

***Frequently Asked Questions About  
Health Savings Accounts (HSA's) - HSA Medical Plans***

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**Updated November 2011**

**1) What is an HSA?**

An HSA is a tax-exempt medical savings account established exclusively for the purpose of paying qualified medical expenses of the account beneficiary who, for the months for which contributions are made to an HSA is covered by a qualified high-deductible health plan.

**2) Who is eligible to establish an HSA?**

An “eligible individual” is one who is covered under a high-deductible health plan (HDHP) on the first day of any month and is not also covered by any other health plan that is not an HDHP (with certain exceptions for plans providing certain limited types of coverage). Individuals entitled to and enrolled in Medicare (generally those age 65 and older) are not eligible individuals. An eligible individual may not establish an HSA if claimed on another persons tax return.

**3) What is a high-deductible health plan (HDHP)?**

Generally, a HDHP is a health plan that satisfies certain minimum and maximum requirements with respect to deductibles and out-of-pocket expenses. These amounts are announced annually and indexed for inflation. In 2012, for self-only coverage, a HDHP must have a minimum annual deductible of at least \$1,200., and maximum out-of-pocket expenses (deductibles, co-payments and other amounts, but not premiums) not exceeding \$6,050. (previously \$5,950.). In 2012, for family coverage, a HDHP must have a minimum annual deductible of \$2,400., and maximum out-of-pocket expenses not exceeding \$12,100. (previously \$11,900.). *In the case of family coverage, a plan is a HDHP only if, under the terms of the plan and without regard to which family member or members incur expenses, no amounts are payable from the HDHP until the family has incurred annual covered medical expenses in excess of the minimum annual deductible.* A plan does not fail to qualify as an HDHP because it has no deductible or a smaller deductible applying to preventative care expenses. However, except for preventative care, a plan may not provide benefits for any year until the deductible for that plan year is met.

#### **4) How much may be contributed to a Health Savings Account in 2011?**

Beginning in 2012, a taxpayer may contribute to an HSA and deduct up to \$3,100. (formerly \$3,050.) for self-only coverage, or \$6,250. (formerly \$6,150.) for family coverage, regardless of the amount of deductible under the applicable high deductible health plan (HDHP). The Tax Relief and Health Care Act of 2006 (TRHCA), signed into law December 20, 2006, expanded contribution options for HSA's. In addition under TRHCA, a taxpayer who becomes eligible to contribute to an HSA in the middle of the year and who is eligible for the last month of the year may contribute and deduct up to the full amount even though the contribution limit is usually calculated on a monthly basis. However, individuals who become HSA-eligible individuals in the middle of the year and who make the full year contribution must remain as eligible individuals for the 13 month period beginning in December of the year the contribution was made and ending Dec. 31 of the following year (or face tax ramifications). Individual's age 55 or older and younger than 65 may also contribute up to \$1,000 in catch-up contributions in 2012.

#### **5) How does the recently enacted Patient Protection and Affordable Care Act (PPACA) impact HSA Plans?**

Effective January 1, 2011, a physician prescription is required for over-the-counter (OTC) drugs, medicines and biologicals (products found in medicines), to be considered eligible for reimbursement from the savings account. As a result members may be required to submit a copy of the prescription along with the receipts when requesting reimbursement. This rule does not apply to insulin, which can be purchased without a prescription. The prescription requirement also does not apply to those items that are not medicines or drugs, such as crutches, badges, diagnostic devices (i.e. blood sugar test kits), or personal care items that qualify as medical expenses. Otherwise, the excise tax for using HSA funds for non-qualified or other expenses increased from 10% to 20%.

#### **6) Who may contribute to an HSA?**

Any eligible individual may contribute to an HSA. For an HSA established by an employee, the employee, the employee's employer, or both, may contribute to the HSA of the employee in a given year. For an HSA established by a self-employed (or unemployed) individual, the individual may contribute to the HSA. Family members may also make contributions to an HSA on behalf of another family member as long as that other family member is an eligible individual.

**7) What is the tax treatment of an eligible individual's HSA contributions?**

Contributions made by an eligible individual to an HSA are deductible by the eligible individual in determining adjusted gross income (i.e. "above the line"). The contributions are deductible whether or not the eligible individual itemizes deductions. Contributions can also be made on a pre-tax basis through an employer Section 125 Plan.

**8) What is the tax treatment of contributions made by a family member on behalf of an eligible individual?**

Contributions made by a family member on behalf of an eligible individual to an HSA are deductible by the eligible individual in computing adjusted gross income. The contributions are deductible whether or not the eligible individual itemizes deductions. An eligible individual who may be claimed, as a dependent on another person's tax return is not an eligible individual and may not deduct contributions to an HSA.

**9) What is the tax treatment of employer contributions to an HSA?**

In the case where an employee is an eligible individual, employer contributions to the employee's HSA are treated as employer-provided coverage for medical expenses under accident and health plans and are excludable from the employee's gross income. The employer contributions are not subject to withholding from wages for income tax or subject to FICA, FUTA, or the Railroad Retirement Tax Act. Contributions to an employee's HSA through a cafeteria plan are treated as employer contributions.

**10) What is the tax treatment of an HSA?**

An HSA is generally exempt from tax (like an IRA), unless it has ceased to be an HSA. Earnings on amounts in an HSA are not includable in gross income while held in an HSA (i.e. inside build-up is not taxable).

**11) When may HSA contributions be made? Is there a deadline for contributions to an HSA for a taxable year?**

Contributions for the taxable year can be made in one or more payments, at the convenience of the individual or employer, at any time prior to the time prescribed by law (without extensions) for filing of the eligible individual's federal income tax return for that year, but not before the beginning of that year. For calendar year taxpayers, the deadline for contributions to an HSA is generally April 15 following the year for which the contributions are made. Although the annual contribution is determined monthly, the maximum contribution may be made on the first day of the year.

**12) What kinds of health coverage may an individual maintain without losing eligibility for an HSA?**

An individual does not fail to be eligible for an HSA along with coverage under a HDHP if the individual has coverage for any benefit provided by "permitted insurance". Permitted insurance includes coverage under workers compensation, tort liabilities, automobile insurance, insurance for a specified disease or illness, insurance that pays a fixed amount for hospitalization, accident insurance, disability, dental and vision care or long-term care. However, a person may not be covered by another health plan and be eligible for an HSA, including a general purpose health Flexible Spending Arrangement (FSA) or general purpose Health Reimbursement Arrangement (HRA). Special rules and special transition rules apply to individuals electing coverage under a HSA qualified HDHP when currently covered under general-purpose FSA's or general purpose HRA's.

**13) How does an eligible individual establish an HSA?**

An eligible individual may establish an HSA with a qualified HSA trustee or custodian in much the same way that individuals establish IRA's. Qualified trustees and custodians include banks, insurance companies, and other financial institutions. Simply inquire of these institutions to see if they are qualified. No permission or authorization from the Internal Revenue Service (IRS) is necessary to establish an HSA.

**14) Does the HSA need to be opened at the same institution that provides the HDHP?**

No, the HSA can be established through a qualified trustee or custodian who is different from the HDHP provider. Qualified Trustee's or Custodians include banks, insurance companies, and other financial institutions.

**15) When is an individual permitted to receive distributions from an HSA?**

An individual is permitted to receive distributions from an HSA at any time.

**16) How are distributions from an HSA taxed?**

Distributions from an HSA used exclusively to pay for qualified medical expenses of the account beneficiary, his or her spouse, or dependents are excludable from gross income (even if the individual is not currently eligible for contributions to an HSA). However, any amount of distribution not used exclusively to pay for qualified medical expenses of an account beneficiary, spouse or dependents is includable in gross income of the account beneficiary and is subject to an additional 20% tax (effective in 2011) on the amount includable, except in the case of distributions made after the account beneficiary's death, disability, or attaining the age of 65.

**17) Are health insurance premiums qualified medical expenses?**

Generally, health insurance premiums are not qualified medical expenses except for the following: qualified long term care insurance, COBRA health care continuation coverage, and health care coverage while an individual is receiving unemployment compensation. In addition, for individuals over age 65, premiums for Medicare Part A and B, Medicare HMO, and the employee share of premiums for employer sponsored health insurance, including premiums for employer-sponsored retiree health insurance can be paid from an HSA. Premiums for Medigap policies are not qualified medical expenses.

**18) How are distributions from an HSA taxed after an account beneficiary is no longer an eligible individual?**

If an eligible individual is no longer an eligible individual (e.g. the individual is over age 65 and entitled to and enrolled in Medicare benefits, or no longer has a HDHP), distributions used exclusively to pay for qualified medical expenses continue to be excludable from the account beneficiary's gross income.

**19) Must employers who make contributions to an employee's HSA determine whether HSA distributions are used exclusively for qualified medical expenses?**

No, that burden of proof rests with the individual/employee.

**20) What are the income tax consequences after the HSA account beneficiary's death?**

Upon death, any balance remaining in the account beneficiary's HSA becomes the property of the individual named in the HSA instrument as the beneficiary of the account. If the account beneficiary's surviving spouse is the named beneficiary of the account, the HSA account becomes the HSA of the surviving spouse. If the account passes to a person other than the account beneficiary's surviving spouse, the HSA ceases to be an HSA as of the date of the account beneficiary's death, and the person is required to include in gross income the fair market value of the HSA assets as of the date of death. For such a person (except for the decedent's estate) the includable amount is reduced by any payments from the HSA made for the decedent's qualified medical expenses, if paid within one year after death.

**21) What discrimination rules apply to HSA's?**

If an employer makes HSA contributions, the employer must make available comparable contributions on behalf of all "comparable participating employees" (i.e. eligible employees of comparable coverage) during the same period. The comparability rule is applied separately to part-time employees (i.e. employees who are customarily employed for fewer than 30 hours per week). If an employer makes contributions to his/her employees' HSA's that were not comparable, the employer must pay an excise tax of 35% of the amount contributed. The comparability rule does not apply to contributions that were made through a cafeteria plan. See Internal Revenue Bulletin: 2004-33 dated August 16, 2004, Notice 2004-50 Health Savings Accounts – Additional Qs & As for more detailed information on employer HSA contribution comparability rules.

**22) Can an HSA be offered under a cafeteria plan?**

Yes, both an HSA and a HDHP can be offered as options under a cafeteria plan. Thus, an employee can elect to have amounts contributed as employer contributions to an HSA and a HDHP on a pre-tax salary reduction basis.

**23) What reporting is required for an HSA?**

Employer contributions to an HSA must be reported on the employees Form W-2, in Box 12 with code W. Employees report contributions to their HSA using Form 8889, and file it with their Form 1040. Employees/Individuals report HSA deductions on Line 25 of their Form 1040. Individuals should receive Form 5498 from the trustee/custodian showing the amount contributed to their HSA during the year.

**24) Are HSA's subject to COBRA continuation coverage under Section 4980B?**

No, HSA's are not subject to COBRA continuation coverage.

**25) May eligible individuals use debit, credit or stored value cards to receive distributions from an HSA for qualified medical expenses?**

Yes.

**26) May an otherwise eligible individual who is eligible for Medicare, but not enrolled in Medicare Part A or Part B, contribute to an HSA, and make the additional catch-up contributions allowed for persons age 55 and older but younger than 65?**

Yes.

**27) If an account beneficiary's spouse or dependents are covered under a non-HDHP (like through a spouses employers plan), are distributions from an HSA to pay their qualified medical expenses excluded from the account beneficiary's gross income?**

Yes, as long as distributions made for those expenses are not reimbursed from another health plan.

**28) If both spouses have HSA's and one spouse uses distributions from his or her HSA to pay or reimburse the qualified medical expenses of the other spouse, are the distributions excluded from the account beneficiary's gross income?**

Yes, however both HSA's may not reimburse the same expense amounts (no double dipping allowed).

**29) Are distributions from an HSA to pay for long-term care services qualified medical expenses, which are excludable from gross income?**

Yes.

**30) Which requirements that apply to health Flexible Spending Arrangements (FSA's) under a Section 125 Cafeteria Plan do not apply to HSA's?**

The following requirements for health FSA's under Section 125 Cafeteria Plans are not applicable to HSA's: (1) the prohibition against a health benefit that defers compensation by permitting employees to carry over unused elective contributions or plan benefits from one plan year to another plan year; (2) the requirement that the maximum amount of reimbursement must be available at all times during the coverage period; and (3) the mandatory 12 month period of coverage.

**31) What are permissible investments for HSA's?**

HSA funds may be invested in investments approved for IRA's, including bank accounts, certificates of deposit, stocks, mutual funds, bonds or annuities.

**32) What happens if Excess Contributions are made to an HSA?**

Excess contributions are contributions greater than the amounts discussed earlier. Excess contributions are not deductible by the individual. Employers report excess contributions *made by the employer* on the individual's W-2 in box 1. If excess contributions are not included in the individual's W-2 box 1, the individual must report the excess as "Other Income" on his/her tax return. Generally, individuals must pay a 6% excise tax on excess contributions. However, individuals may withdraw excess contributions by the due date (including extensions) of their tax return for the year the contributions were made, and withdraw any income earned on the withdrawn contributions, and include the earnings in "Other Income" on their tax return for the year they withdrew the contributions and earnings.

**33) What do's and don'ts should employers follow with regards to employer and employee contributions to health savings accounts?**

According to an October 27, 2006 Department of Labor Field Bulletin, employers should not give employees a list of recommended HSA vendors and then take a payment or discount from those vendors for pointing potential buyers in their direction. Employers may select an HSA provider that offers the same investment options that are offered in a 401(k) without making the HSA subject to ERISA, as long as workers have a reasonable choice of HSA investment options and can move their funds to a different HSA. Employers may pay the fees associated with the HSA for their workers without making the plan subject to ERISA. HSA providers can offer cash incentives to individuals who establish an HSA, but only if the money goes into the HSA. Employers must promptly transmit employees HSA contributions to their accounts, or risk violating federal law.

**34) Are there special rules that apply for married individuals?**

Yes. In general, if either spouse has family coverage, both spouses are treated as having only such family coverage. Also, if each spouse has family coverage under different health plans; both spouses are treated as having family coverage under the plan with the lowest deductible (see IRC Section 223(b)(5)). See Internal Revenue Bulletin: 2005-19 dated May 2, 2005, Rev. Rul. 2005-25 for more details.

**35) Is an individual an eligible individual for contributions to an HSA when covered by a HDHP and also covered by a Limited-Purpose FSA or HRA?**

Yes. An individual covered by a HDHP and also covered by a Limited-Purpose Flexible Spending Arrangement (FSA), or Limited-Purpose Health Reimbursement Arrangement (HRA), is an eligible individual for contributions to an HSA. A Limited-Purpose FSA or HRA is a plan that pays or reimburses benefits for "permitted coverage". "Permitted Coverage" (whether through insurance or otherwise) includes coverage for accidents, disability, dental care, vision care, and preventative care benefits.

**36) What are seen as some of the advantages of a HDHP along with the HSA as an alternative to more traditional health insurance plans?**

First, the HDHP may have lower monthly premium costs than traditional health insurance plans, and that premium savings can be used to help fund the Health Savings Account. Amounts remaining in the Health Savings Account are automatically rolled-over from one year to the next, and earnings on those account balances are not taxable. Second, due to the inherent financial incentives to individuals to save and grow their savings, individuals are expected to become more consumer cost-conscious in shopping for, and in receiving, health care services. Third, amounts remaining in an individual's Health Savings Account can be used towards health expenditures and certain insurance premiums during retirement, and fourth, amounts left in a Health Savings Account at death, go to the individual's chosen beneficiary's.

**37) What else changed in regards to HSA Plans with the enactment of the Tax Relief and Health Care Act of 2006 (TRHCA)?**

TRHCA allows for HRA and health FSA rollovers. Effective in 2007 and for tax years beginning before 2012, a participant in a health reimbursement arrangement (HRA) or health flexible spending arrangement (health FSA) may, one time per arrangement, make a qualified HSA distribution. A qualified HSA distribution is an employer-to-trustee transfer from an HRA or a health FSA to an HSA. The rollover may not exceed the lesser of the balance in the HRA or the health FSA on September 21, 2006 or the date of distribution. Additionally, beginning in 2007, a taxpayer may, once in his lifetime, make a qualified HSA funding distribution. A qualified HSA funding distribution is a trustee-to-trustee transfer from an IRA to an HSA in an amount that does not exceed the annual HSA contribution limitation for the taxpayer.

Sources: The Internal Revenue Service (IRS), the National Association of Health Underwriters (NAHU), the U. S. Department of Labor (DOL), and Blue Cross Blue Shield of Michigan, Tax Facts – December 21, 2007, Employee Benefit Plan Review Magazine, Society of Human Resource Management, Canopy Financial – 2008 HSA Insider Edition.

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