Implementing an HSA? What your FSA Participants Need to Know Webinar Q&A

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The following questions were asked during the two webinar sessions in November 2019:

FSA Terms

Q: What is the difference between a runout period and a grace period? What is rollover for FSA (I thought it was "Use-it or Lose-it")? Could you provide examples for each?

A: The **runout period** is an extended amount of time after the end of the Plan Year in which FSA participants can submit claims incurred during the Plan Year. This does not provide any additional time in which participants can incur claims. A standard runout period is 3 months.

Example: For a January 1, 2019 – December 31, 2019 Plan Year with a 3 month runout period, participants can incur claims between 1/1/19 – 12/31/19. Once the claims have been incurred, they can submit the claim for reimbursement until 3/31/2020.

This is very useful in cases such as a participant seeing a doctor on December 30th. It is very possible that they will not receive their invoice until mid-February and their Explanation of Benefits (EOB) may come later yet. Because the claim was incurred in 2019, they can still be reimbursed, provided they submit the claim by 3/31/20.

The **grace period** is an extended amount of time (2.5 months) after the end of the Plan Year in which FSA participants can submit claims incurred during the Plan Year plus the 2.5 months that go into the next plan year. The FSA funds are collected over 12 months, but the participant will have 14.5 months to incur expenses. Reimbursement will exhaust the prior year balance before starting to use the current year FSA election. Plan sponsors determine if the grace period will be available and include this on their plan. The grace period helps reduce unused amounts that would otherwise be forfeited. Plans with grace period are able to also include the runout period.

Example: For a January 1, 2019 – December 31, 2019 Plan Year with a 2.5 month grace period as well as 3 month runout period, participants can incur claims between 1/1/19 – 3/15/20. Once the claims have been incurred, they can submit the claim for reimbursement until 3/31/2020.

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This is very useful in cases such as a participant not having incurred enough claims throughout the plan year to utilize their full FSA. If a participant has $1,000 unused funds at the end of the plan year, they are able to incur additional claims for 2.5 months after the plan year ends. Assuming a calendar year plan, the participant can go to an eye doctor in February after then plan year ends and incur eligible expenses. Even though the claim was incurred in 2020, it can be paid from the 2019 Plan. The participant must submit the claim for reimbursement by the end of the runout period, 3/31/20.

Keep in mind, if a participant has a balance at the end of the plan year grace period is triggered. Regardless of when they exhaust their balance after that time, the health care FSA participant will not be eligible for an HSA until the first of the month following the end of the grace period.

Rollover is an optional provision that plan sponsors can include on Health Care FSAs. The IRS regulations limit the maximum rollover amount to $500. In addition, a Health Care FSA that offers rollover cannot also offer grace period (on the Health Care FSA). A plan can offer rollover on the Health Care FSA and grace period on Dependent Care FSA. Rollover dollars are moved from the prior plan year into the new plan. These funds remain available for the entire new plan year in addition to any new plan year elections.

Example: For a January 1, 2019 – December 31, 2019 Plan Year with rollover as well as 3 month runout period, participants with unused funds at the end of 2019 can roll up to $500 (or a lesser amount as defined by their Plan) into their 2020 plan year. If a participant has $600 in unused Health Care FSA as of 12/31/2019, $500 can rollover into the 2020 plan year. This amount is available all year for claims incurred in 2020.

This is very useful in cases such as a participant not having incurred enough claims throughout the plan year to utilize their full FSA. Unlike grace period, the time in which the participants need to use their funds is not limited.

Keep in mind, that when an employee has funds in their account on the last day of the plan year, they will potentially be ineligible for an HSA for the entire next plan year. There are a few exceptions when an employee elects to participate in a Limited Health Care FSA in the next plan year, or the employer has an auto-convert to Limited Health Care FSA feature on their plan.

If an employee uses all of their prior year balance during the runout period for prior year's expenses, the HSA eligibility is delayed until the first of month following the runout period.

Employer Plan Options:

Q: What are the drawbacks of offering a post-deductible health care FSA vs. a limited health care FSA?

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A: Post-deductible FSAs can cause a lot of participant confusion, which leads to dissatisfaction in the employer plan as well as the administration.

This stems from multiple items. The first of which is the difficulty in predicting how much expenses above the already high HDHP deductible will be incurred. As this is difficult to predict and because once an amount is elected for the FSA, it cannot be changed – it has led to unintended forfeitures and participants didn't fully understand the benefit. In most cases, participants are not maximizing their HSA contributions, and the dollars would be better placed in the HSA.

The limited health FSA is easier to understand as the benefit is consistent throughout the entire plan year and reimburses for dental and vision only. These expenses are also more predictable than medical expenses beyond the HDHP deductible.

In addition, the post-deductible plans require customized forms which participants must complete. Many participants do not understand when these should be submitted and what documentation is required to support the forms. Finally, post-deductible plans which are accessible through the Benefits Card can create additional issues by working for services which are not eligible as the card swipe doesn't capture date of service. This can result in required repayments on medical expenses before that minimum deductible was met.

For these reasons, Employee Benefits Corporation has made the business decision to not offer Post-deductible FSAs.

Q: Our company has offered FSA's for many, many years. We have allowed medical, dental and vision expenses to be reimbursed from this account. A few years ago, we began a Health Reimbursement Account which pays the final $1500 of a $5000 single deductible and the final $3,000 of a $10,000 family deductible. We continue to offer the FSA as well. Are we not in compliance?

A: The FSA and HRA you offer should not be causing any compliance issues. You are able to offer both FSAs and HRAs that both cover medical expenses as long as the employee is not double dipping and claiming the same expense and getting tax free reimbursement from both plans.

Issues arise when certain FSAs and/or HRAs are offered alongside of an HSA qualified high deductible health plan and employees are establishing HSAs. If at any time you decide to implement this type of plan with HSAs, you would want to review your FSA and HRAs to see if either would need amended in order for your participants to be HSA eligible.

Q: Can we have both a limited and standard Health Care FSA for the employees to make the choice? I'm thinking of those who currently have an FSA who may want to go to a limited FSA and take advantage of the HSA. We have some employees who are currently using the FSA who do not get insurance through us so I'm sure they will want to keep the standard FSA.

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A: Yes, you can offer both a limited and standard Health Care FSA and allow employees to choose between the two. This does work well as some employees may want to take advantage of the HSA, and others my prefer the FSA or may not be eligible for an HSA.

Q: I understand that an employee cannot have FSA or HRA when they have an HSA. However, can an employer offer all 3 and leave it to the employee to decide which option to use?

A: Yes! Many employers offer a full suite of products for employees to choose from. For example, they can offer one medical plan (not HSA qualified) with an HRA and a second medical plan that is HSA compatible. Employees are able to choose between the two plans. In addition, the employer can offer both a standard Health Care FSA and a limited Health Care FSA. This would allow participants who want to establish an HSA to enroll in the limited Health Care FSA and allows participants who do not want to establish (or are not eligible to establish) an HSA to enroll in the standard Health Care FSA. It is also possible to structure the HRA to be HSA compatible, so that reimbursements do not occur until after the employee meets the minimum required high deductible expense (2020: $1400 Single and $2800 Family).

Q: If we have a PPO as well as a HDHP, can we offer a HRA with first dollar and standard Health Care FSA for those employees electing the PPO?

A: Yes, you can pair an HRA with only one medical plan offered. In addition, you can offer the standard Health Care FSA to all participants. This would allow an employee who has enrolled in the HSA qualified HDHP to enroll in the standard Health Care FSA if they have other disqualifying coverage and choose to participant in the standard Health Care FSA (such as a Medicare entitled participant).

In addition, you may want to consider adding a limited Health Care FSA for those who do elect the HSA qualified HDHP.

HSA Eligibility

Q: If an employee has a standard Health Care FSA on a 2019 calendar year plan with rollover, never used their plan and has funds remaining at the end of the year, can the employee forgo or terminate their FSA in order to enroll in the HSA option for January 2020?

A: No. All elections that are made for a Health Care FSA are irrevocable based on the IRS regulations. The only way that an employee can voluntarily terminate their plan is if they have a permitted election change event. Making changes to your health insurance is not an event that permits a change to an FSA election. The employee does not have an option to forfeit their plan in order to become HSA eligible.

Q: If I take an HSA with my company, but my spouse is at a different company. If he signs up for FSA can I use the FSA, even though I have a HSA?

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A: If an employee's spouse has a standard Health Care FSA, the employee would not be eligible to establish an HSA. A standard Health Care FSA (yours or your spouses) is disqualifying coverage for both for the duration of the FSA Plan Year for both individuals because it would allow the reimbursement of expenses for the employee, spouse and children up to the age of 26. It does not matter what the FSA funds are actually used for, it is the possibility that the expenses can be claimed for medical care for the entire family.

Q: Are the minimum deductibles to be HSA eligible lower for non-embedded plans? For example, I've seen HSA plans with a $2000 deductible. What are the requirements to be HSA eligible if the plan is non-embedded?

A: In order to meet the minimum family deductible of an HSA eligible High Deductible Health Plan (HDHP), any individual within the family or a combination of family members must meetthe minimum family deductible ($2,800 for 2020). Below is what that looks like:

Aggregate or Non-Embedded Deductible: Under this structure, any one family member or combination of family members would have to meet the first $2,800 of expenses.

- Family Deductible: $2,800
- Example:
  - Single Coverage Deductible: $1,400
  - Family Coverage Deductible: $2,800

Embedded Deductible: Under this structure, any one family member would be subject to the IRS family limit (or a higher combined family limit) prior to the plan reimbursing any expenses.

- Family Deductible: $2,800 per person, not to exceed a higher family maximum
- Example:
  - Single Deductible: $2,800
  - Family Deductible: $2,800 per person, not to exceed $5,600 per family

Q: Is a new hire, enrolled in the middle of the plan year, eligible for an HSA? IE: HSA plan year January thru December and a new hire is employed in May, can they make contributions?

A: Yes! If an employee is newly hired and becomes benefits eligible mid-year, they are eligible to make contributions as long as they meet HSA eligibility criteria. The employee should be cautious about the amount that they can contributed in the case they are only HSA eligible for a portion of the year. This would also be true of an employee who enrolls on your HSA qualified HDHP at the beginning of the year, but becomes HSA eligible mid-year (such as in the case where they have a standard FSA with grace period and the employee becoming HSA eligible 4/1 – or a case where a spouse has a standard FSA with a plan year that ends mid-calendar year).

It is possible for an individual to deposit the full annual contribution for the year based upon the coverage they are enrolled in on December 1st, as long as they maintain enrollment in the HSA

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qualified coverage for all of the next calendar year. If they fail to maintain coverage, the prorating rule will apply.

Please refer to slide 44 of the Presentation for information on the maximum amount an employee can contribute if they become HSA eligible mid-year.

Q: With an FSA, an owner who owns more than 5% of a company cannot enroll in FSA. Can an owner who owns 10% or more of a company enroll in a HSA?

A: Federal regulations establish which owners can and cannot participate in cafeteria plans. This includes making pre-tax insurance premium payments, flexible spending accounts, and making pre-tax contributions to an HSA. It may be possible to make HSA contributions directly to the HSA custodian and take the tax benefits on their income tax returns.

Below is a table outlining what owners can and cannot participate:

• C corporation • LLC taxed as C corporation	Owners are employees of the company that they have ownership in and **can participate tax-free** in a cafeteria plan or HRA that the employer sponsors.
• More-than 2% subchapter S corporation owner • More-than 2% subchapter S corporation owner's spouse and lineal ascendants (parents) and descendants (children, grandchildren) that work for the organization • Both criteria above apply to LLC taxed as subchapter S corporation	Owners, spouses, ascendants and descendants are all considered to be self-employed, are not employees of the organization and **cannot be provided with tax-free benefits** through a cafeteria plan or HRA.
• Sole proprietorship • Partnership and LLP • LLC taxed as a partnership	Owners, spouses, ascendants and descendants are all considered to be self-employed, are not employees of the organization and **cannot be provided with tax-free benefits** through a cafeteria plan or HRA. Spouses or dependents of these owners who work for these organizations are considered employees and **can participate tax-free** in a cafeteria plan or HRA that the employer sponsors.

Based on the table above, if an owner can participate in the tax-free benefits, they would be able to make the pre-tax HSA contributions. For the other owners, they would not be eligible to make pre-

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tax contributions to the HSA. They can however, still establish and participate in the HSA. They can make their contributions on a post-tax basis. When the file their taxes, they would list the amount of post-tax contributions and receive an above the line deduction for this amount. This would then provide them with the tax benefits (except FICA and Medicare), just like other participants. They would also be able to take distributions for eligible expenses tax-free and would be able to earn interest on their accounts tax-free.

Q: You mentioned that telemedicine may be an HSA disqualifier. Do you know what determines this?

A: First and foremost, there is no published guidance from the IRS on this, but most view telemedicine similar to "mini med" benefits.

The following is suggested:

- × If an employer offers a telemedicine program to participants where telemedicine services are provided at no cost (or at a copayment below fair market value) to the employee – this could be disqualifying coverage.
- × If an employee pays a monthly premium for unlimited calls through the telemedicine service, this could be disqualifying coverage.

Conversely,

- ✓ If participants use a telemedicine service in which they are paying for the full cost (or fair market value) of the service (until the minimum HSA required deductible is met), this should not interfere with HSA eligibility.
- ✓ Many health insurance plans now include a telemedicine option. On plans designated as HSA compatible, the employee should be paying for telemedicine as part of their deductible. Again, this should not interfere with HSA eligibility.

Contributions

Q: If a husband and wife are both HSA eligible. I thought the moderator said both a husband and wife on the same plan can each contribute the annual maximum ($7,000 for 2019) to their own individual HSAs. The only caveat is that they can only pay for their own medical costs from their HSA. One spouse cannot pay the expenses of the other spouse. Did I hear this correctly?

A: If both a husband and wife are HSA eligible, enrolled on either the same or separate qualified High Deductible Health Plans and establish an account in both of their names, they are limited to contributing no more than the family HSA limit ($7,100 for 2020). The example from the webinar was in the case of Domestic Partners, which does work differently. The HSA regulations do include a specific rule regarding marriage so that the family limit applies to the combination of the contributions made into both spouses' accounts. If both spouses are over age 55 and they both maintain an HSA in their name, they would both be able to make the $1,000 catch-up contribution. Both spouses can use their HSA funds for their own medical expenses or for the expenses of their spouse.

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Q: Does the HSA grow with interest?

A: Yes! Not only does the HSA grow with interest, but the interest earned is not subject to income tax!

When your HSA is first established, most banks and administrators will deposit your funds into a money market account. Once your account balance has met a minimum threshold (often $1,000), the account holders can move funds into different investment options (as you would with a retirement account).

Q: In your presentation today about Implementing an HSA, one slide stated:

In general, your children on your health coverage cannot establish an HSA, but… Only until they are no longer a tax dependent (under age 19 at end of tax year or a student under age 24 at end of tax year)

Be aware of impact of Adult Dependents and Domestic Partners!!

- **You cannot use your HSA funds to reimburse expenses of your adult dependents or domestic partners.**
- **Your adult dependent or domestic partner covered by your HSA-qualified HDHP can establish an HSA in their own name.**

So does this mean I cannot use my HSA funds to cover medical expenses for an IRS Qualified Relative who is over age 24 and is being claimed as a qualified relative on my taxes but they could establish their own HSA?

A: There are times in which an HSA account holder and use their HSA funds on an adult dependent and/or a domestic partner (or another individual).

HSA funds can be used for the account holder's eligible expenses as well as any eligible expenses of their tax dependents as defined by IRC § 152. This would include a "Qualifying Child" or "Qualifying Relative". Because these individuals would be someone else's tax dependent, they would not be eligible to establish their own HSA.

A **Qualifying Child** in general is someone who:

- Is a child (including stepchild or eligible foster child) of the taxpayer (or a descendent of such a child), adopted child (including legally placed for adoption), brother, sister, stepbrother or stepsister of the taxpayer, or a descendent of any such relative;
- Is not yet 19 or is a student who is not yet 24 by the end of that year or is permanently and totally disabled at any time during the year;
- Has not provided more than half of his or her own support in that year; and has the same principal place of abode as the taxpayer for more than half of the relevant calendar year.

Note: A student for this purpose must be a full-time student for at least five (5) calendar months during the year.

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A **Qualifying Relative** in general is someone who:

- Is a child (including stepchild, or eligible foster child) of the taxpayer (or a descendant of such child), brother, sister, stepbrother, stepsister, father, mother (or ancestor), stepmother, stepfather, niece, nephew, aunt, uncle, in-law (father-in-law, mother-in-law, sister-in-law, brother-in-law, son-in-law, or daughter-in-law) or who (other than a spouse) has the same principal place of abode as the taxpayer and is a member of his or her household (unless the relationship violates local law);
- Receives half or more of his or her support in the year from the taxpayer; and
- Is not a "Qualifying Child" of any taxpayer in the year

Because the definition of qualifying relative is broad, unrelated individuals may be claimed as a dependent and domestic partners may qualify as a Qualifying Relative dependent, but not as a spouse.

Q: We have filled out a form before on the person qualified for Medicare and gotten their money back for the previous 6 months. Has this changed recently where that is no longer an option? (Note: the withdrawal was in the same year, before taxes were filed.)

A: At any time, if an HSA account holder discovers they have contributed excess contributions to their HSA, they are able to request a withdrawal of excess contributions from their HSA. This could be due to retroactive Medicare Coverage or for other reasons. Some individuals may need to do this if their employer makes a large up-front deposit into their HSA at the beginning of the year, and shortly thereafter, the individual loses HSA eligibility. Removing the excess contributions prior to your tax filing will result in income taxes on the money and its earnings, but will allow the account holder to avoid the 6% excise tax for excess contributions.

Most banks/administrators require a form for this.

NOTE: Employers are not permitted to recoup deposits they make to their employee's HSA, except for in limited circumstances (see slide 49).

Q: Is the full annual contribution (Last Month Rule) only available for the 1st year when you become HSA eligible mid-year? (See slide 44)

A: The full annual contribution (Last Month Rule) would apply anytime that you become HSA eligible mid-year. This may occur more than once if you have changes in your HSA eligibility year to year. Below is an example in which you could benefit from this in more than one year:

Example: In July 2019, your employer first offers an HSA qualified HDHP. You enroll as single coverage. Because you expect to remain on this plan through all of 2020, you contribute $3,500 (2019 single max) to your HSA. You remain HSA eligible for all of 2020 and contribute $3,550 during that year. You have satisfied the testing period and your 2019 and 2020 contributions are compliant.

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In October of 2021, you get married and add your spouse to your medical plan. Again, you expect to remain HSA eligible for all of 2022, so you contribute the full FAMILY limit into your HSA for 2021 ($7,100 + inflation adjustment). In addition, you remain HSA eligible for all of 2022 and you contribute the full Family limit into your HSA for 2022. Again, you have satisfied the testing period and your 2021 and 2022 contributions are compliant.

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