

Health Savings Accounts (HSAs) – Common Questions

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As we see more and more employers offering high-deductible health plans (HDHPs), there is an increased need for employers and employees to understand HSA eligibility rules, contribution requirements, and which expenses are reimbursable on a tax-favored basis. Below is a quick summary of HSA eligibility and contribution rules, followed by a series of frequently asked questions and responses.

HSA Basics

Only eligible individuals can make contributions to their HSA accounts. 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,” including Medicare; 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 the 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, an individual must be enrolled in a qualifying HDHP to be eligible to contribute to an HSA, but an individual who is ineligible to contribute to an HSA can still enroll in HDHP coverage if the plan eligibility requirements are met.

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. Contribution limits are adjusted annually. The 2020 annual contribution limits are as follows:

- 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.*

Common HSA Questions

Does turning 65, or becoming Medicare eligible, make the individual ineligible to contribute to an HSA?

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

In addition, even if the individual becomes ineligible to contribute to an HSA upon enrolling in Medicare, the funds previously contributed to the HSA remain available to reimburse the individual for qualifying medical expenses until the funds are exhausted (the expenses do not have to be incurred while the individual is HSA eligible).

What are some of the key differences between an HRA, a health FSA, and an HSA?

Although all three types of accounts are available to reimburse the individual for qualifying medical expenses on a tax-favored basis, there are some significant differences:

- An HRA is funded solely by the employer, whereas a health FSA and an HSA could be funded by employee and/or employer contributions.
- The health FSA and HSA have annual contribution limits, whereas the HRA does not.
- An HRA and health FSA funds are generally forfeited upon a loss of plan eligibility, whereas the HSA funds will remain with the employee (beyond employment) until the funds are exhausted.

- An HRA and health FSA are subject to ERISA and COBRA, whereas HSAs typically are not.

An employee who was enrolled in single HDHP coverage all year turned 55 in October. How much can the employee contribute in 2020?

The employee can contribute up to \$4,550 for 2020 (\$3,550 + \$1,000 catch-up). Individuals who are age 55 or older may contribute up to \$83.33 (1/12 of \$1,000) as a catch-up contribution for each month the individual is HSA eligible. However, if the individual turns 55 by December 1st, the individual is eligible for the catch-up contribution for all months of the year the individual was HSA eligible.

Whose qualifying medical expenses are eligible for reimbursement by the HSA?

Reimbursement is allowed on a tax-favored basis for qualified medical expenses for the HSA account holder, and for the account holder's spouse and tax dependents. This is true even if the spouse or other tax dependents are not enrolled in HDHP coverage or if they have other disqualifying coverage (e.g. Medicare).

Tax dependents generally include a "qualifying child" or "qualifying relative." That being the case, a dependent who doesn't meet either definition 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 (e.g. is married or has income above the threshold limit).

Can a married couple share an HSA (a joint HSA)?

No. If both spouses are HSA eligible and want to contribute to an HSA, it is not possible for them to have a joint HSA account. HSAs are individually owned accounts. Although one spouse could contribute to the other spouse's HSA, the HSA nevertheless belongs to only one of them.

Also keep in mind that there is a special rule regarding contribution limits for spouses. When both spouses are enrolled in HDHP coverage and are 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.

If an employer wants to contribute to an HSA, is it okay to differentiate contributions between categories of employees, or to match some or all employee HSA contributions?

The answer depends upon whether the employer includes the HSA in its 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: (i) current full-time, (ii) current part-time, or (iii) former employees.

If the employer runs the HSA through its cafeteria plan, and also allows employees to make pre-tax HSA contributions, employer HSA contributions are not subject to comparability rules. 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, which restrict the extent to which employers may favor highly compensated individuals on a tax-favored basis. Keep in mind that all benefits offered through a cafeteria plan are aggregated for purposes of discrimination testing.

What happens upon the death of an HSA owner?

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. If a beneficiary isn't named, the funds transfer according to the terms of

the HSA trust or custodial account agreement. 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.

What is the employer's role/responsibility for ensuring that employees are HSA eligible and do not exceed annual contribution limits?

For the most part, the responsibility lies with the employees regarding HSA eligibility, staying within annual contribution limits, and requesting reimbursement for eligible expenses. The employer's responsibility is fairly limited. If the employer is making HSA contributions, 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).

What if the HDHP has an embedded single deductible for family coverage? Is it still a qualifying HDHP for purposes of HSA eligibility?

For family HDHP coverage with an embedded individual deductible, the embedded individual deductible cannot be less than the minimum deductible applicable to family coverage (\$2,800 for 2020). So, for example, if the family deductible is \$5,000, an embedded individual deductible of anywhere from \$2,800 to \$5,000 would be okay; anything less than \$2,800 would not. Said differently, no one enrolled in family HDHP coverage may receive coverage (other than for preventive) prior to meeting the minimum family HDHP deductible of \$2,800 for plan years beginning in 2020.

For an HDHP with a non-calendar plan year, when is it necessary to comply with the latest deductible and OOP maximum limits requirements for a qualifying HDHP?

For HDHPs with non-calendar year plans, the HDHP deductible and out-of-pocket limits for the calendar year in which the HDHP's plan year begins can be applied for the entire plan year. In other words, for a July–June plan year, changes to the deductible limits for 2020 would have applied beginning in July 2020.

How are excess contributions to the HSA corrected?

Individuals may request what's called a "curative distribution" from the HSA trustee/custodian if excess contributions are made. If this is requested before the tax filing deadline (typically April 15), the 6% excise tax can be avoided.

The employee should notify the HSA trustee/custodian of the excess contribution and request a distribution of the excess amount and attributable earnings (since these will be taxable). If insufficient funds remain in an individual's HSA to accomplish a curative distribution, the individual can ask the HSA trustee/custodian to report earlier distributions as including a distribution of the excess contributions, plus earnings. The trustee/custodian will

report the distribution on Form 1099-SA, coded as an excess contribution. If the employer doesn't include the excess contributions as the employee's wages on the W-2, the employee should report this amount as "other income" on their federal income tax return.

What are the employer's obligations if the employee fails to establish an 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. There are no specific rules or regulations that would be violated if the employer HSA contributions were not made for those who fail to establish an HSA in accordance with the employer's policy. Employee contributions, if any, should be returned as taxable income.

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.
- 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.

What types of coverage will make an individual ineligible to contribute to an HSA?

The following types of coverage are considered disqualifying coverage:

- Medical plans with a deductible or OOP maximum less than the HDHP statutory minimums;
- General-purpose health FSA or HRA reimbursing before the minimum HDHP statutory deductible;
- Medicare, TRICARE, or Medicaid;
- Indian health services (if services have been received in the previous 3 months);
- VA coverage (if the individual does not have a disability rating and services have been received in the previous 3 months);
- On-site clinics providing significant medical care (if individuals do not pay fair market value); and
- Executive reimbursement plans (unless limited solely to annual physicals).

There is little to no guidance regarding telemedicine services or 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.

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