

An aid for Health Savings Accounts and Small Group High Deductible Plans

presented by **Time Insurance**

GENERAL INFORMATION

What is an HSA?

An HSA is a tax-favored savings account which allows funds to be accumulated tax-free to pay for current and future qualified healthcare expenses. HSAs were made possible by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003.

Who can establish an HSA?

Most people with a qualified high deductible health insurance plan may establish an HSA. To be eligible, an individual must also: 1) not be covered under a health plan that does not have a high deductible*; 2) not be entitled to benefits under Medicare, and; 3) not be claimed as a dependent on another person's tax return. An HSA is established with an HSA trustee or custodian – usually an insurance company or bank (much the same way that IRAs are established).

** Exceptions to this rule are "permitted insurance exceptions." The permitted exceptions are: Worker's Compensation, Tort Liabilities, Property and Casualty, Insurance for Specific Disease or Illness or Insurance that pays a fixed amount per day of hospitalization.*

What is a high deductible health plan (HDHP)?

Generally, a high deductible health plan satisfies certain requirements with respect to deductibles and out-of-pocket expenses.

- For single coverage, a high deductible health plan has an annual deductible of at least \$1,000 and Annual out-of-pocket expenses (deductibles, coinsurance and other amounts, but not premiums or out-of-network costs) not exceeding \$5,000.
- For family coverage, a high deductible health plan has an annual deductible of at least \$2,000 and annual out-of-pocket expenses (deductibles, coinsurance and other amounts, but not premiums or out-of-network costs) not exceeding \$10,000.

CONTRIBUTIONS

Who may contribute to an HSA?

Individuals, employers and their employees.

Can the employer and employee make contributions to the HSA at the same time?

Yes, federal regulations allow for both the employer and the employee to make HSA contributions to an account in any one tax year.

How is money contributed to the HSA?

Contributions may be made in one lump sum or in regular installments by the employer, the employee or both.

How much can be contributed to an HSA in 2004?

- The maximum contribution for a single person is either \$2,600 or an amount equal to the insurance plan deductible – whichever is less.
- The maximum contribution for a family is either \$5,150 or an amount equal to the insurance plan deductible – whichever is less.
- Limits are indexed for inflation so they will change annually on January 1st.
- If a high deductible plan starts after January 1st, the maximum HSA contribution is prorated based on the number of full months the plan will be in-force during the calendar year.
- For people between ages 55 and 65, the HSA contribution limit is increased by \$500 in calendar year 2004. This catch-up amount increases by \$100 annually, until it reaches \$1,000 in calendar year 2009 and will remain at \$1,000 thereafter.

What happens if more money is contributed than allowed?

To avoid a tax penalty, a refund of excess contributions plus interest must be requested through the HSA administrator. These excess funds must be taken out of the HSA by the date taxes are due or by April 15th of the following year, whichever comes first. It is the responsibility of the account holder to not exceed the maximum allowed.

What happens if an employer or employee forgets to make an HSA contribution?

Contributions can be posted to the HSA any time before April 15th or when taxes are posted the following year.

What happens to the HSA balance at the end of the year?

Unspent HSA funds roll over each year and belong to the employee. There is no “use it or lose it” provision with HSAs. These funds can continue to be used for qualified medical expenses, along with any new contributions.

How can an employer afford to make HSA contributions for employees?

Because HSAs must be coupled with a high deductible health plan, the health insurance premiums can be substantially lower. Employers often find that these premium savings are large enough to cover the HSA contributions they make on behalf of their employees, without increasing their current outlay for health care benefits.

What is the tax treatment of HSA contributions?

- Employer contributions made to an HSA are tax deductible.
- Employee contributions made to an HSA are tax deductible. The contributions are deductible whether or not the eligible individual itemizes deductions. HSA contributions may not, however, also be deducted as medical expenses.
- If an employee is contributing through a cafeteria plan, contributions are made before taxes and the employer saves on FICA taxes as well.

Are rollover contributions to HSAs permitted?

Rollover contributions from a Medical Savings Account (MSA) and other HSAs are permitted. Rollover contributions need not be in cash. Rollovers are not subject to the annual contribution limits.

Rollovers from an IRA, a Health Reimbursement Arrangement (HRA), or a Flexible Spending Account (FSA) are not permitted.

If the employer gives employees a bonus, can this amount be put into the HSA?

Bonuses may be given and employees can choose to deposit some or all the amount into their HSA (as long as the maximum annual contribution is not exceeded).

If the account is funded monthly and the employee incurs an expense which exceeds the amount currently in the account, can the employee withdraw the full amount of the expense like with a Flexible Spending Account?

No, the maximum an employee can withdraw is the amount currently in the account. After additional deposits are made to the HSA, the employee may then make more withdrawals to reimburse him/herself or pay the balance of the bill.

Can the amount of employer funding vary based on classes of employees?

No, there are comparability rules that must be followed when funding the HSA. In general, the employer must make available comparable contributions on behalf of all employees with comparable coverage during the same period. Contributions are considered comparable if they are either the same amount or the same percentage of the deductible under the plan.

Are HSA accumulations tax-free or tax-deferred?

HSA accumulations are tax-free if used to pay for qualified medical expenses. Accumulations are tax-deferred if they are held in the account until the age of 65 and then used for purposes other than qualified medical expenses.

If the employee has an HDHP with family coverage, but his or her spouse is not covered under that plan or other family coverage, can the employee still contribute to the family maximum under the employee's plan?

Yes, if the spouses file joint tax returns or agree to aggregate their contribution maximums that way. Otherwise, the employee's contribution maximum will be one-half of the family maximum under the employee's plan.

If the employee's family is not covered under the employee's qualified HDHP, can the employee still use his or her HSA funds to pay their qualified expenses?

Yes, the employee may use HSA funds to pay the qualified expenses of the dependents listed (claimed) on income taxes.

May an employer who does not provide health insurance for its employees contribute to an employee's HSA?

Although the new HSA law expressly permits an employer to contribute funds to an employee's HSA on a tax-favored basis, the ERISA implications are not yet clear. There are many questions yet to be answered regarding how ERISA's reporting, claims procedures, disclosure, fiduciary duty and other requirements apply to employee-controlled HSAs when an employer makes contributions. Because of these uncertainties, we are not recommending that our agents promote employer contributions to employee HSAs where the employee is covered by a qualified health plan that the employer does not sponsor.

DISTRIBUTIONS/WITHDRAWALS

What can HSA funds be used for?

Funds can be withdrawn for any purpose. However, if not withdrawn for qualified medical expenses by someone under age 65, the amount withdrawn is taxable and subject to a 10% penalty by the IRS. After age 65, there is no penalty for non-qualified withdrawals but amounts are taxable at ordinary income rates.

Funds used to pay for the following are tax-free and penalty-free:

- Qualified medical expenses as defined under Section 213 of the IRS Code (this is the same code section that governs MSAs)
- COBRA insurance
- Health insurance premiums for individuals receiving unemployment compensation
- Qualified long-term care insurance and expenses
- Medicare and retiree health insurance premiums, but not Medicare Supplement premiums

Are health insurance premiums considered qualified medical expenses?

The following types of insurance premiums count as qualified medical expenses under an HSA:

- COBRA health care continuation coverage
- Health care coverage while an individual is receiving unemployment compensation
- Medicare and retiree health insurance (but not Medicare Supplement plans)*
- Qualified long-term care insurance

Exceptions to the general rule are indicated under the response to Question 2 on page 1.

** Medicare is a federal Health Insurance Program for people 65 years of age and older, some disabled people under 65 years of age, and people with End-Stage Renal Disease (permanent kidney failure treated with dialysis or a transplant). A Medicare Supplement policy is a health insurance policy sold by private insurance companies to fill "gaps" in original Medical Plan coverage.*

Are HSA withdrawals monitored to make sure they are for qualified medical expenses?

No, the account holder is responsible for determining if withdrawals are for qualified medical expenses. If the IRS questions any withdrawals, it is the sole responsibility of the insured to prove those expenditures were for qualified medical expenses.

How are disbursements from an HSA taxed?

HSA disbursements used to pay for qualified medical expenses of the account holder (or spouse/dependents) are not taxed.

Any amount of the disbursements not used to pay for qualified medical expenses is subject to ordinary tax plus an additional 10% penalty. This penalty does not apply in the case of distributions made after the account holder's death, disability, or attaining age 65.

How are disbursements taxed if the account holder is no longer eligible for an HSA?

If the account holder is no longer eligible for an HSA (e.g., he/she is over age 65 and entitled to Medicare benefits, or no longer has a high deductible health plan), distributions used to pay for qualified medical expenses are still tax-free. If distributions are used to pay for items other than qualified medical expenses, then they are taxed as ordinary income (and subject to the 10% penalty).

HSA ADMINISTRATION

Who administers an HSA?

The employer selects an HSA administrator. Time's recommended HSA administrator is MSAver Resources L.L.C. MSAver will not charge a separate administrative fee when the HSA is combined with a qualified high deductible HSA plan from Time Insurance.

How do employees sign up for the HSA?

Once the employer has decided to purchase a qualified Time HDHP and selects a MSAver HSA, each employee must complete a MSAver HSA enrollment form. Forms are available from the Supply Department and can be found on www.fortisgroupmsa.com.

How will employees know when an HSA is active?

Once the enrollment forms are received by MSAver, each person receives a welcome kit from MSAver with all the necessary documentation as well as starter checks, debit cards and required forms.

How can account holders access their HSA funds?

MSAver offers two easy ways to access HSA funds:

1. Debit Card: The free HSA Premier Plus debit card can be used to conveniently pay for prescription drugs at point of service and for other medical expenses that will not be discounted by the PPO network. The card is valid wherever MasterCard is accepted. Claim forms are not needed and there are no transaction fees.
2. Checkbook: Account holders receive free start-up checks to pay for medical expenses directly from their HSA. Claim forms are not needed and there are no transaction fees. Additional checks can be obtained for a fee.

For medical expenses incurred at a PPO provider, insureds should wait to receive their Explanation of Benefits statement which may include PPO provider discounts that can save them money.

Can the debit card be used for other purchases or to obtain cash?

No, the card is intended to be used solely for qualified medical expenses (as defined above). The card also will not work for cash withdrawals at ATM locations. If the IRS questions any withdrawals, it is the responsibility of the insured to prove those expenditures were for qualified medical expenses. We strongly encourage all HSA account holders to keep receipts and diligent transaction records.

Do HSA account holders receive statements from MSAver?

Yes, monthly statements including contributions and disbursements are sent to the account holders. Statements also include debit card transactions with purchase amount and place of purchase.

Can HSA funds be invested?

Yes, insureds can invest their HSA funds through MSAver's brokerage account with FiServe Investor Services, Inc. There's no large balance required and customers can move their money from the bank to the investment account and back again at their own discretion.

How much interest do HSA funds earn?

Interest rates vary and are tiered dependent upon the balance in the bank account. Call MSAver to obtain the most current rates.

Can the interest earned on the HSA funds be used to pay for qualified medical expenses?

Yes, both the HSA contributions and the interest earned may be used to pay for qualified medical expenses tax-free.

If an employee changes from single to family coverage or vice versa, or has another life event change, how is the HSA affected?

If the HSA plan is affected by a change in policy status, the HSA will be updated to reflect a new maximum allowable contribution amount.

Does MSAver allow clients/individuals to invest their HSA funds using their own custodian and arrange for MSAver to have access for deposits or withdrawals?

No, this is not feasible since reporting links have to be set up with the custodian to transfer money.

Is there a minimum amount required to open an HSA?

Regardless of how the account is funded, a minimum of \$100 is required by MSAver.

Does MSAver require a minimum account balance?

No, unless the account holder also has an investment account. In that case, a \$100 minimum must be maintained to offset any transaction fees that may be charged on the investment account.

Can employees contribute directly to their account with a check?

It depends on how the HSA is set up. If the HSA is offered through a cafeteria plan, contributions will be made by the plan administrator. If the HSA is not set up with a cafeteria plan, an employee may make contributions with a check.

What happens if a claim is incurred after the employee's policy add-on date, but prior to the HSA effective date?

For contribution purposes, the HSA is effective the first of the month following an employee add-on to an HSA plan. Qualified medical expenses will be reimbursed from the HSA retroactive to the date the employee was added to the HSA plan.

Example: An employee who is added to the policy on 2/15 can begin contributing to the HSA on 3/1, but will still be reimbursed for services rendered on 2/20.

Why does Time recommend using a different administrator for HRAs and HSAs?

HRAs may require claims adjudication while HSAs do not. Employee Benefits Corporation (EBC) specializes in administering FSAs and HRAs, both of which require claim adjudication, but they do not administer HSAs. MSAver specializes in administering MSAs and now HSAs. These accounts do not require claims adjudication but require banking arrangements so that funds may be invested for account holders.

MISCELLANEOUS

What happens to the HSA if the health plan changes?

Even if the health plan is no longer a qualified high deductible health plan, account holders can still withdraw previously contributed HSA money to pay for qualified medical expenses, or continue to let the funds grow tax-deferred. Account holders cannot, however, make contributions to the HSA unless an HSA-qualified insurance plan is in place.

What happens to the HSA balance if the employee leaves the company?

The HSA belongs to the employee. Therefore, unspent HSA funds remain with the individual. Account holders can still use their HSA money to pay for qualified medical expenses, or continue to let it grow tax-deferred. Account holders cannot, however, make contributions to the HSA unless an HSA-qualified insurance plan is in place.

Is an HSA allowed for those small business owners who are not eligible for an HRA?

Yes, an employer can set up an HSA for him/herself and an HRA for employees.

What are the income tax consequences after the HSA account holder's death?

Upon death, any balance remaining in the HSA becomes the property of a beneficiary named in the HSA paperwork.

If the beneficiary is the surviving spouse, distributions not used for qualified medical expenses are subject to ordinary income tax.

If the beneficiary is a person other than the surviving spouse, the HSA ceases to be an HSA as of the date of the account holder's death, and the beneficiary is required to include in gross income the fair market value of the HSA assets as of the date of death. This amount is reduced by any payments from the HSA made for the account holder's qualified medical expenses, if paid within one year after death.

What discrimination rules apply to HSAs?

If an employer makes HSA contributions, the employer must make available comparable contributions on behalf of all "comparable participating employees" (i.e., eligible employees with comparable coverage) during the same period. Contributions are considered comparable if they are either the same amount or same percentage of the deductible under the high deductible health plan.

What reporting is required for an HSA?

Employer contributions to an HSA must be reported on the employee's Form W-2. The IRS will release forms and instructions, similar to those required for MSAs, on how to report HSA contributions, deductions, and distributions (withdrawals).

What are the federal tax advantages of an HSA?

HSA contributions are tax deductible and withdrawals used for qualified medical expenses are not subject to tax or penalty. In addition, interest earned on HSA savings is tax-free if used to pay for qualified medical expenses.

Can HSA deductibles and out-of-pocket limits change?

Yes, HSA deductibles, annual out-of-pocket maximums and annual contributions can change annually based upon changes in the Consumer Price Index (CPI) issued by the Department of Labor.

What is the difference between a Medical Savings Account and a Health Savings Account?

HSAs are a significant expansion of the MSA program. Unlike MSAs, HSAs provide the following:

- Participation by large groups and individuals. MSAs were available to only small groups and individuals who were self-employed.
- Funding by both the employer and employee within the same calendar year.
- Broader deductible ranges with an HSA plan.
- Larger maximum contributions – the lesser of the deductible or \$2,600 for singles or \$5,150 for families. MSAs only allowed for a maximum contribution of 65% of a single plan deductible and 75% of a family plan deductible.

Are MSA Plans still available? What about existing MSAs?

Effective 1/1/2004 MSAs are no longer offered. Congress originally created the Medical Savings Account program in 1996 as a pilot. The program was not renewed by Congress. Existing accounts are “grandfathered” and may rollover to an HSA.

Can an MSA be rolled into an HSA?

Yes, MSAs can be rolled into HSAs on a tax-free basis, but it is not necessary. If your client chooses to roll to a MSaver HSA, have him/her complete a Rollover Request Form available at www.fortisgroupmsa.com.

How is the HSA plan priced compared to the HRA?

The HSA plan is priced slightly lower than the HRA plan. Since the HSA is the employee’s own money and is permanent, we believe we will see better utilization with an HSA plan as compared to an HRA plan.

Can HSAs and HRAs be written in combination with other medical plans?

Normal Employee Choice rules apply to HSA plans. As with current HRA plans, an anti-selection load is applied to the group if an HSA plan is written in combination with a traditional copay plan.

How are wellness benefits handled under an HSA plan?

HSA legislation allows Time to continue to offer certain preventive care benefits at 100%. This is similar to other plans from Time.