005 (Feb. 12, 2014) – https://www.irs.gov/pub/irs-wd/1413005.pdf.

MEDICARE

Individuals who are "entitled" to Medicare (that is, they are both eligible and enrolled) are ineligible to contribute to an HSA. Mere eligibility for Medicare (or reaching a particular age – e.g., 65) will not affect HSA eligibility.

Medicare Part A enrollment is automatic for some individuals (i.e., those who are already receiving Social Security benefits when they turn 65). These individuals simultaneously become eligible, enrolled, and entitled upon reaching age 65. Choosing not to enroll in Part B does not help; Part A alone makes an individual ineligible to contribute to an HSA. Other individuals become eligible for Medicare, but must file an application in order to become enrolled in benefits.

Employees who have coverage under an employer-sponsored plan may want to delay Medicare enrollment for things such as maintaining eligibility to contribute to an HSA. But keep in mind that if entitlement to Medicare is delayed by deferring receipt of Social Security Benefits, then once a person is enrolled, Medicare benefits are generally retroactive up to 6 months, which means HSA ineligibility is retroactive as well. In this case, it is advisable to either cease making any contributions prior to enrolling in Medicare or calculate the maximum contribution for the year and contribute accordingly (e.g., if the individual enrolled in Medicare on November 1, the effective date may be backdated to April 1, which means the individual would only have been HSA eligible for 3 months (January, February, and March), and the maximum HSA contribution for that year would be 3/12 of the annual maximum + 3/12 of the $1,000 catch-up contribution).

© 2020 Benefit Comply LLC

HSA Contributions

Calculating the Annual Contribution Limit

2020 Annual Limits

- Maximum self-only HDHP (individual) annual contribution = $3,550
- Maximum other than self-only HDHP (family) annual contribution = $7,100

*** Catch-up contributions – HSA-eligible individuals who have attained age 55 by the end of the taxable year can make an annual $1,000 extra catch-up contribution.

See chart of contribution limits for 2014-2020 in Appendix A.

Eligibility to contribute to an HSA is determined monthly based on the 1st day of the month. Each month that an individual is HSA eligible, the individual is eligible to contribute up to 1/12 of the annual maximum (unless the individual is taking advantage of the full-contribution rule).

The amount that an individual is eligible to contribute to an HSA is dependent upon the tier of coverage in which the individual is enrolled (i.e., single or family). If the individual is enrolled in family HDHP coverage, and is eligible to contribute to an HSA, the individual may contribute up to the family annual contribution amount (subject to a special rule for spouses, described below). This is true even if the spouse or dependents who are enrolled in the HDHP coverage have other disqualifying coverage and are not HSA eligible, as illustrated in IRS Notice 2008-29, Q&A #16 (excerpt below):

> *Q-16. How do the maximum annual HSA contribution limits apply to an eligible individual with family HDHP coverage for the entire year if the family HDHP covers spouses or dependent children who also have coverage by a non-HDHP, Medicare, or Medicaid?*
>
> *A-16. The eligible individual may contribute the § 223(b)(2)(B) statutory maximum for family coverage. Other coverage of dependent children or spouses does not affect the individual's contribution limit, except that if the spouse is not an otherwise eligible individual, no part of the HSA contribution can be allocated to the spouse.*

See examples in Appendix B. In addition, here is a link to a spreadsheet tool to assist in calculating annual contribution amounts: http://benefitcomply.com/resources/wp-content/uploads/2019/05/HSAContributionCalculations_2020.xlsx

Full Contribution Rule

Under the "full contribution rule" (or "last month rule"), individuals may make a full year's contribution based on the HDHP coverage in effect on December 1st so long as the individual remains eligible to contribute to an HSA for a thirteen-month "testing period" that starts on December 1st and runs until the following December 31st. For example, an individual who enrolls in HDHP coverage in June 2020 would be able to contribute only 7/12 of the 2020 annual contribution limit under the standard rules; however, using the full contribution rule, the employee could make the full 2020 annual contribution so long as the individual remains eligible to contribute to an HSA from December 1st, 2020, through December 31st, 2021. If an individual takes advantage of the full contribution rule and fails to remain an eligible individual for the entire testing period (e.g., drops HDHP coverage in June 2021), then the difference between what that person would have been allowed to contribute without the last month rule and the amount actually contributed would be includable in gross income in the year the individual first failed to remain an eligible individual during the testing period, and such amounts would also be subject to a 10% penalty tax.

Special Rule for Spouses

When both spouses are enrolled in HDHP coverage and are both HSA-eligible, so long as one spouse has family coverage, then both are treated as having family coverage for purposes of HSA contribution limits; however, together they cannot exceed the annual family contribution amount ($7,100 in 2020). The contribution limit is divided equally unless the spouses agree on a different division. See the chart found in Appendix C that further illustrates this rule.

If both spouses are HSA eligible and want to contribute to an HSA, it is not possible to have a "joint HSA account" (see IRS Notice 2004-50, 2004-33 I.R.B. 196, Q/A-63). HSAs are individually owned accounts. Although one spouse could contribute to the other spouse's HSA, the HSA then belongs to only one of them. NOTE – Notwithstanding the special rule for spouses, each spouse who is age 55 or older may still make up to the full annual catch-up contribution (up to $1,000). If both spouses are 55 or older, and there is a desire to take advantage of catch-up contributions, each spouse must have his or her own HSA.

Excess Contributions & Corrections

When an individual contributes too much to their HSA, or makes contributions when not eligible to do so, such contributions are considered "excess contributions" and are subject to a 6% excise tax on the individual if corrections are not made. In order to avoid a 6% excise tax on the excess contributions, the employee should request a distribution of the excess contributions and earnings before the individual's federal income tax filing deadline (including extensions).

Although the employee may request a curative distribution for any excess amount contributed to an HSA (including both employee and employer contributions), employer HSA contributions are generally non-forfeitable for the employer, meaning employers may not recoup the contributions but should re-characterize any excess contributions as taxable income to the employee if possible. The only exceptions to this rule, potentially allowing the employer to reverse contributions, are for the following circumstances:

- The individual has never been HSA eligible;
- The employer erroneously contributed more than the full maximum annual contribution; or
- Clear evidence of administrative or process error (e.g., duplicative contributions, decimal point in the wrong place, deposited into another employee's HSA with a similar name).

It's important to understand that there is no exception to the non-forfeitability rule for employer contributions if the individual was HSA eligible and then ceased to be HSA eligible (e.g., because of Medicare enrollment). See more detail on circumstances which may allow employer HSA contributions to be recovered in IRS Notice 2008-59 and IRS Information Letter No. 2018-0033 (dated Sept. 9, 2015).

Timing of Contributions

Contributions for any given year may not be made **before** the tax year begins (January 1) or, if later, before the HSA is established; nor can they be made **after** the original filing due date for the individual's tax return (generally April of the following year). Contributions can be made in monthly amounts or in another periodic lump sum (or lump sums).

If an employee elects to make HSA contributions on a pre-tax basis through a cafeteria plan, it is necessary to follow §125 election change rules. §125 rules require the plan to allow HSA election changes to be made at least monthly, without any reason (at the employee's discretion), but the changes may only be made prospectively.

Who May Contribute

HSA contributions may be made by the HSA account holder or by any other person, including an employer or family member, but are generally made by either the employee or the employer.

© 2020 Benefit Comply LLC

Considerations for Employee Contributions

Employee contributions may be made on a pre-tax basis through a §125 cafeteria plan if allowed by the employer, or made directly into the HSA on an after-tax basis and then be taken as an “above the line” deduction on the individual’s tax return. In either case, the taxation ends up working out about the same for the employee, but it may be administratively easier for the employee to be able to make pre-tax contributions directly from payroll through a cafeteria plan. NOTE: Wages paid through a cafeteria plan save the employer money on payroll taxes and save the employee money on FICA taxes, so there is some tax advantage to running the employee contributions through the cafeteria plan.

If the employer allows for pre-tax HSA contributions through its cafeteria plan, then as noted above under “Timing of Contributions,” salary reduction elections are not subject to the irrevocability rules that otherwise apply to other benefits offered through a cafeteria plan. Employee HSA contributions can be changed at any time during the year as long as the change is made prospectively, and employers are required to allow employees to change HSA elections at least monthly. The reason for the contribution change (e.g., an unexpected medical cost) wouldn’t matter. See Notice 2004-50 (Q-58).

NOTE: Individuals considered to be self-employed (i.e., a sole proprietor, a partner in a partnership, or a director serving on the corporation’s board of directors) or a more-than-2% shareholder of an S-Corporation are not considered employees and are not able to participate in tax-favored options such as cafeteria plans, and therefore may not make HSA contributions on a pre-tax basis. Such individuals would have to make contributions on an after-tax basis and then could take an above-the-line deduction when filing their personal tax return.

Considerations for Employer Contributions

Employer contributions can be made outside a cafeteria plan, or through a cafeteria plan if the employer also allows employees to contribute on a pre-tax basis. Regardless, employer HSA contributions made to an employee’s HSA may be provided on a tax-favored basis, if it is reasonable to believe, at the time of the contribution, that the contribution will be excludable from the employee’s income. The employer’s responsibility in regard to determining HSA eligibility is fairly limited. Employers are responsible for determining only: (1) whether the employee is covered under an HDHP or low-deductible health plan or plans (including health FSAs and HRAs) sponsored by that employer; and (2) the employee’s age (for catch-up contributions). The employer may rely on the employee’s representation as to his or her date of birth.

On the other hand, if contributions are deposited in the HSA of a non-employee (e.g., spouse of an employee), the amounts contributed would generally need to be treated as taxable income to the employee (see IRS Notice 2008-59, Q&A #26). Employer contributions to a partner’s or S-Corp 2% or more shareholder’s HSA may need to be handled on an after-tax basis, depending upon the circumstances. See IRS Notice 2005-8 for details.

Employer Contributions Made Outside a Cafeteria Plan

Employer contributions made outside a cafeteria plan are subject to **the comparability rules**, which require that an employer make the same contribution amount (or the same percentage of the deductible) for all HSA-eligible employees in a given tier (e.g., single or family) in the same non-collectively bargained employee category. These categories are:

- current full-time,
- current part-time, or
- former employees.

Violating the comparability rules with contribution structures such as matching contributions, contributions tied to wellness participation, or contributing more toward a certain class of employees (e.g., management) may incur a 35% excise tax on all HSA contributions the employer makes for the year (including any contributions that otherwise would have complied with the comparability rules).

© 2020 Benefit Comply LLC

Employer Contributions Made Through a Cafeteria Plan

Employer contributions made through a cafeteria plan are not subject to comparability rules, but are subject to **§125 nondiscrimination rules**, which prohibit offering benefits in a way that favors highly compensated individuals. By offering HSA contributions through a cafeteria plan, the employer has more flexibility to offer differing contributions (e.g., matching contributions, or contributions by class of employee) so long as it does not cause an issue under §125 nondiscrimination rules. That being the case, keep in mind that all benefits offered through a cafeteria plan are aggregated for purposes of discrimination testing.

Timing of Employer Contributions

Although allocating a lump sum at the beginning of the year may seem easier administratively, it may make more sense to divide the annual contribution up quarterly or monthly, for the following reasons:

- Employer contributions to HSAs are generally non-forfeitable. Therefore, the employer will be required to make the full lump sum contribution regardless of whether employees remain employed or eligible all year.
- Depending upon the size of the employer contribution, it could exceed the employee's annual contribution maximum if the employee is HSA eligible for only a portion of the year, resulting in excess contributions subject to excise taxes unless the employee obtains a curative distribution. While the employee who becomes HSA eligible mid-plan year might choose to take advantage of the full contribution rule, or be willing to pay the 6% excise tax on any excess contributions, it would be safer not to make that assumption. If the employer chooses to make a lump sum contribution rather than contribute throughout the year, the employer will need to make a decision about how to handle mid-year enrollment. For example:
    - Offer the employer HSA contribution only to those who are HSA eligible as of a particular date (e.g., January 1st). Those who enroll mid-plan year will not receive an employer HSA contribution for the year;
    - Pro-rate the employer HSA contribution based on when the employee becomes HSA eligible; or
    - Make the full employer HSA contribution to the extent that it doesn't exceed the employee's annual contribution maximum.

Employee Fails to Open HSA

If employer HSA contributions are made through a cafeteria plan, ideally the plan document includes language indicating that if accounts are not opened within a particular time frame, the employer is not obligated to make any employer contributions. However, there are no specific rules or regulations that would be violated if the employer HSA contributions are not made for those who fail to establish an HSA in accordance with the employer's policy.

On the other hand, if contributions are made outside of a cafeteria plan, the comparability rules require the following process to be followed:

- The employer must provide a written notice stating that each eligible employee, by the end of February of the following calendar year, must establish an HSA and notify the employer to receive a comparable contribution to the HSA for the current calendar year. The notice must be provided no earlier than 90 days before the employer makes its first HSA contribution for the year and no later than January 15 of the following calendar year. A model notice is available in Treas. Reg. §54.4980G-4, Q/A-14(c).
- The employer must make a comparable contribution by April 15 of the following calendar year to the HSA of each eligible employee who establishes an HSA and notifies the employer by the end of February in the following calendar year.

© 2020 Benefit Comply LLC

Design and Administration Considerations

Employers who choose to make HSA contributions to employees are not under any obligation to make HSA contributions for employees who choose not to enroll in the employer's HDHP offering. Most often, employers will offer HSA contributions, if any, only to those who enroll in the employer's HDHP. However, there is nothing prohibiting the employer from offering HSA contributions to employees enrolled in another HDHP (e.g., through individual coverage or through a spouse's employer), although the employer would need to establish reasonable administrative procedures to ensure that the other HDHP coverage is in place prior to allowing employee pre-tax HSA contributions through a cafeteria plan or making employer HSA contributions.

If the employer chooses to make HSA contributions, the employer is not under any obligation to make a contribution to those individuals who enroll in an HDHP but are not eligible to make HSA contributions (e.g. enrolled in Medicare or eligible to participate in a spouse's general-purpose health FSA). That being the case, some employers choose to make an alternative contribution (e.g. health FSA or HRA contribution, or additional taxable compensation) to those who are not eligible to receive an employer HSA contribution.

In addition, employers have the option of designating and requiring use of a particular HSA vendor, or of forwarding contributions to each employee's chosen HSA trustee/custodian. It adds to the administrative hassle for the employer if the employer chooses to allow use of different vendors. In addition, if the employer chooses to forward contributions to a particular vendor, or chooses not to facilitate the process at all, the employees still have the option of opening an HSA account and contributing on their own.

HSA Distributions (Reimbursements)

HSA distributions are tax free if used for reimbursement of qualified medical expenses so long as the expenses will not be reimbursed by insurance or any other source.

Qualifying Medical Expenses

Qualifying medical expenses are defined under §213(d) and are further described in Pub. 502 and Pub. 969.

Although considered a qualifying medical expense under§213(d), HSA funds are generally not allowed to reimburse insurance premiums on a tax-favored basis, except for:

- COBRA or USERRA coverage;
- A qualified long-term care insurance contract;
- Any health plan maintained while the individual (i.e., the HSA holder or his or her spouse or dependent) is receiving unemployment compensation under federal or state law; or
- For HSA holders age 65 or over, any deductible health insurance (e.g., retiree medical coverage) other than a Medicare supplemental policy.

Reimbursement is allowed for qualified medical expenses for the HSA account holder, as well as for the account holder's spouse and tax dependents (as generally defined under §152), regardless of whether the spouse and tax dependents are enrolled in HDHP coverage. §152 generally defines "dependent" as a qualifying child or a qualifying relative.

- A "Qualifying Child" includes the employee's child or other relative younger than the employee: who has not attained age 19 (or 24 if a full-time student); who lives with the employee at least half of the year; who does not provide more than one-half of his or her own financial support; and who has not filed a joint return (other than only for a claim of refund) with his/her spouse. The age limitations are waived for a qualifying child who is totally disabled.
- A "Qualifying Relative" includes the employee's child or other relative or member of the employee's household: for whom the employee provides over half of the individual's financial support; whose gross income is less than the exemption amount; and who is not the qualifying child of the employee or any other person.

However, for purposes of establishing eligibility to receive reimbursement from an account holder's HSA, the definition of dependent is expanded slightly to include:

- An individual who is married and files a joint return with another taxpayer;
- An individual who could have been claimed as a dependent but who received more than the exemption amount in gross income; and
- An individual who could have been claimed as a dependent, except that the HSA account holder, or spouse if filing jointly, was claimed as a dependent on someone else's tax return.

Therefore, in some cases, a dependent who doesn't meet the definition of "Qualifying Child" or "Qualifying Relative" may still be able to have his or her expenses reimbursed from the account holder's HSA if he or she meets the expanded eligibility criteria.

© 2020 Benefit Comply LLC

Timing of Reimbursements

To be reimbursable, qualifying medical expenses must be incurred after the HSA was established. As a general rule, an HSA is "established" on the date that it is established under applicable state trust law. Most state trust laws require that a trust be funded (i.e., a deposit has been made) to be established. So even if an individual was an eligible individual for the entire year, if he or she didn't actually establish the HSA account until midyear, then expenses incurred prior to that point wouldn't be reimbursable on a pre-tax basis using funds in the HSA. That being the case, once the HSA is established, any expenses incurred after that date may be reimbursed at any point in the future; the expense does not have to be reimbursed within the same year in which the expense was incurred.

Individuals are typically not required to provide any documentation or proof of medical expenses incurred upon requesting a distribution from their HSA, but should keep receipts and records to show that reimbursements were taken only for qualifying medical expenses in case of an IRS audit.

In addition, reimbursement is not dependent upon HSA eligibility. Once the HSA is established and monies are contributed, the funds remain available to the HSA account holder to reimburse qualifying medical expenses until the funds are exhausted, even if the account holder subsequently loses HSA eligibility.

Funds Used for Non-Qualifying Expenses

If funds from the HSA are used for non-qualifying medical expenses, the distribution is included in the account holder's gross income and generally is subject to an additional 20% tax. However, if it was a mistake, there may be an option to return the money to the HSA prior to April 15th of the following year. Or if enough other qualifying medical expenses are incurred during the same year, the individual could avoid having to include the amount in gross income and pay the penalty tax.

HSA Rollovers

In general, rollovers are allowed only from HSA to HSA, with a one-time exception from a traditional or Roth IRA to an HSA.The following requirements apply to the IRA/HSA transfer:

- Funds can come from only one account, and the account must be either a traditional IRA or a Roth IRA.
- The rollover counts against the annual HSA contribution limit and, as a result, reduces the HSA owner's ability to reduce taxable income in the year of the rollover.
- Only one such rollover is permitted per lifetime.
- The HSA owner must remain an HSA-eligible individual through a "testing period," defined as the twelve-month period following the month of the rollover (i.e., up to thirteen total months). If the individual ceases to be eligible for any reason other than death, the entire rollover becomes taxable and subject to penalty.

Although it is possible to roll over funds from one HSA to another HSA for the same account holder (e.g., individual changes HSA vendors or perhaps consolidates two separate HSAs), it's not possible to roll over HSA funds into another individual's HSA. When HSA funds are transferred to another HSA of the same account holder, such rollover funds do not count toward the annual contribution limit.

Death of an HSA Account Holder

Upon the death of an HSA account holder, any amounts remaining in the HSA transfer to the beneficiary named in the HSA beneficiary designation form. The HSA is then treated differently for purposes of taxation depending upon whether the beneficiary is the account holder's surviving spouse or someone else.

- If the beneficiary is the deceased account holder's surviving spouse, then the spouse becomes the account holder of the HSA and the transfer is not taxable. The HSA amounts would be subject to income tax only to the extent that any distributions from the HSA were not used for qualified medical expenses. And at that point, like any other HSA account holder, the surviving spouse may designate a beneficiary to receive any amounts remaining in the HSA upon his or her own death, may roll over (or directly transfer) some or all of

the HSA's account balance into another HSA or an Archer MSA, and may add to the HSA through rollovers, transfers, and contributions so long as the surviving spouse is HSA eligible.

- If the beneficiary is someone other than the deceased account holder's surviving spouse, then the HSA ceases to be an HSA, and an amount equal to the fair market value of the account assets as of the date of the account holder's death is includible in the beneficiary's gross income (or, if the beneficiary is the deceased account holder's estate, includible in the decedent's gross income for the year in which the death occurred). A non-spouse beneficiary (other than the deceased account holder's estate) may reduce the includible amount by the amount of any payments made from the HSA for qualified medical expenses incurred by the decedent before death, but only if the payments are made within one year after the death. The beneficiary will also be entitled to a deduction for estate tax attributable to the amount included in income.

© 2020 Benefit Comply LLC

Miscellaneous

ERISA and COBRA Considerations

HSAs are not generally considered group health plans and are therefore not subject to ERISA or COBRA continuation requirements.

§4980H Considerations

Although employer HSA contributions may be taken into consideration when determining whether an HDHP provides minimum value (i.e., 60% or better actuarial value), employer HSA contributions do not affect affordability since HSAs cannot generally be used to pay premiums for employer-sponsored health coverage.

IRS Reporting Requirements

HSA owners are required to report HSA contributions and distributions on Form 8889, which is then filed with the Form 1040. Excess contributions must be reported on Form 5329.

Employers must report all employer contributions to employees' HSAs in Box 12 of Form W-2, using code W. For this purpose, employer contributions include all contributions made through a cafeteria plan—even pre-tax salary reductions. 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.

© 2020 Benefit Comply LLC

Appendix A – HDHP Requirements and Contribution Limits

	HDHP Minimum Deductible	HDHP Maximum OOP	HSA Contribution Limit
2014	Single - $1,250	Single - $6,350	Single - $3,300
	Family - $2,500	Family - $12,700	Family - $6,550
2015	Single - $1,300	Single - $6,450	Single - $3,350
	Family - $2,600	Family - $12,900	Family - $6,650
2016	Single - $1,300	Single - $6,550	Single - $3,350
	Family - $2,600	Family - $13,100	Family - $6,750
2017	Single - $1,300	Single - $6,550	Single - $3,400
	Family - $2,600	Family - $13,100	Family - $6,750
2018	Single - $1,350	Single - $6,650	Single - $3,450
	Family - $2,700	Family - $13,300	Family - $6,900
2019	Single - $1,350	Single - $6,750	Single - $3,500
	Family - $2,700	Family - $13,500	Family - $7,000
2020	Single - $1,400	Single - $6,900	Single - $3,550
	Family - $2,800	Family - $13,800	Family - $7,100

© 2020 Benefit Comply LLC

Appendix B – Contribution Limit Examples

- *Example 1 – Individual enrolled in self-only HDHP for May–Dec 2020 with no other disqualifying coverage (individual is not 55 or older)*
  - Individual may contribute $2,366.66 during 2020 (8/12 of $3,550).
  - Under the full-contribution rule, so long as the individual remains enrolled through Dec 2021, the individual may contribute $3,550 during 2020.

- *Example 2 – 58-year-old individual enrolled in self-only HDHP for May–Dec 2020 with no other disqualifying coverage*
  - Individual may contribute $3,033.33 during 2020 (8/12 of $3,550 + $1,000).
  - Under the full-contribution rule, so long as the individual remains enrolled through Dec 2021, the individual may contribute $4,550 during 2020 ($3,550 + $1,000).

- *Example 3 – Individual enrolled in family HDHP for Jan–May of 2020 with no other disqualifying coverage (individual is not 55 or older)*
  - Individual may contribute $2,958.33 during 2020 (5/12 of $7,100).

- *Example 4 – Husband is enrolled in self-only HDHP coverage during all of 2020, and wife is also enrolled in self-only HDHP coverage during all of 2020 (neither is 55 or older)*
  - Each spouse may contribute up to $3,550 during 2020.

- *Example 5 – Husband is enrolled in self-only HDHP coverage during all of 2020, and wife is enrolled in family HDHP coverage during all of 2020 (neither is 55 or older)*
  - Maximum contribution between the spouses is $7,100 during 2020.

© 2020 Benefit Comply LLC

Appendix C – Special Rule for Married Individuals

		Spouse A				
		No coverage	**Single Non-HDHP**	**Single HDHP**	**Family non-HDHP**	**Family HDHP**
Spouse B	**No coverage**	Neither is eligible to contribute to an HSA	Neither is eligible to contribute to an HSA	A may contribute up to $3,550 to an HSA. B is not eligible to contribute to an HSA	Neither is eligible to contribute to an HSA	A may contribute up to $7,100 to an HSA. B is not eligible to contribute to an HSA
	Single Non-HDHP	Neither is eligible to contribute to an HSA	Neither is eligible to contribute to an HSA	A may contribute up to $3,550 to an HSA. B is not eligible to contribute to an HSA	Neither is eligible to contribute to an HSA	A may contribute up to $7,100 to an HSA. B is not eligible to contribute to an HSA
	Single HDHP	B may contribute up to $3,550 to an HSA. A is not eligible to contribute to an HSA	B may contribute up to $3,550 to an HSA. A is not eligible to contribute to an HSA	Both A and B are eligible to contribute to an HSA; maximum contribution for each is $3,550	Neither is eligible to contribute to an HSA, *unless* B is not covered by A's family non-HDHP (in which case B may contribute up $3,550 to an HSA)	Both A and B are eligible and treated as having family coverage. Their maximum contribution together is $7,100
	Family Non-HDHP	Neither is eligible to contribute to an HSA	Neither is eligible to contribute to an HSA	Neither is eligible to contribute to an HSA, *unless* A is not covered by B's family non-HDHP (in which case A may contribute up $3,550 to an HSA)	Neither is eligible to contribute to an HSA	Neither is eligible to contribute to an HSA, *unless* A is not covered by B's family non-HDHP (in which case A may contribute up $7,100 to an HSA)
	Family HDHP	B may contribute up to $7,100 to an HSA. A is not eligible to contribute to an HSA	B may contribute up to $7,100 to an HSA. A is not eligible to contribute to an HSA	Both A and B are eligible and treated as having family coverage. Their maximum contribution together is $7,100	Neither is eligible to contribute to an HSA, *unless* B is not covered by A's family non-HDHP (in which case B may contribute up $7,100 to an HSA)	Both A and B are eligible. Their maximum contribution together is $7,100

© 2020 Benefit Comply LLC

Appendix D: Comparison of HRAs, Health FSAs, and HSAs

	Health Reimbursement Arrangement (HRA)	**Health Flexible Spending Account (FSA)**	**Health Savings Account (HSA)**
Eligibility	Depends on Employer	Depends on Employer	Enrolled in HSA qualified high-deductible health plan (HDHP), with no other non-qualified coverage
Requirements for Associated Health Plan	None, but usually paired with high-deductible health plan	None, but must be available only to those who are also eligible for (not necessarily enrolled in) the Employer's group medical plan to maintain excepted benefit status	Minimum deductible and maximum OOP limits set annually by regulations
Contribution Source	Employer only	Employer or employee	Employer or Individual
Contribution Maximum	Employer determines	Employer – $500 or match of employee contribution to maintain excepted benefit status Employee – Set annually by regulations	Set annually by regulations
Plan Design and Withdrawal Rules	Funds used for eligible health care expenses – employer determines plan design	Funds used for eligible health care expenses – employer determines plan design	Individual Controls Distributions – Tax-free only for qualified medical expenses
Carryover/Rollover	Employer determines if unused funds may be rolled over or vested	Employer determines if up to $500 may be carried over to the next plan year	Unused funds rolled over and are portable

© 2020 Benefit Comply LLC

Appendix E – Additional Resources

Basic rules for HSAs are found in Code §223 – Health Savings Accounts

Comparability rules for employer HSA contributions not run through a cafeteria plan – Treas. Reg. §§54.4980G-1 through 54.4980G-5

IRS Notices including Q&A on various HSA requirements:

- IRS Notice 2004-02 – https://www.irs.gov/irb/2004-02_IRB#NOT-2004-2
- IRS Notice 2004-50 – https://www.irs.gov/irb/2004-33_IRB#NOT-2004-50
- IRS Notice 2008-52 – https://www.irs.gov/irb/2008-25_IRB#NOT-2008-52
- IRS Notice 2008-59 – https://www.irs.gov/irb/2008-29_IRB#NOT-2008-59

IRS Publication 969 – Health Savings Accounts and Other Tax-Favored Health Plans – https://www.irs.gov/pub/irs-pdf/p969.pdf

© 2020 Benefit Comply LLC