abd Insurance & Financial Services

Office Hours

Go All the Way With HSA:
Everything HDHP/HSA You Need to Know

Audio

Brian Gilmore
Lead Benefits Counsel, VP

SEPTEMBER 27, 2018

ICYMI: Recent Office Hours Library

http://www.theabdteam.com/abd-insights/presentations/

- **Mergers and Acquisitions:**
  The Top Five Issues for H&W Employee Benefits Plans
- **Medicare for Employers:**
  The Top Five Issues for Group Health Plans
- **2017 Employee Benefits Year in Review:**
  Plus What Lies Ahead in 2018
- **Health Benefits While on Leave:**
  The Rules All Employers Need to Know
- **The San Francisco Paid Parental Leave Ordinance:**
  Complying with the City's New 2017 Paid Leave Law
- **Health Benefits for Domestic Partners:**
  Review of the Tax and Coverage Rules for Employers

Triple-Tax Advantaged Account

HSAs Provide Tax Benefits that are Unparalleled

Unparalleled Three Tiers of Federal Tax Savings:

A

Pre-Tax Contributions

- Employee contributions through payroll are made on a pre-tax basis through the Section 125 cafeteria plan. Employee contributions outside of payroll receive an above-the-line tax deduction.
- Employer contributions are tax-free to the employee.

B

Tax-Free Growth

HSA gains are not subject to interest, dividend, or capital gains taxes.

C

Tax-Free Distributions

Distributions for qualifying medical expenses are not subject to taxation.

Why HDHP HSA?

HSA Eligibility: Can You Make or Receive HSA Contributions?

HSA eligibility has two key requirements. You must satisfy both to be eligible to make or receive HSA contributions (and cannot be claimed as a tax dependent by someone else).

1) Covered by an HDHP: The most fundamental HSA eligibility rule is its link to HDHPs. Only individuals covered by a HDHP can be HSA eligible.

Specifics:

- Must be covered by an HDHP (and have no disqualifying coverage) as of the first day of the calendar month to be HSA eligible for that calendar month
- Mid-month enrollment would mean not HSA eligible until the following month
- Mid-month loss of HDHP coverage does not affect HSA eligibility for that calendar month

2) No Disqualifying Coverage: Generally requires that the employee not be covered by any other medical coverage that pays before the minimum HDHP deductible.

Specifics:

- Includes coverage under a general purpose health FSA or HRA (whether through your employer or the employer of a spouse/parent)
- Includes Medicare Parts A, B, C, or D
- Does not include dental or vision coverage or limited-scope dental/vision health FSA or HRA
- Does not include EAP or wellness program coverage as long as they don't provide "significant benefits in the nature of medical care or treatment"

HSA Contribution Limits

The annual statutory maximum HSA contribution limits are for all contributions combined (employer and employee). These amounts are subject to cost-of-living adjustments each year based on chained CPI (TCJA). (Note: The catch-up contribution limit has been fixed by law at $1,000 since 2009 and will not further adjust for inflation.)

	2018	2019
Annual Contribution Limit	Individual Coverage: $3,450 Family Coverage: ~~$6,900~~ ~~$6,850~~ $6,900	Individual Coverage: $3,500 Family Coverage: $7,000
Age 55+ Catch-Up Contribution	$1,000	$1,000

HSA Contribution Limits:
Mid-Year Loss of HSA Eligibility

Contribution Limit Proportional to Number of Months HSA Eligible

- You may contribute a proportional amount of the statutory HSA contribution limit based on the number of months in the year in which you were HSA-eligible
- Remember, HSA-eligible months are any calendar month in which you were covered by a HDHP and had no disqualifying coverage on the first day of the month

Example

- Bryce enrolls in HDHP coverage January 1, 2018
- Bryce switches from HDHP coverage to non-HDHP coverage as of October 1, 2018 upon getting married (and remains in non-HDHP coverage through December 31, 2018)

Result

- Bryce was HSA eligible for 9/12 of the year (3/4)
- This means Bryce's 2018 HSA contribution limit is $3,450 x ¾ = $2,587.50
  - If Bryce's 2018 HSA contributions (combined employer/employee) exceeded $2,587.50, he will need to make a corrective distribution from the HSA of the excess contributions by his tax filing due date (generally April 15, 2019, unless he files for an extension)
  - This will avoid a 6% excise tax on the excess contributions

HSA Contribution Limits: Becoming HSA Eligible Mid-Year

General Rule: Contribution Limit Proportional to Number of Months HSA Eligible

- You may contribute a proportional amount of the statutory HSA contribution limit based on the number of months in the year in which you were HSA eligible (same as prior slide)

Special Rule: The Last-Month Rule (aka Full Contribution Rule)

- The last-month rule allows HSA contributions up to the full statutory limit even though the employee was not HSA eligible for the full year, provided:

1) The employee is HSA eligible on December 1 of the year at issue, AND
2) The employee remains HSA eligible for the entire following year (i.e., the 13-month period from December of year one through December of year two)

Example

- Kris enrolls in HDHP coverage October 1, 2018 and is HSA eligible through the rest of the year and through all of 2019

Result

- Kris can contribute the full statutory limit for 2018 under the last-month rule because he was HSA eligible in the 13-month testing period from December 2018 through December 2019 (otherwise the 2018 contribution limit would be 3/12 the statutory limit)
  - If Kris made the full 2018 statutory contribution and failed to remain HSA eligible for all of 2019, he would be subject to income taxes and a 10% additional tax on the other 9/12 contribution amount

HSA Contribution Limits:
Individual and Family Coverage

Contribution Limits Calculated on Monthly Basis

- Eligible to contribute 1/12 of the family limit for months of year in family coverage
- Eligible to contribute 1/12 of the individual limit for months of year in individual coverage

IRS Form 8889 Instructions "Limitation Chart and Worksheet"

- https://www.irs.gov/pub/irs-pdf/i8889.pdf

Line 3 Limitation Chart and Worksheet

Before you begin: *See the instructions for line 3, earlier.*
Go through this chart for each month of 2017.
(Keep for your records)

Self-only coverage	Family coverage
Enter $3,400 on the line below for the month. If you were age 55 or older at the end of 2017, enter $4,400 for the month.	Enter $6,750 on the line below for the month. If, at the end of 2017, you were unmarried and age 55 or older, enter $7,750 for the month.

Month in 2017	Amount from chart above
January	
February	
March	
April	
May	
June	
July	
August	
September	
October	
November	
December	
Total for all months	
Limitation. Divide the total by 12. Enter here and on line 3	

HSA Contribution Limits: Contribution Deadline

Contributions for the Year are Due by April 15 of Following Year

- Individuals and employers may make HSA contributions by the tax deadline filing date the following year (generally April 15)
- Even though the individual's HSA contribution limit is determined monthly (or via the last-month rule), there is no requirement to contribute monthly

Example

- Wil enrolls in family HDHP coverage January 1, 2018 and is HSA eligible for the entire year
- Wil's employer contributes $125 per pay period to his HSA
- Wil contributes $162.50 per pay period to his HSA through the cafeteria plan
- In February 2019, Wil's employer realizes it missed one employer contribution in 2018 and makes the final $125 contribution by April 15, 2019
  - Wil's employer notifies the HSA custodian and Wil that the $125 contribution made in 2019 is a contribution for the prior year (2018), even though made in 2019

Result

- All of Wil's and Wil's employer contributions described above ($6,900) apply to the 2018 contribution limit because all contributions were made by April 15, 2019

HSA Contribution Limits: Catch-Up Contributions ($1,000)

Individuals Age 55+ Are Eligible for $1,000 Catch-Up Contribution

- The 2018 contribution limit for catch-up eligible individuals is $4,450/$7,900
- To qualify, the individual must turn age 55 by the end of the taxable year
- The $1,000 catch-up is not subject to any further inflation adjustments

Married Individuals

- Both spouses may make the additional $1,000 catch-up contribution if both are at least age 55
- Each spouse must make catch-up contributions to his or her own HSA to take advantage of the double catch-up contribution ($1,000 to each HSA)

Example

- Anthony and his spouse Chelsea are both age 55, covered by a family HDHP, and HSA eligible for all of 2018

Result

- Anthony may contribute up to $7,900 to his HSA ($6,900 + $1,000 catch-up)
- If Anthony contributes $7,900, Chelsea may contribute her $1,000 catch-up contribution to her HSA (cannot make her catch-up to Anthony's HSA)

HSA Distributions:
Timing Issues (Good and Bad)

Good: Tax-Free Distribution Can Be Made in Future Tax Year

- HSA distributions for a medical expense may be made at any time in the future
- Means the HSA owner could delay taking the tax-free reimbursement until many years later (and enjoy the tax-free growth in the meantime!!)
- Individual must keep sufficient records to show that the distributions were exclusively to pay or reimburse qualified medical expenses
  - Also must show that the expenses were not paid or reimbursed from another source, and that the individual did not claim the expenses as an itemized deduction in any prior taxable year

Example

- Marcel incurs the full $1,300 deductible in medical expenses under his HDHP in 2018 (and also had an HSA in place for all of 2018)
- Marcel also paid $700 out-of-pocket (i.e., not covered by insurance) in 2018 for new prescription glasses and a dental crown
- Marcel keeps records of the expenses for the rest of his life

Result

- Marcel can take a $2,000 tax-free distribution from his HSA to cover the qualifying medical expenses he incurred in 2018…or in 2028…or 2050…etc.

HSA Distributions:
Timing Issues (Good and Bad)

Good: Tax-Free Distribution Not Affected by HSA Eligibility

- An individual does not need to maintain HSA eligibility to take tax-free distributions for medical expenses
- Means the HSA owner could build up an HSA balance, move to a non-HDHP, and still use that HSA account to cover qualifying medical expenses tax-free
- REMEMBER: HSA eligibility is relevant only for determining the ability to make or receive HSA contributions—not for purposes of tax-free distributions
  - This is a VERY common misconception, don't fall for it!

Example

- Marcel moves to a non-HDHP HMO in 2019 with a $1,500 balance in his HSA
- Marcel incurs $1,500 in qualifying medical OOP expenses through copays, coinsurance, contact lenses, sunscreen, glasses, bandages, etc. in 2019

Result

- Marcel can take a $1,500 tax-free distribution from his HSA in 2019 to cover the qualifying medical expenses he incurred—even after losing HSA eligibility!
- Loss of eligibility just means he can't make or receive HSA contributions in 2019

HSA Distributions:
Timing Issues (Good and Bad)

Bad: Expense Must Be Incurred After HSA Established

- A qualified tax-free medical distribution is available only if the medical expenses is incurred after the HSA has been "established"
- State trust law determines when an HSA is considered "established"
- Most state laws require that a trust be funded to be established
  - Means that an HSA won't be established in most cases until a contribution is actually deposited in the HSA

Example

- Carlos signs up for his company's HDHP at open enrollment for 2019
- Carlos's employer makes quarterly HSA contributions to any HSA-eligible employee enrolled in the HDHP (Carlos does not make any HSA contributions)
- The company's first quarterly contribution is deposited in Carlos's HSA as of April 1, 2019

Result

- Carlos's medical expenses incurred prior to April 1 are not eligible for tax-free medical distribution from the HSA
- Only those expenses incurred after the establishment date (4/1/19) are eligible

HSA Distributions:
Timing Issues (Good and Bad)

Bad: Expense Must Be Incurred After HSA Established

- There is a significant exception to the establishment rule from the prior slide if the individual had previously established an HSA
- The new HSA is deemed to be established when the first HSA was established as long as the first HSA had a balance greater than zero at any time during the 18-month period ending on the date the new HSA is established
  - This allows medical expenses to be reimbursed on tax-free basis from the new HSA even if they were incurred prior to the date the new HSA is funded

Example

- Carlos established an HSA January 2014 while in a prior company's HDHP
- He distributed the last funds from that first HSA on November 15, 2017
- Carlos signs up for his new company's HDHP at open enrollment for 2019
- The first contribution is deposited in Carlos's HSA on April 1, 2019

Result

- Because the new HSA is established within 18 months of November 15 2017, the new HSA is deemed established in 2014 (not April 1, 2019)
  - This allows Carlos's medical expenses incurred January 1, 2019 to March 31, 2019 under the new HDHP to be reimbursed on tax-free basis (before the new HSA is funded)

HSA Reporting:
Employer Reporting (Form W-2)

HSA Contributions Reported on Employee's Form W-2

- All employer and employee contributions to the employee's HSA are reported on Box 12, Code W
- Includes the employer contribution amount and the amounts contributed pre-tax by employees through payroll (via the Section 125 cafeteria plan)
- Note that HSA contributions are not subject to the separate requirement to report the aggregate cost of employer-sponsored health coverage in Box 12, Code DD

Example

- Addison contributes $3,900 to his family HSA on a pre-tax basis through his employer's Section 125 cafeteria plan in 2018
- Addison's employer contributes $3,000 to his HSA in 2018

Result

- Box 12 of Addison's Form W-2 from his employer should show $6,900 in HSA contributions by using Code W

HSA Reporting:
Custodian (Bank) Reporting

HSA Contributions Reported on Form 5498-SA

- The HSA custodian reports all contributions to the account for the year on Form 5498-SA
- Also reports the fair market value of the account as of the last day of the year
- Custodian files the Form 5498-SA with the IRS by May 31 of the following year
- Individual receives a copy of the form by May 31 of the following year

HSA Distributions Reported on Form 1099-SA

- The HSA custodian reports all distributions from the account in the year on Form 1099-SA
- Provided to individuals by January 31 of the following year
- Custodian files copy of the form with the IRS by March 31 of the following year
- Bank does not report whether distributions were for qualified medical expenses

HSA Reporting:
Employee Reporting (Form 8889)

HSA Contributions and Distributions Reported on Form 8889

- All individuals who had HSA contributions or distributions must report the activity on Form 8889, which is included with the individual tax return (Form 1040)
- Includes information showing HDHP coverage, employer contribution amount (including employee pre-tax payroll contributions), and whether any additional taxes for excess contributions or non-qualified distributions apply
- In some cases, Form 5329 must also be completed to report excess contributions and earnings

IMPORTANT NOTE RE TAXATION

- Form 8889 is a self-reporting structure where the individual reports any distributions that were made for qualified tax-free medical expenditures
- There is no administrative gatekeeper here—it is up to the individual to properly report that a distribution was subject to income tax and (generally if under age 65) the 20% additional tax for non-medical distributions
- Also used to report the 10% additional tax for individuals who fail to maintain HDHP coverage through the 13-month testing period that applies to the last-month rule

HSAs and Reaching Age 65 (Medicare)

You Do Not Lose HSA Eligibility Automatically Upon Reaching Age 65!

- Only Medicare enrollment causes an individual to lose HSA eligibility
- Many employees age 65 and older do not enroll in Medicare
- Note that anyone who is receiving Social Security retirement benefits is automatically enrolled in Medicare Part A (no opt-out permitted), and therefore automatically loses HSA eligibility

You Are No Longer Subject to the 20% Additional Tax

- Individuals who reach age 65 do not pay the 20% additional tax on distributions from the HSA for non-medical expenses
- This is why HSAs are also frequently used as a retirement savings vehicle (IRA-like)
- Remember that you will need to pay the ordinary income tax on any non-medical distribution even once you reach age 65 (like a traditional 401(k)/IRA)

Example

- Jose reaches age 65 in August 2018 but does not enroll in Medicare
- He is covered by an HDHP with no disqualifying coverage for all of 2018
- In December 2018, Jose decides to purchase a $2,500 75” Ultra HD 4K TV with HSA funds

Result

- Jose is HSA eligible for all of 2018 (and therefore can contribute the max plus catch-up)
- The $2,500 HSA distribution for the 4K UHDTV is subject only to ordinary income taxes

HSAs and Post-Age 65 (Medicare)

Delayed Medicare Enrollment Causes Six-Month Retroactive Enrollment

- No retroactive enrollment issue for individuals who enroll in Medicare at age 65 (or begin Social Security prior to age 65, and therefore have Part A coverage automatically at 65)
- However, if you delay enrolling in Medicare until after first becoming eligible (including later application for Social Security benefits), the later Part A enrollment will be retroactive for up to six months
- The six-month retroactive enrollment in Part A will block HSA eligibility retroactive to the start of the Medicare coverage

How to Address the Retroactive Enrollment

1) **Plan Ahead**: Stop making or receiving HSA contributions at least six months before applying for Medicare; or
2) **Correct Mistake:** Make a corrective distribution of the excess contributions by the due date (including extensions) for filing the individual tax return (generally April 15, without extension)

Example

- Jose reaches age 65 in August 2017 but does not enroll in Medicare
- Jose signs up for Social Security benefits in on October 1, 2018, which automatically enrolls him in Medicare Part A retroactive to April 1, 2018

Result

- Jose retroactively loses HSA eligibility as of April 2018—and therefore can contribute only 3/12 of the HSA statutory limit for 2018 (plus 3/12 of the catch-up contribution)
- If he already contributed in excess of that limit, he must make a corrective distribution of the excess contributions by April 15, 2019 (assuming no extensions to his individual return)

HSAs and Post-Age 65 (Medicare)

Where to Direct Employees

- **CMS Fact Sheet: Deciding Whether to Enroll in Medicare Part A and Part B When You Turn 65**

  https://www.cms.gov/Outreach-and-Education/Find-Your-Provider-Type/Employers-and-Unions/FS3-Enroll-in-Part-A-and-B.pdf

FACT SHEET: Deciding Whether to Enroll in Medicare Part A and Part B When You Turn 65

☐ **I have health insurance based on my (or my spouse's) current employment, from an employer with *20 or more employees*** (this includes those with Federal Employees Health Benefits (FEHB))

> ***NOTE:*** *If you have COBRA or retiree coverage, or if your employer gives you an amount of money to purchase health insurance, you do NOT have health insurance based on "current employment." If you have one of these types of insurance, you should find that situation in the fact sheet.*

Do I have a health savings account?

Health savings accounts (HSAs) are a special kind of tax-deferred account available only to people who have a high-deductible health plan. HSAs are not the same as a flexible spending account (FSA) or health reimbursement account (HRA). If you aren't sure if you have an HSA, ask your benefits administrator or plan.

☐ I have an HSA

☐ I do not have an HSA

Your decision to enroll in Part A and Part B **depends on whether you have a high-deductible health plan with a health savings account (HSA):**

○ ***I do NOT have a Health Savings Account (HSA)***

Part A: If you qualify for premium-free Part A, you should enroll in Part A when you turn 65. However, if you have to pay a premium for Part A, you can delay Part A until you (or your spouse) stop working or lose that employer coverage. You will NOT pay a penalty for delaying Part A, as long as you enroll within 8 months of losing your coverage or stopping work (whichever happens first).

Part B: You can delay Part B until you (or your spouse) stop working or lose that employer coverage. This allows you to save the cost of your Part B premium. It also allows you to postpone your one-time "Medigap open enrollment period" until a later time, when you may want to purchase this type of coverage.

You will NOT pay a penalty for delaying Medicare, as long as you enroll within 8 months of losing your coverage or stopping work (whichever happens first). You'll want to plan ahead and enroll in Part B at least a month before you stop working or your employer coverage ends, so you don't have a gap in coverage.

▸▸ ***You have completed TASK 2. Go to TASK 3 on page 7.***

HSAs and Post-Age 65 (Medicare)

Where to Direct Employees

- **CMS Fact Sheet: Deciding Whether to Enroll in Medicare Part A and Part B When You Turn 65**
  https://www.cms.gov/Outreach-and-Education/Find-Your-Provider-Type/Employers-and-Unions/FS3-Enroll-in-Part-A-and-B.pdf

You have completed TASK 2. Go to TASK 3 on page 7.

○ ***I have a High-Deductible Health Plan AND a Health Savings Account (HSA)***

Once you enroll in any part of Medicare, you won't be able to contribute to your HSA. If you would like to continue making contributions to your HSA, you can delay both Part A and Part B until you (or your spouse) stop working or lose that employer coverage. You will NOT pay a penalty for delaying Medicare, as long as you enroll within 8 months of losing your coverage or stopping work (whichever happens first).

You should talk with your employer benefits manager about whether it makes sense to delay Part A and Part B.

NOTE: *If you qualify for premium-free Part A, your coverage will go back (retroactively) up to 6 months from when you sign up. So, you should stop making contributions to your HSA 6 months before you enroll in Part A and Part B (or apply for Social Security benefits, if you want to collect retirement benefits before you stop working).*

You have completed TASK 2. Go to TASK 3 on page 7.

HSAs and Telemedicine

Telemedicine That is Part of the HDHP: Not Disqualifying Coverage

- In this case, the employee's costs related to the telemedicine services are subject to the same HDHP cost-sharing rules as non-telemedicine services
- In other words, the HDHP deductible applies to telemedicine in the same manner as in-person services
- Preventive care or EAP/Wellness/Disease Management services are not required to be subject to the deductible (same as in-person services)

Telemedicine That is Not Part of the HDHP: May Be Disqualifying Coverage

- Separate telemedicine plans that are not subject to the HDHP deductible—therefore another exception must apply to the telemedicine benefit to avoid blocking HSA eligibility
- Main exemptions that could apply are:

1) **Preventive Services**: Telemedicine limited to preventive services only; or
2) **EAP/Wellness/Disease Management:** Telemedicine that does not provide "significant benefits in the nature of medical care or treatment"

"Significant Benefits" Standard Difficult to Apply to Telemedicine

- Best examples come from HIPAA/ACA excepted benefit regulations preamble:
- *"For example, an EAP that provides only limited, short-term outpatient counseling for substance use disorder services (without covering inpatient, residential, partial residential or intensive outpatient care) without requiring prior authorization or review for medical necessity does not provide significant benefits in the nature of medical care. At the same time, a program that provides disease management services (such as laboratory testing, counseling, and prescription drugs) for individuals with chronic conditions, such as diabetes, does provide significant benefits in the nature of medical care."*

HSAs and Dependent Medical Expenses

Children: Age 26 Rule Does Not Apply

- Unlike health FSAs and HRAs, the HSA rules do not incorporate the ACA Age 26 rule
- Means that the child must be a tax dependent for the child's expenses to qualify
- Generally requires that the child be under age 19, or under age 24 and a full-time student
  - In most cases, children of divorced parents can be treated as a dependent of both

Spouse: Same-Sex or Opposite-Sex Spouse

- Since the US Supreme Court's Windsor decision overturning DOMA in 2013, same-sex spouses and opposite-sex spouses are treated identically for federal tax purposes
- Same-sex spouse medical distributions therefore now always qualify

Domestic Partner: Only Tax-Dependent DPs Qualify

- There is no federal tax recognition of domestic partner status
- Therefore, a domestic partner must qualify as a tax dependent for expenses to be eligible
- This generally requires that the DP:

1) Have the same principal place of abode and is a member of the employee's household
2) Receive over half of his or her support from the employee (community property issues)
3) Not be anyone's qualifying child for tax purposes
4) Be a U.S. citizen or resident of the U.S. or country contiguous to the U.S.

- Note that certain tax-dependent status requirements are removed from this health tax-dependent definition.

HSAs and Domestic Partners

Tax-Free Medical Expenses Distribution Available Only for Tax-Dependent DPs

- Individuals will be subject to income tax and a 20% additional tax for distributions for non-tax dependent domestic partner
- Tax-free HSA distributions available for medical expenses of a tax-dependent DP in the same manner as for a spouse

Family Coverage Limit Applies for DP HDHP Coverage

- Employees covering a non-tax dependent DP may contribute the family HSA limit
- Family coverage is defined as “any coverage other than self-only coverage”

The Domestic Partner Double Family Contribution Loophole

- Normal rule is that employee and spouse have a combined family contribution limit ($6,900 in 2018) that may be allocated between spouses in any manner (applies where at least one of the spouses has family coverage)
- The combined limit rule doesn’t apply to domestic partners because not spouses
- If both the employee and domestic partner are covered by family HDHP coverage and are both HSA eligible, they could each contribute the family HSA limit to their own HSA ($6,900 to each HSA, $13,800 total)
  - IRS Informal ABA Guidance: http://www.americanbar.org/content/dam/aba/migrated/jceb/2010/2010IRSFINAL.authcheckdam.pdf

HSAs and Disabled Veterans

General Rule

- HSA eligibility generally requires:

1) The individual be covered by an HDHP; and
2) The individual not have any other disqualifying coverage.

Special VA Rule

- Veterans who are eligible for VA benefits but have not actually received VA benefits in the past three months are not considered to have disqualifying coverage

New Rule from 2015 Legislation for Veterans with Service-Connected Disabilities

- Veterans with service-connected disabilities do not have to worry about the general three-month rule for VA services provided for a service-connected disability
- VA coverage will not be considered disqualifying coverage under these circumstances

Enhanced ACA Potluck Guidance (IRS Notice 2015-87)

- All VA services provided to a veteran with a service-connected disability will be deemed to be for the service-connected disability—and therefore not disqualifying
- In other words, VA benefits will never be disqualifying coverage for veterans with a service-connected disability

HSAs and Male Contraception/Sterilization

Preventive Care Not Subject to Minimum Deductible

- HDHPs may (and typically do) provide first-dollar coverage for preventive care
- "Preventive care" includes services listed in IRS Notice 2004-23 and
- Also includes ACA preventive services required to be provided without cost sharing for non-grandfathered health plans

New IRS Guidance for State Male Contraception and Sterilization Mandates

- A few states (Maryland, Illinois, Vermont, Oregon) have recently imposed insurance mandates requiring male contraceptive/sterilization services be covered at no cost
- Default rule would be that no fully insured plans in those states could meet the requirements of an HDHP (and no individuals covered could be HSA eligible)

IRS Provides Transition Relief Until 2020

- IRS Notice 2018-12 provides a transition period until 2020
- During the transition period prior to 2020, these mandates will not prevent HDHP status

What Happens in 2020?

- Likely that states will either:

a) Remove the state insurance mandate that blocks HDHP status; or

b) Modify it to accommodate HDHP status requirements (e.g., subject to deductible)

- Also possible that Congress or IRS will modify the HDHP preventive services definition to accommodate these common male sterilization/contraceptive mandates

HSAs and Section 125 Cafeteria Plan

All Employee Pre-Tax HSA Contributions are Made Through Section 125

- The Section 125 cafeteria plan can permit employees to make pre-tax premium payments to the HDHP and pre-tax contributions to the HSA
- There is no other mechanism for these elections to be made on a pre-tax basis
- Employers that permit pre-tax HSA contributions are subject to the Section 125 cafeteria plan nondiscrimination rules (not the much more difficult HSA comparability rules)

Special Rule Provides for HSA Election Changes At Least Monthly

- The general rule for Section 125 elections is that they are irrevocable for the plan year unless the employee experiences a permitted election change event
- However, there is an exception to this rule for employee pre-tax HSA contribution elections
- The cafeteria plan must permit employees to change their HSA contribution election at least once per month for any reason (with no change in status or other event required)

Employee Pre-Tax HSA Contributions Avoid Employer Payroll Taxes

- As with all employee pre-tax contributions for health benefits, HSA contributions are excluded from both payroll and income taxes (state exceptions apply)
- The big difference is that unlike all other contributions, employees could make the same HSA contribution outside of payroll (with after-tax dollars) and later claim an above-the-line deduction on the personal tax return that results in the same employee tax treatment
- However, the employer avoids the need to pay the employer-share of the FICA taxes (6.2% Social Security, 1.45% Medicare) only if the employee contributes pre-tax through payroll

HSAs and Above-the-Line Deductions

2017 Form 1040

- Pre-TCJA, the above-the-line deduction for HSA contributions made outside of a Section 125 cafeteria plan (i.e., not pre-tax through payroll) was part of the Form 1040 itself:

Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** **2017** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2017, or other tax year beginning , 2017, ending , 20 See separate instructions.

Your first name and initial | Last name | Your social security number

If a joint return, spouse's first name and initial | Last name | Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. | Apt. no. | ▲ Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).

Foreign country name | Foreign province/state/county | Foreign postal code

Presidential Election Campaign Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse

Filing Status Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) (see instructions)

Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

Boxes checked on 6a and 6b

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			☐
			☐
			☐
			☐

If more than four dependents, see instructions and check here ▶ ☐

No. of children on 6c who:
• lived with you
• did not live with you due to divorce or separation (see instructions)

Dependents on 6c not entered above

d Total number of exemptions claimed

Add numbers on lines above ▶

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2		7
8a	**Taxable** interest. Attach Schedule B if required		8a
b	**Tax-exempt** interest. **Do not** include on line 8a	8b	
9a	Ordinary dividends. Attach Schedule B if required		9a
b	Qualified dividends	9b	
10	Taxable refunds, credits, or offsets of state and local income taxes		10
11	Alimony received		11
12	Business income or (loss). Attach Schedule C or C-EZ		12
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13
14	Other gains or (losses). Attach Form 4797		14
15a	IRA distributions 15a	b Taxable amount	15b
16a	Pensions and annuities 16a	b Taxable amount	16b
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17
18	Farm income or (loss). Attach Schedule F		18
19	Unemployment compensation		19
20a	Social security benefits 20a	b Taxable amount	20b
21	Other income. List type and amount		21
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22

Adjusted Gross Income

23	Educator expenses	23	
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24	
25	Health savings account deduction. Attach Form 8889	25	
26	Moving expenses. Attach Form 3903	26	
27	Deductible part of self-employment tax. Attach Schedule SE	27	
28	Self-employed SEP, SIMPLE, and qualified plans	28	
29	Self-employed health insurance deduction	29	
30	Penalty on early withdrawal of savings	30	
31a	Alimony paid b Recipient's SSN ▶	31a	
32	IRA deduction	32	
33	Student loan interest deduction	33	
34	Tuition and fees. Attach Form 8917	34	
35	Domestic production activities deduction. Attach Form 8903	35	
36	Add lines 23 through 35		36
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2017)

HSAs and Above-the-Line Deductions

2018 Form 1040

- Post-TCJA, the above-the-line deduction for HSA contributions made outside of a Section 125 cafeteria plan (i.e., not pre-tax through payroll) is handled via Schedule 1:

Form **1040** Simplified — Department of the Treasury—Internal Revenue Service — **U.S. Individual Income Tax Return** 2018 — OMB No. 1545-0074 — IRS Use Only—Do not write or staple in this space.

☐ Married filing separately ☐ Qualifying widow(er) ☐ Head of household

Your first name and initial | Last name | Your social security number

Standard deduction: ☐ Someone can claim you as a dependent ☐ You were born before January 2, 1954 ☐ You are blind

Spouse or qualifying person's first name and initial (see inst.) | Last name | Spouse's social security number

Standard deduction: ☐ Someone can claim your spouse as a dependent ☐ Your spouse was born before January 2, 1954

Home address (number and street). If you have a P.O. box, see instructions. | Apt. no. | Presidential Election Campaign. Check here if you want $3 to go to this fund (see inst.) ☐ You ☐ Spouse

City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6. | ☐ Full-year health care coverage (see instructions)

Dependents (see instructions) (1) First name | Last name | (2) Social security number | (3) Relationship to you | (4) ✓ if qualifies for (see inst.): Child tax credit | Credit for other dependents

Sign Here — Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately reflect all amounts and sources of income I received during the tax year. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records. | Your signature | Date | Your occupation | If the IRS sent you an Identity Protection PIN, enter it here (see inst.) | Spouse's signature. If a joint return, both must sign. | Date | Spouse's occupation | If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparers | Print/Type preparer's name | Preparer's signature | PTIN | Check if: ☐ 3rd Party Designee ☐ Self-employed | Firm's name ▶ | Firm's EIN ▶

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2018)

Form 1040 (2018) Page 2

1	Wages, salaries, tips, etc. Attach Form W-2		1
2a	Tax-exempt interest 2a	b Taxable interest	2b
3a	Qualified dividends 3a	b Ordinary dividends	3b
4a	IRAs, pensions, and annuities 4a	b Taxable amount	4b
5a	Social security benefits 5a	b Taxable amount	5b
6	Additional income and adjustments to income. Attach Schedule 1		6
7	Adjusted gross income. Combine lines 1 through 6		7
8	Enter the standard deduction; otherwise, attach Schedule A		8
9	Qualified business income deduction (see instructions)		9
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-		10
11	Tax (see instructions). Attach Schedule 2 if required		11
12	If your only nonrefundable credit is the child tax credit and/or credit for other dependents, enter the total here; otherwise, attach Schedule 3		12
13	Subtract line 12 from line 11		13
14	Other taxes. Attach Schedule 4		14
15	Total tax. Add lines 13 and 14		15
16	Federal income tax withheld from Forms W-2 and 1099		16
17	Refundable credits: a EIC (see inst.) b Sch 8812 c Form 8863 d Other payments or refundable credits from Schedule 5		
18	Add lines 16 and 17 a through d. These are your total payments		18
19	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you **overpaid**		19
20a	Amount of line 19 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		20a
b	Routing number ▶ c Type: ☐ Checking ☐ Savings		
d	Account number		
21	Amount of line 19 you want **applied to your 2019 estimated tax** ▶ 21		
22	**Amount you owe.** Subtract line 18 from line 15. For details on how to pay, see instructions ▶		22
23	Estimated tax penalty (see instructions) ▶ 23		

Standard Deduction for— • Single or married filing separately, $12,000 • Married filing jointly or Qualifying widow(er), $24,000 • Head of household, $18,000 • If you checked any box under Standard deduction, see instructions.

Refund — Direct deposit? See instructions.

Amount You Owe

Form **1040** (2018)

SCHEDULE 1 (Form 1040) — Department of the Treasury Internal Revenue Service

Additional Income and Adjustments to Income

▶ Attach to Form 1040.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074 — 2018 — Attachment Sequence No. 01

Name(s) shown on Form 1040 | Your social security number

Additional Income	1–9b	Reserved		1–9b
	10	Taxable refunds, credits, or offsets of state and local income taxes		10
	11	Alimony received		11
	12	Business income or (loss). Attach Schedule C or C-EZ		12
	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13
	14	Other gains or (losses). Attach Form 4797		14
	15a	Reserved		15b
	16a	Reserved		16b
	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17
	18	Farm income or (loss). Attach Schedule F		18
	19	Unemployment compensation		19
	20a	Reserved		20b
	21	Other income. List type and amount ▶		21
	22	Combine the amounts in the far right column. If you don't have any adjustments to income, enter here and on Form 1040, line 6. Otherwise, go to line 23		22
Adjustments to Income	23	Educator expenses	23	
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	24	
	25	Health savings account deduction. Attach Form 8889	25	
	26	Moving expenses for members of the armed forces. Attach Form 3903	26	
	27	Deductible part of self-employment tax. Attach Schedule SE	27	
	28	Self-employed SEP, SIMPLE, and qualified plans	28	
	29	Self-employed health insurance deduction	29	
	30	Penalty on early withdrawal of savings	30	
	31a	Alimony paid b Recipient's SSN ▶	31a	
	32	IRA deduction	32	
	33	Student loan interest deduction	33	
	34	Reserved	34	
	35	Reserved	35	
	36	Add lines 23 through 35		36
	37	Subtract line 36 from line 22. Enter here and on Form 1040, line 6		37

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F Schedule 1 (Form 1040) 2018

HSAs and Employer Contributions

Employer Contributions Count Toward the Statutory Limit

- The statutory limit is a combined limit for all sources of contributions, including employer/employee contributions

HSA Funding Timing at Employer Discretion

- Employer may make one up-front lump sum contribution, semiannual contributions, quarterly contributions, monthly contributions, per pay period contributions, etc.
- Only real limitation is that the contributions be made to the HSA by the tax filing deadline of the following year (generally April 15)
- **Advantage of up-front funding:**
  - Avoids employees not having sufficient funds in their HSA early in the year to cover the deductible or other out-of-pocket health expenses
- **Disadvantage of up-front funding:**
  - No ability to claw back contributions if an employee terminates or changes plans mid-year
  - Can result in a windfall for the employee—but can also result in excess contributions

Employer Not Responsible for Determining HSA Eligible Status of Employees

- Employer is responsible only for determining (1) that the employee is covered by an HDHP and has no disqualifying coverage <u>sponsored by that employer</u> (cannot verify outside disqualifying coverage), and (2) the employee's age (for catch-up contribution eligibility)
- Employee bears all other responsibility for determining HSA eligibility
  - The employer is not liable if the employee is ultimately incorrect in that determination

HSAs and Health FSAs

General Purpose Health FSA of Employee or Spouse is a Problem!

- General purpose health FSA enrollment of employee or spouse (or parent) is disqualifying coverage for both individuals—blocks eligibility to make or receive HSA contributions
- In other words, if either spouse is enrolled in a general purpose health FSA, neither spouse is HSA eligible (although both could still be covered by an HDHP)
- This is because a general purpose health FSA will pay for medical expenses pre-deductible

HSA Eligibility Blocked for Health FSA Plan Year Unless Coverage Terminates

- If an employee or spouse is enrolled in an health FSA, both individuals will be HSA ineligible for the entire health FSA plan year
- Exception would be if the participant terminates health FSA coverage mid-year based on permitted election change event or termination of employment (and does not elect COBRA)
- The employee or spouse draining health FSA balance to zero is irrelevant
  - Both individuals remain "covered" by the health FSA even when balance is exhausted

Limited Purpose Health FSA Does not Block HSA Eligibility

- A limited purpose health FSA covers only dental, vision, and/or preventive care expenses and therefore does not cause employee to lose HSA eligibility
- Why enroll in a limited purpose health FSA when the HSA can reimburse dental/vision expenses? Answer: You can save more in your triple-tax advantaged HSA!
  - Use the limited purpose health FSA funds first because they are subject to use-it-or-lose-it

HSAs and Health FSAs (Examples)

Example #1

- Mike's spouse Jessica is enrolled in a general purpose health FSA through her employer (which has a July 1 plan year)
- At OE, Mike enrolls in his employer's HDHP for the 2019 calendar plan year
- Jessica spends her full $2,650 health FSA election by the end of 2018

Result

- Mike is not HSA eligible during his spouse's health FSA period of coverage
- This means that Mike cannot make or receive HSA contributions until July 2019
- Doesn't matter that Jessica spent down her entire health FSA balance in 2018
- Mike can still be covered by the HDHP for January through June of 2019—he just won't be HSA eligible until July 2019 (assuming Jessica does not elect the general purpose health FSA again for the next plan year)

Example #2

- Mike's spouse Jessica is enrolled in a general purpose health FSA through her employer (which has a July 1 plan year)
- At OE, Mike enrolls in his employer's HDHP for the 2019 calendar plan year
- Jessica terminates employment at the end of February 2019

Result

- Jessica's health FSA coverage ends as of February 28, 2019 (assuming no COBRA)
- This means that Mike becomes HSA eligible beginning in March 2019

HSAs and Health FSA Carryover

$500 General Purpose Health FSA Carryover is a Problem!

- Employees who want to move to an HDHP for year two, but have general purpose health FSA amounts remaining in their account from year one subject to the $500 carryover, have a HSA eligibility issue
- If the employee carries over any amount as general purpose health FSA balance into year two, the carryover will block HSA eligibility for all of year two

Two Main Ways to Avoid the Carryover HSA Eligibility Issue

- The IRS issued guidance in 2014 permitting two approaches to maintain HSA eligibility:

1) **Automatic Conversion of Carryover Balance to Limited Purpose:**

- Structure the plan to automatically convert the general purpose carryover amount to limited purpose where the employee is moving to an HDHP (preferred approach where available)

2) **Election to Forfeit Carryover Balance:**

- Allow the employee to waive the general purpose carryover balance and have it forfeit to the plan (fallback approach for plans that do not offer limited purpose option)

Example

- Manny moves from standard HMO in 2018 to HDHP in 2019
- He has $10 remaining of general purpose health FSA balance from 2018 that will carry over into the 2019 calendar plan year

Result

- Manny's employer's plan utilizes the first approach above to automatically convert general purpose carryover to limited purpose where employee moves to HDHP
- The limited purpose health FSA carryover will not block HSA eligibility!

HSAs and Health FSA Grace Period

General Purpose Health FSA Balance Available in Grace Period is a Problem!

- Employees who want to move to an HDHP for year two, but have general purpose health FSA amounts subject to the 2½-month grace period, have a HSA eligibility issue
- General rule is that the employee will not be HSA eligible until month four in year two (i.e., April for a calendar plan year) because the grace period will be disqualifying coverage for the first three months

Two Main Ways to Avoid the Grace Period Eligibility Issue

1) **Spend Down the Account Balance to Zero By End of Plan Year:**

- If the employee spends down the health FSA to zero by the last day of the plan year on a cash basis (meaning the account balance is actually zeroed out through reimbursements), the grace period will not affect HSA eligibility for year two

2) **Automatic Conversion of Grace Period Balance to Limited Purpose:**

- Structure the plan to automatically convert the general purpose grace period amount to limited purpose for all employees (must be mandatory even for those not moving to an HDHP)

Example

- Manny moves from standard HMO in 2018 to HDHP in 2019
- He is also enrolled in the company's general purpose calendar plan year health FSA that has a 2½-month grace period (until March 15 of year two)
- Manny has his entire $2,650 health FSA account balance reimbursed prior to December 31, 2018 (not just claims incurred or claims pending—actual reimbursement of full amount)

Result

- Manny is HSA eligible (assuming no other disqualifying coverage) as of January 2019

HSAs and Mistaken Contributions

General Rule: HSA Contributions are Nonforfeitable

- The employer cannot recoup from an employee's HSA any portion of the employer's contribution to the employee's HSA
- Means there can't be any vesting schedule or other conditions on amounts contributed to the HSA—if the employee terminates, the HSA contributions remain in the account

Example

- David's employer funds HSA contributions once per calendar plan year on January 1
- David terminates employment on January 2, 2019 after receiving the full calendar plan year employer HSA contribution of $3,000 on January 1, 2019

Result

- David's employer cannot recover any of the nonforfeitable $3,000 HSA contribution made on January 1 even though David terminated the next day
- Note: David must be careful to avoid excess contributions in this scenario

Three Major Exceptions to Nonforfeitability Rule for Mistaken Contributions

1) **Employee Was Never HSA Eligible**
2) **Employer Contributions Exceed Statutory Limit**
3) **Clear Documentary Evidence Demonstrating Administrative or Process Error**

HSAs and Mistaken Contributions

Exception #1: Employee Was Never HSA Eligible

- If an employer contributes to the HSA of an employee who was never HSA eligible, the IRS takes the position that the HSA never existed
- The employer may request that the bank return the contributions to the employer
- If the bank does not return the funds to the employer by the end of the year, the amounts must be included as gross income and wages on the employee's Form W-2 for the year during which the employer made the contributions

Example #1

- On January 1, 2018, David's employer contributed $3,000 to his "HSA"
- In July 2018, the employer learns that David's account is not an HSA because David was never HSA eligible
- Employer requests that the bank holding the contribution return the $3,000 (adjusted for earnings, losses, and administration fees directly paid from the account) to the employer

Result

- If the bank agrees to return the funds to the employer, and the employer receives the funds by the end of 2018, there are no tax consequences for David
- If the bank does not return the funds to the employer by the end of 2018, the employer must include the amounts in David's gross income and wages on his 2018 Form W-2

Example #2

- Same as above except the employer does not discover the mistake until July 2019

Result

- The employer must issue a corrected 2018 Form W-2 to David, and David must file an amended 1040 to reflect the income from the contributions
- David will also have a 6% excise tax owed for the excess contributions (and will need to take a corrective distribution of the excess to avoid additional excise taxes)

HSAs and Mistaken Contributions

Exception #2: Employer Contributions Exceed Statutory Limit

- If an employer contributes to an employee's HSA in excess of the statutory annual maximum contribution limit, the employer may correct the error
- The employer may request that the bank return the contributions to the employer
- If the bank does not return the funds to the employer by the end of the year, the amounts must be included as gross income and wages on the employee's Form W-2 for the year during with the employer made the contributions

Example #1

- David is covered by family HDHP coverage in 2018
- In August 2018, employer discovers that the employer contributions to his HSA account total $7,000 ($6,900 limit)
- Employer requests that the HSA bank return the $100 excess contributions (adjusted for earnings, losses, and administration fees directly paid from the account) to the employer

Result

- If the bank agrees to return the excess contributions to the employer, and the employer receives the funds by the end of 2018, there are no tax consequences for David
- If the bank does not return the excess contributions to the employer by the end of 2018, the employer must include the amounts in David's gross income and wages on his 2018 Form W-2

Example #2

- Same as above except the employer does not discover the mistake until July 2019

Result

- The employer must issue a corrected 2018 Form W-2 to David, and David must file an amended 1040 to reflect the income from the excess contributions
- David will also have a 6% excise tax owed for the excess contributions (and will need to take a corrective distribution of the excess to avoid additional excise taxes)

HSAs and Mistaken Contributions

Exception #3: Clear Documentary Evidence of Administrative or Process Error

- New exception from September 9, 2015 IRS Information Letter
- Where there is clear documentary evidence demonstrating that there was an administrative or process error, the employer may request that the bank return the mistaken contributions to the employer
- The employer should maintain documentation to substantiate the mistaken contribution

Example

- David is covered by employee-only HDHP coverage in 2018
- The employer contributes $1,500 for to the HSA for employee-only coverage, $3,000 for family coverage
- David's employer mistakenly contributes $3,000 to the HSA (not $1,500 for employee-only coverage)
- Employer requests that the HSA bank return the $1,500 excess contributions (adjusted for earnings, losses, and administration fees directly paid from the account) to the employer

Result

- The bank may agree to return the mistaken $1,500 excess contribution to the employer
- Before this new IRS guidance, arguably that amount would have been an nonforfeitable contribution (i.e., a windfall) to David with no ability to recoup

HSAs and Premiums

General Rule is No Tax-Free Qualified HSA Distributions for Premiums

- Similar to the health FSA rule, the general rule for HSAs is that premiums are not a qualifying medical expense
- This is different from the general HRA rule, which does permit distributions for premiums (although ACA issues abound)

Exceptions: The Following Premiums Are Qualifying Expenses

1) **COBRA Premiums:** COBRA or any other continuation coverage premiums required by federal law (including USERRA continuation coverage)
2) **Long-Term Care Insurance Premiums:** Annual limitations for eligible LTC premium amounts apply
3) **Any Health Plan Premium While Individual is Receiving Federal or State Unemployment:** Includes health premiums for a spouse or dependent receiving unemployment
4) **Age 65+ Premiums:** Premiums for Medicare (excluding any Medicare supplemental policy) or employer-sponsored retiree coverage

Example

- Xander is involuntarily terminated from employment at age 64 and begins receiving unemployment
- At the time of termination, he was covered under the company's HDHP with an HSA balance of $5,000

Result

- Xander can pay for his COBRA premiums with his $5,000 HSA balance as tax-free qualified distributions
- He could also pay for Exchange coverage premiums (or any other coverage) with tax-free HSA distributions because he is receiving unemployment
- Upon reaching age 65, Xander can use any remaining HSA funds to pay for Medicare premiums tax-free

HSAs and ERISA

HSAs Generally are Not Subject to ERISA

- HSAs generally are not treated as a group health plan under ERISA or other employee benefits laws
- Means the standard ERISA plan document, SPD, Form 5500, fiduciary duties, etc. do not apply, and HSAs are not subject to HIPAA, COBRA, the ACA market reforms, etc.
- But remember the HDHP is an ERISA group health plan!

Requirements for Employers to Avoid Application of ERISA to HSAs

- Establishment of the HSA must be completely voluntary on the part of the employees
- Furthermore, the employer must not:

1) **Limit the ability of eligible individuals to move their funds to another HSA;**
2) **Impose conditions on the utilization of HSA funds;**
3) **Make or influence the investment decisions with respect to funds contributed to an HSA;**
4) **Represent that the HSAs are an employee welfare benefit plan (i.e., subject to ERISA); or**
5) **Receive any payment or compensation in connection with an HSA.**

Example

- Eric is covered by his employer's HDHP, and his employer contributes $1,500/year to his HSA
- He terminates from employment at the end of September 2018

Result

- Eric must be offered COBRA to continue coverage under the HDHP
- However, the HSA is not a group health plan subject to ERISA, therefore no COBRA requirements apply to the employer HSA contributions (but he could continue to contribute to the HSA on his own)

HSAs and Post-Deductible HRAs

Remember that Medical HRAs Also Block HSA Eligibility

- It's becoming more common for employers to provide some form of reimbursement outside the major medical plan for certain medical expenses typically not covered by the plan
- Examples: Infertility, transgender, autism, concierge services, telemedicine, other specialized care
- These employee reimbursements create an HRA that is a group health plan subject to ERISA, COBRA , HIPAA, the ACA, Section 105(h) nondiscrimination, etc.
- These HRAs will also be disqualifying coverage for any individual covered by an HDHP

Post-Deductible HRAs Are Not Disqualifying Coverage

- To avoid the HRA blocking employee's HSA eligibility, the HRA needs to be structured as post-deductible
- This requires that the HRA not permit any reimbursements (i.e., not pay any benefits) until the employee has reached the statutory minimum deductible (2019: $1,350 individual/$2,700 family) <u>in expenses covered by the HDHP</u>
- Means that any expenses incurred for the items or services the HRA is designed to cover would not count toward the deductible (because they aren't covered by the HDHP)

Example

- Mookie's employer offers a specialty HRA for infertility services—he is covered under the family HDHP
- The HDHP does not cover any infertility expenses

Result

- If Mookie is eligible for reimbursement under the infertility HRA, he's blocked from being HSA eligible
- The employer has two ways of avoiding this issue:

1) Exclude employees covered by the HDHP from eligibility under the HRA; or
2) Make the HRA post-deductible for anyone covered by the HDHP

- #2 requires that Mookie incur at least $2,700 in expenses covered by the HDHP (not infertility) before the HRA can pay

HSAs and Transfers from IRAs

Qualified HSA Funding Distributions

Once-Per-Lifetime Rule

- HSA eligible individuals are permitted to make a tax-free transfer from an IRA to an HSA once per lifetime
- The IRA and HSA owners must be the same person

Direct Transfers Only

- Traditional rollovers are not permitted
- Must be a custodian to custodian direct transfer of assets

Counts Toward Contribution Limits

- Transfers count as contributions when applying the general HSA contribution limit and catch-up limit for the year in which the transfer occurs
- Cannot use the April 15 rule for transfers—the transfer will always apply to the contribution limit for the actual year in which the transfer occurs

Special 12-MonthTesting Period

- Must maintain HSA eligibility for 12 months following the transfer
- This is different from the 13-month testing period for the last-month rule!
- Failure to remain HSA eligible during testing period results in transfer becoming taxable

HSAs and the 6% Excise Tax

6% Excise Tax Applies Each Year on Any Excess Contributions

- Individuals must use IRS Form 5329 to report excess contributions and determine excise tax amount
- Must continue to pay the 6% excise tax each year until the excess contributions are distributed

Corrective Distribution By Tax Filing Deadline Avoids Excise Tax

- The individual can avoid the 6% excise tax by making a corrective distribution by tax filing deadline
- Generally means that the excess must be distributed by April 15 (or later if filing for extension)
- Corrective distribution is included in individual's gross income, but no excise tax imposed
- Special provisions in Form 5329 Instructions allows corrections up to six months after filing deadline

Example

- Salvador was covered by a family HDHP (and HSA eligible) for January through September of 2018
- In October 2018, he changed jobs and moved to a non-HDHP HMO
- However, he had already contributed the $6,900 statutory maximum to his HSA before he left the job

Result

- Salvador's HSA contribution limit in 2018 was $5,175 (9/12 of $6,900)

1) **Corrective Distribution Avoiding 6% Excise Tax:**

- Salvador makes a corrective distribution from the HSA of the $1,725 in excess contributions (adjusted for earnings) by his 2018 tax filing deadline (generally April 15, 2019)
- He also includes the corrective distribution in his 2018 gross income

2) **6% Excise Tax:**

- Salvador fails to make a corrective distribution of the excess contributions
- He must pay a 6% excise tax on the excess contributions each year until they are distributed

HSAs and the Last-Month Rule Tax

10% Additional Tax Applies For Failure to Maintain HSA Eligibility in Testing Period

- The last-month rule requires that the individual be HSA eligible in December of the current year through December of the subsequent year (13-month testing period)
- If the individual loses HSA eligibly during that testing period, he or she must include in income the amount that was contributed by using the last-month rule, and that amount is also subject to a 10% additional tax reported on Form 8889
- This is not treated the same way as an excess contribution:
  - The additional tax amount is 10% (not 6%)
  - It's a one-time only additional tax (not recurring until distributed)
  - There is no option to make a corrective distribution to avoid the additional tax

Example

- Salvador was covered by a family HDHP (and HSA eligible) for December of 2018
- In September 2019, he changed jobs and moved to a non-HDHP HMO
- Salvador had contributed the $6,900 statutory maximum to his HSA for 2018 under last-month rule

Result

- Salvador failed to maintain HSA eligibility for the full testing period (through December 2019)
- This means his 2018 contribution limit was actually $575 (1/12 of $6,900)
- Salvador must therefore include $6,325 in his 2018 income ($6,900 – $575)
- He must also pay a 10% additional tax on that amount ($632.50)
- There is no option to make a corrective distribution to avoid the income and additional tax
- To add insult to injury, Salvador will need to re-file his 2018 tax return to report this additional income

HSAs and State Income Taxes

Vast Majority of States Provide Same Tax Treatment as Federal IRC

- Almost all states either conform to the federal income tax treatment for state income tax purposes (or they do not impose a state income tax—which makes this issue irrelevant for those states)
- This means that in almost all states, individuals will receive the same triple-tax advantaged benefits for HSAs for both federal and state income tax purposes

However, ~~Three~~ Two States Tax HSAs

- In these ~~three~~ two states, although employee contributions to an HSA will be pre-tax for federal income tax purposes, the contributions will be after-tax for state income tax purposes:

1) **California**
2) **New Jersey**
3) ~~**Alabama**~~

- Also will not receive the same tax-free growth as provided at the federal level
- Remember: None of this issue applies to the HDHP!

Example

- Jackie lives in California and is covered by his employer's HDHP
- In 2018, he contributes $3,900, and his employer contributes $3,000 to his family HSA

Result

- Jackie's employee/employer HSA contributions are pre-tax for federal income tax purposes
- However, the HSA contributions are standard taxable compensation for California state income tax purposes, subject to state withholding and payroll taxes
- Jackie will also use the California Schedule CA to report the taxable income from interest and dividends

Why HDHP HSA?


FEB
California
2019
HDHP HSA
GOLDEN BEARS
Limited
ULTIMATE

HSAs and the (Post-ACA) Future?

Graham-Cassidy Approach is Only ACA Repeal/Replace Bill Still in Discussion

- Bill focused on state block grants to provide more flexibility for states to address health care reform
- Came close to receiving enough support in September 2017 despite lingering quietly for most of the year, but ultimately came up just short when three Senators announced they could not support the bill

HSA Changes Proposed

1) **Doubling the Contribution Limit**
- Increasing the HSA annual contribution limit to match the HDHP OOPM (2019: $6,750 / $13,500)

2) **Return to 10% Additional Tax**
- Additional tax for non-medical distributions prior to age 65 would decrease from ACA 20% level to 10%

3) **Spousal Catch-Up Contributions**
- Permits both catch-up eligible spouses to make the $1,000 additional contribution to the same HSA

4) **HSA Establishment Grace Period**
- Tax-free distributions of expenses incurred prior to HSA establishment (within 60 days of HDHP enrollment)

5) **OTC Medicines and Drugs**
- Eliminates ACA Rx requirement for tax-free distribution of OTC medicine or drug (other than insulin)

6) **HSAs Grow Up (to Age 26)**
- Incorporates §105 ACA definition of dependent to include children to age 26 (replacing §152 definition)

7) **HSAs for Premiums**
- Permits tax-free distributions for any individual market policy premium (may lead to end of GHP!)

HSAs and the Bipartisan* Future?

H.R. 6199: Restoring Access to Medication and Modernizing Health Savings Accounts Act of 2018

- An semi-bipartisan bill to improve HSAs
- Passed the House on July 25, 2018 with 231 Republican and 46 Democrat votes in support
- Most Democrats voted against the bill (141 Nay votes)
- Does not bode well for passage in the Senate, where 60 vote are needed to avoid filibuster
- Different approach from the more bipartisan approach that was outlined in the "Bipartisan HSA Improvement Act of 2018" (H.R. 5138) that actually had five Democrat cosponsors
- A hybrid approach between the changes in Graham-Cassidy and the a bipartisan effort

H.R. 6311 Increasing Access to Lower Premium Plans and Expanding Health Savings Accounts Act of 2018

- A barely semi-bipartisan bill to improve HSAs in tandem with H.R. 6199
- Passed the House on July 25, 2018 with 230 Republican and 12 Democrat votes in support
- Almost all Democrats voted against the bill (175 Nay votes)
- Much less likely to pass in the Senate, where 60 vote are needed to avoid filibuster
- More controversial/partisan than H.R. 6199 because it doubles the HSA contribution limit
- Interestingly, the bill does not open up the use of HSAs for premiums—which is strange because that's probably the only good reason to increase HSA contribution limits so significantly

HSAs and the Bipartisan* Future?

HSA Changes Proposed (H.R. 6199)

1) Limited First-Dollar HDHP Coverage

- Allows HDHPs to provide first-dollar coverage (*i.e.*, before satisfying the HDHP minimum deductible) for non-preventive services up to $250 per year for individuals, and $500 per year for families

2) Concierge Primary Care

- Concierge-style primary care services would not be disqualifying coverage for HSA eligibility as long as the fee to access the primary care practitioner does not exceed $150 per month for individuals or $300 per month for families

3) On-Site Medical Clinics

- Employer-provided on-site medical clinics that offer free or discounted services would not be disqualifying coverage—provided the clinic's offerings are limited to the enumerated qualified items and services

4) Spousal Health FSA

- An employee's enrollment in a general purpose health FSA would no longer be disqualifying coverage for HSA eligibility for the employee's spouse—provided the employee does not submit any of the spouse's expenses for reimbursement under the health FSA

5) FSA/HRA Conversions to Fund HSAs

- Upon enrolling in a HDHP, employees could elect to convert existing FSA or HRA balances into an HSA contribution, limited to $2,650 for an individual and $5,300 for a family

6) OTC Medicines and Drugs Without Rx

- Removes the new ACA requirement that HSA distributions for over-the-counter medicines and drugs be provided pursuant to a physician prescription to qualify for a tax-free distribution (while also adding menstrual care products as a qualifying expense).

7) Wellness Costs as Medical Expenses

- Adds "qualified sports and fitness expenses," including gym memberships, as a tax deductible medical expense for all purposes (including tax-free HSA medical distributions). The limit is $500 for individual filers and $1,000 for joint returns.

HSAs and the Bipartisan* Future?

HSA Changes Proposed (H.R. 6311)

1) Expanded Health FSA Carryover

- Expands on the current $500 carryover provision to allow health FSA balances of up to three times the annual FSA salary reduction election contribution limit (currently $2,650) to be carried over—this would effectively end the use-it-or-lose-it rule

2) Medicare Part A Not Disqualifying

- Permits individuals to remain HSA eligible after enrollment in Medicare Part A, which is automatic and irreversible for those receiving Social Security retirement benefits

3) Doubling the HSA Contribution Limit

- Increasing the HSA annual contribution limit to match the HDHP out-of-pocket maximum—that would permit HSA-eligible individuals to contribute up to $6,650 for individuals and $13,300 for families in 2018

4) Spousal Catch-Up Contributions

- Currently, spouses who are catch-up eligible (age 55+) must contribute the up to $1,000 additional amount to their own HSA—the bill would permit both catch-up eligible spouses to make the $1,000 additional contribution to the same HSA

5) HSA Establishment Grace Period

- HSA distributions currently may be made on a tax-free basis if the medical expense was incurred on or after establishing the HSA (i.e., funding the HSA)—the bill would permit tax-free distributions incurred prior to HSA establishment, provided the account is funded within 60 days of HDHP enrollment

6) Bronze and Catastrophic Plans for HSA Eligibility

- Expands the definition of HDHP to include all Bronze level and catastrophic coverage to qualify for HSA eligibility

7) Copper Plans Open to All

- Unrelated to HSAs, the bill would allow anyone to purchase a lower-level “Copper” plan (currently limited to under age 30)

8) Health Insurance Premium Tax Moratorium Extended

- Also unrelated to HSAs, the bill would eliminate the ACA health insurance premium tax for 2020 and 2021 (on top of 2019)

HSAs and Crystal Ball Predictions

HSAs to Lead the Way After ACA

http://www.theabdteam.com/abd-insights/newsletter/abd-commentary-hsas-lead-way-after-aca

- An in-depth look at the radical HSA revolution that may be down the road
- Doubling the HSA contribution limit would put intense new emphasis on the value of HSAs as a triple-tax-advantaged investment vehicle
- The ability to use HSAs to pay for premiums unlocks the potential for major individual market advancement
- Employer opt-out credit structures could lead to many employees seeking individual market coverage with large employer HSA contributions as an alternative to group coverage

ABD Commentary

HSAs to Lead the Way After ACA

The Large HSA Opt-Out Approach: It is fairly common now for employers to offer a small opt-out credit to employees with access to other coverage (e.g., through a spouse, domestic partner, or parent) to avoid the cost of coverage where possible.

However, what if the opt-out credit becomes an enticement to join the individual market?

For example, assume an employer offers three medical plan options. The employer offers an opt-out credit equal to the employer-share of the premium for the lowest-cost plan option for employees who verify HDHP enrollment in the individual market. This opt-out credit is deposited directly in an HSA—not as taxable cash.

The employee uses this large HSA deposit to pay the premium for the individual market HDHP coverage on a tax-free basis. Employees may choose a lower actuarial value plan (e.g., 58% based on previous proposals) that

Wrap Up
Takeaways

Go All the Way With HSA

Top Three Items You Need to Know About HDHP/HSA

Three Key Points to Remember:

A

HSAs are uniquely triple-tax advantaged in a manner that makes them the most powerful (tax) force in the universe. Harnessing this power requires playing by a number of complex rules, particularly with respect to eligibility and contribution limits. IRS Publication 969 provides a useful summary of these rules.

B

Taking full advantage of HSAs requires an understanding of a number of special rules designed to your benefit. From the last-month rule, to the ability to take qualifying medical distributions years after the expense was incurred, to the exception to the 20% additional tax for non-medical distributions once you reach age 65—there are so many fancy ways to go all the way with your HSA!

C

…But don't get too bogged down in the details. HSAs are horrendously complex at the deepest levels, and your employees (and maybe you) don't have the patience to learn details beyond the basics. Promoting the basic triple-tax advantaged structure and addressing issues as they arise is the best approach.

Content Disclaimer

Go All the Way With HSA

The intent of this analysis is to provide the recipient with general information regarding the status of, and/or potential concerns related to, the recipient's current employee benefits issues. This analysis does not necessarily fully address the recipient's specific issue, and it should not be construed as, nor is it intended to provide, legal advice. Furthermore, this message does not establish an attorney-client relationship. Questions regarding specific issues should be addressed to the person(s) who provide legal advice to the recipient regarding employee benefits issues (*e.g.*, the recipient's general counsel or an attorney hired by the recipient who specializes in employee benefits law).

ABD makes no warranty, express or implied, that adherence to, or compliance with any recommendations, best practices, checklists, or guidelines will result in a particular outcome. ABD does not warrant that the information in this document constitutes a complete list of each and every item or procedure related to the topics or issues referenced herein. Federal, state or local laws, regulations, standards or codes may change from time to time and the reader should always refer to the most current requirements and consult with their legal and HR advisors for review of any proposed policies or programs.

Thank you!

Brian Gilmore
Lead Benefits Counsel, VP
ABD Insurance & Financial Services, Inc.
brian.gilmore@theabdteam.com

Insurance &
Financial Services