Health Savings Account FAQ

Note that IRS limits for HDHP minimum deductibles, out-of-pocket limits, and HSA contribution limits are indexed annually and subject to change. Please verify limits using Alliant's Comprehensive Table of Limits or at IRS.gov.

Q What is a health savings account (HSA)?

A It's essentially a tax-favored bank account that certain eligible individuals can use to pay for medical expenses. HSAs can be funded on a pre-tax basis through a cafeteria plan.

Q Who can make contributions into an HSA?

A The HSA owner, the owner's employer, family members, or any other individual or entity. As noted above, employee and employer contributions into an HSA can be made through a cafeteria plan.

Q Can business owners like partners and more than 2% shareholders be HSA eligible?

A Partners in a partnership and more-than-2% shareholders in an S corporation can be eligible to establish an HSA. An HSA established by such an individual may be funded (a) directly by the individual; or (b) by the partnership or S corporation. If the individual funds the HSA, the individual must do so on an after-tax basis and take a deduction on his or her income tax return. The individual will not be able to fund the HSA on a pre-tax basis through a cafeteria plan. An HSA may also be funded by the partnership or S corporation. However, if the HSA is funded in this way, special rules apply. The IRS has issued guidance that describes these special rules in detail and provides examples of their application. There are differences in tax treatment depending on whether an HSA contribution is made by a partnership or an S corporation and depending on whether a partnership contribution is treated as a distribution of cash or as a guaranteed payment. But in all cases, the partner or shareholder on whose behalf an HSA contribution is made (assuming that the partner or shareholder is an eligible individual for HSA purposes) may make an above-the-line deduction from gross income in an amount equal to the HSA contribution (just as an eligible individual making an HSA contribution on his or her own behalf would be able to do).

Q Is an HSA a health plan?

A No. While HSAs operate in conjunction with health plan coverage, HSAs generally are not themselves health plans and are not subject to the reporting and disclosure rules that apply to health plans (such as the requirement to have an SPD, report on Form 5500, etc.)

For ERISA governed plans, IRS guidance provides that an employer can establish an HSA for employees and make employer contributions, pay HSA fees, restrict HSA contributions to a single vendor, choose an HSA vendor that offers the same investments as are offered under the employer's 401(k) plan, and include an HSA as part of a Code §125 cafeteria plan without

subjecting the HSAs to ERISA. In addition, the following is required in order to avoid application of ERISA:

- HSA contributions must be completely voluntary;
- Employer must not limit the employees' ability to move funds to another HSA;
- Employers must not impose conditions on fund utilization;
- Employer must not make or influence investment decisions;
- Employers must not represent that the HSA in an ERISA plan;
- Employers must not receive any payment in connection with the HSA.

Q Who is HSA eligible?

A An individual with qualifying high deductible health plan coverage (HDHP coverage) and no disqualifying non-HDHP coverage can be HSA eligible. An individual who can be claimed by another person as a tax dependent is not HSA eligible.

Q What are some examples of coverage that would be "disqualifying" for HSA purposes?

A The following coverage is generally disqualifying:

- Coverage through a general purpose flexible spending account (FSA) — even a spouse's FSA;
- Coverage through an employer-paid general purpose health reimbursement arrangement (HRA);
- Non-HDHP "carve-out" coverage;
- Coverage through Indian Health Service, if benefits have been received in the past three months;
- Medicare, Medicaid, and TRICARE coverage.

Q What about Veteran's coverage?

An individual is not eligible to make HSA contributions for a month if he or she has received VA medical benefits at any time during the previous three months. An individual is eligible to make contributions for a given month if he or she did not actually receive VA medical benefits (other than allowable preventive care, dental, or vision coverage) during the preceding three months. As of January 2016, receipt of VA hospital care or medical services for a service connected disability will not affect an individual's ability to make HSA contributions, regardless of when the VA care or services were provided. For this purpose, a service connected disability is a disability that was incurred or aggravated in the line of duty in the active military, naval, or air service. This rule only applies to coverage under programs administered by the VA. It does not apply to TRICARE, which is administered by the Department of Defense. The IRS has acknowledged that it is administratively complex and burdensome for employers and others to distinguish between those VA services that make an individual ineligible to make HSA contributions, and the services that do not interfere with HSA eligibility. In light of that, the IRS has announced a "rule of administrative simplification" under which any hospital care or medical services received from the VA by a veteran with a disability rating from the VA may be disregarded for purposes of determining eligibility to make HSA contributions.

Q What are some examples of coverage that would be permissible coverage?

A The following coverage is generally permissible:

- Coverage for preventive care under the ACA (includes COVID-19 vaccine);
- Coverage for preventive care/screenings described in Notice 2004-23 and 2004-50;
- Coverage for preventive care for certain chronic conditions listed in Notice 2019-45;
- Coverage for testing and treatment of COVID-19 as described in Notice 2020-15;
- Telemedicine services -TEMPORARY - optional COVID-19 relief allowed HSA compatible HDHPs to provide first-dollar telehealth and other remote care services beginning on January 1, 2020 through plan years starting on or before December 31, 2021. This relief was extended for the calendar months of April through December 2022 (does not apply on a plan year basis). Relief was extended again to plan years beginning on or before December 31, 2024 (2023 and 2024 plan years).
- AD&D coverage (permissible when any health benefits are limited to expenses triggered by the accident or injury);
- Automobile insurance with medical coverage benefits (permissible if medical coverage is provided in the event of accident);
- Dental or vision coverage, as long as general medical benefits are not provided;
- Disability coverage ;
- Disease management programs and EAPs as long as "significant" benefits in the nature of medical care are provided;
- Disease-specific insurance (i.e., cancer policy), as long as the benefit is insurance and principal health coverage is provided through the HDHP;
- Limited purpose FSAs or HRAs that only reimburse for dental and vision expenses;
- Suspended FSAs or HRAs that only reimburse after the individual has met the statutory deductible for the HDHP (see IRS Employee Benefit Limits).

Q Is it possible to have dual coverage with HDHP coverage? For example, what if an employee's spouse has Medicare but is also covered on the employee's HDHP? Does that impact HSA eligibility?

A An individual can have dual HDHP and non-HDHP coverage, but any non-HDHP coverage would mean that individual is not HSA eligible (can't make or have contributions made on their behalf). In other words, the *coverage restrictions apply only to individuals who want to remain HSA eligible.* So, in the above example, an individual could be covered by an HDHP and Medicare simultaneously, but would not be HSA eligible. The individual's spouse could still be eligible if he/she had HDHP coverage and no disqualifying coverage and he/she can contribute the family limit if covered by HDHP family coverage. Both spouses' medical expenses can also be reimbursed from the HSA regardless of whether they are covered by a non-HDHP medical plan.

Q What is the out of pocket limit for an HSA-compatible high deductible plan?

A HSA-compatible HDHPs are subject to both ACA out of pocket (OOP) rules and the IRS OOP rules for high deductible plans. Starting in 2015, these amounts were not identical, and the ACA OOP limits became higher than the IRS' HDHP OOP limits. See IRS Employee Benefit Limits for the most recent limits. HSA compatible plans need to comply with the lower of the two (the IRS'

HDHP limits). For plan years starting in 2016 and beyond, there is an embedded out of pocket limit for each individual with family coverage. This means that the self-only **ACA** cost-sharing limits apply to all individuals regardless of whether the individual is covered by a self-only plan or family plan. For example and for illustrative purposes only, if the out of pocket limit on a family plan is $13,500, no individual in the family can incur out of pocket costs of more than $8,150 (the **ACA limit** (amount is indexed for future years) for self-only coverage). Remember, it's the ACA limit that matters here since the HDHP coverage is family coverage.

Q Are there special rules for people who become HSA eligible in the middle of a tax year?

A Yes. A person who enrolls in an HDHP mid-year (a month other than January) may be able to take advantage of a special rule called the "full-contribution rule." If the individual is HSA eligible on December 1 of that year, the individual may make a full year's worth of contributions even if they were only HSA eligible for part of the year (even only the month of December). However, caution is advised because individuals who take advantage of this rule must remain HSA eligible for a 13-month testing period (i.e., from December 1 through the end of the next calendar year) — otherwise they lose favorable tax treatment. In addition to locking the employee into HDHP coverage that this can create issues when a spouse changes plans and elects a general purpose H-FSA or is given access to HRA funds. It also creates election lock for non-calendar year plans. Employees who become HSA eligible mid-year should generally just contribute the prorated contribution amount based on the number of months they were HSA eligible to avoid issues with the 13-month testing period.

Q What is the annual contribution limit?

A Limits are tied to the HDHP election tier (i.e., self-only or family coverage). These limits apply monthly or are prorated — for example, if an individual has self-only coverage from January through June (six months of the year) the maximum contribution would be the annual contribution limit divided by 12 times six. If an individual switches from self-only coverage after six months to family coverage for the rest of the year, the limit would be ½ of the annual self-only limit plus ½ of the annual family limit. Although it is theoretically possible to apply the principle of the full contribution rule (discussed above) to changes in tier of coverage and contribution limits it is generally not possible to guarantee that the coverage tier will not change in the subsequent 13-month testing period (e.g., death or divorce) so this approach is never recommended. Note: Examples in this FAQ are for illustrative purposes — please verify annual contribution limits at IRS Employee Benefit Limits.

Q What is a "catch-up" contribution?

A The contribution limit is increased by an additional $1,000 for HSA-eligible individuals who turn 55 by the end of the tax year (12/31). The $1,000 catch-up contribution is pro-rated on the same basis as other limits.

Q What is the limit for married couples who are both HSA eligible?

A Married couples (included same-sex married couples) share the maximum contribution limit — meaning they could establish a single HSA with the maximum family contribution, or could each

establish their own HSA and contribute the maximum individual contribution each (or some other division — provided they don't exceed the statutory maximum when the contributions are combined).

Q What about domestic partners?

A If an employee and domestic partner each are enrolled in family HDHP coverage, both may establish an HSA and contribute the maximum family contribution (assuming each of them remains HSA eligible for the entire year.) Domestic partners are not married under federal law, so they do not share the family contribution limit the way married couples do.

Q What happens to the funds when an individual is no longer HSA eligible?

A HSA funds are not forfeited upon a loss of HSA eligibility. An account holder can continue to use HSA funds to pay or reimburse qualifying expenses, though he or she would no longer be able to contribute to the HSA. Note that a distribution from an HSA that is not used for qualified medical expenses is included in the account holder's gross income and generally is subject to an additional 20% tax. As discussed below, the additional tax does not apply to a non-medical distribution after the account holder is age 65, disabled or on death.

Q How do HSA distributions change after age 65 or on the death of the account holder?

A HSA distributions for qualified medical expenses remain tax favored after age 65. A distribution from an HSA that is not for a qualified medical expense of the account holder or his or her spouse or dependent is included in the account holder's gross income but is not subject to the additional 20% tax after age 65. The account holder will file Form 8889 with their Form 1040 to report a non-qualified distribution and note on Line 17 that the distribution is not subject to the additional tax. This exception to the additional 20% tax also applies if the account holder dies or becomes disabled. If the account holder dies, and the beneficiary is the account holder's surviving spouse, the surviving spouse becomes the account holder and the transfer is not taxable. If the beneficiary is someone other than a surviving spouse, the HSA ceases to be an HSA and the value of the account is included in the beneficiary's gross income. The date of death and account value are included in Lines 14 and 15 of Form 8889. See the instructions for Form 8889 for more information.

Q How are employer contributions to an HSA treated?

A Employer contributions are aggregated with other HSA contributions made by or on behalf of the employee. In other words, (unlike the FSA contribution limit) employer contributions "count" toward the maximum contribution limit. Once an employer makes a contribution to an employee's HSA, the funds are generally the employee's property and cannot be forfeited, even if the employee terminates employment.

Q When must HSA contributions be made?

A Generally, contributions cannot be made before the tax year begins (or before the HSA is established) or after the original filing due date (without extensions) for the individual's tax return for that year — usually April 15.

Q Can an employer make contributions once a year or are they required to make monthly contributions?

A An employer may make contributions in one or more payments at its convenience. The only timing restrictions are those set forth above.

Employers can make a single lump-sum contribution at the beginning of the year so that participants can access the funds throughout the year rather than having to wait to seek reimbursement at some later date. Note, however, that HSA funds are generally non-forfeitable and once the employer contribution is made, it cannot be recouped, even if the employee terminates employment mid-year. In that regard, most employers make monthly contributions. Also, employers should be aware of HSA limits for employees who are only HSA eligible for part of the year.

Note that an employer has the flexibility of accelerating part or all of its HSA contributions for an entire calendar year to employees who have incurred qualified medical expenses exceeding the employer's year-to-date HSA contributions. (Note: Employers making HSA contributions outside a cafeteria plan are subject to comparability rules that affect when contributions can be made or accelerated. See below for more information on the comparability rules.)

Q What happens if too much is contributed to an HSA?

A Excess contributions are subject to a cumulative 6% excise tax. However, this can be avoided if the excess contributions (and any attributed net income) are distributed to the account holder before the last day prescribed by law (including extensions) for filing the individual's tax return.

Q What if an employer mistakenly contributes to an employee's HSA account?

A As a general rule, contributions to an individual's HSA are non-forfeitable, and contributions that an employer mistakenly makes to an employee's HSA may not be returned to the employer, even if the employee consents. Formal IRS guidance identifies the following two situations where contributions may be returned to the employer:

1. The employee on whose behalf the employer makes HSA contributions was never eligible for HSA contributions. For tax purposes, employer contributions that the employer recovers by the end of the taxable year in which they were made are disregarded, as if they were never made.
2. The employer erroneously contributes amounts to an employee's HSA that exceed the maximum annual contribution allowed.

An informal IRS "information letter" further expanded the circumstances in which an employer may request the return of HSA contributions. According to the letter, if there is "clear documentary evidence demonstrating that there was an administrative or process error," an employer may request that the HSA custodian/trustee return the amounts to the employer. The letter provides the following examples of contributions which may be corrected this standard:

- an amount withheld and deposited in an employee's HSA for a pay period is greater than the amount shown on the employee's HSA salary reduction election;

- an unintended employer contribution was transmitted because an incorrect spreadsheet was accessed or because employees with similar names were confused;
- an incorrect entry by a payroll administrator (whether in-house or third-party) caused the incorrect amount to be withheld and contributed;
- a second HSA contribution was received by an employee because duplicate payroll files were transmitted;
- an employee receives a greater HSA contribution because a change in employee payroll elections was not processed timely, so amounts withheld and contributed are greater than the employee elected;
- an employee receives a greater HSA contribution because the contribution amount was calculated incorrectly, e.g., if an employee elects a total amount for the year that is allocated by the system over an incorrect number of pay periods; and
- an employee receives a greater HSA contribution because the decimal position was set incorrectly, resulting in a greater than intended contribution.

Q What is an HSA qualified medical expense?

A A "qualified medical expense" includes expenditures for medical care, as defined under the Internal Revenue Code, for the HSA account holder and his or her legal spouse and tax dependents, to the extent that such amounts are not reimbursed by insurance or any other source. Previously, health care reform recognized over the counter medicines and drugs (other than insulin) as qualified medical expenses only if they are prescribed, regardless of whether they can be obtained without a prescription. However, the CARES Act permits certain over the counter the medicines and drugs to be reimbursed without a prescription beginning and for the reimbursement of certain menstrual products. Additionally, amounts paid for personal protective equipment (PPE), such as masks, hand sanitizer and sanitizing wipes, for the primary purpose of preventing the spread of COVID-19 are treated as amounts paid for medical care beginning January 1, 2020 per IRS Notice 2021-7. IRS Publication 502 contains a list of qualified medical expenses. The ACA's expanded definition of dependent child to age 26 (and continued tax-favored treatment through the end of the tax year in which the child turns 26) DOES NOT apply to HSAs. HSAs still use the traditional definition of tax dependent; for children this means through age 18 or age 23 if a full-time student. This means there will be adult children who are enrolled in a parent's HDHP coverage, but whose medical expenses will not qualify for tax free reimbursement from the parent's HSA.

Q Do employer contributions have to comply with non-discrimination rules?

A Employer contributions to employees' HSAs must generally be "comparable" (i.e., same amount or same percentage of HDHP deductible), but the strict and complex "comparability rules" can be disregarded when the HSA is offered **through a cafeteria plan** (if salary deferral contributions are allowed, then the HSA is generally considered to be offered through a cafeteria plan, as long as the plan document contains language permitting this option.) In that case, the plan only

needs to be concerned with passing Section 125 non-discrimination testing – in short, the 125 rules prohibit discrimination "in favor of" highly compensated and "key" employees.

Q What happens when an employer offers an HSA contribution and the employees fails to open an HSA account?

A Under the comparability rules, there is a very specific protocol employers must follow if contributions are NOT made through a cafeteria plan. When contributions are made through a cafeteria plan, employers have considerably more flexibility. Although there is no specific guidance on what an employer should do in this situation, this would likely be governed by contractual principles and it is possible the employer would not have a duty to make a contribution until such time as the employee takes the predicate and necessary action to receive the contribution, i.e., opening the HSA account. In both the cafeteria plan document and enrollment materials, employers should indicate a specific deadline by which employees must open an account or forfeit any employer funds.

Q What obligation does the employer have to ensure an employee is HSA eligible and making compliant contributions?

A Employers have limited responsibility for determining whether an employee's HSA contribution is excludable from income. IRS guidance provides that employers are responsible for determining only the following with respect to an employee's eligibility and maximum annual contribution limit:

1. whether the employee is covered under an HDHP sponsored by that employer;
2. whether the employee is covered under a non-HDHP (including health FSAs and HRAs) sponsored by *that* (not, not another) employer; and
3. the employee's age (for catch-up contributions). In determining an employee's age, the employer may rely on the employee's representation as to his or her date of birth.

Employers may choose to ask employees to certify that they meet the criteria to be an eligible individual for HSA purposes. This could help the employer avoid contributions for an ineligible individual and will also serve as a communication tool to help employees understand the eligibility criteria and the factors that might affect their contribution limit.