

## HSA Overview – What is an HSA?

A Health Savings Account (HSA) is a special "tax-advantaged" account owned by an individual used to pay for current and future "Qualified Medical Expenses"

- \$ goes in "pre-tax" (federal level) and comes out "tax-free" for qualified medical expenses
- Unused \$ in the account continues to roll over year after year and can earn interest
- Money in the account can grow through investment earnings, depending on the HSA trustee
- Upon turning age 65, the individual can use any unused funds in the account for any purpose, penalty free, but subject to ordinary income tax
- HSA's encourage individuals to take a more pro-active approach to their own healthcare
- HSA's must be used in conjunction with a qualified High Deductible Health Plan (HDHP)

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## HSA Overview – What is an HDHP?

HSA's must be used in conjunction with a High Deductible Health Plan (HDHP)

- Insurance that does not cover first dollar medical expenses, except for preventive care
- If you are not covered by a qualified HDHP, you may not contribute to an HSA, but you can spend it down, or leave it to earn interest
- If you change jobs to another company and enroll in an HDHP, you may roll over from one HSA account to another
- Can be an HMO, PPO, or indemnity plan, as long as it meets the requirements
- Regulated by the IRS

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## Who is Eligible for an HSA?

- Any individual that:
  - Is covered by a HDHP
  - Is not covered by other health insurance (dental, vision, EAP, LTC are allowed)
  - Is not enrolled in Medicare (actives age 65+)
  - 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, but contribution limits are applicable
- 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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## HSA Contribution Rules

The maximum *annual* amount that can be contributed to an HSA from all sources is:

\$3,000 (self-only coverage) for 2009\*

\$5,950 (family coverage) for 2009\*

Contributions to the HSA in excess of the contribution limits must be withdrawn by the individual or will be subject to ordinary income tax

\*These amounts are indexed annually

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## HSA Contribution Rules

- Contributions 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)
    - Employee deferrals through a Section 125 Plan are considered employer contributions
    - Only way to have it pre-tax at the paycheck
    - Transfers are made directly to custodial account
  - If made by the individual, it is an "above-the-line" deduction on Form 1040. Payroll transfer (not through 125 plan); bank transfer, manual check
- Contributions must stop once an individual is enrolled in any type of other plan, including Medicare
- For individuals age 55+, additional \$1,000 "catch-up" contributions allowed - 2009
- However, a full year's contribution when eligible only part of the year creates taxes and penalties if not continuously eligible for 12 months after the year in which he/she first become eligible

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## HSA Contribution Rules: Employee Contributions

- Can be made by a salary reduction arrangement through a cafeteria plan (125 plan)
  - Contributions through a cafeteria plan can change on a month-by-month basis (unlike salary reduction contributions to an FSA)
  - Contributions to the HSA through a cafeteria plan are "pre-tax", at the federal level, 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 Contribution Rules: Employer Contributions

- Employer matching contributions to the HSA through a cafeteria plan are not subject to the comparability rules
  - But cafeteria plan nondiscrimination rules apply
    - 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 employees are allowed to contribute to the HSA through a cafeteria plan

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## HSA Distributions

- Distribution is tax-free if taken for "qualified medical expenses".
  - Now includes over-the-counter drugs
- Qualified medical expense must be incurred on or after the HSA was established.
  - 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
- 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)

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## HSA Distributions

□ "Qualified Medical Expense" examples:

- Deductibles, Coinsurance, Copays
- Doctor's fees, including hospital & lab
- Prescription drugs
- Dental, Vision & Hearing services
- Chiropractic & Acupuncture
- Durable medical Equipment
- Certain OTC medicines
- Psychiatric care
- Weight loss & smoking cessation programs

For a complete list, refer to IRS Publication 502.

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## HSA Distributions

If distribution is not used for  
"Qualified Medical Expenses"

Amount of distribution is included in income

and

→ 10% additional tax applies

(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)
- 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

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- 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 15th of the year following the year in which the individual knew or should have known the distribution was a mistake**

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## HSA Accounts

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- Accounts are owned by the individual (not an employer). The individual decides:
  - Whether he or she should contribute
  - How much to use for medical expenses
  - Whether or not the expense is a "Qualified Medical Expense"
  - If he/she wants to use the \$ for non-qualified 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
  - Which company will hold the account
  - What type of investments to grow account

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## HSA Accounts

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- 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
- 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

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## HSA Accounts

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- HSA trustee must report all distributions annually to the individual (Form 1099 SA).
  - Trustee *not required* to determine whether distributions are used for medical purposes; the owner of the HSA account is responsible for 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 Accounts

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- 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 Accounts

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- 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 from 401(k), 403(b) and 457 plans are not permitted

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## Action Plan

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- Amend Section 125 Plan to allow employee/employer contributions to an HSA
- Allow HSA contributions during Section 125 plan open enrollment
- Payroll will code deferrals per IS IFAS instructions to come ...

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Thank you to  
Kimberly Miller  
Alliant Insurance Services

For more information, visit the U.S. Treasury Department website:  
<http://www.treas.gov/offices/public-affairs/hsa/>

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