Health Savings Accounts

Health Savings Accounts (HSAs) came into existence as part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The statutory rules governing HSAs can be found in the Internal Revenue Code section 223. HSAs are tax-favored accounts that can pay for certain medical expenses of eligible individuals and their dependents.

Eligibility
HSAs can be contributed to by, or on behalf, of eligible individuals. Individuals who can be claimed as tax dependents and those who are entitled to Medicare are ineligible to contribute to an HSA. Unlike other tax favored accounts such as HRAs or FSAs, an individual does not need to be an employee to be eligible for an HSA. This means that more than 2% shareholders in a Subchapter S corporation, partners in a partnership, sole proprietors and other self-employed individuals may participate in HSAs. However, when HSAs are offered by the employer under a Cafeteria Plan, those individuals are not able to participate in the Cafeteria Plan and contributions should be made on a post-tax basis. HSA contributions made on a post-tax basis may be deductible on individual tax returns.

To be eligible to establish an HSA, an individual must be covered by a qualified high-deductible health plan (HDHP) that satisfies the minimum annual deductible and maximum out-of-pocket expense requirements. The IRS annually reviews the deductible and out-of-pocket for adjustments based on inflation. For 2016, the minimum deductible is $1,300 (Individual) and $2,600 (Family). When an HSA qualified HDHP plan is set up with an embedded deductible, the individual deductible amount must exceed the minimum statutory family deductible. A deductible is considered to be embedded when one individual in the family can meet their deductible and benefits start paying out instead of having to meet the family limit. The maximum out-of-pocket amount for 2016 is $6,550 (Individual) and $13,100 (Family).

In addition to the minimum annual deductible and maximum out-of-pocket requirements, it is also a requirement that the HDHP coverage may only impose reasonable restrictions on plan benefits. Restricting a plan’s covered benefits will be considered reasonable if "significant other benefits remain available under the plan, in addition to the benefits subject to the restriction or exclusion”. The Internal Revenue Service (IRS) has not provided a comprehensive definition of significant benefits, although several examples such as restriction for expenses for hospitalization, including exclusions for coverage of inpatient or outpatient care have been provided. Therefore plans that provide only limited office visits and no hospital coverage are likely to not qualify as HSA eligible HDHPs, regardless of whether the minimum annual deductible or maximum out-of-pocket criteria is met.

Contribution Requirements
The IRS sets the annual HSA contribution limits. For 2016, the individual limit is $3,350 with a family limit of $6,750. There is also a $1,000 annual catch-up limit for individuals age 55 and older. Any contributions in excess of the limits are subject to a 6% excise tax for each taxable year the HSA holder has excess contributions. This excise tax may be avoided if excess contributions are distributed to the account holder before the due date for the account holder’s federal income tax return for the taxable year (generally April 15). Excess contributions made by an employer to an employee’s HSA should be included in the gross income of the employee to the extent they exceed the individual’s maximum contribution amount or are made on behalf of an employee who is not an eligible individual.
An individual’s annual HSA contributions may not exceed the monthly limitations for all months they are an eligible individual. For example if an individual is covered for six months of the year with self-only coverage, the maximum contribution is $1,675 (6/12 of $3,350). However, there is a full contribution rule that allows a full year of HSA contributions to be made for someone who is HSA eligible for only a portion of the year. The full contribution rule provides that an individual who is HSA eligible on December 1st of that year is treated as an eligible individual during all months of the year. However, if an individual takes advantage of the full contribution rule they must remain HSA eligible during the 13 month testing period. The testing period begins on the December of the year contributions were made and ends on the last day of the 12th month following that December (December 31st of the following year), to avoid adverse tax consequences.

Comparability Rules
Contributions made by the employer on behalf of employees are subject to the comparability rules if contributions are made outside of the Cafeteria Plan. The comparability rules permit different employer HSA contributions for four categories of HDHP coverage (i.e., self, self-plus one, self-plus two, and self-plus three or more). The rules do not allow employers to vary their HSA contributions based on bona-fide employment classification except for current full-time employees, current part-time employees and former employees. If employer contributions are made through a Cafeteria Plan they are not subject to the comparability rules, instead the Cafeteria Plan nondiscrimination rules apply, which may offer more flexibility. HSA contributions for more than 2% shareholders in a Subchapter S corporation, partners in a partnership, sole proprietors and other self-employed individuals are not subject to the Cafeteria Plan nondiscrimination rules, as they are not considered employees.

Permitted Coverage
Certain types of arrangements may interfere with HSA eligibility. An individual cannot have other non-HDHP coverage that provides coverage, for any benefit covered by the HDHP. Therefore an eligible individual may not be covered under a general-purpose Flexible Spending Account (FSA) or a typical Health Reimbursement Arrangement (HRA). An individual may be covered by a limited-purpose FSA that covers dental and vision expenses only, or by an HRA that reimburses post-deductible, and still be eligible to contribute to an HSA. FSAs that have a grace period to spend down funds will cause a person to be ineligible for HSA contributions until the grace period has expired. In addition, an FSA that allows for the rollover/carry-over up to a maximum of $500, will prevent eligibility for HSA contributions for the entire year. An employer may implement a limited-purpose FSA to allow rollovers that will not interfere with HSA eligibility. Another consideration is an individual’s spouse covered by a general-purpose FSA or an HRA, which does not exclude expenses for the other spouse, will cause an individual to be ineligible to contribute to an HSA. Compliance with these limitations requires planning and education of the participants.