

LEGAL AND TAX ADVANTAGES TO HSAs

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Consumer Driven Health Care

- Definition
 - Variety of vehicles to provide health insurance or fund health costs which have high level of employee involvement
- Rationale
 - Empowerment and cost savings
 - Consumer in the driver's seat
 - Cost Shifting

Consumer Driven Health Care

- Employer Advantages
 - Risk/cost-shifting to employee
 - Educated and empowered employees will make better healthcare decisions
- Employer Disadvantages
 - Employees may not understand program
 - Employee perception issue – Less is not more

Types of CDHC on today's Agenda

- Funding Vehicles for Health Expenses
 - Medical Savings Account (“MSA”)
 - Health Savings Account (“HSA”)
 - Health Reimbursement Arrangement (“HRA”)
 - Health Flexible Spending Account (“FSA”)

CDHC Distinguished

- **MSA:** portable IRA-type account to pay qualified medical expenses not covered by a high-deductible health plan (HDHP)
- **HSA:** portable IRA-type account to pay qualified medical expenses not covered by a HDHP
- **HRA:** employer-funded plan to pay qualified medical expenses (no salary reduction) not covered by HDHP
- **FSA:** employer-sponsored, employee-funded plan to pay qualified medical expenses not covered by insurance or another arrangement

Employer Contributions Allowed?

- HSAs: Yes
- HRAs: Yes
- FSAs: Yes (but rare)

Employee Contributions Allowed?

- HSAs: Yes
- HRAs: Generally, no
(would prevent carryovers of unused \$)
- FSAs: Yes

Pre-tax employee contributions allowed?

- HSAs: Yes
- HRAs: No
- FSAs: Yes

Maximum contributions

- HSAs: \$2900 Single coverage
 \$5800 Family coverage
 Plus “catch-up”
- HRAs: None
- FSAs: None

Carryover unused amounts to next year?

- HSAs: Yes
- HRAs: Yes
- FSAs: No (but “grace period”)

Rollovers permitted?

- HSAs: Yes, from other HSAs
- HRAs: No
- FSAs: No

High-deductible health plan participation required?

- HSAs: Yes
- HRAs: No (but often integrated with high-deductible health plans)
- FSAs: No

Use it or lose it rule?

- HSAs: No
- HRAs: No, but forfeited if leave employer
- FSAs: Yes

HSA – What is it?

- Health Savings Account (IRC § 223)
- Individual IRA-type trust account
- Began in 2004 under Medicare Prescription Drug Improvement and Modernization Act of 2003
- Pre-tax contributions
- Tax-free earnings on account balance
- No tax when used for qualified medical expenses (after 65, no tax for any purpose)

HSA – Overview of Legal Issues

- ERISA?
- Comparability of Contributions
- High Deductible Health Plan
- Eligibility
- Qualified Medical Expenses
- Tax Treatment of Contributions
- Distributions

HSA – ERISA

- DOL: if voluntary and satisfy current exception for group type insurance benefits, HSA not an ERISA plan
 - Related HDHP is subject to ERISA, however
- Employer cannot:
 - Limit employee's ability to move funds or place additional conditions on the use of the funds
 - Make investment decisions
 - Receive payment or compensation
 - Represent that HSA part of employer established plan

HSA – Comparability of Contributions

- Any employer contribution to an HSA must be “comparable” for all employees
 - *i.e.*, same amount, or same percentage of deductible in HD plan
 - If ANY then ALL
- Applied separately to single and family coverage; also to part-time employees
- Penalty: 35% excise tax

HSA – “Comparability” Considerations

- Innovative, creative approaches (matching contributions, incentives)
 - IRS Regulations give employers a roadmap
 - Treas. Reg. Section 54.4980G-1 through 5
- Exceptions
 - Cafeteria Plan Exception
 - Collectively-Bargained Employees

HSA – HDHP Requirement

- HSAs must be offered related to a High Deductible Health Plan
- Two key features
 - Annual deductibles of at least:
 - \$1,100 (individual)
 - \$2,200 (family)
 - Out of pocket maximums of not more than:
 - \$5,600 (individual)
 - \$11,200 (family)

HSA – HDHP (Cont'd)

- Preventive care – “first dollar” coverage will not disqualify
- But what exactly is “preventive care”?
 - IRS safe harbor includes: periodic health evaluation, routine prenatal and well-child care, child and adult immunizations, tobacco cessation programs, weight-loss programs, and various screenings

HSA – HDHP (Cont'd)

- Networks – in network maximums are used (out-of-network can be higher)
- Self-insurance is an option
- “Embedded” deductible could disqualify

HSA -- Eligibility

- Generally, no other health or similar coverage
 - That is not HD coverage; and that covers any benefit covered by HD plan
- Exceptions:
 - Insured or self-insured: accident, disability, dental, vision, or long-term care
 - “Permitted Insurance” for: specific disease, fixed-amount hospitalization, workers comp, auto

HSA – Eligibility (cont'd)

- Issue: Does Health FSA or HRA participation make one ineligible to use HSA?
 - Conventional FSA – Yes
 - Restricted FSA (*i.e.*, FSAs with only dental or vision benefits) – Maybe
- If not eligible for HSA, may be eligible for HRA if offered

HSA – Eligibility (cont'd)

- Prescription drug coverage
 - No exception
- Entitlement to Medicare
 - No additional contributions
 - OK to use HSA funds

HSA – Qualified Medical Expenses (QME)

- *Defined: Expenses for “medical care” incurred by employee (or spouse, dependents), no compensated by insurance or otherwise*
- Same broad tax code definition of “medical care” used in Health FSA administration
 - IRS Publication 502
- This includes over the counter drugs and medicines
- No third-party substantiation needed (Participants can substantiate their own claims)

HSA – QMEs: Insurance Premium Considerations

- Generally, insurance are not a QME
- But some important exceptions:
 - Health insurance (except Medicare supplements) **after reaching age 65**
 - COBRA or long-term care coverage
 - Coverage during a period of unemployment assistance
- Age 65 requirement could be a weakness for retiree programs
- Pre-65 retirees could not use HSAs to pay for employer plan coverage

HSA – Tax Treatment of Contributions

- Pre-tax contributions if cafeteria plan
- Employer may deduct employer contributions
- Interest on account balance tax-free
- HSA Maximum Contribution Limit
 - \$2,900 self only
 - \$5,800 family

HSA – Tax Treatment of Distributions

- QMEs (for spouse, dependent, too) generally excluded from gross income
- True even when individual can no longer contribute to HSAs (*ex*: post-65 retiree who is receiving Medicare benefits)
- Other distributions – subject to income tax and 10% penalty
 - Exception to penalty: distributions after turning 65 (any purpose ok), disability or death

HRA – What is it?

- Health Reimbursement Arrangement (IRC § 105; IRS Notice 2002-45)
- Generally – more limited than an HSA
- Typically credits an amount equal to a portion of HDHP premium to a separate account to pay for qualified medical expenses
- May also be stand-alone

HRA – Legal Requirements

- Most often used with a HDHP, but may be stand-alone
- Employee must be ineligible for HSA
- Individual contributions may not be made
- Unused amounts may be forfeited if employee terminates employment or switches coverage
- No interest may be earned on account balance
- Carryover only if employee remains in same HDHP
- Reimbursements for QMEs only

HRA – Advantages/Disadvantages

- Advantages
 - Option for those not eligible for HSA
 - Not disqualified if also participating in FSA
 - No minimum deductibles or maximum out-of-pocket amounts
- Disadvantages
 - Less employee control
 - Fewer tax advantages

Health FSA – What is it?

- Health Flexible spending Account (IRC § 125)
- Voluntary medical expense reimbursement plan
- Employee “elects” to participate and determines the amount to fund annually
- Offered under a § 125 cafeteria plan
- Health plan under § 105

Health FSA – Legal Requirements

- Health Plan Requirements

- Written plan document
- Qualified medical expenses only
- Must meet nondiscrimination tests
- No reimbursement if tax deduction

- Health FSA Requirements

- Uniform coverage
- 12 month plan year
- Claims must be reimbursed monthly
- No reimbursement of insurance premiums
- Claims must be substantiated
- Must be subject to “use-it-or-lose-it” rule

Health FSA – Use it or Lose it

- IRS Notice 2005-42
 - Extended year-end deadline for submission of expenses by two and one-half months
 - Expenses from prior plan year may be reimbursed during the extended period

Rev. Rule 2005-86

- Issued to address how the new grace period can overlap with HSAs
 - Eligible to begin HSA contributions first day of month following the end of the new FSA grace period
 - Convert FSA into an allowed FSA (limited purpose – e.g., dental and vision only) during the grace period

COBRA ISSUES

- General COBRA principles
 - Applies to “group health plans”
 - Temporary continuation of health coverage upon qualifying event
 - Each qualified beneficiary has a right to COBRA continuation coverage independent of employee’s right
- HSAs – No
 - IRC amended to exclude HSAs

COBRA ISSUES (cont'd)

- HRAs – Yes “but”
 - IRS guidance states COBRA applies to HRA
 - *But*, no guidance on how it applies
 - Strategy: One continued HRA account for all qualified beneficiaries to avoid “mushrooming”
- Health FSAs – Yes
 - No continuation coverage if account “overspent”
 - Continuation limited to current plan year
 - Do you notices include FSA references?
 - Administrative challenge

HIPAA ISSUES

- General HIPAA Components
 - Portability
 - Privacy
 - Security
- HSAs
 - Not subject to ERISA
 - If not ERISA welfare benefit plan, HIPAA should not apply
- HRAs
 - Portability rules apply unless exception exists
 - Debit Cards not HIPAA electronic transaction

HIPAA ISSUES

- FSAs
 - Debit cards not HIPAA electronic transactions
 - Portability requirements apply unless “excepted benefit” (creditable coverage, etc.)
 - Most Health FSAs are excepted benefits
 - Must still comply with privacy rules and security standards
 - *Except.* Self-funded, self-administered Health FSAs with fewer than 50 participants do not need to comply with any HIPAA’s requirements