

Summary of Health Savings Account Comparability Rules

Health Savings Accounts (HSAs) are tax-favored¹ individual trust or custodial accounts that can be contributed to by or on behalf of eligible individuals who are covered by a qualifying high-deductible health plan (HDHP). There are other eligibility criteria as well, most notably that HSA eligible individuals cannot have any other medical coverage that would pay qualified medical expenses² before the HDHP's deductible is met. The HSA can be used on a tax-favored basis to pay for medical expenses before the HDHP's deductible is met and also for medical expenses of eligible individuals and their spouses and tax dependents (not including adult children to age 26 that are not otherwise tax dependents). HSAs offer a significant tax advantage in that contributions are tax-deductible (they may also be made pre-tax through a Cafeteria Plan), earnings and interest are tax-free, and any withdrawals for qualified medical expenses are tax-free. If HSAs are used to pay for other expenses that are not qualifying medical expenses, penalties generally apply.

Comparability Rules

The Comparability Rules govern employer contributions to HSAs that are not made through a Cafeteria Plan. An employer that contributes to its employees' HSAs outside of a Cafeteria Plan must make "comparable contributions" for all "comparable participating employees." To be comparable, the contributions must be: (1) the same dollar amount, or (2) the same percentage of the HDHP deductible. This rule also applies when an employer offers multiple HDHP options and may warrant structuring contributions as a percentage of the deductible if deductibles vary significantly.

The only permissible categories of comparable employees for Comparability testing are: (1) current full-time employees, (2) current part-time employees, and (3) former employees with retiree coverage. Also, employees with different tiers of HDHP coverage are treated separately for Comparability testing. Distinctions based on four HDHP coverage tiers are permissible - self-only coverage, self-plus-one, self-plus-two, and self-plus-three-or-more. However, another rule provides that employer contributions can only increase with higher tiers of coverage.

The Comparability Rules significantly constrain how employers contribute to HSAs and preclude many common funding strategies. Employers may not vary their HSA contributions based on employment at different geographic locations or worksites, bona fide employment classifications like being hourly or salaried, or even based on regional differences in benefits costs. This framework also prevents employers from making matching contributions when an employee funds their own HSA and from making incentive contributions for participating in a wellness plan.

The Comparability Rules also apply on a controlled group basis. Being part of a controlled group means that the Internal Revenue Service treats two or more employers as a single employer when there is sufficient common ownership or a combination of joint ownership and common activity.³ Therefore, when an employer that is a member of a controlled group makes contributions to its employees' HSAs, its Comparability testing must consider comparable participating employees of other employers that are members of the same controlled group. This rule can result in inadvertent Comparability Rule violations if an employer does not have detailed information on HSA contributions made by a related employer within its same controlled group.

¹ Internal Revenue Code § 223.

² IRC § 213(d).

³ These rules are described in IRC § 414(b), (c), and (m) and Code § 1563.

These rules do not require employers to make contributions to all classes of comparable employees or for all tiers of coverage. For example, an employer that contributes to the HSAs of employees with family HDHP coverage is not required to contribute any amount to the HSAs employees with self-only HDHP coverage. Similarly, just because an employer makes an HSA contribution to an employee category like current full-time employees, it is not required to make comparable HSA contributions for employees in any other employee category (current part-time employees or retirees).

Another challenge under the Comparability Rules is that contributions must actually be made not just made available. This creates administrative and financial problems when employees fail to open HSAs or provide the information necessary for an account to be opened on their behalf. In order to comply with the comparability rules for a calendar year when an employee fails to open an account, the employer must give all such employees a written notice stating that each HSA-eligible employee who, by the last day of February of the following calendar year (Year 2), both establishes an HSA and notifies the employer that he or she has done so will receive a comparable contribution to the HSA for the calendar year (Year 1). The employer must provide the notice no earlier than 90 days before the employer makes its first HSA contribution for the calendar year (Year 1) and no later than January 15 of the following calendar year (Year 2). The IRS has provided a model notice. To comply with the contribution requirement for a calendar year (Year 1), the employer must make a comparable contribution (plus reasonable interest) by April 15 of the following calendar year (Year 2) to the HSA of each HSA-eligible employee who establishes an HSA and so notifies the employer by the end of the following February (in Year 2). When HSAs are funded through a Cafeteria Plan, plan documents and employee communications can provide that if employees do not open an account by a specified date they lose the employer funding. Lastly, the following employees are excluded from Comparability testing because they are not counted as comparable participating employees: individuals who are not HSA eligible, collectively bargained employees where benefits were the subject of good faith bargaining, former employees who have elected COBRA coverage, independent contractors, self-employed individuals (including sole proprietors, partners, and more-than-2% shareholders in an S-corporation). Certain Highly Compensated Employees⁴ also are not counted as comparable participating employees, but only to the effect that employers may contribute more to non-HCEs' HSAs than to HCEs' HSAs.

Although the Comparability Rules are complex, a basic chart gives a good indication as to whether contributions are comparable. However, multiple HDHP options also require comparable contributions and plans and contributions by employers in the same controlled group must be included in testing.

HDHP Plan One	Self-Only	Self-Plus-One	Self-Plus-Two	Self-Plus-Three
Current FT				
Current PT				
Retiree				
HDHP Plan Two	Self-Only	Self-Plus-One	Self-Plus-Two	Self-Plus-Three
Current FT				
Current PT*				
Retiree*				

* Contributions for Plan Two must be the same as those for Plan One or the same percentage of the deductible.

⁴ Highly Compensated Employee is defined under IRC § 414(q) as a 5-percent owner at any time during the year or the preceding year, or an employee with compensation from the employer in excess of \$120,000 for 2018 (indexed) or is among the top paid 20% of employees.

Comparability testing must be performed on a calendar-year, not plan-year, basis. An employer that fails to make comparable contributions will be subject to an excise tax of 35% of all of its contributions for the calendar year. This should be self-reported on Form 8928 and paid annually by April 15 of the following year. Although IRS may waive penalties where a failure is due to reasonable cause there are no existing waiver request procedures.

Funding Comparable Contributions

Contributions are deemed comparable if they are comparable when determined on a month-to-month basis. There are three contribution methods available to employers making contributions to the HSAs of their HSA-eligible employees outside of a Cafeteria Plan: (1) the pay-as-you-go method, (2) the look-back method, (3) and the pre-fund method. Mixing and matching contribution methods is not permitted although different methods can be used for different categories of comparable participating employees.

With the pay-as-you-go method, employers contribute to HSAs at one or more dates during the year. An employer can make contributions on the first day of each month, the first day of each quarter, semi-annually, etc., but the schedule must be the same for all HSA-eligible individuals with the same category of HDHP coverage. Contributions can also be tied to payroll periods even though payroll period dates may vary for different groups (hourly vs. salaried). For comparability purposes those contributions are considered to be made at the same time. An employer that makes contributions on a pay-as-you-go basis for a period covering more than one month (for example, quarterly) must make prorated HSA contributions for any employees hired after the funding date for that period. The same rule applies when an employee switches tiers of HDHP coverage. An employer may change or terminate contributions during the year.

With the look-back method, an employer determines comparable contributions for the calendar year at the end of the year or specified period. Like the pay-as-you-go method, the look-back method requires employers to establish a reasonable and consistent funding schedule, such as the last day of each month, the last day the quarter, semi-annually, annually etc. Contributions under the look-back method must be made for any month in which an individual was an HSA-eligible individual employed by the employer, even if the individual is not employed for the entire month. This means that active employment as of the last day of the year or other funding interval cannot be a prerequisite to receiving the employer's contribution. When employees separate during a look-back period and before the contribution is made, the contribution amount is prorated and then paid to the employee at the scheduled time. Finding separated employees to make contributions presents practical problems. Employers must make reasonable efforts to locate former employees, including using certified mail, the Internal Revenue Service Letter Forwarding Program, or the Social Security Administration's Letter Forwarding Service. Unlike the pay-as-you-go method, the look-back approach does not generally allow an employer to change or terminate contributions mid-year.

With the pre-funded method, an employer can make an entire calendar year's HSA contributions for employees who are HSA-eligible individuals at the beginning of the calendar year. Contributions may be made to employees hired after the date of initial funding on a pre-funded basis, a pay-as-you-go basis, or a look-back basis, so long as the same contribution method is used for all employees hired after the date of initial funding. This method can raise overfunding concerns if a large pre-funded employer contribution is made to an employee who then loses eligibility to contribute to an HSA.

The Cafeteria Plan Exception

The comparability rules do not apply to HSA contributions an employer makes "through a Cafeteria Plan." All employer HSA contributions are considered made "through a Cafeteria Plan" if employees have the

option to salary-reduce to fund their HSAs through the employer's Cafeteria Plan. This Cafeteria Plan offering allows employers to make matching HSA contributions, incentive-based HSA contributions and employ other more flexible contribution strategies.

When contributions are made "through a Cafeteria Plan" Cafeteria Plan nondiscrimination rules apply.⁵ In very general terms, these rules prohibit discrimination in favor of Key Employees⁶ and certain Highly Compensated Employees. Employers should be cautious in implementing an HSA funding strategy that favors these groups either intentionally or in operation. For example, only making matching contributions for 5% shareholders would be problematic. A less obvious but potentially problematic design would be only making matching employer contributions for employees with family coverage who elect to salary reduce at least \$250 per month, which would fund the HSA to the statutory limit. The issue with that design is that Highly Compensated Employees would be significantly more likely to take advantage of that employer offering because of the minimum salary reduction election amount. However, testing the Cafeteria Plan would ultimately determine whether the offering was discriminatory.

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⁵ IRC § 125.

⁶ Key Employee is defined in IRC § 416(i) as officers with annual compensation greater than \$175,000 for 2018(indexed), more-than-5% owners, and more-than-1% owners with compensation over \$150,000 (not indexed).

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