

Understanding the Acronyms:

The Basics of Health Savings Accounts and Health Flexible Spending Accounts

Ohio Chamber of Commerce

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Introduction

- Overview of HSAs
- HSA Design Rules
 - Eligibility
 - High Deductible Health Plans (HDHPs)
 - Contributions and Distributions
- HSAs and Cafeteria Plans
- Administration
- Comparison of HSAs to Health FSAs and HRAs
- Implementation Issues
- Questions

Overview of HSAs

- HSAs are tax-exempt accounts used to pay for qualified medical expenses
 - Favorable tax treatment
 - Contributions (subject to limits) are deductible (or, if made by an employer, are excluded from gross income)
 - Earnings on contributions are tax-free
 - Distributions for medical expenses are excluded from gross income
 - Account is non-forfeitable, trustee and fully portable
 - Eligible individual must be covered by an HDHP and no other disqualifying health coverage

Eligibility Requirements

- An individual is eligible to make or receive HSA contributions if, as of the first date of any month, the individual is:
 - Covered by an HDHP
 - Not covered under disqualifying coverage
- An individual is not eligible if:
 - Entitled to (enrolled in) Medicare
 - Received benefits under TRICARE or from VA during prior 3 months
 - May be claimed as dependent on another's tax return

What is an HDHP?

- An HDHP is an insured or self-insured health plan with
 - Minimum annual deductible (2017: \$1,300 single, \$2,600 family)
 - Maximum out-of-pocket limit (2017: \$6,550 single, \$13,100 family)
 - Both limits are increased for cost-of-living adjustments
- Minimum annual deductible
 - Plans with “embedded deductibles” may not satisfy minimum deductibles
 - Preventive care benefits are not subject to minimum deductibles
- Out-of-pocket limits
 - Deductibles, co-payments and co-insurance count against OOP limits
 - Out-of-network benefits are not subject to maximum OOP limits
 - Under ACA, for 2016 and later, OOPM under the ACA applies to each covered individual whether covered under single or family coverage, so ACA OOPM rule may require plan to pay benefits for an individual before the family HDHP OOPM is met

Preventive Care

- Preventive care includes:
 - Periodic health evaluations (including related tests and diagnostic procedures)
 - Routine pre-natal and well-child care
 - Child and adult immunizations
 - Tobacco cessation and obesity weight loss programs
 - Screening services
 - Coordination with ACA definition of preventive care
- Preventive care does not include any service or benefit intended to treat an existing illness, injury or condition
 - However, if it would be unreasonable or impracticable to perform another procedure or treat an existing condition, treatment that is incidental or ancillary to a preventive care service or screening is treated as preventive care
- State law mandates are treated as preventive care only if the mandate satisfies the IRS definition of preventive care

Permitted Coverage or Insurance

- Permitted coverage includes coverage (whether provided through insurance or self-insurance) for accidents, disability, dental care, vision care or long-term care
- Permitted insurance includes insurance under which substantially all of the coverage relates to liabilities incurred under workers' compensation laws, tort liabilities, liabilities relating to ownership or use of property, insurance for a specified disease or illness, and insurance that pays a fixed amount per day for hospitalization
 - Permitted insurance generally must be provided under an insurance contract and may not be self-insured, unless the self-insured coverage satisfies statutory requirements and any resulting medical care benefits are secondary or incidental to other benefits (e.g., workers comp)

Disqualifying Coverage

- What is disqualifying coverage?
 - Coverage under any non-HDHP (except for preventive care or permitted coverage or permitted insurance) whether as an employee, spouse or dependent (such as an HRA or a spouse's health FSA)
 - On-site Clinic Issues
 - Health FSA grace period and carry-over issues
- What is not disqualifying coverage?
 - Preventive care
 - Coverage under EAPs, disease management programs, discount cards and wellness programs that do not provide significant medical benefits

Disqualifying Coverage (Health FSAs and HRAs)

An individual may not make or receive HSA contributions if covered by a Health FSA or HRA, with four exceptions:

- Limited purpose Health FSA and/or HRA
 - Health FSA that reimburses for permitted coverage or HRA that reimburses for permitted coverage or permitted insurance
- Suspended HRA
 - Employee elects before HRA coverage period to forego reimbursement from HRA during that period
- Post-deductible Health FSA and/or HRA
 - Health FSA or HRA does not pay medical expenses incurred before the minimum annual HDHP deductible is satisfied
- Retirement HRA
 - HRA that pays medical expenses incurred only after retirement

Contributions

- May be made by anyone, including the individual, the individual's employer, a member of the individual's family or any other person
 - Contributions made by an employer or by an employee through pre-tax salary reduction are excluded from income
 - Contributions made by or on behalf of an individual are deductible as an "above the line" deduction
- Monthly contribution limit is 1/12 of a specified dollar amount (for 2017 amounts are \$3,400 for single coverage and \$6,750 for family coverage)
- Catch-up contributions (\$1,000) are permitted for individuals who attain age 55 by end of contribution year
- Full contribution rule allows full year's worth of contribution to be made if account holder is HSA-eligible on 12/1 and remains HSA eligible during 13-month testing period that begins on 12/1

Contributions

- Special rules for spouses
 - Contribution limits for an individual can vary depending on the type of coverage maintained by the individual's spouse (single vs. family, and HDHP vs. non-HDHP)
- Special rules for embedded deductibles
- Excess contributions are subject to a 6% excise tax, unless excess contributions plus earnings are distributed by tax filing deadline
- Employers that make HSA contributions must make comparable contributions for comparable participating employees (i.e., same dollar amount or same percentage of HDHP deductible)
- Effect of HSA contributions on ACA minimum value requirements and Cadillac Tax

Distributions

- Distributions used for qualified medical expenses are tax-free
 - Qualified medical expenses generally defined under 213(d)
 - But qualified medical expenses do not include premiums for health insurance coverage, except for COBRA premiums, qualified long-term care insurance premiums, health insurance premiums while unemployed, and health insurance premiums paid while eligible for Medicare (including premiums for Medicare Part A or B, Medicare Advantage coverage, or retiree health coverage, but not premiums for Medigap policies)
- Distributions **not** used for qualified medical expenses are included in gross income and subject to 20% excise tax, unless distribution occurs after individual dies, becomes disabled or becomes eligible for Medicare

Distributions

- Rollovers permitted (one per year)
- Transfers on divorce are not a taxable event
- Mistaken distributions may be returned without tax consequences (assuming HSA permits)
- Distributions after death
 - If spouse is beneficiary, then no taxable event
 - If non-spouse is beneficiary, beneficiary is taxed on fair market value of HSA
- Substantiation
 - Individuals must be prepared to substantiate
 - HSA trustees and employers are not required to substantiate

HSAs and Cafeteria Plans

- Employers may offer HSAs as a cafeteria plan option
- Employees may use cafeteria plan to have employer transmit pre-tax salary reduction contributions to an HSA trustee
- Comparability rule does not apply to contributions made under a cafeteria plan
- Some cafeteria plan rules do apply
 - Nondiscrimination rules (if contributions made through cafeteria plan)
- But most cafeteria plan rules do not apply
 - Change in status rules
 - Health FSA rules (e.g., “use it or lose it” and “uniform coverage” rules)

Administration

- Assets must be held by trustee or custodian
 - Trustee or custodian must be bank, insurance company or other IRS-approved entities
- Trust requirements
 - Cash contributions only (except for rollovers)
 - No investment in life insurance contracts
 - HSA assets pledged as security are taxable distribution
 - May have reasonable restrictions on the frequency or minimum amount of distributions
 - No restrictions on using distributions to pay for eligible medical expenses
- No prohibited transactions

Administration

- Trustees/custodians may not restrict uses of HSA funds or individual's ability to rollover HSA funds
- Employers not required to determine whether employee is eligible or the maximum contribution limit; but employers must determine:
 - Whether an employee is covered under an HDHP (and the deductible)
 - Whether an employee is covered under any non-HDHPs of the employer (e.g., a health FSA)
 - Age of employee (employer can rely on employee's representation of date of birth)
- Reporting – available at www.irs.gov/pub
 - Individuals (IRS Form 8889)
 - Trustees/custodians (IRS Forms 5498-SA and 1099-SA)
 - Employers (IRS Form W-2, box 12, Code W)
 - Model Custodial Account (Form 5305-C); Model Trust Account (Form 5305-T)
 - Publication 969

Application of ERISA

- ERISA will likely apply to employer-sponsored HDHPs
- ERISA will not apply to HSAs if employees establish HSAs voluntarily and the employer does not:
 - Limit the availability of individuals to move funds to another HSA
 - Impose conditions on utilization of HSA funds
 - Make or influence investment decisions for HSA funds
 - Represent that the HSAs are an employee welfare benefit plan maintained by the employer
 - Receive any payment or compensation in connection with administering the HSA program
 - Cash contributions made by a bank or insurance company as incentive to establish an HSA do not result in a prohibited transaction

Comparing HSAs to Health FSAs and HRAs

- Health FSAs
 - Tax-favored accident or health plan
 - Uniform coverage rule
 - Use-it-or-lose it rule (\$500 carryover or 2 ½ month grace period)
 - Medical expenses must be substantiated
 - Cannot reimburse health insurance premiums
- Health FSAs typically are offered as a cafeteria plan option and financed solely with employee pre-tax salary reduction contributions

Comparing HSAs to Health FSAs and HRAs

- HRAs
 - Tax-favored accident or health plan
 - Typically structured as an unfunded bookkeeping account
 - Medical expenses must be substantiated
 - Not subject to uniform coverage or use-it-or-lose-it rules
 - Unused funds may be carried over (depends on plan design)
 - May reimburse health insurance premiums
- HRAs must not be offered as a cafeteria plan option and must be financed exclusively with employer contributions or credits (i.e., no employee pre-tax contributions); active employee HRAs must be integrated with other medical coverage; stand alone HRAs are permitted for retiree only plans.

Comparing HSAs to FSAs and HRAs

Comparative Differences Between Individual Account Health Plans			
	HSAs	Health FSAs	HRAs
Employer involvement	None required	Required	Required
Eligibility	Individuals must be covered by HDHP and not covered by a non-HDHP; individuals may or may not be employees	Specified by employer as part of plan design; individuals must be employees	Specified by employer as part of plan design; individuals must be employees or retirees; no stand alone HRAs for actives
High-deductible plan coverage	Required as condition of eligibility	Not required	Not required (but plan design typically requires high deductible coverage for integration)
Carryover of unused funds	Automatic	Not permitted (except for \$500 carryover or 2 ½ month grace period)	Permitted (carryover features are common)
Vesting	Required; account is nonforfeitable	Permitted (vesting is not common)	Permitted (vesting is not common)
Portability	Fully portable; HSA account holder may rollover to another HSA	Limited portability; individual must elect COBRA to continue access to account	Limited portability; plan design typically provides some access to account following termination of employment
Contribution sources	Individual, employee, employer and rollover contributions permitted	Employee and employer contributions permitted; individual and rollover contributions not permitted	Only employer contributions permitted; individual, employee and rollover contributions not permitted

Comparing HSAs to FSAs and HRAs

Comparative Differences Between Individual Account Health Plans			
	HSAs	Health FSAs	HRAs
Contribution limits	Statutory limits apply; in 2017, lesser of HDHP single/family deductible or \$3,400/\$6,750	2017: \$2,600	No statutory limits, except as limited by plan design
Distributions for medical expenses	May reimburse medical expenses, but only certain types of health insurance premiums	May reimburse medical expenses, but may not reimburse health insurance premiums	May reimburse medical expenses and health insurance premiums
Distributions for non-medical expenses	Permitted, but included in income and 10% tax applies	Not permitted	Not permitted
Cafeteria plan option	May be offered as cafeteria plan option	May be offered as cafeteria plan option	May not be offered as cafeteria plan option
Nondiscrimination rules	Individual contributions not subject to nondiscrimination rules; employer contributions subject to comparability requirement or nondiscrimination rules under Code §125 (if offered under a cafeteria plan)	Employer contributions subject to nondiscrimination rules under Code section 105(h) (and Code §125 if offered under a cafeteria plan)	Contributions subject to nondiscrimination rules under Code section 105(h)

Comparing HSAs to FSAs and HRAs

Comparative Differences Between Individual Account Health Plans			
	HSAs	Health FSAs	HRAs
COBRA	COBRA does not apply	Limited COBRA requirements apply	Full COBRA requirements apply
Substantiation	Neither employers nor HSA trustees or custodians required to substantiate medical expenses; individuals must be prepared to substantiate	Employers required to substantiate medical expenses	Employers required to substantiate medical expenses
Reporting	Individuals, HSA trustees and custodians and employers must report to IRS	No IRS reporting required; employer may need to file Form 5500 under ERISA	No IRS reporting required; employer may need to file Form 5500 under ERISA
ERISA	ERISA does not apply to HSAs with limited employer involvement	ERISA applies, with special exceptions for ERISA Parts 6 and 7	ERISA applies
“Use-it-or-lose-it” rule	Does not apply	Applies	Does not apply
“Uniform coverage” rule	Does not apply	Applies	Does not apply

HSA Legislative Update

- Both the House and Senate bills to replace the ACA would expand HSAs
 - Highlight the advantages of HSAs, including:
 - Tax-deductible contributions
 - Contributions can be invested and grow tax-free
 - Withdrawals not taxed as long as they are used for qualified medical expenses

HSA Legislative Update

- House and Senate health care bills would increase flexibility of HSA rules
 - Permit individuals to contribute up to the maximum allowed for out-of-pocket costs to their HSAs
 - Allow both spouses to make catch-up contributions to one HSA beginning in 2018
 - Permit qualified medical expenses incurred before HSA-qualified coverage begins to be reimbursed from HSA if the account is established within 60 days
 - Allow individuals to use HSAs to pay for over-the-counter medications
 - Lower tax penalty if an individual uses an HSA to pay for unqualified medical expenses to 10%
 - Instead of 20%
 - Individuals 65 or older may withdraw from HSAs without penalties, but they do not receive a tax break if they use the money for non-health care expenses

HSA Implementation Issues

- Basic questions
 - Level, if any, of employer involvement (sponsorship and financing)?
 - Integration of HSA and HDHP into existing plan structure?
 - Avoid or accept application of ERISA?
- Vendor selection and vendor contracts
 - Separate or combined vendors for the HDHP and HSA?
 - Multiple HSA custodians or single HSA custodian?
 - Degree of integration between HDHP and HSA?
 - Do vendors support consumer-driven tools and resources?
 - Do vendors offer simple interest or investment options?

HSA Implementation Issues

- Design and enrollment
 - Offer HDHP as a full replacement or an additional option?
 - Provide employer subsidy and/or permit employee pre-tax contributions?
 - Does payroll vendor support pre-tax HSA contributions?
 - Revise existing health FSA and/or develop limited purpose health FSA?
 - Who pays HSA administration fees?
 - Are communications for open enrollment adequate?
- Plan formalities
 - Revise existing documents for cafeteria plan, health FSA and/or HRA
 - Develop new documents for HDHP (and HSA if ERISA plan)
 - Develop or revise SPDs for ERISA plans

Common Employer Hang-ups

- Understanding the HSA
 - Think checking account with special rules
 - FSA = use it or lose it*; HSA = use it or accrue it
- Use it or lose it
- Health FSA timing rules
 - Grace periods
 - Run-out periods
- Limited purpose health FSA

Common Employer Hang-ups

- Reimbursement for over-the-counter medication
- Dependent care FSA
- Corrections for mistaken/excess contributions and correcting administrative errors
 - Be mindful of IRS limits and prior employment
- Action Plan
 - Prepare clear communications for open enrollment and new hires
 - Hold benefits meetings around open enrollment and at the beginning of the year
 - Carefully monitor during year

Some Helpful Resources

- IRS Publication 969: Health Savings Accounts and Other Tax-Favored Health Plans
- HSAs
 - Code Section 223
 - IRS Notice 2004-2
 - IRS Notice 2004-50
 - IRS Notice 2008-59
- HRAs – Notice 2015-87
- Health FSAs – Notice 2013-71