

# HSA

## Business & Health Savings Accounts

*Includes 2010 Limits*

Questions & Answers

## Purpose

The purpose of this brochure is to present a business decision-maker with basic information about HSAs so a business can decide what role, if any, it wishes to take with respect to Health Savings Accounts.

## What is a Health Savings Account (HSA)?

An HSA is a tax-preferred account similar to a 401(k) plan or an IRA. It is a quasi-trust account established on behalf of a specific person. It is an individual account, not a joint account. HSAs have the special feature that funds withdrawn to pay the qualified medical expenses of the HSA account owner, his or her spouse or any dependent will be tax free.

## When can a person establish an HSA and have contributions made to such HSA?

A person is eligible to have a contribution made to an HSA only if he or she is an “eligible” individual. This is true whether a business makes the contribution, the individual makes a contribution for himself or herself, or the contribution is made by a family member or any other person or entity. A person is only eligible if he or she meets all four of the following requirements: (i) is covered by a high-deductible health plan (HDHP), (ii) is not covered by any plan which is not an HDHP (i.e. a low-deductible plan), (iii) is not enrolled in Medicare and (iv) may not be claimed as a dependent on someone else’s tax return.

Note that there is no requirement for a person to be employed, to have compensation, or to not be covered by a pension plan in order to be eligible to have a contribution made to his or her HSA.

There is also no requirement that an employer sponsor an HDHP. An individual may purchase an HDHP for himself or herself. Or, a parent could buy the coverage for a child. However, an employer may also choose to sponsor an HDHP. If the employer sponsors the HDHP, it will want to receive a written statement from its health insurer that its health plan qualifies as an HDHP for HSA purposes.

The general rule is—a person must be covered by an HDHP in order for an HSA contribution to be permissible. There is an exception for certain rollover and transfer contributions. A person who continues to maintain an Archer Medical Savings Account may roll over or transfer such funds from the Archer MSA to an HSA. A rollover or transfer from one HSA to another HSA is permissible, even though the indi-

vidual is ineligible to make an annual HSA contribution because he or she is no longer covered by an HDHP.

## **Why do many businesses choose to pay the cost of the health insurance premiums for their employees?**

Under federal income tax laws, the employer's payments are generally deductible as a necessary business expense, and such payments are excluded from the employee's income for federal tax purposes (income, social security and Medicare).

## **How will a business save money by switching to an HDHP?**

The cost of the premium for an HDHP will usually be less than the cost of the premium for a low-deductible health plan (non-HDHP). For example, Tennis Inc. has 50 employees. In 2009, the corporation paid \$300 per month for single coverage for each employee, with a low annual deductible of \$250. The monthly cost totaled \$15,000. The annual cost totaled \$180,000. No longer believing it can continue to bear this cost, in June of 2009, Tennis Inc. solicited quotes for a high-deductible health plan to apply for 2010. The plan would have a deductible of \$1,500, with an annual out-of-pocket limit of \$3,500. The cost for such coverage was quoted to be \$200 per month per employee. The 2010 monthly cost would be \$10,000. The annual cost would be \$120,000. The effect of going to an HDHP was to reduce its monthly cost by \$5,000 and its annual cost by \$60,000.

## **What health plans qualify as a High-Deductible Health Plans (HDHPs) for HSA purposes?**

A high-deductible health care plan is a health plan that contains certain minimum dollar limitations on the annual deductible, and maximum limitations on the out-of-pocket expenses listed under the plan. A health care plan that provides individual coverage will be considered a high-deductible plan if it has an annual deductible of at least \$1,150 for 2009, and \$1,200 for 2010. A health care plan that provides family coverage will be considered a high-deductible plan if it has an annual deductible of at least \$2,300 for 2009, and \$2,400 for 2010. Out-of-pocket expenses for 2009 may not exceed \$5,800 for individual coverage, and \$11,600 for family coverage. Out-of-pocket expenses for 2010 may not exceed \$5,950 for individual coverage, and \$11,900 for family coverage. Out-of-pocket expenses include deductibles, co-payments and other

amounts the participant must pay for covered benefits, but do not include premiums.

## **Is a business required to contribute to the HSAs of its employees?**

No. A business may choose to contribute to its employees' HSAs, but there is no law requiring a business to make such contributions.

As mentioned previously, Tennis, Inc. saved \$60,000 by switching to an HDHP. Tennis, Inc. decides to contribute \$600 to each employee's HSA, or \$30,000. There is still a net savings to Tennis, Inc. of \$30,000. The combined contributions of the employer and the employee cannot exceed the applicable annual contribution limit.

## **Do certain nondiscrimination rules apply to HSAs?**

Yes. If an employer makes HSA contributions, the employer must make available comparable contributions on behalf of all "comparable participating employees" (i.e., eligible employees with comparable coverage) during the same period. Contributions are considered comparable if they are either the same amount or same percentage of the deductible under the HDHP.

The comparability rule is applied separately to part-time employees (i.e., employees who are customarily employed for fewer than 30 hours per week). The comparability rule does not apply to amounts rolled over from an employee's HSA or Archer MSA, or to contributions made through a cafeteria plan. If employer contributions do not satisfy the comparability rule during a period, the employer is subject to an excise tax equal to 35% of the aggregate amount contributed by the employer to HSAs for that period and is ineligible for the tax deduction.

## **How do employees establish an HSA?**

An employer will wish to ask the financial institution it has chosen to act as the HSA custodian/trustee to furnish it with the necessary forms so that employees may establish the HSAs. A person establishes an HSA in the same way he or she would establish an IRA. After being furnished a copy of an HSA plan agreement by a financial institution, the individual and the financial institution will complete the form and sign the document. A person will be able to designate one or more beneficiaries to receive the funds within the HSA if he or she should die.

## **Does a business have the right to select one financial institution to serve as the HSA custodian?**

Yes. In order to simplify the administration of HSAs, the IRS and the DOL have said, if certain rules are followed, the employer may choose one financial institution at which all of its employees will be required to establish their HSA. For further information on this subject, a business should refer to Field Assistance Bulletin 2004-1 as issued by the Employee Benefit Security Administration (ESBA) on April 7, 2004.

## **Why would an employer want to consider making contributions to the HSAs of its employees?**

(1) To save money; (2) To help employees by contributing to an HSA; (3) To help employees by having a health plan with more preventive-medicine features; and (4) To encourage employees to maintain a more healthy life style.

An employer contribution to an HSA is a new type of employee benefit. An employer will contribute to its employees' HSAs so that funds may be accumulated for health purposes and other wealth-building purposes.

## **How will employees benefit with an HDHP and an HSA?**

Money which otherwise would have been spent on health insurance premiums may be accumulated and owned by the individual within his or her HSA.

## **What is the federal tax treatment when a business contributes funds to the HSAs of its employees?**

For federal tax purposes, a business is entitled to treat its HSA contributions as if it had paid the cost of health insurance premiums. The business will be able to deduct its contributions. The business will be able to exclude such contributions from the income of the employees for purposes of Federal income tax withholding, social security taxes and Medicare taxes.

## **What is the federal tax treatment when a business has established a cafeteria plan allowing its employees to defer their wages into their HSA?**

For federal tax purposes, these deferred amounts will be excluded from the income of the employees for purposes of Federal income tax withholding, social security taxes and Medicare tax purposes.

The employees will defer a portion of their wages to purchase the HDHP insurance and/or to make a contribution to an HSA.

### **What is the federal tax treatment when a business establishes an HSA payroll-deduction program?**

An employee may instruct its employer to withhold funds from his or her paycheck and then forward such funds to an HSA custodian/trustee. The employee will claim a tax deduction for his or her HSA contributions. The employer will claim no deduction for such contributions.

### **If a business has never purchased health insurance coverage for its employees, should it consider establishing and funding an HDHP?**

Yes. There presently are many small businesses that have chosen not to furnish any health insurance coverage to their employees because of the cost. With the lower premium cost associated with an HDHP, a business may now be able to afford this cost. A person who is covered by an HDHP is certainly better off than one who has no health coverage.

### **How will a person use HSA funds?**

An individual will use HSA funds to pay medical expenses to meet the plan's deductible, co-pays, and other expenses not covered by the HDHP.

Because there is no time limit as to when a person must reimburse themselves for medical expenses which were paid with personal funds, the HSA may be used to accumulate wealth faster than most other methods available. A person can reimburse himself at any point in the future, as long as the necessary documentation has been retained.

If an individual withdraws HSA funds and uses them to pay or reimburse the qualified medical expenses of himself or herself, a spouse or any dependent, then the amount withdrawn will not be taxed. In order to receive this tax-free treatment, the HSA must exist at the time the medical expense is incurred.

If an account owner withdraws the funds and does not use them to pay or reimburse qualified medical expenses, then the amount withdrawn will be taxed at the individual's applicable marginal income tax rate. A 10% additional tax will generally apply if the recipient is younger than age 65. Under current law, the withdrawal of funds to pay HDHP or other medical insurance premiums is not considered a qualified

medical expense; such distribution will be taxed and will be subject to the 10% additional tax if the person is younger than age 65. Note: HSA funds used for a spouse or a dependent qualify as qualified medical expense.

## **Is the business' role limited with respect to an employee's HSA?**

Yes. It is very limited. A business has no responsibility to monitor how a person uses the funds within his or her HSA. The employer has no direct role in the establishment of the HSA. The individual (i.e. the employee) and the HSA custodian must sign the plan agreement form. The employer does not sign the HSA plan agreement.

Employers are only responsible for determining the following with respect to an employee's eligibility and maximum annual contribution limit for HSA contributions: (1) whether the employee is covered under an HDHP (and the deductible) or low-deductible health plan or plans (including health FSAs and HRAs) sponsored by that employer; and (2) the employee's age (for catch-up contributions). The employer may rely on the employee's representation as to his or her date of birth.

An employer who has agreed to make HSA contributions pursuant to an employee's instructions, must contribute those funds on a timely basis to the employee's HSA.

A business needs to keep in mind that the IRS has adopted the rule that once the funds are contributed to a person's HSA, there is no authority allowing the return of such money, even if the employer somehow made a mistake.

## **What governmental reporting will an employer do with respect to the contributions it makes to an employee's HSA?**

The employer will have to prepare the employee's Form W-2 to coincide with the type of contribution made to the HSA. An "employer" contribution to an employee's HSA is excluded from income for income, social security and Medicare tax purposes. A payroll-deduction contribution which is contributed to an employee's HSA is subject to income, social security, and Medicare taxes. An employer will be required to report HSA contributions on an employee's W-2 form. The IRS has stated that "W" and the contribution amount are to be inserted in box 12 of the Form W-2. An employer will want to review the IRS instructions for completing Form W-2; see the IRS website: [www.irs.gov](http://www.irs.gov).

## **What are the contribution and deduction limits for 2009 and subsequent years?**

The 2009 limit is \$3,000, if the employee has single coverage under an HSA-qualifying HDHP, and \$5,950, if the employee has family coverage under an HSA-qualifying HDHP. Note that the old requirement that the contribution was the lesser of the deductible or the annual amount no longer applies for 2007 and subsequent years. The contribution amount is now the annual contribution amount as determined after being adjusted for cost-of-living changes.

## **What are the contribution and deduction limits for 2010?**

The 2010 limit is \$3,050, if the individual has self-only coverage under an HSA-qualifying HDHP, and \$6,150, if the individual has family coverage under an HSA-qualifying HDHP.

## **What are the "catch-up contributions" for individuals age 55 or older?**

These are special contributions. In the case of HSAs, these individuals are those who are age 55 and older and who are still eligible to contribute to an HSA. The maximum catch-up contribution amount for 2009 is \$1,000, and for 2010, it is also \$1,000. If both spouses are over age 55, then each is eligible to make his or her own catch-up contribution. Each spouse is required to make the catch-up contribution to his or her own HSA. That is, one spouse cannot make his or her catch-up contribution to the other spouse's HSA.

## **How is the contribution limit determined if an individual is not covered for a full year under the HDHP?**

There are two different methods which may apply to determine the contribution limit for a given year. The first method is a "pro-rata" rule. The second method is an exception to the pro rata rule and allows the HSA owner to make a full year's contribution even though he or she was only eligible for part of the year.

**The Pro Rata Calculation:** The contribution is the sum of the monthly limitations. For example, if the employee is covered by the HDHP on the first day of each month for 2009, then the employee is entitled to the full annual contribution amount (i.e. \$3,000 or \$5,950, as applicable). If the employee is not covered on the first day of every month, then the employee is only entitled to a pro rata contribution as fol-

lows. If the employee is covered for 1 month, then the employee is entitled to contribute 1/12 of the applicable amount; if he or she is covered for 3 months, then he or she would be entitled to contribute 3/12 of the applicable amount; if he or she has covered for 11 months, then he or she would be entitled to contribute 11/12 of the applicable amount; etc. Note that if he or she has coverage under an HDHP as of January 1, but is not covered under the same HDHP as of December 31, then the pro rata contribution rule will apply.

**The Special Calculation:** However, a special rule applies if he or she becomes covered by the HDHP on February 1 or the first day of any following month, and remain covered as of December 31. In this case, he or she is allowed to contribute the full annual contribution amount, and it is not reduced on a pro rata basis for the months you were not covered.

This method allows a person to contribute a larger amount. There is a financial incentive to set up an HSA later in the year. An individual is not required to use the second method. The employee is eligible for this exception if he or she is covered by an HSA qualifying HDHP no later than December 1 and remains covered on December 31. There is a special tax recapture rule beyond the scope of this brochure which will apply if you do not retain coverage under the HDHP for the entire subsequent calendar year.

## **In what form must HSA contributions be made?**

Annual contributions to an HSA must be made in cash. For example, contributions may not be made in the form of stock or other property unless it is a rollover or transfer.

## **What is the deadline for making an HSA contribution?**

The deadline for annual contributions to an HSA is the time prescribed by law for filing individual Federal income tax returns, excluding extensions. Normally this is April 15. Like an IRA, contributions to an HSA can be made for the current year through April 15 of the next year.

Contributions for the taxable year can be made in one or more payments, at the convenience of the individual or the employer, at any time prior to the time prescribed by law (without extensions) for filing the eligible individual's federal income tax return for that year, but not before the beginning of that year. For calendar-year taxpayers, the deadline for contributions to an HSA is generally the April 15 following

the year for which the contributions are made. Although the annual contribution is determined monthly, the maximum contribution may be made on the first day of the year. However, after an individual becomes enrolled in Medicare benefits, contributions, including catch-up contributions, cannot be made to an individual's HSA.

## **Are rollover and transfer contributions to HSAs permitted?**

Rollover and transfer contributions from Archer MSAs and other HSAs into an HSA are permitted. Rollovers and transfers into HSAs are subject to rules very similar to the rules applying to IRAs. The consequence of rolling or transferring funds from an Archer MSA or an HSA to another HSA is that the funds will not be taxed in the income of the account owner even though the funds were not used to pay the qualified medical expenses of the account owner.

## **Are special transfer contributions ever permitted?**

Yes. HSA law changes enacted on December 20, 2006, allow an individual with funds in a traditional IRA (and, in limited cases, a Roth IRA), who is eligible to make an HSA contribution, to make a special election once during their lifetime to transfer funds from their traditional IRA to their HSA. The amount transferred in such a direct trustee-to-trustee transfer will not be taxed. This amount shall not exceed the annual contribution limit for single or family coverage, as applicable, as based on the HDHP coverage as of the time of the special transfer, or, in some cases, the amount of an earlier qualified HSA funding distribution. The special transfer contribution does count against the annual contribution.

This one-time transfer rule allows a person to change funds which would be taxable (money distributed from an IRA) to funds which will escape taxation if they are withdrawn from the HSA and used to pay qualified medical expenses.

There is also a special transfer rule allowing a person to transfer funds from an FSA and/or HRA termination to an HSA.

The employee should contact his or her own tax advisor.

*The information provided in this brochure is not intended to be legal or tax advice. You should consult your attorney or tax advisor for information that relates to your specific circumstances.*

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