Advanced HSA Concepts

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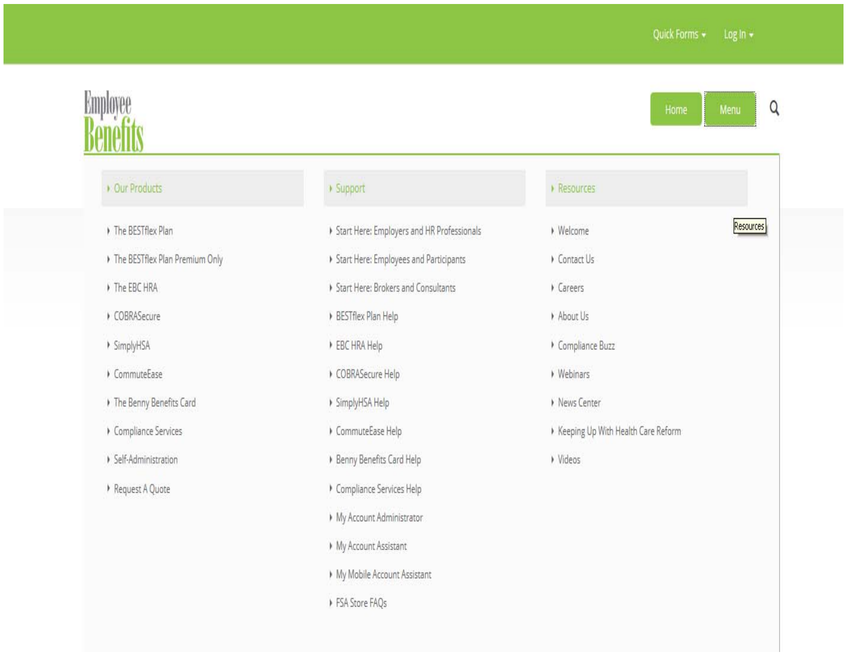

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Today's Agenda:

- HSA Basics Review
- HSAs and Cafeteria Plans
- HSA with Limited Health FSA
- HSA with Post Deductible Health FSA
- HSA with Compatible HRA
- Advantages of Stacking Plans
- How to Avoid HSA Headaches

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HSA Basics Review

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HSA Basics

- **HSAs are authorized under §223**
- Eligible individuals can make or receive contributions to their HSA accounts
- **Contributions can be made post-tax and taken as a tax deduction when filing taxes, or**
- Contributions can be made pre-tax through a §125 cafeteria plan
- **Distributions from HSA account are tax free for eligible medical care expenses**
- Contribution rules and reporting requirements apply

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HSA Basics: Eligible Individual

Eligible to make or receive HSA contributions*

- **Not another individual's tax dependent**
- Not entitled to (enrolled in) Medicare
- **Covered by a qualified High Deductible Health Plan (HDHP)**
  - **Includes sole proprietors, partners in a partnership, members of a LLC and 2% or greater shareholders in Sub S Corporation and their family members**
- Not covered by any disqualifying coverage

*HSA contribution can be made if Eligible Individual has qualified HDHP coverage as of the 1st day of the month

HSA Basics: Eligible Individual

- **Not another individual's tax dependent**
  - Income tax dependent means that you can claim that individual for income tax filing purposes
  - **Note:** Adult children can remain on parents HDHP until age 26
    - Adult children are HSA eligible based upon the family coverage they are enrolled in and can establish and can separately contribute to their own HSA at the family level.

HSA Basics: Eligible Individual

Not entitled to (enrolled in) Medicare

- Refers to status of account holder, not to the spouse or dependent of the account holder
  - ✓ Individual who is entitled to (enrolled in any Part of) Medicare cannot contribute into own or other spouse's HSA account
  - ✓ Individual entitled to Medicare can be reimbursed for expenses from the HSA
- Some age 65 or older individuals are not enrolled in Medicare – are not entitled to Medicare
  - ✓ Individual who is not entitled to Medicare can contribute into own or other spouse's HSA account

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HSA Basics: Eligible Individual

Must be covered by qualified HDHP

No disqualifying coverage

- No coverage that reimburses expenses prior to satisfying HDHP minimum deductible as out of pocket expense
- Examples of disqualifying coverage
  - ✓ HRA that reimburses prior to satisfying minimum HDHP deductible
  - ✓ Health FSA (own, spouse's or parent's)
  - ✓ Health insurance that has first dollar coverage or a lower deductible than HDHP minimums
  - ✓ Medicaid, TriCare and basic VA benefits
  - ✓ Prescription drug coverage prior to satisfying HDHP deductible (e.g., drugs covered after a co-pay prior to satisfying deductible)

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HSA Basics: Eligible Individual

Permitted coverage

- Coverage allowed to reimburse expenses prior to satisfying HDHP minimums
  - ✓ Specified disease (e.g., cancer ins.)
  - ✓ Preventive care
  - ✓ Stand-alone dental and/or vision coverage
  - ✓ Insurance paying a fixed amount per day for hospitalization
  - ✓ Workers' compensation, tort liability or property insurance
  - ✓ Limited Health FSA or Post-deductible Health FSA
  - ✓ Limited HRA or Post-deductible HRA
  - ✓ VA benefits for "service connected disability"

HSA Basics: Eligible Individual

Qualified HDHP

- All expenses, except preventive care, apply to the deductible
- Minimum annual deductible*
  - ✓ $1,300 for single coverage and $2,600 for other than single coverage – limited family, family, etc. (2017)
  - ✓ $1,350 for single coverage and $2,700 for other than single coverage – limited family, family, etc. (2018)
- Maximum out of pocket amounts under the HDHP*
  - ✓ $6,550 for single and $13,100 for family (2017)
  - ✓ $6,650 for single and $13,300 for family (2018)
- Maximum annual contribution*
  - ✓ $3,400 for single and $6,750 for family (2017) + $1,000>55
  - ✓ $3,450 for single and $6,900 for family (2018) + $1,000 >55

*Amounts are indexed – can be adjusted annually

HSA Basics: Employee Contributions

Annual maximum contributions

- Individuals who are eligible individuals on the first day of the last month of the taxable year (12/1) are allowed the full annual contribution based on the coverage they have **December 1** (plus catch up contribution, if 55 or older by year end), regardless of the number of months the individual was an eligible individual in the year.
- **CATCH:** Must remain HSA eligible for the following 12 months after the tax year ends **(testing period).**
- For individuals who are no longer eligible individuals on the first day of the last month of the taxable year or do not remain HSA eligible for the entire 12 months following the tax year, both the HSA contribution and catch up contribution apply pro rata based on the number of months of the year a taxpayer is an eligible individual.

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HSA Basics: Employer Contributions

- **Employer contributions to the HSA must be coordinated with any employee contributions.**
- **Employer contributions count towards annual contribution limits.**
- **Carefully consider the frequency of the Employer contributions to the HSA.**
  - Lump Sum
  - Pro rata
  - Only Participants of employer-sponsored HDHP
  - All HSA Eligible Individuals

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HSA Basics: Employer Contributions

- **Once an Employer contribution is made to the HSA it generally CANNOT be reversed.**
  - Only 2 exceptions (IRS Notice 2008-59 "HSA Grab Bag Guidance"):
    - Contribution was for someone who was NEVER eligible.
    - Contribution made exceeds statutory maximum for the year.

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HSA Basics: Employer Contributions

- **Employer contributions made outside a cafeteria plan are subject to the HSA comparability rules.**
- **Employers not in compliance with comparability rules are subject to 35% excise tax penalty on its contributions for the calendar year.**
  - **Permissible contribution methods:**
    - **Same dollar amount or same percentage of the HDHP deductible.**
    - **Permit differences based upon tiers of coverage as long as everyone in the tier is treated the same.**
    - **Exclude collectively bargained employees.**
    - **Permit more generous treatment of Non-HCE**

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HSA Basics: Employer Contributions

– **Outside of a cafeteria plan, the Employer cannot vary Employer contributions to the HSA based upon the following:**
  - Difference between Salaried and Hourly Employee
  - Matching contributions
  - Employment at different geographic locations or worksites
  - Employment at different divisions within the same company
  - Linked to participation in Health Assessments or Disease Management
  - Regional differences in cost
  - Differences in age or years of service
  - Differences in wage rates
  - Differences in employees' general health

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HSA Basics: Employer Contributions

Avoiding HSA Comparability Rules

1. Make Employer contributions through a Code § 125 cafeteria plan.
   - **Subject to cafeteria plan nondiscrimination testing rules.**
   - Small groups with potential nondiscrimination testing problems should be cautious about lump sum contributions made at the beginning of the plan year.
   - Ability to do matching contributions to encourage employee contributions.
   - Sole-proprietors, partners, members of LLC, S Corp 2% or greater shareholders and family members cannot participate in a cafeteria plan.
2. Make same Employer contributions for all HSA eligible employees outside the cafeteria plan.

Note: Employer cannot require proof of expenses as a condition for employer contributions to the HSA.

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How FSA, HRA and HSA can be used together to stretch any size benefit budget

FSA, HRA and HSA Stacking

Overview

- **HSAs authorized under §223**
- IRS has provided guidance on compatibility of certain health FSAs and HRAs with HSAs
- **Stacking HSAs with certain health FSAs or HRAs can provide advantages for participants and employers**
  - ✓ **Use HSA to save for future expenses – spend FSA or HRA on current expenses**
- Compliance issues can arise

HSAs and Cafeteria Plans

HSAs and Cafeteria Plans

- IRS Code § 223 prompted amendment of § 125 to allow HSAs in Cafeteria Plans
- Must adopt or amend the Cafeteria Plan for pre-tax HSA contributions through the premium only component
  - ✓ Same as documenting pre-tax medical or dental
- Pre-tax contributions are an election
  - ✓ Are considered "premiums" for medical care
  - ✓ Regulation allows for prospective election changes (no event needed Proposed Treasury Regulation 1.125-2)
- Any employer contributions to HSAs are noted in the employer contribution section
  - ✓ Employer contributions count toward individual's HSA maximum contribution for the year

HSAs and Cafeteria Plans

- Employer can adopt a Limited Health FSA or Post Deductible Health FSA for employees who want to make HSA contributions and also want to have a Health FSA*
  - ✓ Regular Health FSA is disqualifying coverage – makes individual ineligible to make or receive HSA contributions

*IRS Notice 2008-59, Q&A 4

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HSA with Limited Health FSA

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HSA with Limited Health FSA

Limited Health FSA

- **Recognized in IRS Notice 2008-59**
  - ✓ Is not disqualifying coverage – allows employee to make or receive HSA contributions
- **What can it cover?**
  - ✓ Dental expenses
  - ✓ Vision expenses
  - ✓ Preventive Care expenses*
- Most TPAs do not include preventive care reimbursement since under the ACA the HDHP covers preventive care with no deductible or copays

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HSA with Limited Health FSA

Limited Health Care FSA

- **If Limited Health FSA is to be offered, must adopt or amend Cafeteria Plan to include it**
- **Follows all the same rules as a regular Health FSA**
  - ✓ Uniform Coverage rule
  - ✓ Use-It-or-Lose-It (forfeiture) rule
  - ✓ Third party substantiation of expenses
  - ✓ Permitted election change events
  - ✓ Possible $500 Roll Over

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HSA with Limited Health FSA

HSA with Limited Health FSA

Example:

- ✓ Employer sponsors a qualified HDHP and Employee enrolls in Single Coverage
- ✓ Employee funds a Health Savings Account up to $3,400 Single Coverage for 2017 ($3,450-2018)
- ✓ Employee can enroll in a Limited Health Care FSA up to $2,600 for 2017 for dental and vision expenses

HSA with Post Deductible Health FSA

HSA with Post Deductible Health FSA

Post Deductible Health FSA

- Recognized in IRS Notice 2008-59 – is not disqualifying coverage
  - ✓ Allows employee to make or receive HSA contributions
- Only dental or vision expenses eligible until minimum HDHP deductible is satisfied
- All medical care expenses incurred after satisfying the minimum HDHP deductible are eligible expenses
- Follows all the Health FSA rules
- Requires special claims processing
  - ✓ Participant must provide proof of satisfying HDHP minimum deductible – send in EOB with proof of deductible satisfied – for future medical care expenses to be eligible

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HSA with Compatible HRA

HSA with Compatible HRA

- **Limited HRA – IRS Notice 2008-59**
  - ✓ Reimburses only dental or vision expenses
  - ✓ Is not disqualifying coverage
- **Post-deductible HRA – IRS Notice 2008-59**
  - ✓ Reimburses out-of-pocket medical care expenses after participant has incurred at least the minimum HDHP deductible as an out-of-pocket expense
  - ✓ Is not disqualifying coverage

HSA with Compatible HRA

- **Post-deductible HRA**

  Example: HDHP has $3,000 single deductible, $6,000 family aggregate deductible

  - **Employer's HRA reimburses after employee has incurred $1,500 of single deductible or $3,000 of family deductible**
    - ✓ Reimbursement not available until after minimum HDHP deductible out-of-pocket expense of **$1,300** single and **$2,600** is incurred for **2017 (2018: $1,350 single and $2,700)**
  - **HRA is not disqualifying coverage**

HSA with Compatible HRA

HSA Compatible HRAs + HSA + Limited Health FSA

Example: Employer's HDHP deductible is $2,600/single, $5,200/family aggregate; 100% thereafter

HRA design:

Single plan: first $1,300* employee, remaining $1,300 HRA

Family plan: first $2,600*employee, remaining $2,600 HRA

***2017 minimum HDHP deductible. (2018 minimum deductible $1,350 single and $2,700 family)**

Family minimum deductible is aggregate for family. This might be met by one person depending upon family circumstances.

HSA with Compatible HRA

- **HSA Compatible HRAs + Post HSA Deductible Health FSA**

Example: Employer's HDHP deductible is $2,600/single, $5,200/family aggregate; 80/20 coinsurance thereafter

HRA design:

Single plan: first $1,300* employee responsibility, remaining $1,300 paid 100% by HRA

Family plan: first $2,600* employee responsibility, remaining $2,600 paid 100% by HRA ***2017 minimum HDHP deductible. (2018 minimum deductible $1,350 single and $2,700 family).**

✓ Employee could elect up to $2,600 in a Post-HSA Deductible Health FSA (2017)

- FSA Reimbursement would be restricted to dental, vision and preventive care until employee certifies that they have met the minimum HDHP deductible.
- After that they can claim any general expenses not paid by the HRA (coinsurance and copays).

Advantages of Stacking Plans

Advantages of Stacking Plans

HSA with Limited or Post Deductible Health FSA

- **Employee or employer contributions to these FSAs do not disqualify employee from making or receiving HSA contributions**
- Full FSA amount is available regardless of amount deposited when expense is incurred (Uniform Coverage rule)
- **Employee that can afford contributions to both accounts can use FSA for known dental or vision expenses and "save" HSA contributions for future medical expenses**
  - ✓ **Example: Use FSA for monthly orthodontic expenses**
- Employer contributions to the FSA do not become employee funds – could be forfeited to employer if not used – unlike employer contributions to employees' HSA accounts

Advantages of Stacking Plans

HSA with Limited or Post Deductible Health FSA

- **Example: Employer has HDHP with $2,000 single deductible, $4,000 family aggregate deductible**
  - ✓ Employer makes $500 contribution to every eligible employee's limited Health FSA instead of $500 HSA contribution
  - ✓ Employer contribution is in addition to any pre-tax election by the employee (does not count against maximum $2,600 pre-tax FSA amount)
  - ✓ Employer contribution can only be used for dental or vision expenses (unlike if contribution was made into HSA account)
  - ✓ At year end, unused FSA funds are subject to forfeiture, unlike if contributed to HSA

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Advantages of Stacking Plans

HSA with Limited or Post Deductible HRA

- **Employer funding of HRA does not disqualify employee from making or receiving HSA contributions**
- Employer controls what expenses are eligible for reimbursement from HRA, amount of reimbursement and availability of funds
- **Employee's HSA contributions can be used for expenses not reimbursed by the HRA or any other eligible medical care expense**
- Employer funds in the HRA do not become employee funds – could be forfeited to employer if not used

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Advantages of Stacking Plans

HSA with Limited or Post Deductible HRA

- **Example: Employer has HDHP with $2,000 single deductible, $4,000 family aggregate deductible**
  - ✓ Employer reimburses last $500 of single deductible or last $1,000 of family deductible instead of HSA contribution
  - ✓ Employer HRA funds do not count against the employee's HSA maximum contribution limit
  - ✓ Employer HRA funds can only be used for expenses associated with HDHP deductible, unlike if contribution was made into HSA account
  - ✓ At year end, unused HRA funds are subject to forfeiture, unlike if contributed to HSA

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How to Avoid HSA Headaches

How to Avoid HSA Headaches

- **Make sure you have the appropriate HSA compatible High Deductible Health Plan (HDHP).**

  Not all HDHP are HSA compatible!

  - **Spousal benefit plans (including Health FSA) may disqualify you!**
- Make sure employees understand that there is no first dollar coverage on office visits and Rx. All expenses go towards satisfying the HDHP deductible.
- Note: Paying your current HDHP medical premiums pre-tax through a cafeteria plan DOES NOT effect HSA eligibility.

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How to Avoid HSA Headaches

- **TIMING IS EVERYTHING!**
- **Set your Section 125 Plan renewal to coincide with the health insurance plan renewal or amend at renewal to sync up.**
- **Changes made to a health insurance plan during an active Section 125 Plan year will not constitute a qualifying event that permits changes to the Medical FSA.**
- **If you are planning to fund the HSA pre-tax through the cafeteria plan, the plan document must be amended to add language.**
- **2 ½ month Grace Period adopted as part of cafeteria plan may cause HSA eligibility problems until the start of the first full month following the grace period.**
- **Health FSA Rollover may cause HSA eligibility problems for entire plan year.**

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How to Avoid HSA Headaches

Year End Transition to HDHP and HSA

If employer does offer the Grace Period*

- Participants that have a $0 Health Care FSA balance on last day of plan year can begin contributing to the HSA on first day of new plan year
- Participants with a Health Care FSA balance at year end must wait until end of run-out period to begin making contributions to the HSA (1st of the month following end of Grace Period)
- Employer can amend the current plan to remove Grace Period prior to year end and all participants can make HSA contributions starting with new year

* IRS Notice 2005-86

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How to Avoid HSA Headaches

Year End Transition to HDHP and HSA

If employer does offer the Grace Period*

Additional option*

- Convert all Health Care FSAs to Limited or Post Deductible Health Care FSAs during the grace period
  - **Cannot be a choice to participants**
  - **Challenges for those who do not have dental or vision expenses – could result in forfeitures**
- Requires amendment, effective last day of plan year, to convert to Limited or Post Deductible Health Care FSA

* IRS Notice 2005-86

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How to Avoid HSA Headaches

Mid-Year adoption of HDHP with HSAs

- **Example:** Employer offers a calendar year Cafeteria Plan but the health insurance renews on August 1.
  - ✓ Employer currently offers an HMO but will offer an HDHP on August 1 with an HSA
  - ✓ Employer has many employees enrolled in the Health Care FSA
- What are the employer's options?

How to Avoid HSA Headaches

Mid-Year adoption of HDHP with HSAs

Informal IRS guidance March 2005

Option 1:

- Convert all participants to a Limited or Post Deductible Health Care FSA on August 1
  - ✓ Expenses incurred after August 1 can only be for dental or vision
  - ✓ Participants may forfeit money if they do not have enough dental or vision care needs
  - ✓ All employees can start making HSA contributions August 1

How to Avoid HSA Headaches

Mid-Year adoption of HDHP with HSAs

Option 2:

- **Do not convert Health Care FSA**
- Participants who are enrolled in the Health Care FSA cannot contribute to the HSA
  - ✓ Cannot revoke Health Care FSA since change to HDHP is a Coverage Change
  - ✓ May begin contributing on January 1 if their account balance is $0 or the Grace Period is not present
  - ✓ If the Grace Period is present and there is an account balance, the participant can begin contributing to an HSA on April 1 of the next plan year (1st of the month following Grace period)

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How to Avoid HSA Headaches

Mid-Year adoption of HDHP with HSAs

Option 3:

- **Plan ahead**
  - ✓ Run a short plan year in the BESTflex Plan to make it match the health insurance plan year (e.g., 1/1 – 7/31)
  - ✓ Requires that employer anticipates change to HDHP with HSAs prior to BESTflex Plan renewal on January 1 so amendment can be made for short plan year, or
  - ✓ Then, year end transition issues apply

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How to Avoid HSA Headaches

How the Health FSA Rollover Affects HSA Eligibility

IRS guidance (memorandum February, 2014)

- Participation in a health FSA, even if only Rollover dollars, makes the employee ineligible to make or receive HSA contributions for entire plan year
- If any dollars that could rollover are completely used to reimburse prior year run out expenses, the employee becomes HSA eligible the 1st of the month following the Run out Period
- If employee elects a limited health FSA or post-deductible health FSA for new plan year, then employee is eligible to make or receive HSA contributions on 1st day of plan year

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How to Avoid HSA Headaches Recap

Caution: **Regular Health FSA and/or HRA participation (regardless of balance available in their account(s)) may disqualify employees from receiving or contributing to an HSA.**

Work Around (amendments may be required):

- **Limited Health FSA** (dental, vision, preventive care) to preserve HSA eligibility and maximize tax savings.
- **Possible to have both a Health FSA and Limited Health FSA in the same plan.** Can elect one or the other at the beginning of the plan year.
- **Post Minimum HDHP Deductible Health FSA** (expenses limited to dental, vision, preventive care until the minimum required statutory HDHP deductible has been satisfied, then general expenses are eligible.)

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Advanced HSA Concepts

In Conclusion

- **HSAs authorized under §223**
- IRS has provided guidance on compatibility of certain health FSAs and HRAs with HSAs
- **Stacking HSAs with certain health FSAs or HRAs can provide advantages for participants and employers**
  - ✓ **Use HSA to save for future expenses – spend FSA or HRA on current expenses**
- Compliance issues can arise
- **We can answer your questions about HSAs**

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Questions?

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