Provided by Clarke and Company Benefits

Health Savings Account (HSA) Eligibility Rules

Many employers offer high-deductible health plans (HDHPs) to control premium costs, and then pair this coverage with health savings accounts (HSAs) to help employees with their health care expenses. An HSA is a tax-favored trust or account that can be contributed to by, or on behalf of, an eligible individual for the purpose of paying qualified medical expenses.

HSAs provide a triple tax advantage—contributions, investment earnings and amounts distributed for qualified medical expenses are all exempt from federal income tax, FICA tax and most state income taxes. Due to an HSA's potential tax savings, federal tax law imposes **strict eligibility requirements for HSA contributions**.

Only an eligible individual can establish an HSA and make HSA contributions (or have them made on his or her behalf). An individual's HSA eligibility is determined monthly, and, as a general rule, contributions can only be made for the months in which the individual satisfies all of the HSA eligibility criteria.

LINKS AND RESOURCES

- IRS Publication 969, Health Savings Accounts and Other Tax-favored Health Plans
- IRS Notice 2004-50, which addresses employer eligibility verification
- IRS Notice 2005-8, which includes information about the tax treatment of HSA contributions for partners and more-than-2-percent shareholders

HIGHLIGHTS

GENERAL RULES

- Eligibility for HSA contributions is determined monthly as of the first day of the month.
- Employees, and not employers, are primarily responsible for determining whether they are HSA-eligible.

ELIGIBILITY CRITERIA

To be HSA-eligible, an individual must:

- Be covered by an HDHP;
- Not be covered by other health coverage that is not an HDHP (with certain exceptions);
- Not be enrolled in Medicare; and
- Not be eligible to be claimed as a dependent on another person's tax return.

CLARKE & COMPANY
BENEFITS LLC

GENERAL RULE

An individual's eligibility for HSA contributions is generally **determined monthly as of the first day of the month**. The HSA contribution limit is calculated each month, and a contribution can only be made for months in which the individual meets all of the HSA eligibility requirements.

To be HSA-eligible for a month, an individual must:

- ✓ Be covered by an HDHP on the first day of the month;
- ✓ Not be covered by other health coverage that is not an HDHP (with certain exceptions);
- ✓ Not be enrolled in Medicare; and
- ✓ Not be eligible to be claimed as a dependent on another person's tax return.

The **full-contribution rule** that applies to individuals who are HSA-eligible on Dec. 1 is an exception to this general rule. Under this exception, an individual is treated as HSA-eligible for the entire calendar year for purposes of HSA contributions if he or she becomes covered under an HDHP in a month other than January and is HSA-eligible on Dec. 1 of that year. An individual who relies on this special rule must generally remain HSA-eligible during a 13-month testing period, with exceptions for death and disability.

EMPLOYEE STATUS NOT NECESSARY

An individual does not need to be an employee to be eligible for HSA contributions. Partners in a partnership, more-than-2-percent shareholders in a subchapter S corporation, sole proprietors and other self-employed individuals may be eligible for HSA contributions.

However, since these individuals are not employees, they cannot contribute to an HSA with pre-tax salary reductions under a cafeteria plan, and they cannot receive pre-tax employer contributions to their HSAs. IRS Notice 2005-8 provides more information about the tax treatment of HSA contributions for partners and more-than-2-percent shareholders.

EMPLOYER ELIGIBLITY VERIFICATION

When an employer makes a pre-tax contribution to an employee's HSA, the employer should have a reasonable belief that the contribution will be excluded from the employee's income. However, the employee, and not the employer, is primarily responsible for determining eligibility for HSA contributions. IRS Notice 2004-50 states that an employer is only responsible for determining **whether the employee is covered under an HDHP or any low-deductible health plan sponsored by the employer**, including health flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs).

HDHP COVERAGE

To be eligible for HSA contributions for a month, an individual must be covered under an HDHP as of the first day of the month and have no other impermissible coverage.

An HDHP is a health plan that provides "significant benefits" and satisfies requirements for minimum deductibles and out-of-pocket maximums. An HDHP can be insured or self-funded. With the exception of preventive care benefits, no benefits can be paid by an HDHP until the annual deductible has been satisfied.

Example—HDHP Coverage Begins Mid-month: An employee begins HDHP coverage on the first day of a pay period, which is Aug. 16, 2016, and continues to be covered by the HDHP for the rest of 2016. For purposes of HSA contributions, the employee becomes eligible on Sept. 1, 2016.

Cost-sharing Limits

The 2016 and 2017 annual deductible and out-of-pocket requirements for HDHPs are as follows:

HIGH DEDUCTIBLE HEALTH PLAN (HDHP)		
Type of Coverage	**Minimum Annual Deductible**	**Annual Out-of-pocket Maximum**
Self-only	$1,300	$6,550
Family	$2,600	$13,100

Significant Benefits

An HDHP must provide "significant benefits," although it may be designed with reasonable restrictions limiting the plan's covered benefits. The restrictions will be reasonable only if significant other benefits remain under the plan in addition to the benefits subject to the restrictions. For example, a plan that restricts benefits to expenses for hospitalization or in-patient care, and excludes out-patient services, is not an HDHP because it does not provide significant other benefits in addition to the benefits subject to the exclusion.

Also, a plan will not qualify as an HDHP if substantially all of its coverage is either "permitted insurance" or "permitted coverage" (for example, coverage for accidents, disability, dental care or vision care).

NO DISQUALIFYING COVERAGE

To be eligible for HSA contributions, an individual generally cannot have health coverage other than HDHP coverage. This means that an HSA-eligible individual cannot be covered under a health plan that provides coverage below the HDHP minimum annual deductible.

Being eligible for non-HDHP coverage does not make an individual ineligible for HSA contributions. To determine whether an individual is an HSA-eligible individual, the actual health coverage selected by the individual is controlling. Thus, it does not matter that the individual could have chosen, but did not choose, a low-deductible health plan or other coverage that would have disqualified the individual from contributing to an HSA.

Permissible Types of Coverage

Certain types of non-HDHP coverage will not prevent an individual from being HSA-eligible. These types of coverage include preventive care, permitted insurance or permitted coverage. An individual who has non-HDHP coverage with a deductible below the minimum HDHP deductible that is not preventive care, permitted coverage or permitted insurance will not be an eligible individual for HSA purposes.

Preventive care includes (but is not limited to):	• Periodic health examinations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals; • Routine prenatal and well-child care; • Child and adult immunizations; • Obesity weight loss programs; • Screening services; and • Tobacco cessation.

Permitted insurance includes:	• Insurance in which substantially all of the coverage relates to liabilities incurred under workers' compensation laws, tort liabilities, liabilities relating to ownership or use of property (for example, homeowners or auto insurance) or similar liabilities as specified by the IRS; • Insurance for a specified disease or illness (for example, cancer insurance); or • Insurance that pays a fixed amount per day (or other period) of hospitalization (for example, hospital indemnity insurance).

Permitted coverage includes coverage for:	• Accidents; • Disability; • Dental care; • Vision care; or • Long-term care.

Health FSA and HRA Coverage

Individuals who are covered by general-purpose health FSAs or HRAs are not eligible for HSA contributions. A general-purpose health FSA or HRA is one that pays or reimburses all qualifying medical expenses of the employee.

In addition, an individual's HSA eligibility may be affected when a health FSA incorporates a grace period or a carry-over feature.

- **Grace Period:** Coverage by a general-purpose health FSA with a grace period will disqualify an employee from contributing to an HSA during the FSA's grace period, unless the employee had a zero balance in the FSA at the end of the plan year.

- **Carry-over Feature:** An individual who has coverage under a general purpose FSA solely as a result of a carryover of unused amounts from the prior year is not eligible for HSA contributions for the current year. The IRS has provided two alternative approaches that allow health FSA carryovers while preserving HSA eligibility. These approaches include:

    - Carrying over unused amounts to an HSA-compatible health FSA (that is, a limited-purpose FSA or a post-deductible FSA); and

    - Allowing individuals participating in a general-purpose FSA to decline or waive the carryover.

Permissible Types

Although general-purpose health FSA or HRA coverage will prevent an individual from being eligible for HSA contributions, certain health FSA or HRA designs preserve HSA eligibility. These include:

- ✓ **Limited-purpose health FSA or HRA**—This type of health FSA or HRA pays or reimburses qualifying medical expenses that are permitted coverage, permitted insurance or preventive care (for example, dental or vision coverage).

- ✓ **Post-deductible health FSA or HRA**—This type of health FSA or HRA pays or reimburses medical expenses incurred after the individual has met the minimum annual deductible within the HDHP.

- ✓ **Suspended HRA**—A suspended HRA, pursuant to an election made before the beginning of the HRA coverage period, does not pay or reimburse at any time, any medical expenses incurred during the suspension period, except preventive care, permitted insurance or permitted coverage.

- ✓ **Retirement HRA**: A retirement HRA pays or reimburses medical expenses incurred after the individual retires.

MEDICARE ENTITLEMENT

An individual who is entitled to Medicare benefits is not eligible for HSA contributions. To be entitled to Medicare benefits, an individual generally must be **both eligible and enrolled**. Eligibility for Medicare benefits alone does not make an individual ineligible for HSA contributions.

IRS Notices 2004-50 and 2008-59 confirm that a Medicare-eligible individual who is not actually enrolled in Medicare Part A, Part B, Part D or any other Medicare benefit may contribute to an HSA until the month that he or she is enrolled in Medicare.

> ***Retroactive Effective Date*** – For individuals who delay enrolling in Medicare, Part A coverage may retroactively begin six months prior to their application date (but not earlier than when an individual is eligible for Medicare). To avoid making excess HSA contributions (and incurring a tax penalty), the Centers for Medicare and Medicaid Services (CMS) recommends that individuals should stop contributing to their HSAs at least six months before applying for Medicare.

TAX DEPENDENT

An individual who can be claimed as a tax dependent of another individual is not eligible for HSA contributions. In general, a taxpayer may claim an individual as his or her tax dependent if the individual is:

- The taxpayer's child and under age 19 at the end of the tax year;
- The taxpayer's child, a student and under age 24 at the end of the tax year; or
- A member of the taxpayer's household for whom the taxpayer provided over half of the support for the year and whose gross income does not exceed the personal exemption amount.