



All About HSAs

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HSA Overview

- A Health Savings Account (HSA) is a special account owned by an individual where contributions to the account are to pay for current and future medical expenses
- HSAs are used in conjunction with a “High Deductible Health Plan” (HDHP)
 - Insurance that does not cover first dollar medical expenses (except for preventive care)
 - Can be an HMO, PPO or indemnity plan, as long as it meets the requirements
- HSAs were created in Medicare legislation signed into law by President Bush on December 8, 2003
- HSAs modeled after Archer MSAs

Who Is Eligible for HSAs?

- Any individual that is covered by an HDHP and:
 - Is not covered by other health insurance that is not HDHP (i.e., low-deductible insurance)
 - Is not enrolled in Medicare
 - Can't be claimed as a dependent on someone else's tax return
 - Children cannot establish their own HSAs
- Eligibility to contribute to an HSA does not depend on:
 - Your income (no limits)
 - Earned income (don't have to be working)
 - Who is the primary policy holder
 - Spouses can establish their own HSAs, if eligible
 - Insurance coverage of your children

Who Is Eligible for HSAs?

- **What other health coverage is allowed for you to still be eligible for an HSA?**
 - Specific disease or illness insurance and accident, disability, dental care, vision care and long-term care insurance
 - Employee Assistance Programs, disease management program or wellness program
 - These programs must not provide significant benefits in the nature of medical care or treatment
 - Drug discount cards
 - Eligibility for VA Benefits
 - Unless you have actually received VA health benefits in the last 3 months

Who Is Eligible for HSAs?

- **What “1st dollar” medical benefits make someone ineligible for an HSA?**
 - Medicare
 - Medicaid
 - Tricare (currently no HDHP plan available)
 - Flexible Spending Arrangements (FSA)
 - Health Reimbursement Arrangements (HRA)
 - Coverage under a spouse’s plan, including:
 - Low-deductible insurance coverage
 - FSA or HRA through spouse’s employer

Who Is Eligible for HSAs?

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

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

- Health insurance plan with minimum deductible of (for 2005):
 - \$1,000 (self-only coverage)
 - \$2,000 (family coverage)
 - These amounts are indexed annually for inflation
- Annual out-of-pocket expenses (including deductibles and co-pays) cannot exceed (for 2005):
 - \$5,100 (self-only coverage)
 - \$10,200 (family coverage)
 - These amounts are indexed annually for inflation

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

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

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

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

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

Prescription Drugs

- HDHPs must apply costs of prescription drugs to the annual deductible or the individual may not contribute to an HSA
- Transition relief provided until January 1, 2006 if the individual is covered by a prescription drug benefit provided by a separate plan or rider from the HDHP

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

Preventive Care

- Preventive care generally does not include any service or benefit intended to treat an existing illness, injury or condition
- Safe harbor list of preventive care that HDHP can provide as first-dollar coverage before minimum deductible is satisfied:
 - Periodic health evaluations (e.g., annual physicals)
 - Screening services (e.g., mammograms)
 - Routine pre-natal and well-child care
 - Child and adult immunizations
 - Tobacco cessation programs
 - Obesity weight loss programs

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

Preventive Care

- Can apply co-pays to preventive care services
- Certain drugs and medications can be considered preventive care
 - Drugs taken by a person who has developed risk factors for a disease that has not yet manifested itself or to prevent reoccurrence of a disease
 - Example: Cholesterol-lowering medication for those with high cholesterol

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

Conflicts with State Benefit Mandates

- State mandated first dollar coverage will result in plan losing status as HDHP
 - NJ requires first dollar coverage of any treatment of lead poisoning
- Transition relief for state mandates in place on January 1, 2004
 - Plans containing such mandates will not lose status as HDHP prior to January 1, 2006
 - After that date, plan will lose status as HDHP if such mandates remain in place

HSA Contribution Rules

- Contribution to HSA can be made by the employer or the individual, or both
 - If made by the employer, it is not taxable to the employee (excluded from income and wages)
 - If made by the individual, it is an “above-the-line” deduction
 - Can be made by others on behalf of individual and deducted by the HSA account holder

HSA Contribution Rules

- Maximum amount that can be contributed (and deducted) to an HSA from all sources
= lesser of:
 - HDHP Deductible amount
or
 - Maximum specified in law (indexed annually)
 - \$2,650 (self-only coverage) -- 2005
 - \$5,250 (family coverage) – 2005

HSA Contribution Rules

	HDHP Deductible	Maximum HSA Contribution (2005)
Single Coverage	\$1,000	\$1,000
	\$1,500	\$1,500
	\$2,000	\$2,000
	\$2,500	\$2,500
	\$3,000	\$2,650
Family Coverage	\$2,000	\$2,000
	\$3,000	\$3,000
	\$4,000	\$4,000
	\$5,000	\$5,000
	\$6,000	\$5,250

HSA Contribution Rules

- Special rules when family coverage HDHP has embedded deductibles:
 - Individual embedded deductible amount for each family member must be at least the minimum deductible for HDHP family coverage (\$2,000 in 2005)
 - If not, then the insurance is not a qualifying HDHP
 - Maximum contribution is the lower of:
 - Maximum contribution limit for family coverage
 - The “umbrella” deductible amount applied to the entire family
 - If no umbrella deductible, the embedded individual deductible multiplied by the number of family members covered by the plan

HSA Contribution Rules

- For individuals age 55 and older, additional “catch-up” contributions to HSA allowed
 - 2004 - \$500
 - 2005 - \$600
 - 2006 - \$700
 - 2007 - \$800
 - 2008 - \$900
 - 2009 and after - \$1,000
- If both spouses age 55+, each spouse must have an individual HSA account if both want to make “catch-up” contributions
- Contributions must stop once enrolled in Medicare

HSA Contribution Rules

- Contributions must be pro-rated if not eligible the entire year
 - The total amount of contributions to an HSA are based on the number of months that the individual is covered by an HDHP as of the first day of the month
 - Example: 3 months of HDHP coverage (deductible = \$1,200)
Maximum contribution is 3/12ths of \$1,200 = \$300
- “Catch-up” contributions must also be pro-rated
 - Does not matter when 55th birthday falls during year

HSA Contribution Rules

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

HSA Contribution Rules

- Employee Contributions to an HSA
 - Can be made by a salary reduction arrangement through a cafeteria plan (aka “Section 125” plan)
 - Contributions to the HSA through a cafeteria plan are “pre-tax” and not subject to income or employment taxes
 - Employer can automatically make cafeteria plan contributions on individuals’ behalf unless the individual affirmatively elects not to have such contributions made (“negative elections”)
 - Elections to make contributions through a cafeteria plan can change on a month-by-month basis (unlike salary reduction contributions to an FSA)
 - Employee contributions made outside a salary reduction plan qualify for the “above-the-line” deduction on personal income taxes

HSA Contribution Rules

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

HSA Contribution Rules

- Employer Contributions to an HSA
 - Contributions to employee’s HSAs must be “comparable” for all eligible employees of an employer, thus either:
 - the same dollar amount, or
 - the same percentage of each employee’s annual deductible
 - May count only employees who are “eligible individuals” (i.e., have HDHP coverage)
 - May apply rule separately to:
 - employees that have the “same category of coverage” (i.e., self-only vs. family)
 - Part-time employees (customarily employed fewer than 30 hours per week)

HSA Contribution Rules

- Employer Contributions to an HSA
 - No other classifications of employees are permitted
 - Violations of the comparability rules include:
 - Extra contributions to an HSA on account of employees who meet a specified age or qualify for the catch-up contributions
 - Contributions based on length of service

HSA Contribution Rules

Employer Contributions to an HSA

- Employer matching contributions to HSAs through a cafeteria plan are not subject to the comparability rules
- Cafeteria plan non-discrimination rules apply instead:
 - contributions cannot be greater for higher paid employees than they are for lower paid employees
 - contributions that favor lower paid employees are OK
- Employer contributions to an HSA based on an employee's participation in health assessments, disease management program or wellness program do not have to satisfy the comparability rules if the employee may elect to receive that payment in currently taxable cash rather than having a nontaxable contribution to the HSA
 - Cafeteria plan non-discrimination rules also apply

HSA Distributions

- Distribution is tax-free if taken for “qualified medical expenses”
 - Includes over-the-counter drugs
 - Does not generally include insurance premiums (including premiums for dental or vision care)
 - Specific premiums are reimbursable from an HSA:
 - COBRA continuation coverage
 - Health insurance coverage:
 - while receiving federal or state unemployment compensation
 - when age 65 or older (except Medigap insurance)
 - For individuals enrolled in Medicare:
 - Medicare premiums and out-of-pocket expenses (Part A, Part B, Medicare HMOs, new prescription drug coverage)
 - employee share of premiums for employer-based coverage
 - Cannot pay Medigap insurance premiums
 - Qualified long-term care insurance

HSA Distributions

- Qualified medical expense must be incurred on or after the date the HSA account was established
- Qualified Long Term Care Insurance Premiums
 - Premiums can be paid, tax free, through an HSA, even if amounts were contributed to the HSA through a cafeteria plan
 - FSAs cannot be used to pay for LTC insurance premiums
 - Tax-free reimbursement cannot exceed the annually adjusted “eligible long-term care premiums” in the Internal Revenue Code
 - Amount of eligible LTC premium is based on age (see IRS Pub 502 for dollar limits)

HSA Distributions

- Tax-free distributions can be taken for qualified medical expenses of:
 - person covered by the high deductible
 - spouse of the individual (even if not covered by the HDHP)
 - any dependent of the individual (even if not covered by the HDHP)
- If distribution is not used for qualified medical expenses
 - Amount of distribution is included in income and
 - 10% additional tax except when taken after:
 - Individual dies or becomes disabled
 - Individual is age 65

HSA Distributions

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

HSA Distributions

- No time limit on distributions
 - Distributions from HSA can be used to reimburse prior years' expenses as long as the expenses were incurred on or after the date the HSA was established
 - Individual must keep records sufficient to prove that:
 - the expenses were incurred, and
 - they were not:
 - paid for or reimbursed by another source, or
 - taken as an itemized deduction

HSA Distributions

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

Estate Treatment of HSAs

- If married, the spouse inheriting the HSA is treated as the owner
- If not married
 - The account will no longer be treated as an HSA upon the death of the individual
 - The account will become taxable to the recipient of it (including the estate of the individual)
 - Taxable amount will be reduced by any qualified medical expenses incurred by the deceased individual before death and paid by the recipient of the HSA
 - The taxable amount will also be reduced by the amount of estate tax paid due to inclusion of the HSA into the deceased individual's estate

HSA Accounts

- Accounts are owned by the individual (not an employer), so the individual decides:
 - Whether he or she contributes
 - How much to use for medical expenses
 - Which medical expenses to pay from the account
 - Whether to pay for medical expenses from the account or save the account for the future
 - Which company will hold the account
 - What type of investments to grow account
- Employer cannot restrict
 - What distributions from an HSA are used for
 - Rollovers

HSA Accounts

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

HSA Accounts

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

HSA Accounts

- Establishing an HSA Account
 - If HDHP coverage effective on first day of month, HSA can be established as early as first day of same month
 - If HDHP coverage effective any day other than first day of month, HSA cannot be established until first day of following month
- HSA Custodian or Trustee can put reasonable limits on accessing the money in the account
 - Frequency of distributions
 - Size of the distributions
- Trustee or custodian fees
 - Can be paid from the assets in the HSA account without being subject to tax or penalty
 - Can be directly paid by the beneficiary without being counted toward the HSA contribution limits

HSA Accounts

- Trustee not required to determine whether distributions are used for medical purposes (the account holder does that)
- HSA trustee must report annually to the individual:
 - All distributions on Form 1099-SA
 - Contributions and year-end account value on Form 5498-SA
- Account holders must file Form 8889
 - Individual will report on annual tax return amount of distribution used for qualified medical expenses

HSA Accounts

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

HSA Guidance Issued

- December 22, 2003
 - Notice 2004-2
- March 30, 2004
 - Notice 2004-23
 - Notice 2004-25
 - Rev. Rul. 2004-38
 - Rev. Proc. 2004-22
- May 11, 2004
 - Rev. Rul. 2004-45
- June 25, 2004
 - Notice 2004-43
- July 23, 2004
 - Notice 2004-50
- November 19, 2004
 - Rev. Proc. 2004-71
- January 11, 2005
 - Notice 2005-8
- April 13, 2005
 - Notice 2005-25

Treasury Assistance

- Web site - www.treas.gov (Click on “Health Savings Accounts”) – contains:
 - All Treasury guidance
 - Frequently asked questions
 - IRS forms and publications
 - HSA statute
 - Examples of tax savings from HSA contributions
 - Links to other useful sites
- Still have questions?
 - E-mail address: HSAInfo@do.treas.gov
 - Voice mailbox: (202) 622-4HSA