HSA Basics

City of West Allis

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Agenda

- HSA & HDHP Definitions
- HSA Eligibility
- HSA Basics
  - HSA Owner
  - Employer
  - Custodian
- TCNB HSA Basics
- Contributions
- Distributions
- Resources

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Definitions

- A Health Savings Account (HSA) is a special account owned by an individual & used 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

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What is a "High Deductible Health Plan" (HDHP)?

- Health insurance plan with minimum deductible of (for 2016):
  - $1,300 (self-only coverage)
  - $2,600 (family coverage)
  - These amounts are indexed annually for inflation
- Annual out-of-pocket (including deductibles and co-pays) cannot exceed (for 2016):
  - $6,550 (self-only coverage)
  - $13,100 (family coverage)
  - These amounts are indexed annually for inflation

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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
- All covered benefits must apply to the plan deductible, including prescription drugs
- HDHPs typically have lower plan premiums for both employer and employee

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Who is Eligible for HSAs?

- Any individual that:
  - Is covered by an HDHP
  - Is <u>not</u> covered by other health 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
    - Spouses can establish their own HSAs, if eligible
- No income limits on who may contribute to an HSA
- No requirement of having earned income to contribute to an HSA

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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

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Who is Eligible for HSAs?

- Examples of “1st dollar” medical benefits that make someone ineligible for an HSA:
  - Medicare
  - Tricare Coverage
  - Flexible Spending Arrangements
  - Health Reimbursement Arrangements
- There are permitted HSA/HRA/FSA combinations

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HSA Basics – HSA Owner

- Accounts are owned by the individual (not an employer)
- The HSA owner decides:
  - Whether he or she should contribute
  - 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 future use
  - What type of investments to grow account

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HSA Basics – HSA Owner

- 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

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HSA Basics - Employer

- Employer may choose to contribute to employees' HSAs
  - May be able to deduct the contributions on their business income tax return
- Employer cannot restrict
  - What distributions from an HSA are used for
  - Rollovers

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HSA Basics - Custodian

- Who can be an HSA Custodian?
  - Banks, credit unions
  - Insurance companies
  - Entities already approved by the IRS to be an IRA or Archer MSA custodian
  - Other entities can apply to the IRS to be approved as a non-bank custodian
- HSA Custodian can put reasonable limits on accessing the money in the account
  - Frequency of distributions
  - Size of the distributions

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HSA Basics - Custodian

- 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
    - This is the preferred method to avoid issues with incorrect distribution reporting
  - Fees can overdraw account but not checks/debit card purchases

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HSA Basics - Custodian

- HSA custodian must report all distributions annually to the individual (Form 1099 SA).
  - Trustee not required to determine whether distributions are used for medical purposes; the individual does that.
  - Individual will report on annual tax return amount of distribution used for qualified medical expenses
- Account holders must file Form 8889 as part of their annual tax return.

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HSA Owner Benefits

- Carry over balance from year to year (no “use it or lose it” like FSA)
- Earn tax-free interest on unused balances
- Pay qualified medical expenses with pretax or tax-deductible dollars
- More control of health care decisions
- Lower out-of-pocket premium costs
- HSA account is portable if leave employer

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Employer Benefits

- Lower plan premiums for HDHP
- Lower administrative costs than other health spending accounts
- Tax benefits for contributions to employees HSAs
- Helping employees save for retirement
- Employees become more involved in healthcare decisions
  - Lowered expenses
  - Healthier employees

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TCNB HSA Basics

- Tiered Interest Rates
  - $0 - $9,999
  - $10,000 - $24,999
  - $25,000+
- $1,000 Minimum Balance
  - $4 fee per month if below minimum
  - Ways to avoid minimum balance
    - Link $2,500 in Related TCNB Accounts
    - Have a monthly ACH credit into the account
- 10 Checks Per Month
  - $1 per check written over 10
- 1st Box of Check = Free
- Free Debit Card with no inactivity period
- $50 Minimum Opening Deposit (Waived for City of West Allis Employees)
- $25 Opening Fee (Waived for City of West Allis Employees)

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HSA Contribution Rules

- Contributions to HSAs can be made by the employer, 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 individual
  - Beginning in 2007, individuals can make a one-time transfer from their IRA to an HSA, subject to the contribution limits applicable for the year of the transfer

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HSA Contribution Limits

- For 2016, the maximum amount that can be contributed (and deducted) to an HSA from all sources is:
  - $3,350 (self-only coverage)
  - $6,750 (family coverage)
  - These amounts are indexed annually.
- For individuals age 55 and older, additional “catch-up” contributions to HSA are allowed:
  - 2010 and after - $1,000
- Contributions must stop once an individual is enrolled in any type of Medicare.

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HSA Contribution Rules

- Beginning in 2007, a full year’s contribution (plus the catch-up, if applicable) may be made to an HSA for someone who first becomes eligible during that year, even if they start in December.
- If someone contributes a full year’s contribution but is eligible only part of the year, however, they will be subject to taxes and penalties if they don’t remain eligible for 12 months after the year in which they first become eligible.

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HSA Contribution Rules

- If the individual is not covered by an HDHP for a full year, contributions may be prorated. When prorating, 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.
- "Catch-up" contributions must also be prorated for number of months eligible.
  - Does not matter when 55th birthday falls during year

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2016 Prorated Contribution – Example: Single Coverage

10 months of eligibility

$$\frac{\$3,350}{12} = \$279.17 \text{ monthly}$$

$279.17 x 10 = $2,791.70 annual limit

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2016 Prorated Contribution – Example: Family Coverage with Catch Up

10 months of eligibility

$$\frac{\$6,750 + \$1,000}{12} = \$645.84 \text{ monthly limit}$$

$645.84 x 10 = $6,458.40 annual limit

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HSA Excess Contribution Rules

- Contributions to the HSA in excess of the contribution limits must be withdrawn by the individual or be subject to an excise tax.
  - A pro-rata portion of earnings must be withdrawn also
  - Pay income tax on the withdrawn amount, but no 20% penalty
- 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 20% penalty.

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Employee Contributions

- Can be made by a salary reduction arrangement through a cafeteria plan (125 plan)
  - Elections to make contributions through a cafeteria plan can change on a month-by-month basis (unlike salary reduction contributions to an FSA)
  - Remember that contributions to the HSA through a cafeteria plan are “pre-tax” and not subject to individual 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”)

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HSA Rollovers & Transfers

- 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
- Direct custodian to custodian transfers of HSA amounts are not subject to the rollover restrictions.
  - Thus, multiple custodian to custodian transfers are allowed in a single year
  - Both custodians must agree to do the transfer and they are not required to do so
- Direct rollovers from 401(k), 403(b) and 457 plans are not permitted.

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HSA Distributions

- Distributions are tax-free if taken for “qualified medical expenses”.
  - Over-the-counter drugs require a written prescription and must be dispensed with an Rx number
- Qualified medical expense must be incurred on or after the HSA was established.
  - If HDHP coverage is effective on March 1st but HSA is opened April 1st, expenses incurred between March 1st and April 1st can not be reimbursed or paid from the HSA

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HSA Distributions

- Tax-free distributions can be taken for qualified medical expenses of:
  - person covered by the high deductible plan
  - spouse of the individual (even if not covered by the HDHP)
  - any dependent of the individual (even if not covered by the HDHP)

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HSA Distributions

- If distribution is not used for qualified medical expenses:
  - Amount of distribution is included in income and
  - 20% additional tax except when taken after:
    - Individual dies or becomes disabled
    - Individual is age 65

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HSA Distributions

- "Qualified medical expenses" do not include other health insurance (including premiums for dental or vision care)
- Exceptions:
  - COBRA continuation coverage
  - Any health plan coverage while receiving unemployment compensation
  - For individuals enrolled in Medicare:
    - Medicare premiums and out-of-pocket expenses (Part A, Part B, Medicare HMOs, prescription drug coverage)
    - Employee share of premiums for employer-based coverage
    - Cannot pay Medigap premiums
  - Qualified long-term care insurance premiums

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HSA Distributions

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

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HSA Distributions

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

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HSA Distributions

- Mistaken HSA distributions 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

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Treatment of HSAs upon Death

- If the spouse is the beneficiary, the spouse inheriting the HSA is treated as the owner
  - Spouse must close existing HSA and open one in their name
- To the extent the spouse is not the beneficiary:
  - The account will no longer be treated as an HSA upon the death of the individual
  - The account will become taxable to the decedent in the decedent's final tax return if the estate is the beneficiary, otherwise, it will be taxable to the recipient.
    - 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

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Resources

- **US Treasury** - www.treasury.gov
  - Taxes page in the Resource Center FAQ section
- **IRS** – www.irs.gov
  - Publication 969 – Health Savings Accounts & Other Tax-Favored Health Plans
  - Publication 502 – Medical & Dental Expenses
- Kristen Talbott (414-325-1239)
- Suzanne Gorecki (414-325-1238)

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Other Questions

- This presentation is for informational purposes only and should not be considered tax advice.
- Please consult a qualified tax professional for clarification about information presented and how it may impact your individual situation.

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