

Go All the Way with HSA: Everything HDHP/HSA

2024 Edition



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Guide Topics

The Triple-Tax Advantaged Health Savings Account (HSA)

Endlessly complex in its details, but the basics are fairly straightforward

- The HSA pairs with the HDHP to provide a uniquely tax-advantaged way to save
- Employees are increasingly familiar with the concept of the account-based approach offered by an HSA, and increasingly want to better understand how to fully benefit from the HSA
- Most employees want to use the HSA simply as a spending vehicle to use employer contributions to cover the deductible and other cost-sharing amounts under the major medical plan
- However, more and more employees are looking to go all the way with HSA by maximizing contributions, treating the account as a supplemental retirement savings vehicle, and taking advantage of the amazing shoebox rule

HSA Topics for Discussion

1

Eligibility: The requirements to be able to make or receive HSA contributions.

2

Contributions: The standard limits and how they apply for spouses, partial years, etc.

3

Distributions: The rules for tax-free distributions, including the good and the bad details

4

Reporting: Employer, employee, and bank reporting via Forms W-2, 8889, etc.

5

Everything Else! An overview of all the common HSA tricks of the trade to keep in mind

Why HDHP HSA?



01

HSA Eligibility

Access to the Only Triple-Tax Advantaged Account



Triple-Tax Advantaged Account HSAs Provide Unparalleled Tax Benefits

Three Tiers of Federal Tax Savings

1

Pre-Tax Contributions

- Employee contributions through payroll are made on a pre-tax basis through the Section 125 cafeteria plan.
- Employee contributions outside of payroll receive an above-the-line tax deduction.
- Employer contributions are tax-free to the employee.

2

Tax-Free Growth

HSA gains are not subject to interest, dividend, or capital gains taxes.

3

Tax-Free Distributions

Distributions for qualifying medical expenses are not subject to taxation

HSA Eligibility - Can You Make or Receive HSA Contributions?

HSA eligibility has **two key requirements**. You must satisfy **both** to be eligible to make or receive HSA contributions (and cannot be claimed as a tax dependent by someone else).

Covered by an HDHP

The most fundamental HSA eligibility rule is its link to HDHPs. Only individuals covered by a HDHP can be HSA eligible.

Specifics:

- Must be covered by an HDHP (and have no disqualifying coverage) as of the first day of the calendar month to be HSA eligible for that calendar month
- Mid-month enrollment would mean not HSA eligible until the following month
- Mid-month loss of HDHP coverage does not affect HSA eligibility for that calendar month

No Disqualifying Coverage

Generally requires that the employee not be covered by any other medical coverage that pays before the minimum HDHP deductible.

Specifics:

- Includes coverage under a general purpose health FSA or HRA (whether through your employer or the employer of a spouse/parent)
- Includes Medicare Parts A, B, C, or D
- Does not include dental or vision coverage or limited purpose (dental/vision/preventive) health FSA or HRA
- Does not include EAP or wellness program coverage as long as they don't provide "significant benefits in the nature of medical care or treatment"



HSA Contribution Limits

The annual statutory maximum HSA contribution limits are for all contributions combined (employer and employee). These amounts are subject to cost-of-living adjustments each year based on chained CPI (modified by TCJA).

	2023	2024
Annual Contribution Limit	Individual Coverage: \$3,850 Family Coverage: \$7,750	Individual Coverage: \$4,150 Family Coverage: \$8,300
Age 55+ Catch-Up Contribution	\$1,000	\$1,000

(Note: The catch-up contribution limit has been fixed by law at \$1,000 since 2009 and will not further adjust for inflation.)



The Main HDHP Requirements

The **two key requirements** are that the health plan meets the §223(c)(2) minimum deductible and maximum out-of-pocket expense limitations. These amounts are subject to cost-of-living adjustments each year.

Minimum Annual Deductible	Annual Out-of-Pocket Maximum
<p>1. Employee-Only Coverage:</p> <ul style="list-style-type: none">• 2023: \$1,500• 2024: \$1,600 <p>2. Family Coverage:</p> <ul style="list-style-type: none">• 2023: \$3,000• 2024: \$3,200	<p>1. Employee-Only Coverage:</p> <ul style="list-style-type: none">• 2023: \$7,500• 2024: \$8,050 <p>2. Family Coverage:</p> <ul style="list-style-type: none">• 2023: \$15,000• 2024: \$16,100
<ul style="list-style-type: none">• Family coverage includes any plan other than employee-only (e.g., employee plus spouse, employee plus child, employee plus family)• Preventive services typically not subject to the deductible (see next slide)• Embedded deductible* must be at least the minimum annual family deductible <p>*embedded deductible is an individual, lower deductible inside a family deductible</p>	<ul style="list-style-type: none">• The sum of the annual deductible and any other OOP expenses (copays, coinsurance, etc.) cannot exceed these annual limits• Out-of-network expenses are not required to apply toward the HDHP out-of-pocket maximum (OOPM)



HDHP Specifics

Must be a Major Medical Plan to Qualify as HDHP

- Guidance states that “plan must provide significant benefits to be an HDHP”
- No clear bright-line rule on meeting that standard—generally will require that the plan be considered a traditional major medical
- Only “reasonable benefit restrictions” are permitted
 - Plans only covering hospitalization or in-patient care would not qualify as providing significant benefits

Preventive Care Not Subject to Minimum Deductible

- HDHPs may (and typically do) provide first-dollar coverage for preventive care
- “Preventive care” includes:
 - Periodic health evaluations, including annual physicals
 - Routine prenatal and well-child care
 - Child and adult immunizations
 - Tobacco cessation programs
 - Obesity weight-loss programs
 - Screening services (long list in IRS Notice 2004-23)
 - All ACA preventive services required to be provided without cost sharing for non-grandfathered health plans
 - **New since 2020: Items and services related to exacerbation of a chronic condition**

Additional Preventive Services Permitted

IRS Expands List of First-Dollar Preventive Care to Chronic Conditions

- In July 2019, the IRS issued Notice 2019-45 to add certain medical services and items, including prescription drugs, relating to preventing exacerbation of a chronic condition (or the development of an associated secondary condition)
 - The Notice highlights that the Treasury Department and IRS are aware that cost barriers for care related to chronic conditions can result in some individuals failing to seek or utilize effective and necessary care that would prevent exacerbation of the chronic conditions

Reminder – Preventive Care Not Subject to Minimum Deductible

- HDHPs may (and typically do) provide first-dollar coverage for preventive care
 - These items and services are not subject to the minimum statutory deductible of \$1,600 for single coverage and \$3,200 for family coverage (2024)
- “Preventive care” already included:
 - Periodic health evaluations, including annual physicals
 - Routine prenatal and well-child care
 - Child and adult immunizations
 - Tobacco cessation programs
 - Obesity weight-loss programs
 - Screening services (long list in IRS Notice 2004-23)
 - All ACA preventive services required to be provided without cost sharing for non-grandfathered health plans
 - New for 2020: Items and services related to exacerbation of a chronic condition

Chronic Condition Preventive Services Permitted

Reminder—HDHPs Not Required to Provide These Free Preventive Services

- The new guidance simply permits HDHPs to offer these new chronic condition-related preventive services as first-dollar coverage (i.e., not subject to the deductible)
- Each plan is taking a different approach to if/when it will adopt these optional new services
- Check your plan terms for more details!

The New Chronic Condition Preventive Services (IRS Notice 2019-45)

Preventive Care for Specialized Conditions

- ACE Inhibitors/Beta Blockers
- Inhaled Corticosteroids/Peak Flow Meter
- Insulin and Other Glucose Lowering Agents/Glucometer/Retinopathy Screening/Hemoglobin A1c Testing/Statins
- LDL Testing/Stains
- Anti-Resorptive Therapy
- INR Testing
- SSRIs
- Blood Pressure Monitor

For Individuals Diagnosed with

- Congestive Heart Failure and/or Coronary Artery Disease
- Asthma
- Diabetes
- Heart Disease
- Osteoporosis and/or Osteopenia
- Liver Disease and/or Bleeding Disorders
- Depression
- Hypertension

02

HSA Contribution Limits



Family Coverage Limit Rules

Family Members Do Not Need to be HSA Eligible

- **Family coverage is defined as “any coverage other than self-only coverage”**
- This means that as long as at least one other individual is covered under the plan, the employee will be eligible for the family contribution limit
- That other individual could be a spouse, domestic partner, child, etc.
- The other covered individual(s) **do not need to be HSA eligible** for the family contribution limit to apply

Example

- Ben enrolls in HDHP coverage for himself and his spouse for all of 2024 (and has no disqualifying coverage)
- Ben’s spouse Julianna also has coverage under a non-HDHP HMO at her work

Result

- Ben is eligible to make the full family HSA contribution limit for 2024 (\$8,300)
- The fact that Ben’s spouse Julianna is not HSA eligible is irrelevant for purposes of Ben’s contribution limit
 - Julianna cannot make or receive contributions to her own HSA because she is not HSA eligible (disqualifying coverage)

Mid-Year Loss of HSA Eligibility

Contribution Limit Proportional to Number of Months HSA Eligible

- You may contribute a proportional amount of the statutory HSA contribution limit based on the number of months in the year in which you were HSA-eligible
- Remember, HSA-eligible months are any calendar month in which you were covered by a HDHP and had no disqualifying coverage on the first day of the month

Example

- Bryce enrolls in HDHP coverage January 1, 2024
- Bryce switches from HDHP coverage to non-HDHP coverage as of October 1, 2024 upon getting married (and remains in non-HDHP coverage through December 31, 2025)

Result

- Bryce was HSA eligible for 9/12 of the year (3/4)
- This means Bryce's 2024 HSA contribution limit is $\$4,150 \times \frac{3}{4} = \$3,112.50$
 - If Bryce's 2024 HSA contributions (combined employer/employee) exceeded \$3,112.50, he will need to make a corrective distribution from the HSA of the excess contributions by his tax filing due date (April 15, 2025, unless he files for an extension)
 - This will avoid a 6% excise tax on the excess contributions

Becoming HSA-Eligible Mid-Year

General Rule - Contribution Limit Proportional to Number of Months HSA Eligible

You may contribute a proportional amount of the statutory HSA contribution limit based on the number of months in the year in which you were HSA eligible (same as prior slide).

Special Rule - The Last-Month Rule (aka Full Contribution Rule)

The last-month rule allows HSA contributions up to the full statutory limit even though the employee was not HSA eligible for the full year, provided:

1. The employee is HSA eligible on December 1 of the year at issue, AND
2. The employee remains HSA eligible for **the entire following year** (i.e., the 13-month period from December of year one through December of year two)

Example

Kris enrolls in HDHP coverage October 1, 2024 and is HSA eligible through the rest of the year and through all of 2025

Result

- Kris can contribute the full statutory limit for 2024 under the last-month rule because he was HSA eligible in the 13-month testing period from December 2024 through December 2025 (otherwise the 2024 contribution limit would be 3/12 the statutory limit)
- If Kris made the full 2024 statutory contribution and failed to remain HSA eligible for all of 2025, he would be subject to income taxes and a 10% additional tax on the other 9/12 contribution amount



Individual and Family Coverage

Contribution Limits Calculated on Monthly Basis

- Eligible to contribute **1/12 of the family limit for months of year in family coverage**
- Eligible to contribute **1/12 of the individual limit for months of year in individual coverage**

IRS Form 8889 Instructions
“Limitation Chart and Worksheet”

<https://www.irs.gov/pub/irs-pdf/i8889.pdf>

Line 3 Limitation Chart and Worksheet

Before you begin: ✓ See the instructions for line 3, earlier.
 ✓ Go through this chart for each month of 2022.
 ✓ Keep for your records.

Month in 2022	Amount from chart above
January	\$ _____
February	\$ _____
March	\$ _____
April	\$ _____
May	\$ _____
June	\$ _____
July	\$ _____
August	\$ _____
September	\$ _____
October	\$ _____
November	\$ _____
December	\$ _____
Total for all months	\$ _____
Limitation. Divide the total by 12. Enter here and on line 3	\$ _____

Contribution Deadline

Contributions for the Year are Due by April 15 of Following Year

- **Individuals and employers may make HSA contributions by the tax deadline filing date the following year (generally April 15)**
- Even though the individual's HSA contribution limit is determined monthly (or via the last-month rule), there is no requirement to contribute monthly

Example

- Wil enrolls in family HDHP coverage January 1, 2024 and is HSA eligible for the entire year
- Wil's employer contributes \$125 per pay period to his HSA
- Wil contributes \$220.83 per pay period to his HSA through the cafeteria plan
- In February 2025, Wil's employer realizes it missed one employer contribution in 2024 and makes the final \$125 contribution by April 15, 2025
 - Wil's employer notifies the HSA custodian and Wil that the \$125 contribution made in 2025 is a contribution for the prior year (2024)

Result

- All of Wil's and Wil's employer contributions above (\$8,300) apply to the 2024 contribution limit because all contributions were made by April 15, 2025
- No corrected Form W-2c for 2024 required
 - Employer reports the prior-year (2024) contribution on the current-year (2025) Form W-2 issued following January
 - Not a problem that this may result in Box 12, Code W reporting showing an amount larger than the annual statutory HSA contribution limit (i.e., in excess of \$8,300)
 - Employee will subtract the prior year (2024) HSA contributions on the current-year (2025) individual tax return (generally filed by 4/15/26) on the Form 8889

Combined Limit for Spouses

Combined Contributions Cannot Exceed Family HSA Contribution Limit

- Where both the employee and spouse are HSA eligible, and at least one of the spouses has family coverage, the contribution limit is a joint limit
- That means the combined contribution limit for both spouses is \$8,300 (2024) where at least one of the spouses has family coverage
- The spouses can agree to how they would like to divide the combined limit between them

Example

Buster enrolls in employee + spouse HDHP coverage with his spouse Kristen for all of 2024, and both are HSA eligible for all of 2024

Result

- **Option 1:** Buster can make or receive the full \$8,300 family HSA contribution limit in his HSA—provided Kristen does not contribute to her HSA in 2024; or
- **Option 2:** Kristen can make the full \$8,300 family HSA contribution limit in her HSA—provided Buster (or employer) does not contribute to his HSA in 2024; or
- **Option 3:** Buster and Kristen can agree to divide the contribution between them.
 - For example, Buster contributes \$5,000 to his HSA, Kristen contributes \$3,300 to her HSA

Catch-Up Contributions (\$1,000)

Individuals Age 55+ Are Eligible for \$1,000 Catch-up Contribution

- The 2024 contribution limit for catch-up eligible individuals is \$5,150/\$9,300
- To qualify, the individual must turn age 55 by the end of the taxable year
- The \$1,000 catch-up is not subject to any further inflation adjustments

Married Individuals

- Both spouses may make the additional \$1,000 catch-up contribution if both are at least age 55
- **Each spouse must make catch-up contributions to his or her own HSA to take advantage of the double catch-up contribution (\$1,000 to each HSA)**

Example

Anthony and his spouse Chelsea are both age 55, covered by a family HDHP, and HSA eligible for all of 2024

Result

- Anthony may contribute up to \$9,300 to his HSA (\$8,300 + \$1,000 catch-up)
- Chelsea may contribute her \$1,000 catch-up contribution to **her** HSA **(cannot make her catch-up to Anthony's HSA)**

03

HSA Distributions



Timing Issues (Good and Bad)

Good – Shoebox Rule: Tax-Free Distribution Can Be Made in Future Tax Year

- HSA distributions for a medical expense may be made at any time in the future
- **Means the HSA owner could delay taking the tax-free reimbursement until many years later (and enjoy the tax-free growth in the meantime!!)**
- Individual must keep sufficient records to show that the distributions were exclusively to pay or reimburse qualified medical expenses
 - Also must show that the expenses were not paid or reimbursed from another source, and that the individual did not claim the expenses as an itemized deduction in any prior taxable year

Example

- Marcel incurs the full \$1,500 deductible in medical expenses under his HDHP in 2024 (and also had an HSA in place for all of 2024)
- Marcel also paid \$600 out-of-pocket (i.e., not covered by insurance) in 2024 for new prescription glasses and a dental crown
- **Marcel keeps records of the expenses for the rest of his life**

Result

To cover the qualifying medical expenses he incurred in 2024, Marcel can take a \$2,100 tax-free distribution from his HSA in **2024...or in 2034...or 2054...etc.**

Timing Issues (Good and Bad)

Good – Tax-Free Distribution Not Affected by HSA Eligibility

- An individual does not need to maintain HSA eligibility to take tax-free distributions for medical expenses
- Means the HSA owner could build up an HSA balance, move to a non-HDHP, and still use that HSA account to cover qualifying medical expenses tax-free
- **REMEMBER** - HSA eligibility is relevant only for determining the ability to make or receive HSA contributions—not for purposes of tax-free distributions
 - This is a VERY common misconception, don't fall for it!

Example

- **Marcel moves to a non-HDHP HMO in 2025 with a \$1,500 balance in his HSA**
- Marcel incurs \$1,500 in qualifying medical OOP expenses through copays, coinsurance, contact lenses, sunscreen, glasses, bandages, etc. in 2025

Result

- Marcel can take a \$1,500 tax-free **distribution from his HSA in 2025** to cover the qualifying medical expenses he incurred—even after losing HSA eligibility!
- Loss of eligibility just means he can't make or receive HSA **contributions** in 2025

Timing Issues (Good and Bad)

Bad – Expense Must Be Incurred After HSA Established

- A qualified tax-free medical distribution is available only if the medical expense is incurred after the HSA has been “established”
- State trust law determines when an HSA is considered “established”
- **Most state laws require that a trust be funded to be established**
 - Means that an HSA won't be established in most cases until a contribution is **actually deposited** in the HSA

Example

- Carlos signs up for his company's HDHP at open enrollment for 2024 coverage
- Carlos's employer makes quarterly HSA contributions to any HSA-eligible employee enrolled in the HDHP (Carlos does not make any HSA contributions)
- The company's first quarterly contribution is deposited in Carlos's HSA as of April 1, 2024

Result

- Carlos's medical expenses incurred prior to April 1 are not eligible for tax-free medical distribution from the HSA
- Only those expenses incurred after the establishment date (4/1/24) are eligible

Timing Issues (Good and Bad)

Bad – Expense Must Be Incurred After HSA Established

- There is a significant exception to the establishment rule from the prior slide if the individual had previously established an HSA
- The new HSA is deemed to be established when the first HSA was established **as long as the first HSA had a balance greater than zero at any time during the 18-month period ending on the date the new HSA is established**
 - This allows medical expenses to be reimbursed on tax-free basis from the new HSA even if they were incurred prior to the date the new HSA is funded

Example

- **Carlos established an HSA January 2020 while in a prior company's HDHP**
- **He distributed the last funds from that first HSA on November 15, 2022**
- Carlos signs up for his new company's HDHP at open enrollment for 2024
- The first contribution is deposited in Carlos's HSA on April 1, 2024

Result

- Because the new HSA is established within 18 months of November 15, 2022, the new HSA is deemed established in 2020 (not April 2024)
- This allows Carlos's medical expenses incurred January 1, 2024 to March 31, 2024 under the new HDHP to be reimbursed on tax-free basis (before the new HSA is funded)

04

HSA Reporting



Employer Reporting (Form W-2)

HSA Contributions Reported on Employee's Form W-2

- **All employer and employee contributions to the employee's HSA are reported on Box 12, Code W**
- Includes the employer contribution amount and the amounts contributed pre-tax by employees through payroll (via the Section 125 cafeteria plan)
- Note that HSA contributions are not subject to the separate requirement to report the aggregate cost of employer-sponsored health coverage in Box 12, Code DD (for employers with 250+ W-2s in the prior calendar year)

Example

- Kyle contributed \$4,300 to his family HSA on a pre-tax basis through his employer's Section 125 cafeteria plan in 2022
- Kyle's employer contributed \$3,000 to his HSA in 2022

Result

Box 12 of Kyle's Form W-2 from his employer should show \$7,300 in HSA contributions by using Code W

Employer Reporting (Form W-2)

22222		a Employee's social security number		OMB No. 1545-0008				
b Employer identification number (EIN)			1 Wages, tips, other compensation		2 Federal income tax withheld			
c Employer's name, address, and ZIP code Chicago Cubs			3 Social security wages		4 Social security tax withheld			
			5 Medicare wages and tips		6 Medicare tax withheld			
			7 Social security tips		8 Allocated tips			
d Control number			9		10 Dependent care benefits			
e Employee's first name and initial		Last name	Suff.	11 Nonqualified plans		12a		
Schwarber		Kyle				W \$7,300		
f Employee's address and ZIP code			13 Statutory employee	Retirement plan	Third-party sick pay	12b		
			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>			
			14 Other			12c		
						12d		
15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name		

Form **W-2** Wage and Tax Statement
Copy 1 — For State, City, or Local Tax Department

2022

Department of the Treasury—Internal Revenue Service



Custodian (Bank) Reporting

HSA Contributions Reported on Form 5498-SA

- The HSA custodian reports all contributions to the account for the year on Form 5498-SA
- Also reports the fair market value of the account as of the last day of the year
- Custodian files the Form 5498-SA with the IRS by May 31 of the following year
- Individual receives a copy of the form by May 31 of the following year

2727 VOID CORRECTED

TRUSTEE'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number Big Bats Bank		1 Employee or self-employed person's Archer MSA contributions made in 2019 and 2020 for 2019 \$	OMB No. 1545-1518 2022	HSA, Archer MSA, or Medicare Advantage MSA Information
		2 Total contributions made in 2019 \$ 7,300	Form 5498-SA	
TRUSTEE'S TIN	PARTICIPANT'S TIN	3 Total HSA or Archer MSA contributions made in 2020 for 2019 \$		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2019 General Instructions for Certain Information Returns.
PARTICIPANT'S name Kyle Schwarber		4 Rollover contributions \$	5 Fair market value of HSA, Archer MSA, or MA MSA \$ 4,653	
Street address (including apt. no.)		6 HSA <input checked="" type="checkbox"/> Archer MSA <input type="checkbox"/> MA MSA <input type="checkbox"/>		
City or town, state or province, country, and ZIP or foreign postal code				
Account number (see instructions)				

Form **5498-SA** Cat. No. 38467V www.irs.gov/Form5498SA Department of the Treasury - Internal Revenue Service
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Custodian (Bank) Reporting

HSA Contributions Reported on Form 1099-SA

- The HSA custodian reports all distributions from the account in the year on Form 1099-SA
- Provided to individuals by January 31 of the following year
- Custodian files copy of the form with the IRS by March 31 of the following year
- Bank does not report whether distributions were for qualified medical expenses

9494 VOID CORRECTED

TRUSTEE'S/PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number Big Bats Bank		OMB No. 1545-1517 Form 1099-SA (Rev. November 2019) For calendar year 20 22	Distributions From an HSA, Archer MSA, or Medicare Advantage MSA Copy A For Internal Revenue Service Center File with Form 1096. <small>For Privacy Act and Paperwork Reduction Act Notice, see the current General Instructions for Certain Information Returns.</small>	
PAYER'S TIN	RECIPIENT'S TIN	1 Gross distribution \$ 3,000		2 Earnings on excess cont. \$
RECIPIENT'S name Kyle Schwarber		3 Distribution code 1		4 FMV on date of death \$
Street address (including apt. no.)		5 HSA <input checked="" type="checkbox"/>		
City or town, state or province, country, and ZIP or foreign postal code		Archer MSA <input type="checkbox"/>		
Account number (see instructions)		MA MSA <input type="checkbox"/>		

Form **1099-SA** (Rev. 11-2019) Cat. No. 38471D www.irs.gov/Form1099SA Department of the Treasury - Internal Revenue Service
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Employee Reporting (Form 8889)

HSA Contributions and Distributions Reported on Form 8889

- All individuals who had HSA contributions or distributions must report the activity on Form 8889, which is included with the individual tax return (Form 1040)
- Includes information showing HDHP coverage, employer contribution amount (including employee pre-tax payroll contributions), and whether any additional taxes for excess contributions or non-qualified distributions apply
- In some cases, Form 5329 must also be completed to report excess contributions and earnings

Important Note Regarding Taxation

- Form 8889 is a self-reporting structure where the individual reports any distributions that were made for qualified tax-free medical expenditures
- There is no administrative gatekeeper here—it is up to the individual to properly report that a distribution was subject to income tax and (generally if under age 65) the 20% additional tax for non-medical distributions
- Also used to report the 10% additional tax for individuals who fail to maintain HDHP coverage through the 13-month testing period that applies to the last-month rule

Employer Reporting (Form 8889)

<p>Form 8889</p> <p>Department of the Treasury Internal Revenue Service</p> <p>Name(s) shown on Form 1040, 1040-SR, or 1040-NR Kyle Schwarber</p>	<p>Health Savings Accounts (HSAs)</p> <p>▶ Attach to Form 1040, 1040-SR, or 1040-NR. ▶ Go to www.irs.gov/Form8889 for instructions and the latest information.</p>	<p>OMB No. 1545-0074</p> <p>2022 Attachment Sequence No. 52</p>
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Before you begin: Complete Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, if required.

Part I HSA Contributions and Deduction. See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part I for each spouse.

<p>1 Check the box to indicate your coverage under a high-deductible health plan (HDHP) during 2021. See instructions</p> <p>2 HSA contributions you made for 2021 (or those made on your behalf), including those made from January 1, 2022, through April 15, 2022, that were for 2021. Do not include employer contributions, contributions through a cafeteria plan, or rollovers. See instructions</p> <p>3 If you were under age 55 at the end of 2021 and, on the first day of every month during 2021, you were, or were considered, an eligible individual with the same coverage, enter \$3,600 (\$7,200 for family coverage). All others, see the instructions for the amount to enter</p> <p>4 Enter the amount you and your employer contributed to your Archer MSAs for 2021 from Form 8853, lines 1 and 2. If you or your spouse had family coverage under an HDHP at any time during 2021, also include any amount contributed to your spouse's Archer MSAs</p> <p>5 Subtract line 4 from line 3. If zero or less, enter -0-</p> <p>6 Enter the amount from line 5. But if you and your spouse each have separate HSAs and had family coverage under an HDHP at any time during 2021, see the instructions for the amount to enter</p> <p>7 If you were age 55 or older at the end of 2021, married, and you or your spouse had family coverage under an HDHP at any time during 2021, enter your additional contribution amount. See instructions</p> <p>8 Add lines 6 and 7</p> <p>9 Employer contributions made to your HSAs for 2021</p> <p>10 Qualified HSA funding distributions</p> <p>11 Add lines 9 and 10</p> <p>12 Subtract line 11 from line 8. If zero or less, enter -0-</p> <p>13 HSA deduction. Enter the smaller of line 2 or line 12 here and on Schedule 1 (Form 1040), Part II, line 13</p> <p>Caution: If line 2 is more than line 13, you may have to pay an additional tax. See instructions.</p>	<p><input type="checkbox"/> Self-only <input checked="" type="checkbox"/> Family</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 5%; text-align: center;">2</td> <td style="width: 55%;"></td> <td style="width: 40%; text-align: right;">0</td> </tr> <tr> <td style="text-align: center;">3</td> <td></td> <td style="text-align: right;">7,300</td> </tr> <tr> <td style="text-align: center;">4</td> <td></td> <td style="text-align: right;">0</td> </tr> <tr> <td style="text-align: center;">5</td> <td></td> <td style="text-align: right;">7,300</td> </tr> <tr> <td style="text-align: center;">6</td> <td></td> <td style="text-align: right;">7,300</td> </tr> <tr> <td style="text-align: center;">7</td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">8</td> <td></td> <td style="text-align: right;">7,300</td> </tr> <tr> <td style="text-align: center;">9</td> <td style="text-align: right;">7,300</td> <td></td> </tr> <tr> <td style="text-align: center;">10</td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">11</td> <td></td> <td style="text-align: right;">7,300</td> </tr> <tr> <td style="text-align: center;">12</td> <td></td> <td style="text-align: right;">0</td> </tr> <tr> <td style="text-align: center;">13</td> <td></td> <td style="text-align: right;">0</td> </tr> </table>	2		0	3		7,300	4		0	5		7,300	6		7,300	7			8		7,300	9	7,300		10			11		7,300	12		0	13		0
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Employer Reporting (Form 8889)

Part II HSA Distributions. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part II for each spouse.

14a	Total distributions you received in 2021 from all HSAs (see instructions)	14a	3,000
b	Distributions included on line 14a that you rolled over to another HSA. Also include any excess contributions (and the earnings on those excess contributions) included on line 14a that were withdrawn by the due date of your return. See instructions	14b	0
c	Subtract line 14b from line 14a	14c	3,000
15	Qualified medical expenses paid using HSA distributions (see instructions)	15	
16	Taxable HSA distributions. Subtract line 15 from line 14c. If zero or less, enter -0-. Also, include this amount in the total on Schedule 1 (Form 1040), Part I, line 8e	16	0
17a	If any of the distributions included on line 16 meet any of the Exceptions to the Additional 20% Tax (see instructions), check here <input type="checkbox"/>		
b	Additional 20% tax (see instructions). Enter 20% (0.20) of the distributions included on line 16 that are subject to the additional 20% tax. Also, include this amount in the total on Schedule 2 (Form 1040), Part II, line 17c	17b	0

Part III Income and Additional Tax for Failure To Maintain HDHP Coverage. See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part III for each spouse.

18	Last-month rule	18	0
19	Qualified HSA funding distribution	19	0
20	Total income. Add lines 18 and 19. Include this amount on Schedule 1 (Form 1040), Part I, line 8z, and enter "HSA" and the amount on the dotted line	20	0
21	Additional tax. Multiply line 20 by 10% (0.10). Include this amount in the total on Schedule 2 (Form 1040), Part II, line 17d	21	0

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 37621P

Form **8889** (2021)



05

Everything Else HDHP/HSA



HSA's and Reaching Age 65 (Medicare)

Employees Do Not Lose HSA Eligibility Automatically Upon Reaching Age 65!

- Only Medicare enrollment causes an individual to lose HSA eligibility
- Many employees age 65 and older do not enroll in Medicare
- **Note that anyone who is receiving Social Security retirement benefits is automatically enrolled in Medicare Part A (no opt-out permitted), and therefore automatically loses HSA eligibility**

No Longer Subject to the 20% Additional Tax

- Individuals who reach age 65 do not pay the 20% additional tax on distributions from the HAS for non-medical expenses
- This is why HSA's are also frequently used as a retirement savings vehicle (IRA-like)
- Remember that only ordinary income taxes apply for any non-medical distribution upon reaching age 65 (like a traditional 401(k)/IRA)

Example

- Jose turns 65 in August 2024 but does not enroll in Medicare
- He has HDHP coverage (with no disqualifying coverage) in 2024
- In December 2024, Jose decides to purchase a \$2,500 75" 8K Ultra HD TV with HSA funds



Result

- Jose is HSA eligible for all of 2024 (and therefore can contribute the full statutory maximum plus the \$1k catch-up)
- The \$2,500 HSA distribution for the 8K UHD TV is subject only to ordinary income taxes

HSAs Post-Age 65 (Medicare)

Delayed Medicare Enrollment Causes Six-Month Retroactive Enrollment

- No retroactive enrollment issue for individuals who enroll in Medicare at age 65 (or begin Social Security prior to age 65, and therefore have Part A coverage automatically at 65)
- However, delaying enrolling in Medicare until after first becoming eligible (including later application for Social Security benefits) means the later Part A enrollment will be retroactive for up to six months
- **The six-month retroactive enrollment in Part A will block HSA eligibility retroactive to the start of the Medicare coverage**

How to Address the Retroactive Enrollment

1. Plan Ahead: Stop making or receiving HSA contributions at least six months before applying for Medicare; or
2. Correct Mistake: Make a corrective distribution of the excess contributions by the due date (including extensions) for filing the individual tax return (generally April 15, without extension)

Example

- Jose turns 65 in August 2023 but does not enroll in Medicare
- **Jose signs up for Social Security benefits in on October 1, 2024, which automatically enrolls him in Medicare Part A retroactive to April 1, 2024**



Result

- Jose retroactively loses HSA eligibility as of April 2024—and therefore can contribute only 3/12 of the HSA statutory limit for 2024 (plus 3/12 of the catch-up contribution)
- If he already contributed in excess of that limit, he must make a corrective distribution of the excess contributions by April 15, 2025 (assuming no individual return extension)

HSAs and Medicare

Where to Direct Employees

CMS Fact Sheet

Deciding Whether to Enroll in Medicare Part A and Part B When You Turn 65

<https://www.cms.gov/Outreach-and-Education/Find-Your-Provider-Type/Employers-and-Unions/FS3-Enroll-in-Part-A-and-B.pdf>



FACT SHEET: Deciding Whether to Enroll in Medicare Part A and Part B When You Turn 65

Do I have a health savings account?

Health savings accounts (HSAs) are a special kind of tax-deferred account available only to people who have a high-deductible health plan. HSAs are not the same as a flexible spending account (FSA) or health reimbursement account (HRA). If you aren't sure if you have an HSA, ask your benefits administrator or plan.

- I have an HSA
 I do not have an HSA

- I have health insurance based on my (or my spouse's) current employment, from an employer with 20 or more employees (this includes those with Federal Employees Health Benefits (FEHB))

NOTE: If you have COBRA or retiree coverage, or if your employer gives you an amount of money to purchase health insurance, you do NOT have health insurance based on "current employment." If you have one of these types of insurance, you should find that situation in the fact sheet.

Your decision to enroll in Part A and Part B **depends on whether you have a high-deductible health plan with a health savings account (HSA):**

- I do NOT have a Health Savings Account (HSA)

Part A: If you qualify for premium-free Part A, you should enroll in Part A when you turn 65. However, if you have to pay a premium for Part A, you can delay Part A until you (or your spouse) stop working or lose that employer coverage. You will NOT pay a penalty for delaying Part A, as long as you enroll within 8 months of losing your coverage or stopping work (whichever happens first).

Part B: You can delay Part B until you (or your spouse) stop working or lose that employer coverage. This allows you to save the cost of your Part B premium. It also allows you to postpone your one-time "Medigap open enrollment period" until a later time, when you may want to purchase this type of coverage.

You will NOT pay a penalty for delaying Medicare, as long as you enroll within 8 months of losing your coverage or stopping work (whichever happens first). You'll want to plan ahead and enroll in Part B at least a month before you stop working or your employer coverage ends, so you don't have a gap in coverage.

▶▶ You have completed TASK 2. Go to TASK 3 on page 7.

HSAs and Medicare

Where to Direct Employees

CMS Fact Sheet

Deciding Whether to Enroll in Medicare Part A and Part B When You Turn 65

<https://www.cms.gov/Outreach-and-Education/Find-Your-Provider-Type/Employers-and-Unions/FS3-Enroll-in-Part-A-and-B.pdf>



I have a High-Deductible Health Plan AND a Health Savings Account (HSA)

Once you enroll in any part of Medicare, you won't be able to contribute to your HSA. If you would like to continue making contributions to your HSA, you can delay both Part A and Part B until you (or your spouse) stop working or lose that employer coverage. You will NOT pay a penalty for delaying Medicare, as long as you enroll within 8 months of losing your coverage or stopping work (whichever happens first).

You should talk with your employer benefits manager about whether it makes sense to delay Part A and Part B.

NOTE: *If you qualify for premium-free Part A, your coverage will go back (retroactively) up to 6 months from when you sign up. So, you should stop making contributions to your HSA 6 months before you enroll in Part A and Part B (or apply for Social Security benefits, if you want to collect retirement benefits before you stop working).*

▶ **You have completed TASK 2. Go to TASK 3 on page 7.**

HSAs Post Age-65 (Medicare) – Using Accumulated HSA Funds

Tax-Free Distribution Ability Not Affected by HSA Eligibility

- An individual does not need to maintain HSA eligibility to take tax-free distributions for medical expenses
- Means the HDHP participant could build up an HSA balance, move to Medicare, and still use that HSA account to cover qualifying medical expenses tax-free
- **Remember:** HSA eligibility is relevant only for determining the ability to make or receive HSA contributions—not for purposes of tax-free distributions
 - This is a VERY common misconception, don't fall for it!

Example

- **Marcel moves to Medicare in January 2025 with a \$1,500 balance in his HSA**
- Marcel incurs \$1,500 in qualifying medical OOP expenses through deductibles, copays, coinsurance, contact lenses, sunscreen, glasses, and bandages in 2025



Result

- Marcel can take a \$1,500 tax-free **distribution from his HSA** in 2025 to cover the qualifying medical expenses he incurred—even after losing HSA eligibility!
- Loss of eligibility just means he can't make or receive HSA **contributions** in 2025

Covid Testing and Treatment

General Rule:

Minimum Annual HDHP Deductible Required

1. Employee-Only Coverage:

- 2023: \$1,500
- 2024: \$1,600

2. Family Coverage:

- 2023: \$3,000
- 2024: \$3,200

- Family coverage includes any plan other than employee-only (e.g., employee plus spouse, employee plus child, employee plus family)
- Preventive services typically not subject to the deductible
- Embedded deductible in family coverage must be at least the minimum annual family deductible

Last Year of Covid Relief:

HDHP Status and HSA Eligibility Preserved for First-Dollar Coverage

- IRS Notice 2020-15 was the first piece of IRS guidance related to Covid!
- Provides that HDHPs will not fail to maintain HDHP status if they provide medical care services and items purchased related to testing for and treatment of Covid prior to satisfaction of the applicable minimum deductible
- Means all individuals covered by plans providing first-dollar (i.e., not subject to the deductible) coverage for testing and treatment of Covid can maintain HSA eligibility
- Designed by the IRS to “eliminate potential administrative and financial barriers to testing for and treatment of COVID-19.”
- IRS Notice 2023-37 provides that this relief will remain available for plan years ending on or before December 31, 2024
- **Accordingly, this Covid relief will expire for the 2025 plan year—HDHPs will have to impose the standard deductible**

CARES Act HSA Relief: Extended Through 2024

Last Year of First-Dollar HDHP Telehealth Relief Extended Two Years by CAA 2023

HSA Eligibility Preserved

HDHPs can provide first dollar coverage for telehealth or other remote care services

- Means that individuals covered under a HDHP that waive the deductible for telehealth services or other remote care can maintain HSA eligibility
- Includes non-preventive telehealth/remote care

CARES Act/CAA 2022 Relief: Originally applied for plan years beginning on or before December 31, 2021

- CAA 2022 extension applied from April – December 2022

CAA 2023: Extension of relief makes it available through 2024

- Extension applies to plan years beginning after December 31, 2022 and before January 1, 2025
- Includes 2023 and 2024 for calendar plan year HDHPs
- For plan years beginning on or after January 1, 2025, no relief is available (absent a new act of Congress to again extend relief)

Practical Considerations – Plan Design Issues

First-dollar telehealth relief is an optional plan provision

- HDHPs are not required to offer free telehealth care
- The relief simply permits it without causing loss of HSA eligibility

Fully Insured Plan

- Up to the insurance carrier to make the determination of whether to add first-dollar telehealth/remote care

Self-Insured Plan

- Employers can work with TPA and stop-loss provider to make this plan design decision

Mind the gap

- Was an unfortunate gap from January 2022 through March 2022 with no telehealth relief in place for calendar plan years
- There is another unfortunate gap for non-calendar plan years from January 2023 until start of first plan year beginning in 2023

HDHPs and Telemedicine: Standard HSA Eligibility Rules (After Extended CARES Act Relief Ends in 2025)

Telemedicine That is Part of the HDHP: Not Disqualifying Coverage

- In this case, the employee's costs related to the telemedicine services are subject to the same HDHP cost-sharing rules as non-telemedicine services
- In other words, the **HDHP deductible applies to telemedicine** in the same manner as in-person services
- Preventive care or EAP/Wellness/Disease Management services are not required to be subject to the deductible (same as in-person services)

Telemedicine That is Not Part of the HDHP: May Be Disqualifying Coverage

- Separate telemedicine plans that are not subject to the HDHP deductible—therefore another exception must apply to the telemedicine benefit to avoid blocking HSA eligibility
- Main exemptions that could apply are:
 1. **Preventive Services:** Telemedicine limited to preventive services only; or
 2. **EAP/Wellness/Disease Management:** Telemedicine that does not provide **"significant benefits in the nature of medical care or treatment"**

"Significant Benefits" Standard Difficult to Apply to Telemedicine

- Best examples come from HIPAA/ACA excepted benefit regulations preamble:
- **For example**, "an EAP that provides only limited, short-term outpatient counseling for substance use disorder services (without covering inpatient, residential, partial residential or intensive outpatient care) without requiring prior authorization or review for medical necessity does not provide significant benefits in the nature of medical care. At the same time, a program that provides disease management services (such as laboratory testing, counseling, and prescription drugs) for individuals with chronic conditions, such as diabetes, does provide significant benefits in the nature of medical care."

Permanent CARES Act HSA Improvements

Changes to Eligible HSA/FSA/HRA Expenses

The CARES Act paired a longstanding Republican priority with a longstanding Democrat priority for a bipartisan combo of changes to the list of eligible medical expenses for an HSA/FSA/HRA.

OTC Medicines and Drugs – No Rx Required

CARES Act eliminated the requirement for a prescription to reimburse an over-the-counter medicine or drug

- Prior rule from the ACA restricted eligible account-based plan expenses to only OTC medicines and drugs (other than insulin) provided pursuant to a prescription
- No Rx required anymore for OTC medicines and drugs to qualify as eligible HSA/FSA/HRA expense
- Was effective for expenses incurred on or after January 1, 2020

Menstrual Care Products: Now Eligible Expenses

CARES Act adds menstrual care products to qualifying expenses

- Previously excluded as an item for general health
 - §213(d) applies only to expenses incurred for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body
- **Now HSA/FSA/HRA can reimburse these products tax-free**
- Includes tampons, pads, liners, cups, sponges, or similar products
- Was effective for expenses incurred on or after January 1, 2020

Recent HSA Expense/Eligibility Enhancements

After remaining relatively stable for an extended period since the HSA inception point, HSAs have been experiencing a whirlwind of enhancements in recent years. Although none of the changes by themselves are revolutionary, the modifications are significant in the aggregate by increasing reimbursable expenses and eliminating unnecessary barriers to eligibility. In 2021, Congress and the IRS added two new items to the growing list of improvements.

Personal Protective Equipment (PPE)

IRS Announcement 2021-7 notified taxpayers that amounts paid for PPE now qualify as medical care expenses under §213(d)

- Includes PPE such as masks, hand sanitizer, and sanitizing wipes for the primary purpose of preventing the spread of Covid
- Inclusion in definition of §213(d) medical expense makes PPE eligible to be paid or reimbursed under a health FSA, HRA, or HSA
- PPE eligible expense inclusion was made effective for expenses incurred on or after January 1, 2020

No Surprises Act HSA Eligibility Preservation

CAA adds two provisions to ensure the new surprise billing patient protections do not affect HSA eligibility

1. HSA Eligibility Not Affected by Surprise Billing Payments
 - Individuals will not fail to be HSA-eligible merely because they receive surprise billing benefits required by the CAA No Surprises Act provisions
2. HDHP Status Not Affected by Surprise Billing Protection Payments
 - Plans will not lose HDHP status merely because they provide surprise billing benefits required by the CAA's No Surprises Act patient protection provisions
 - Both effective for plan years beginning on or after 1/1/22

HSAs and Dependent Medical Expenses

Children – Age 26 Rule Does Not Apply

- Unlike health FSAs and HRAs, the HSA rules do not incorporate the ACA Age 26 rule
- Means that the child must be a tax dependent for the child's expenses to qualify
- Generally requires that the child be under age 19, or under age 24 and a full-time student
 - In most cases, children of divorced parents can be treated as a dependent of both

Spouse – Same-Sex or Opposite-Sex Spouse

- Since the US Supreme Court's Windsor decision overturning DOMA in 2013, same-sex spouses and opposite-sex spouses are treated identically for federal tax purposes
- Same-sex spouse medical distributions therefore now always qualify

Domestic Partner – Only Tax-Dependent DPs Qualify

- There is no federal tax recognition of domestic partner status
- Therefore, a domestic partner must qualify as a tax dependent for expenses to be eligible
- This generally requires that the DP:
 1. Have the same principal place of abode and is a member of the employee's household
 2. Receive over half of his or her support from the employee (community property issues)
 3. Not be anyone's qualifying child for tax purposes
 4. Be a U.S. citizen or resident of the U.S. or country contiguous to the U.S.
- Note that certain tax-dependent status requirements are removed from this health tax-dependent definition.

HSAs and Domestic Partners

Tax-Free Medical Expenses Distribution Available Only for Tax-Dependent DPs

- Individuals will be subject to income tax and a 20% additional tax for distributions for non-tax dependent domestic partner
- Tax-free HSA distributions available for medical expenses of a tax-dependent DP in the same manner as for a spouse

Family Coverage Limit Applies for DP HDHP Coverage

- Employees covering a non-tax dependent DP may contribute the family HSA limit—family coverage is defined as “any coverage other than self-only coverage”

The Domestic Partner Double Family Contribution Loophole

- Normal rule is that employee and spouse have a combined family contribution limit (\$8,300 in 2024) that may be allocated between spouses in any manner (applies where at least one of the spouses has family coverage)
- The combined limit rule doesn't apply to domestic partners because not spouses
- If both the employee and domestic partner are covered by family HDHP coverage and are both HSA eligible, they could each contribute the family HSA limit to their own HSA (\$8,300 to each HSA, \$16,600 total)
 - IRS Informal ABA Guidance (Q/A-3):
https://www.americanbar.org/content/dam/aba/events/employee_benefits/technicalsessions/2010irs_final.pdf

HSAs and VA Health Care Services

General Rule

HSA eligibility generally requires:

- The individual be covered by an HDHP; and
- The individual not have any other **disqualifying coverage**.

Special VA Rule

- Veterans who are eligible for VA benefits but have not actually received VA benefits in the past three months are not considered to have disqualifying coverage

New Rule from 2015 Legislation for Veterans with Service-Connected Disabilities

- Veterans with service-connected disabilities do not have to worry about the general three-month rule for VA services provided for a service-connected disability
- VA coverage will not be considered disqualifying coverage under these circumstances

Enhanced Rule from ACA Potluck Guidance (IRS Notice 2015-87)

- All VA services provided to a veteran with a service-connected disability will be deemed to be for the service-connected disability –and therefore not disqualifying
- **In other words, VA benefits will never be disqualifying coverage for veterans with a service-connected disability**



HSAs and Male Contraception/Sterilization

Preventive Care Not Subject to Minimum Deductible

- HDHPs may (and typically do) provide first-dollar coverage for preventive care
- “Preventive care” includes services listed in IRS Notice 2004-23 and
- Also includes ACA preventive services required to be provided without cost sharing for non-grandfathered health plans

New IRS Guidance for State Male Contraception and Sterilization Mandates

- A few states (Maryland, Illinois, Vermont, Oregon) have recently imposed insurance mandates requiring male contraceptive/sterilization services be covered at no cost
- Default rule would be that no fully insured plans in those states could meet the requirements of an HDHP (and no individuals covered could be HSA eligible)
- **IRS Provided Transition Relief Until 2020**
 - IRS Notice 2018-12 provided a transition period until 2020
 - During the transition period prior to 2020, guidance was clear that these mandates will not prevent HDHP status
- **What Happens Now?**
 - Likely that states will either:
 - Remove the state insurance mandate that blocks HDHP status; or
 - Modify it to accommodate HDHP status requirements (e.g., subject to deductible)
 - Also possible that Congress or IRS will modify the HDHP preventive services definition to accommodate these common male sterilization/contraceptive mandates

HSAs and the Section 125 Cafeteria Plan

All Employee Pre-Tax HSA Contributions are Made Through Section 125

- The Section 125 cafeteria plan can permit employees to make pre-tax premium payments to the HDHP and pre-tax contributions to the HSA
- There is no other mechanism for these elections to be made on a pre-tax basis
- Employers that permit pre-tax HSA contributions are **subject to the Section 125 cafeteria plan nondiscrimination rules** (not the much more difficult HSA comparability rules)

Special Rule Provides for HSA Election Changes At Least Monthly

- The general rule for Section 125 elections is that they are irrevocable for the plan year unless the employee experiences a permitted election change event
- However, there is an exception to this rule for employee pre-tax HSA contribution elections
- The cafeteria plan **must** permit employees to change their HSA contribution election **at least once per month** for any reason (with no change in status or other event required)

Employee Pre-Tax HSA Contributions Avoid Employer Payroll Taxes

- As with all employee pre-tax contributions for health benefits, HSA contributions are excluded from both payroll and income taxes (state exceptions apply)
- The big difference is that unlike all other contributions, employees could make the same HSA contribution outside of payroll (with after-tax dollars) and later claim an above-the-line deduction on the personal tax return that results in the same employee tax treatment
- However, the employer avoids the need to pay the employer-share of the FICA taxes (6.2% Social Security, 1.45% Medicare) only if the employee contributes pre-tax through payroll



Above-the-Line HSA Deductions

Post-TCJA Form 1040

Post-TCJA, the above-the-line deduction for HSA contributions made outside of a Section 125 cafeteria plan (i.e., not pre-tax through payroll) is handled via Schedule 1:

1040 Department of the Treasury - Internal Revenue Service **2022** OMB No. 1545-0047 IRS Line Only - Do not write or stamp in this space.

U.S. Individual Income Tax Return

Filing Status: Single Married filing jointly Married filing separately (MFS) Head of household (HOH) Qualifying surviving spouse (QSS)

If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent.

Your first name and middle initial: _____ Last name: _____ Your social security number: _____

If joint return, spouse's first name and middle initial: _____ Last name: _____ Spouse's social security number: _____

Home address (number and street), if you have a P.O. box, see instructions: _____ Apt. no.: _____ Presidential Election Campaign

City, town, or post office, if you have a foreign address, also complete spaces below: _____ State: _____ ZIP code: _____ Check here if you, or your spouse if filing jointly, want \$3 to go to the fund. Checking a box below will not change your tax or refund.

Foreign country name: _____ Foreign province/state/country: _____ Foreign postal code: _____ Yes Spouse

Digital Assets At any time during 2022, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, gift, or otherwise dispose of a digital asset or a financial interest in a digital asset? (See instructions.) Yes No

Standard Deduction Someone can claim: You as a dependent Your spouse as a dependent Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness Year: Were born before January 2, 1958 Are blind Spouse: Was born before January 2, 1958 Is blind

Dependents (see instructions): If more than four dependents, see instructions and check here:

(A) First name	Last name	(B) Social security number	(C) Relationship to you	(D) Check the box if qualified for paid reduction: Child tax credit	Credit to other dependents

Income

1a Total amount from Forms W-2, box 1 (see instructions) **1a**

1b Household employee wages not reported on Forms W-2 **1b**

1c Tip income not reported on line 1a (see instructions) **1c**

1d Medicare waiver payments not reported on Forms W-2 (see instructions) **1d**

1e Taxable dependent care benefits from Form 2441, line 26 **1e**

1f Employee-provided adoption benefits from Form 8839, line 29 **1f**

1g Wages from Form 9913, line 8 **1g**

1h Other earned income (see instructions) **1h**

1i Nontaxable combat pay election (see instructions) **1i**

2 Add lines 1a through 1i **2**

2a Tax-exempt interest **2a**

2b Taxable interest **2b**

3a Qualified dividends **3a**

3b Ordinary dividends **3b**

4a IRA distributions **4a**

4b Taxable amount **4b**

5a Pensions and annuities **5a**

5b Taxable amount **5b**

6a Social security benefits **6a**

6b Taxable amount **6b**

7 Capital gain or (loss). Attach Schedule D if required. If not required, check here:

8 Other income from Schedule 1, line 10 **8**

9 Add lines 2, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** **9**

10 Adjustments to income from Schedule 1, line 20 **10**

11 Subtract line 10 from line 9. This is your **adjusted gross income** **11**

12 Standard deduction or itemized deductions from Schedule 1, line 12 **12**

13 Qualified business income deduction from Form 8969 or Form 8995-A **13**

14 Add lines 12 and 13 **14**

15 Subtract line 14 from line 11. If zero or less, enter -0- **15** This is your **taxable income** **15**

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Part II Adjustments to Income

11 Educator expenses		11
12 Certain business expenses of reservists, performing artists, and fee-basis government officials—Attach Form 2106		12
13 Health savings account deduction. Attach Form 8889		13
14 Moving expenses for members of the Armed Forces—Attach Form 3900		14
15 Deductible part of self-employment tax. Attach Schedule SE		15
16 Self-employed SEP, SIMPLE, and qualified plans		16
17 Self-employed health insurance deduction		17
18 Penalty on early withdrawal of savings		18
19a Alimony paid		19a
b Recipient's SSN		
c Date of original divorce or separation agreement (see instructions):		
20 IRA deduction		20
21 Student loan interest deduction		21
22 Reserved for future use		22
23 Archer MSA deduction		23
24 Other adjustments:		
a Jury duty pay (see instructions)		24a
b Deductible expenses related to income reported on line 8i from the rental of personal property engaged in for profit		24b
c Nontaxable amount of the value of Olympic and Paralympic medals and USOC prize money reported on line 8m		24c
d Reforestation amortization and expenses		24d
e Repayment of supplemental unemployment benefits under the Trade Act of 1974		24e
f Contributions to section 501(c)(18)(D) pension plans		24f
g Contributions by certain chaplains to section 403(b) plans		24g
h Attorney fees and court costs for actions involving certain unlawful discrimination claims (see instructions)		24h
i Attorney fees and court costs you paid in connection with an award from the IRS for information you provided that helped the IRS detect tax law violations		24i
j Housing deduction from Form 2555		24j
k Excess deductions of section 67(e) expenses from Schedule K-1 (Form 1041)		24k
z Other adjustments. List type and amount:		24z
25 Total other adjustments. Add lines 24a through 24z		25
26 Add lines 11 through 23 and 25. These are your adjustments to income . Enter here and on Form 1040 or 1040-SR, line 10, or Form 1040-NR, line 10a		26

Schedule 1 (Form 1040) 2022



Employer HSA Contributions

Employer Contributions Count Toward the Statutory Limit

- The statutory limit is a combined limit for all sources of contributions, including employer/employee contributions

HSA Funding Timing at Employer Discretion

- Employer may make one up-front lump sum contribution, semiannual contributions, quarterly contributions, monthly contributions, per pay period contributions, etc.
- Only real limitation is that the contributions be made to the HSA by the tax filing deadline of the following year (generally April 15)
- **Advantage of up-front funding:**
 - Avoids employees not having sufficient funds in their HSA early in the year to cover the deductible or other out-of-pocket health expenses
- **Disadvantage of up-front funding:**
 - No ability to claw back contributions if an employee terminates or changes plans mid-year
 - Can result in a windfall for the employee—but can also result in excess contributions

Employer Not Responsible for Determining HSA Eligible Status of Employees

- Employer is responsible only for determining (1) that the employee is covered by an HDHP and has no disqualifying coverage **sponsored by that employer** (cannot verify outside disqualifying coverage), and (2) the employee's age (for catch-up contribution eligibility)
- Employee bears all other responsibility for determining HSA eligibility
 - The employer is not liable if the employee is ultimately incorrect in that determination

Health FSA Interaction with HSA

General Purpose Health FSA of Employee or Spouse is a Problem!

- General purpose health FSA enrollment of employee or spouse (or parent) is disqualifying coverage for both individuals—blocks eligibility to make or receive HSA contributions
- In other words, if either spouse is enrolled in a general purpose health FSA, neither spouse is HSA eligible (although both could still be covered by an HDHP)
- This is because a general purpose health FSA will pay for medical expenses pre-deductible

HSA Eligibility Blocked for Health FSA Plan Year Unless Coverage Terminates

- If an employee or spouse is enrolled in an health FSA, both individuals will be HSA ineligible for the entire health FSA plan year
- Exception would be if the participant terminates health FSA coverage mid-year based on permitted election change event or termination of employment (and does not elect COBRA)
- The employee or spouse draining health FSA balance to zero is **irrelevant**
 - Both individuals remain “covered” by the health FSA even when balance is exhausted

Limited Purpose Health FSA Does not Block HSA Eligibility

- A limited purpose health FSA covers only dental, vision, and/or preventive care expenses and therefore does not cause employee to lose HSA eligibility
- Why enroll in a limited purpose health FSA when the HSA can reimburse dental/vision expenses? Answer: You can save more in your triple-tax advantaged HSA!
 - Use the limited purpose health FSA funds first because they are subject to use-it-or-lose-it



Health FSA Interaction with HSA

Examples

Example 1

- Mike's spouse Jessica is enrolled in a general purpose health FSA through her employer with a July 1, 2023 to June 30, 2024 plan year
- At OE, Mike enrolls in his employer's HDHP for the 2024 calendar plan year
- Jessica spends her full \$2,850 health FSA election by the end of December 31, 2023

Result

- Mike is not HSA eligible during his spouse's health FSA period of coverage
- This means that Mike cannot make or receive HSA contributions until July 2024
- Doesn't matter that Jessica spent down her entire health FSA balance in 2023
- Mike can still be covered by the HDHP for January through June of 2024—he just won't be HSA eligible until July 2024 (assuming Jessica does not elect the general purpose health FSA again for the next plan year)

Example 2

- Mike's spouse Jessica is enrolled in a general purpose health FSA through her employer with a July 1, 2023 to June 30, 2024 plan year
- At OE, Mike enrolls in his employer's HDHP for the 2024 calendar plan year
- **Jessica terminates employment at the end of February 2024**

Result

- Jessica's health FSA coverage ends as of February 28, 2024 (assuming no COBRA)
- This means that Mike becomes HSA eligible beginning in March 2024



Health FSA Carryover and HSA Eligibility

General Purpose Health FSA Carryover is a Potential Problem!

- Employees who want to move to an HDHP for year two, but have general purpose health FSA amounts remaining in their account from year one subject to the carryover, have an HSA eligibility issue
- If the employee carries over any amount as general purpose health FSA balance into year two, the carryover will block HSA eligibility for all of year two

Two Main Ways to Avoid the Carryover HSA Eligibility Issue

New IRS Notice 2021-15 reiterates the IRS issued guidance in 2014 permitting two approaches to maintain HSA eligibility:

1. **Automatic Conversion of Carryover Balance to Limited Purpose:** Structure the plan to automatically convert the general purpose carryover amount to limited purpose where the employee is moving to an HDHP (preferred approach where available)
2. **Election to Forfeit Carryover Balance:** Allow the employee to waive the general purpose carryover balance and have it forfeit to the plan (fallback approach for plans that do not offer limited purpose option)

Example

- Manny moves from standard HMO in 2024 to HDHP in 2025
- He has \$100 remaining of general purpose health FSA balance from 2024 that will carry over into the 2025 calendar plan year

Result

- Manny's employer's plan utilizes the first approach above to automatically convert general purpose carryover to limited purpose where employee moves to HDHP
- The limited purpose health FSA carryover will not block 2025 HSA eligibility!



Health FSA Grace Period and HSA Eligibility

General Purpose Health FSA Balance Available in Grace Period is a Potential Problem!

- Employees who want to move to an HDHP for year two, but have general purpose health FSA amounts subject to the 2½-month grace period, have an HSA eligibility issue
- General rule is that the employee will not be HSA eligible until month four in year two (i.e., April for a calendar plan year) because the grace period will be disqualifying coverage for the first three months

Three Main Ways to Avoid the Grace Period HSA Eligibility Issue

New IRS Notice 2021-15 adds the same two approaches as the carryover to maintain HSA eligibility:

- 1. Automatic Conversion of Grace Period Balance to Limited Purpose:** Structure the plan to automatically convert the general purpose grace period amount to limited purpose where the employee is moving to an HDHP (preferred approach)
- 2. Election to Forfeit Grace Period Balance:** Allow the employee to waive the general purpose grace period balance and have it forfeit to the plan (fallback approach for plans that do not offer limited purpose option)
- 3. Spend Down the Account Balance to Zero By End of Plan Year:** The employee spends down the health FSA to zero by the last day of the plan year on a cash basis (meaning the account balance is actually zeroed out through reimbursements)

Example

- Manny moves from standard HMO in 2024 to HDHP in 2025, with \$100 remaining of general purpose health FSA balance from 2024 that will be available in the 2 ½-month grace period in 2025

Result

- Manny's employer's plan utilizes the first approach to automatically convert general purpose carryover to limited purpose where employee moves to HDHP—so the grace period will not block HSA eligibility in 2025



HSA Contributions Nonforfeitable

General Rule – HSA Contributions are Nonforfeitable

- The employer cannot recoup from an employee's HSA any portion of the employer's contribution to the employee's HSA
- Means there can't be any vesting schedule or other conditions on amounts contributed to the HSA—if the employee terminates, the HSA contributions remain in the account

Example

- David's employer funds HSA contributions once per calendar plan year on January 1
- David terminates employment on January 2, 2024 after receiving the full calendar plan year employer HSA contribution of \$3,000 on January 1, 2024

Result

- David's employer cannot recover any of the nonforfeitable \$3,000 HSA contribution made on January 1 even though David terminated the next day
- Note: David must be careful to avoid excess contributions in this scenario

Three Major Exceptions to Nonforfeitability Rule for Mistaken Contributions



**Employee was Never
HSA Eligible**



**Employer Contributions
Exceed Statutory Limit**



**Clear Documentary Evidence
Demonstrating Administrative
or Process Error**

Mistaken HSA Contributions

Exception #1: Employee Was Never HSA Eligible

- If an employer contributes to the HSA of an employee who was never HSA eligible, the IRS takes the position that the HSA never existed
- The employer may request that the bank return the contributions to the employer
- If the bank does not return the funds to the employer by the end of the year, the amounts must be included as gross income and wages on the employee's Form W-2 for the year during which the employer made the contributions

Example 1

- On January 1, 2024, David's employer contributed \$3,000 to his "HSA"
- In **July 2024**, the employer learns that David's account is not an HSA because David was never HSA eligible
- Employer requests that the bank holding the contribution return the \$3,000 (adjusted for earnings, losses, and administration fees directly paid from the account) to the employer

Result 1

- If the bank agrees to return the excess contributions to the employer, and the employer receives the funds by the end of 2024, there are no tax consequences for David
- If the bank does not return the excess contributions to the employer by the end of 2024, the employer must include the amounts in David's gross income and wages on his 2024 Form W-2

Example 2

Same scenario except the employer **does not discover the mistake until July 2025**

Result 2

- The employer must issue a corrected 2024 Form W-2 to David, and David must file an amended 1040 to reflect the income from the excess contributions
- David will also have a 6% excise tax owed for the excess contributions (and will need to take a corrective distribution of the excess to avoid additional excise taxes)



Mistaken HSA Contributions

Exception #2: Employer Contributions Exceed Statutory Limit

- If an employer contributes to an employee's HSA in excess of the statutory annual maximum contribution limit, the employer may correct the error
- The employer may request that the bank return the contributions to the employer
- If the bank does not return the funds to the employer by the end of the year, the amounts must be included as gross income and wages on the employee's Form W-2 for the year during with the employer made the contributions

Example 1

- David is covered by family HDHP coverage in 2024
- In **August 2024**, employer discovers that the employer contributions to his HSA account total \$8,400 (\$8,300 limit)
- Employer requests that the HSA bank return the \$100 excess contributions (adjusted for earnings, losses, and administration fees directly paid from the account) to the employer

Example 2

Same scenario except the employer **does not discover the mistake until July 2025**

Result 1

- If the bank agrees to return the excess contributions to the employer, and the employer receives the funds by the end of 2024, there are no tax consequences for David
- If the bank does not return the excess contributions to the employer by the end of 2024, the employer must include the amounts in David's gross income and wages on his 2024 Form W-2

Result 2

- The employer must issue a corrected 2024 Form W-2 to David, and David must file an amended 1040 to reflect the income from the excess contributions
- David will also have a 6% excise tax owed for the excess contributions (and will need to take a corrective distribution of the excess to avoid additional excise taxes)



Mistaken HSA Contributions

Exception #3: Clear Documentary Evidence of Administrative or Process Error

- New exception from [IRS Information Letter 2018-0033](#)
- Where there is **clear documentary evidence demonstrating that there was an administrative or process error**, the employer may request that the bank return the mistaken contributions to the employer
- The employer should maintain documentation to substantiate the mistaken contribution

Example 1

- David is covered by employee-only HDHP coverage in 2024
- The employer contributes \$1,500 for to the HSA for employee-only coverage, \$3,000 for family coverage
- **David's employer mistakenly contributes \$3,000 to the HSA (not \$1,500 for employee-only coverage)**
- Employer requests that the HSA bank return the \$1,500 excess contributions (adjusted for earnings, losses, and administration fees directly paid from the account) to the employer

Example 2

- The bank may agree to return the mistaken \$1,500 excess contribution to the employer
- Before this new IRS guidance, arguably that amount would have been a nonforfeitable contribution (i.e., a windfall) to David with no ability to recoup

HSAs and Premiums

General Rule is No Tax-Free Qualified HSA Distributions for Premiums

- Similar to the health FSA rule, the general rule for HSAs is that premiums are not a qualifying medical expense
- This is different from the general HRA rule, which does permit distributions for premiums (although ACA issues abound)

Exceptions – The Following Premiums Are Qualifying Expenses

1. **COBRA Premiums:** COBRA or any other continuation coverage premiums required by federal law (including USERRA continuation coverage)
2. **Long-Term Care Insurance Premiums:** Annual limitations for eligible LTC premium amounts apply
3. **Any Health Plan Premium While Individual is Receiving Federal or State Unemployment:** Includes health premiums for a spouse or dependent receiving unemployment
4. **Age 65+ Premiums:** Premiums for Medicare (excluding any Medicare supplemental policy) or employer-sponsored retiree coverage

HSAs and Premiums

Example

- Xander is involuntarily terminated from employment at age 64 and begins receiving unemployment
- At the time of termination, he was covered under the company's HDHP with an HSA balance of \$5,000

Result

- Xander can pay for his COBRA premiums with his \$5,000 HSA balance as tax-free qualified distributions
- He could also pay for Exchange coverage premiums (or any other coverage) with tax-free HSA distributions because he is receiving unemployment
- Upon reaching age 65, Xander can use any remaining HSA funds to pay for Medicare premiums tax-free

HSAs: Not an ERISA Welfare Benefit Plan

HSAs Generally are Not Subject to ERISA

- HSAs generally are not treated as a group health plan under ERISA or other employee benefits laws
- Means the standard ERISA plan document, SPD, Form 5500, fiduciary duties, etc. do not apply, and HSAs are not subject to HIPAA, COBRA, the ACA market reforms, etc.
- But remember the HDHP is an ERISA group health plan!

Requirements for Employers to Avoid Application of ERISA to HSAs

- Establishment of the HSA must be completely voluntary on the part of the employees
- Furthermore, the employer must not:
 1. Limit the ability of eligible individuals to move their funds to another HSA;
 2. Impose conditions on the utilization of HSA funds;
 3. Make or influence the investment decisions with respect to funds contributed to an HSA;
 4. Represent that the HSAs are an employee welfare benefit plan (i.e., subject to ERISA); or
 5. Receive any payment or compensation in connection with an HSA.

HSAs: Not an ERISA Welfare Benefit Plan

Example

- Eric is covered by his employer's HDHP, and his employer contributes \$1,500/year to his HSA
- He terminates from employment at the end of September 2024

Result

- Eric must be offered COBRA to continue coverage under the HDHP
- However, the HSA is not a group health plan subject to ERISA, therefore no COBRA requirements apply to the employer HSA contributions (but he could continue to contribute to the HSA on his own)

Preserving HSA Eligibility: Post-Deductible HRAs

HRAs Will Generally Block HSA Eligibility

- It's becoming more common for employers to provide some form of reimbursement outside the major medical plan for certain medical expenses typically not covered by the plan
- Examples: Infertility, gender dysphoria, autism, abortion-related medical travel, mental health, other specialized care
- These employee reimbursements create an HRA that is a group health plan subject to ERISA, COBRA, HIPAA, the ACA, Section 105(h) nondiscrimination, etc.
- HRAs that are not specially designed as HSA-compatible are also disqualifying coverage for any individual covered by a HDHP

Post-Deductible HRAs Are Not Disqualifying Coverage

- **To avoid the HRA blocking employee's HSA eligibility, the HRA needs to be structured as post-deductible**
- This requires that the HRA not permit any reimbursements (i.e., not pay any benefits) until the employee has reached the statutory minimum deductible (2024: \$1,600 individual/\$3,200 family) in expenses covered by the HDHP
- Means that any expenses incurred for the items or services the HRA is designed to cover would not count toward the deductible (because they aren't covered by the HDHP)
- Only expenses for services incurred after satisfying the minimum deductible are eligible for reimbursement
- Expenses incurred before the date the employee satisfies the statutory minimum HDHP deductible are not eligible—even if the employee submits receipts for those expenses after satisfying the deductible

Preserving HSA Eligibility: Post-Deductible HRAs

Example	Result
<ul style="list-style-type: none">• Mookie’s employer offers a specialty HRA for infertility services—he is covered under the family HDHP• The HDHP does not cover any infertility expenses	<ul style="list-style-type: none">• If Mookie is eligible for reimbursement under the infertility HRA, he’s blocked from being HSA eligible• The employer has two ways of avoiding this issue:<ol style="list-style-type: none">1. Exclude employees covered by the HDHP from eligibility under the HRA; or2. Make the HRA post-deductible for anyone covered by the HDHP• #2 requires that Mookie incur at least \$1,600 (employee-only) or \$3,200 (family) in expenses covered by the HDHP before the HRA can pay

Transfers from IRAs to HSAs

Qualified HSA Funding Distributions

- **Once-Per-Lifetime Rule**

- HSA eligible individuals are permitted to make a tax-free transfer from an IRA to an HSA once per lifetime
- The IRA and HSA owners must be the same person

- **Direct Transfers Only**

- Traditional rollovers are not permitted
- Must be a custodian-to-custodian direct transfer of assets

- **Counts Toward Contribution Limits**

- Transfers count as contributions when applying the general HSA contribution limit and catch-up limit for the year in which the transfer occurs
- Cannot use the April 15 rule for transfers—the transfer will always apply to the contribution limit for the actual year in which the transfer occurs

- **Special 12-Month Testing Period**

- Must maintain HSA eligibility for 12 months following the transfer
- This is different from the 13-month testing period for the last-month rule!
- Failure to remain HSA eligible during testing period results in transfer becoming taxable

6% Excise Tax on Excess HSA Contributions

6% Excise Tax Applies Each Year on Any Excess Contributions

- Individuals must use IRS Form 5329 to report excess contributions and determine excise tax amount
- Must continue to pay the 6% excise tax each year until the excess contributions are distributed

Corrective Distribution By Tax Filing Deadline Avoids Excise Tax

- The individual can avoid the 6% excise tax by making a corrective distribution by tax filing deadline
- Generally means that the excess must be distributed by April 15 (or later if filing for extension)
- Corrective distribution is included in individual's gross income, but no excise tax imposed
- Special provisions in Form 5329 Instructions allows corrections up to six months after filing deadline

6% Excise Tax on Excess HSA Contributions

Example

- Salvador was covered by a family HDHP (and HSA eligible) for January through September of 2024
- In October 2024, he changed jobs and moved to a non-HDHP HMO
- However, he had already contributed the \$8,300 statutory maximum to his HSA before he left the job

Result

Salvador's HSA contribution limit in 2024 was \$6,225 (9/12 of \$8,300)

1. Corrective Distribution Avoiding 6% Excise Tax:

- Salvador makes a corrective distribution from the HSA of the \$2,075 in excess contributions (adjusted for earnings) by his 2024 tax filing deadline (generally April 15, 2025)
- He also includes the corrective distribution in his 2024 gross income

2. 6% Excise Tax:

- Salvador fails to make a timely corrective distribution of the excess contributions
- He must pay a 6% excise tax on the excess contributions each year until they are distributed

The HSA Last-Month Rule Tax

10% Additional Tax Applies For Failure to Maintain HSA Eligibility in Testing Period

- The last-month rule requires that the individual be HSA eligible in December of the current year through December of the subsequent year (13-month testing period)
- If the individual loses HSA eligibility during that testing period, he or she must include in income the amount that was contributed by using the last-month rule, and that amount is also subject to a 10% additional tax reported on Form 8889
- This is **not** treated the same way as an excess contribution:
 - The additional tax amount is 10% (not 6%)
 - It's a one-time only additional tax (not recurring until distributed)
 - There is no option to make a corrective distribution to avoid the additional tax

The HSA Last-Month Rule Tax

10% Additional Tax Applies For Failure to Maintain HSA Eligibility in Testing Period

Example

- Salvador was covered by a family HDHP (and HSA eligible) **for only December of 2023**
- **In September 2024**, he changed jobs and moved to a non-HDHP HMO
- Salvador had contributed the \$7,750 statutory maximum to his HSA for 2023 under last-month rule

Result

- Salvador failed to maintain HSA eligibility for the full testing period (through December 2024)
- This means his 2023 contribution limit was actually \$645.83 (1/12 of \$7,750)
- **Salvador must therefore include \$7,104.17 in his 2023 income (\$7,750 – \$645.83)**
- **He must also pay a 10% additional tax on that amount (\$710.41)**
- There is no option to make a corrective distribution to avoid the income and additional tax
- To add insult to injury, Salvador will need to re-file his 2023 tax return to report this additional income

HSAs and Estate Planning

General Rule

- HSAs permit the HSA holder to designate a beneficiary to receive the account's funds upon the HSA holder's death
 - If the HSA holder fails to designate a beneficiary, the HSA will generally pass to the HSA holder's estate by default

Spouse is the HSA Beneficiary

- **If the HSA holder designates a spouse as the HSA beneficiary, the HSA passes to the spouse without change upon the HSA holder's death**
- **The spouse will take over the HSA without any taxation, and the HSA will preserve the same tax-advantaged status as an HSA for the spouse**

Any Individual Other than Spouse is the HSA beneficiary

- The HSA will lose its tax-advantaged status upon the HSA holder's death (the account ceases to be an HSA)
- The fair market value of the account becomes taxable to the beneficiary in the year of the HSA holder's death
- The non-spouse beneficiary can reduce the taxable amount by any payments made by the beneficiary for the HSA holder's qualifying medical expenses incurred prior to the HSA holder's death (and paid within one year of the HSA holder's death)

Estate is the Beneficiary

- The HSA will lose its tax-advantaged status upon the HSA holder's death (the account ceases to be an HSA)
- The fair market value of the account upon death is included in the HSA holder's taxable income for the deceased HSA holder's final tax return



HSAs and State Income Taxes

Vast Majority of States Provide Same Tax Treatment as Federal IRC

- Almost all states either conform to the federal income tax treatment for state income tax purposes (or they do not impose a state income tax—which makes this issue irrelevant for those states)
- This means that in almost all states, individuals will receive the same triple-tax advantaged benefits for HSAs for both federal and state income tax purposes

However, Two States Tax HSAs (at State Income Tax Level Only)

- In these two states, although employee contributions to an HSA will be pre-tax for federal income tax purposes, the contributions will be after-tax for state income tax purposes:
 - **California**
 - **New Jersey**
- Also will not receive the same tax-free growth as provided at the federal level
- Remember: None of this issue applies to the HDHP!

Note: Alabama was a third state in the past, but it conformed to the IRC treatment as of 2018

State Income Taxes

Example

Example	Result
<ul style="list-style-type: none">• Jackie lives in California and is covered by his employer's HDHP• In 2024, he contributes \$5,300, and his employer contributes \$3,000 to his family HSA	<ul style="list-style-type: none">• Jackie's employee/employer HSA contributions are pre-tax for federal income tax purposes• However, the HSA contributions are standard taxable compensation for California state income tax purposes, subject to state withholding and payroll taxes• Jackie will also use the California Schedule CA to report the taxable income from interest and dividends

Why HDHP HSA?



Wave of the Future?

Bipartisan HSA Improvement Act (H.R. 5688)

- Prevents onsite clinics from blocking HSA eligibility
- Prevents spousal enrollment in a health FSA from blocking HSA eligibility
- Allows transfer of unreimbursed FSA or HRA funds to HSA

HSA Modernization Act (H.R. 5687)

- Prevents VA, Medicare Part A, and IHS coverage from blocking HSA eligibility
- Allows use of HSA to pay for expense incurred 60 days prior to establishment
- Allows married couple to make both catch-up contributions to same spouse's HSA
- Increases contribution limits to the OOPM maximum

Reality Check

- We've seen these proposals time and time again each time the GOP controls the House
- Many of these were part of the core proposals of the Trump campaign/administration's pledge to repeal/replace the ACA
- Very limited Democrat support for any proposals to expand HSAs, GOP doesn't seem committed to forcing issue
- **These are mostly symbolic political statements of intended GOP policy with very little chance of becoming law—even when GOP controlled all three branches in 2017-2018 they failed to enact these modest reforms!**

WRAP-UP

Takeaways



Top Three Items You Need to Know About HDHP/HSA

1

HSAs are uniquely triple-tax advantaged in a manner that makes them the most powerful (tax) force in the universe. Harnessing this power requires playing by a number of complex rules, particularly with respect to eligibility and contribution limits. IRS Publication 969 provides a useful summary of these rules.

2

Taking full advantage of HSAs requires an understanding of a number of special rules designed to your benefit. From the last-month rule, to the ability to take qualifying medical distributions years after the expense was incurred (shoebox rule), to the exception to the 20% additional tax for non-medical distributions once you reach age 65—there are so many fancy ways to go all the way with your HSA!

3

But don't get too bogged down in the details. HSAs are overly complex at the deepest levels, and your employees (and maybe you) don't have the patience to learn details beyond the basics. Promoting the basic triple-tax advantaged structure as a vehicle to cover cost-sharing, and addressing issues as they arise, is usually the best and most effective approach.

Content Disclaimer

Go All the Way With HSA

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Thank you

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