Health Savings Account (HSA)
Frequently Asked Questions

What are the Basic Rules Related to Health Savings Accounts and Flexible Benefit Plans?

Health Savings Trust Account (HSA) salary reduction contributions can be integrated into your existing Flexible Benefit Plan, however, there are several points to consider:

- The employee/participant must first own a High Deductible Health Plan (HDHP) that qualifies as an HSA compatible insurance plan. Your group insurance plan may offer only the qualifying HDHP or it might offer a dual option plan that gives the employee the choice between a traditional PPO or HMO Plan and an HDHP option.
- The employer determines which health plan coverage a participant must own to allow salary reduction contributions into the HSA Trust Account. This could include only the company's HDHP insurance or any employee-owned qualifying HDHP coverage.
- The Employer also determines whether the HSA Trust contributions will be made into a single bank or qualifying institution (selected by the employer) or if the employee can select a bank of his or her choice. NOTE: Administration costs often are reduced if an employer chooses one bank to receive all deposits for the HSA Trust Accounts.

What are the HSA Trust Contribution Limits?

In addition to your group health, dental, vision and supplemental health insurance premiums and dependent care and/or health care spending account options, the employer can add the HSA Trust Account contributions as a tax-free salary reduction option.

The allowable salary reduction amount to be deposited into the HSA Trust, is limited to the federal HSA limit each tax year. NOTE: the combination of the employer and employee HSA Trust Contribution cannot exceed these limits and is prorated per month based on the first day of the month following purchase of the HDHP insurance coverage.

For 2011 Federal Limits (indexed each year):	Individual	$3,050
	Family	$6,150

Proration Exception: There is an exception to this rule. If an individual funds the HSA Trust to the maximum limit for the calendar year, but does not own the HDHP insurance for the full calendar year, the individual must continue to own the HDHP insurance plan for the entire next calendar year. Otherwise, the maximum contribution is prorated, based on the number of months during which the individual actually owned the HDHP insurance plan for the short year.

The catch-up contribution amounts (for individuals who are 55 or older / $1000 for 2011) are always prorated based on the number of months of owning the HDHP insurance during the calendar year (no exceptions).

Proration Example: The employee owns an individual HDHP that has a $3,000 deductible. The maximum contribution for 2011 is $3,050 (federal limit). However, the employee did not own the HDHP on January 1st but rather purchased the HDHP on June 20th. Therefore, the maximum allowable contribution to the HSA Trust is limited to the prorated values from July 1st through December 31st, or $1,525. Otherwise, if they fund the full calendar year maximum of $3,050 then the individual must continue to own a HDHP Plan for the entire next calendar year

(2012) in order to not be penalized for over-contributing to the HSA Trust. We recommend HSA Trust contributions be based on the number of calendar months, during which a HDHP is owned (based on the first day of any given month).

What are Catch Up Contributions?

A "catch-up" contribution is an additional contribution that applies when an individual turns 55 years of age during a given tax year or is currently age 55 or older. This individual can contribute an additional $1,000 in 2011, prorated from the first day of the month following the purchase of the qualifying HDHP. Catch-up contributions must always be pro-rated.

What Types of Insurance can I own and still contribute to my HSA Trust Account?

If an individual owns a qualifying HDHP, she/he can also own other insurance products as defined by the IRS, including:

- Dental
- Vision
- Long Term Care
- Auto and Home Owners Insurance
- Accident Coverage
- Specific Disease (Example: Cancer policy)
- Critical Illness (heart attack, stroke etc.), and
- Hospital Income (per diem only plans)

If a spouse and/or children are covered under a traditional indemnity, PPO or HMO Plan the employee may still purchase individual HDHP coverage and participate in the HSA Plan, as long as she/he is not covered under any conflicting insurance policy.

Conflicting coverage may include:

- Traditional general-use Flex Health Care Spending Account;
- Traditional general-use Health Reimbursement Arrangement (HRA); and
- Any other "non-permitted" insurance that could pay something toward the deductible under the HDHP. Under IRS guidelines, anyone owning any of these plans will be disqualified from depositing dollars into an HSA Trust.

When can change my Pre-Tax Dollar contributions into my HSA Trust Account?

When an employee enrolls in the HDHP, the election for the health insurance is irrevocable for a 12-month time period, unless an eligible status change occurs. For the HSA Trust, the employee may make an election change <u>monthly</u> - there is no required "status change" for this part of a Flexible Benefit Plan.

> *Note: Once elected, before-tax insurance premium deductions will continue from plan year to plan year until the employee signs a waiver form to discontinue this election. <u>The waiver can only be signed during an open enrollment period or as the result of an eligible status change.</u>*

Group HDHP premiums are currently tax-free when paid by the employer and/or when paid by the employee through a Flexible Benefit Plan. If the employee purchases an individual HDHP policy, the premiums are paid on an after-tax basis.

How are Flexible Spending Accounts (FSA's) impacted by an HSA?

Dependent Care Spending Account
This reimbursement account is unaffected by the addition of an HSA Plan to the Flexible Benefit Plan options.

Health Care Spending Account
This reimbursement account must be amended and restated from a general-use Flex Health Care Spending Account (which reimburses of all Code 213(d) expenses) to become a limited-use Flex Health Care Spending Account (which reimburses generally only dental and vision. The limited-use Flex Health Care Spending Account can also be expanded in definition to include preventive care expenses and expenses exceeding the deductible, although these two options are not recommended. The limited-use Health Care Spending Account is compatible with the new HDHP coverage with the HSA Trust Account option.

If the employer offers a dual choice health insurance plan, then a dual choice Flex Health Care Spending Account can also be offered. Employees electing a traditional group health plan (indemnity, PPO or HMO option) would continue to have the general-use Flex Health Care Spending Account, whereas, employees electing the HDHP with the HSA Trust Account would have the limited-use Flex Health Care Spending Account. The plan document must be amended to reflect this change and all changes must be proactive, not retroactive in nature.

Can an Employer Reimburse Individually-Owned Premiums?

The employer may offer a reimbursement account for individually-owned health insurance policies. Premium dollars are deducted from the employee's gross pay and reimbursed to the employee for eligible policy premiums. This account is not recommended as it may violate HIPAA and ERISA rules, though it is permissible under IRS rules for Flex Plans.

However, an employer may fund, without conflict, part of the HSA Trust and allow salary reduction contributions to the HSA Trust account attached to an individually-owned HDHP. This may be a consideration when group health insurance is not offered by the company; yet the employer would like to make tax-free contributions to help defray the cost of health care.

How do we set up Payroll Procedures for the Pre-Tax HSA Trust Contributions?

It is very important for the payroll person and the plan coordinator to work closely together. Open Enrollment must be completed prior to the start of a plan year and payroll must have enough time to make the necessary adjustments based on the employee before-tax and after-tax elections. The HSA Trust contribution allow salary reduction changes monthly during the plan year without the requirement of an eligible "status change" event.

All changes during the Plan Year are computed on a prorated basis. <u>Changes during a Plan Year must be elected prior to the effective date of the change.</u>

Under a Flexible Benefit Plan the following taxes are exempted on all dollars redirected from wages to tax-free benefits:

1. Social Security contribution
2. Medicare contribution
3. Federal Withholding Taxes
4. Federal Unemployment Taxes
5. State Withholding Taxes (all states except New Jersey)
6. State Unemployment Taxes (applies to Colorado - must be verified in other states)

Colorado: For government employers under the Public Employees Retirement Association (PERA), contributions are exempted on both the employer and employee contributions. The Colorado Police and Fireman's retirement fund contributions are **not** exempted.

Worker's Compensation Insurance is **not** exempted in Colorado under the State Worker's Compensation Insurance Plan. Individual carriers may vary on requirements. Review this question with your Worker's Compensation Insurance broker for the requirements of your carrier.

Other States: The employer should verify if State Unemployment and Worker's Compensation contributions are exempted on Flexible Benefit Plan dollars in your particular state.

What is Reported on the W-2?

Both employer and employee HSA Trust contributions made through salary reduction must be reported on the W-2 Form. It is recommended that the employer contribution also be tracked through the payroll to ensure ease of reporting of these dollars on the W-2 Form. The employer contribution can be designated as part of a benefit allowance that is provided to the employee, added to the gross wage and then deducted along with any additional employee designated dollars into the HSA Trust. This is the preferred way to handle the Employer HSA Contribution and the recommended way to prevent ERISA concerns. **NOTE: All HSA dollars – employee salary reduction contributions and employer contributions are considered to be "employer-paid HSA dollars" when reported on the W-2 Form.**

Are there Special Banking Considerations?

Flexible Spending Account (FSA) dollars from Dependent Care, Health Care and Premium Reimbursement Accounts can be held in your general fund account. No special bank account is required. However, the HSA Trust Account must be established individually by each participant and is established under his/her individual Social Security Number. Until the Trust account is established, medical expenses incurred will not be eligible for reimbursement from the Trust. Therefore, it is important for employees to establish their new accounts as soon as possible after purchasing the qualifying HDHP insurance plan.

The employer can determine which bank will be used for the company contributions and for the employee salary reduction contributions. The employee is then free to move the dollars to another HSA Trust at another Bank without conflict. Once the dollars are deposited into the Trust they belong the individual account holder.

How do we process Terminations?

Upon termination the employee must be provided with appropriate COBRA or Senate Bill 51 (Colorado) information and may be eligible for continuation in the HDHP (if company sponsored). However, there is no continuation of the HSA Trust contributions through salary reduction as there is no salary following termination.

What do we do it there are Ownership & Corporate Changes during the Flex Plan year?

Flexible Benefit Plan Coordinators need to be aware that changes in their company's corporate structure **<u>during</u>** a Plan Year can produce some unanticipated and unwanted results. If you know of any forthcoming mergers, acquisitions, changes from C-Corporation to S-Corporation structures, or even layoffs, please notify FlexMagic Consulting, Inc. We will help you determine what effect, if any, the change will have on Flexible Benefit Plan compliance issues.

More than 2% owners of S-corporations, partnerships, llc, llps and sole proprietors (non-C-corporation owners) can contribute to an HSA Trust and pay their HDHP premiums with company dollars. However, the total cost of the premium and the amount of the HSA Trust Contribution are considered “imputed income” to the owner and are then fully deductible as self-employed health insurance premiums and HSA Trust Contributions on the individual tax return. Contact your CPA to properly set-up and track owner contributions.