FlexMagic® Consulting, Inc.
Employee Benefit Consulting Services

Health Savings Accounts (HSA)
Integration Options

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When an employer group is ready to implement a new High Deductible Health Plan (HDHP) with an HSA Trust there are several steps to follow to ensure proper compliance when integrating the HSA into the overall benefit package. Here are a few plan design variables and rules which should be adhered to carefully when an employer sets up an HSA. This article can be reproduced only with permission of the author.

The Basics

Health Saving Accounts (HSA) always have two parts:

I. High Deductible Health Plan (HDHP)
II. Health Savings Account Trust Account (HSA Trust Account)

<u>High Deductible Health Plan:</u>

- Can be purchased by the employee as group insurance or can be individually owned
- Group insurance can be employer and/or employee paid (combination pay)
- The employee-share of the group HDHP premium can be paid pre-tax through a Flexible Benefit Plan as a Premium-Only-Plan or can include Premiums, Child/Dependent Care and Health Care Spending Accounts (restrictions apply)
- Anyone can own a HDHP

NOTE: Although anyone can own a HDHP, to qualify to put money into the HSA Trust Account the <u>individual must not own any other insurance</u> that will disqualify him/her from participation in an HSA Plan. Examples of disqualifying insurance plans include: enrolled in Medicare, being covered under a spouse's PPO plan with co-payment features, participating in any regular Flexible Benefit Plan Health Care Spending Account (including participation under a spouse's plan), participating in a regular employer-sponsored Health Reimbursement Plan etc..

<u>Health Savings Account Trust:</u>

- An HSA Trust Account must be set up by the Individual Account Holder at a qualifying institution (Employer can designate a specific Bank or Institution for contributions; to allow ease of employer administration – However, the individual can then transfer his/her HSA dollars to another HSA Trust Account of his/her choice)
- Each Trust Account is set-up under only one Social Security number
- Both the individual and/or the employer can contribute dollars into the HSA Trust Account
- Contributions are limited annually to the federally mandated limit 2007 values = $2,850 individual limit; $5,650 family limit

- Dollars deposited into the HSA Trust Account belong to the Individual Account Holder and can carry forward from year to year (unlike Flex Plan dollars)
- HSA Trust Account dollars must be funded in the current tax year (or before the tax return filing date in the subsequent year)
- Contributions into the Trust can only be made after a qualifying HDHP is purchased by the Account Holder; and eligibility to make contributions is always based on the first day of the month for that calendar month (maximum values are prorated for the first year) Example: New HDHP purchased June 15th - cannot make a Trust contribution for the month of June – Can make contributions in July. New rules apply for maximum contributions allowed per year.

Employer Considerations

When an employer changes from a traditional insurance plan to a HDHP with a qualifying HSA Trust Account, or to a dual choice medical plan, the following considerations are important and will impact how the company should proceed to ensure compliance.

Will the Employer pay some or all of the HDHP Premiums?

- If the employer is paying 100% of the single and family premiums as an employer-paid benefit then no additional formal documents are required. Insurance eligibility rules should be clearly defined in the employer's benefit policies to eliminate any discrimination concerns.
- If the employer and employee are sharing the cost of the group insurance premiums the employer should consider setting up a Flexible Benefit Plan Premium-Only-Plan (POP) so the employee share of premiums can be paid pre-tax. If they have an existing Flex Plan, the document will likely need to be re-stated to allow for the new HDHP premiums to be paid pre-tax. Paying premiums with pre-tax dollars through salary reduction reduces payroll taxes for both the employer and employee.

Will the Employer make a contribution to the HSA Trust Account?

If the employer makes a contribution into the HSA Trust on behalf of employees in a "comparable manner" then no special documents are required. However, the employer should define and communicate its policy clearly to all employees and contributions must be equal for all employees. Comparable means: same contribution amount for all employees electing single or family coverage; part-time and full-time variations are allowed and a percentage of deductible formula, rather than a dollar amount is also allowable.

If the employer instead, gives a Benefit Allowance to eligible employees then these dollars can be used toward a choice of benefit options: HDHP premiums, HSA Trust Contributions or toward other benefits as defined in the Flexible Benefit Plan document (such as child/dependent care, retirement plan or supplemental insurance). This option provides more flexibility than the comparable contribution method and also allows the employee the option to add their own pre-tax dollars to the HSA Trust Account or to pay for other benefit options as defined in the document.

If the employer makes any contribution and the employee is able to make contributions to the HSA Trust Account with pre-tax dollars through salary reduction, then the HSA Trust Contribution option must be added to the Flexible Benefit Plan document, a Summary Plan Description is required, and a formal salary reduction election must be made and formal rules are required. Salary reduction HSA Trust contributions are tested under the Flexible Benefit Plan umbrella.

COMMENTS: When the employee elects to contribute to the HSA Trust Account through salary reduction, it is advantageous for many reasons:

- Employer & Employee both save on FICA & Medicare Contributions when dollars are deposited into the HSA Trust through salary reduction under a Flexible Benefit Plan
- Employee realizes immediate federal and state tax savings, rather than waiting until filing a tax return and taking the deduction on the federal tax return at the end of the year (Why lend your money to the government interest free all year when you can have an immediate tax savings?)
- Employee contributes dollars into the HSA Trust Account prior to taking the pay check home – therefore funding of the Trust Account is assured – which is a vital component to making an HSA work for participants

When salary reduction HSA Trust Account contributions are allowed through salary reduction, the employee can change the HSA contribution amount monthly. The usual Flexible Benefit Plan irrevocability rules do not apply (but can apply depending on the employer's choice of plan design). All rules and maximum contributions must be defined in the Flexible Benefit Plan Document.

CAUTION: Some employers prefer to make a lump sum contribution into the HSA Trust Account at the start of the year for the entire year. While being generous, the employer may encounter problems later should an employee terminate employment, drop the HDHP and then not be eligible for the dollars already deposited into his/her HSA Trust Account. The employer will not be able to recover the over-funded HSA Trust Account dollars. Funding the HSA Trust Account on a monthly, pro-rated basis is usually a preferable, but not mandated, method of funding.

<u>Does the Employer have an existing Flexible Benefit Plan?</u>

If the employer has a POP plan in place and wants to add the HSA Trust Account salary reduction contribution option, then the Flex Plan rules need to be defined and the document amended and restated to add this option. Otherwise, the employee can fund the HSA Trust Account with <u>after-tax</u> dollars and take the deduction on a tax return at the end of the year. However, the employee loses the opportunity for immediate tax savings and both the employer and employee lose the FICA and Medicare savings (15.3% combined).

If the employer has a Full Flexible Benefit Plan with a Health Care Spending Account then the employer must determine how best to proceed. Any employee participating in a regular Health Care Spending Account makes the employee <u>ineligible</u> to sign up for the HSA Trust Account. Therefore, the new HDHP with the HSA Trust contribution option should be introduced when the Flexible Benefit Plan year renews.

The Flexible Benefit Plan Health Care Spending Account can be modified to accommodate the new HSA Trust by one of the following methods:

- Limit the Health Care Spending Account to only dental, vision care only (easiest to administer) or can also include preventive care, and expenses exceeding the deductible.
- Offer a dual choice Health Care Spending Account that allows employees with traditional insurance to continue with a general-use Health Care Spending Account and employees electing the HSA Plan to participate in a limited-use Health Care Spending Account, as noted above.

The new Flexible Benefit Plan design must be incorporated into the Plan Document and clearly communicated to the employees. A new Summary Plan Description must be distributed to all benefit eligible employees.

<u>Does the Employer have an existing Health Reimbursement Arrangement (HRA)?</u>

If the employer has an existing HRA, then it must be modified to work in tandem with the new HSA Plan and not cause participants to be ineligible to make HSA Trust Account contributions.

The HRA can be modified in different ways – for example:

- Limit the HRA reimbursements to only dental, vision, preventive care and expenses exceeding the deductible
- Suspend the HRA so that dollars are not available until "post retirement" when an employee can no longer add money to the HSA Trust Account

What if the employer is an S-Corporation owner, Partner, LLC, LLP or Sole Proprietor?

Owners of C-corporation are bona-fide employees and fall under the regular rules discussed above.

Owners of S-Corporations, Partnerships, LLCs, LLPs and Sole Proprietorships are not bona-fide common law employees if they own 2% or more owner of the company. The rules change for these owners. These owners are not eligible to participate in a Flexible Benefit Plan or Health Reimbursement Arrangement (HRA), although their common law employees can participate in these plans.

However, these non-employee owners can participate in an HSA Plan, but the rules change. HSA Trust Account contributions and the cost of the HDHP premium are "imputed income" to these owners. A full individual tax deduction is then allowed on the federal tax return under "self-employed IRS regulations". The IRS recently commented specifically on the HSA Plan tax treatment of these non-employee owners and the company's CPA should be consulted regarding the tax treatment of these owners. Generally HSA contributions for owners are treated the same as the payment of HDHP premiums; taxable for federal and state withholding but not for FICA and Meciare since these dollars are "fringe benefit" dollars and not "salary dollars."

Closing Comments

FlexMagic Consulting, Inc. is here to support you in your efforts to design a meaningful, simple and cost-effective health benefit package for employees. We appreciate being part of your Consulting Team and to provide recommendations and compliance services necessary to ensure the correct implementation and integration of these valuable benefit options.

FlexMagic Consulting, Inc. provides HSA Trust Account salary reduction integration within the Flexible Benefit Plan. The nominal one-time fee for this service is only $100, when added to a POP of Full Flexible Benefit Plan Consulting Contract. Services can be ordered on-line at www.flexmagic.com.

For a FREE consultation Call FlexMagic Consulting, Inc.: 303-649-1922 or 800-888-9084

Thank you for your consideration of our services:

- Flexible Benefit Plan Consulting (POP and Full Plans)
- HSA Trust Contribution Salary Reduction Options (with POP and Full Plans)
- Health Reimbursement Arrangement (HRA) Consulting
- Third-Party Administration Services (Flex & HRA with Debit Card, available)

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