

HSA ROAD RULES



**HSA Road Rules for Employers
Sixth Edition, January 2008**

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Introduction to Health Savings Accounts (HSAs)

A Health Savings Account (HSA) is like a 401(k) for healthcare. It is a tax-advantaged personal savings or investment account that your employees can use to save and pay for qualified health expenses, now or in the future. Paired with a qualified high deductible health plan (HDHP), an HSA is a powerful financial tool that empowers your employees to be more actively involved in their health care decisions.

Unlike other financial savings vehicles (Roth IRA, Traditional IRA, 401K, etc.), an HSA has the unique potential to offer your employees triple tax savings through:

- ✓ Pre-tax or tax-deductible contributions to the HSA
- ✓ Tax-free interest or investment earnings
- ✓ Tax-free distributions, when used for qualified medical expenses

Contributions to the HSA can be made by the employer, the employee, or both. Tax-free withdrawals can be made by the employee to pay for qualified medical expenses incurred by the accountholder, spouse, children and other dependents.

HSA-eligible health plans reduce healthcare costs for U.S. businesses dramatically, with some studies citing a 20-30% lower cost than average premiums (*AHIP HSAs and Account-Based Health Plans*, June 2006). Sharing a portion of these premium savings with your employees through a recurring, employer contribution to their HSAs greatly increases the likelihood that a higher percentage of your employees will adopt the company's HSA plan—which can add up to big premium savings for your company. This practice allows the employer to recognize significant cost savings while reducing the out-of-pocket healthcare cost risk for the employee.

HSAs are also portable, which means that your employees keep their HSAs, if the change jobs or become unemployed—another incentive to encourage your employees to adopt your lower-cost HSA plan. There is also no “use-it-or-lose-it” provision, like with a Flexible Spending Account (FSA).

Instead, unused contributions roll over each year, with interest and/or investment earnings compounding on a tax-free basis, like an IRA or 401(k). HSAs offer your employees the potential for long-term, tax-free savings that can be used for future medical expenses, such as Medicare premiums and certain long-term care expenses and insurance.

Any employee who is not already enrolled in Medicare and is covered by an HDHP (and has no other first dollar coverage except for preventive care) may establish an HSA. There are no income limitations.

Section 1

Universal HSA Principles

1. Employees must be enrolled in an HSA-qualified high deductible health plan (HDHP) to open or contribute to a Health Savings Account (HSA) in their own name.
2. Switching to an HDHP from a traditional low deductible health plan will substantially lower your company's health plan premiums. Some of the money saved in premiums should be deposited into employees' HSAs to make it a win-win situation for both the employer and its employees.
3. The money in the HSA, including employer contributions, stays with employees when they change jobs or become unemployed. This is an attractive benefit for employees, which benefits the employer by making it more likely that the employee will sign up for the lower-cost HSA plan.
4. Employees are empowered by being put in charge of their HSA funds, making them more actively involved in their health care decisions. Spending their own money means that employees will more likely inquire about the cost of their health care expenditures, helping to introduce marketplace competition into the world of health care.
5. There is no time limit as to when employees can reimburse themselves for health care expenses; they just need to keep legible receipts and records in case they are audited.
6. Employee decides whether and how much to spend from the account for their medical expenses, whether to spend out-of-pocket or to save the HSA money for the future. Just like a 401(k), earnings that compound tax-free for several years have the potential to grow exponentially into a supplemental retirement nest egg. After age 65 (or if disabled), employees can withdraw funds for non-qualified expenses without being subject to the 10% penalty, but ordinary income taxes still apply.
7. Employers can opt to make pre-tax contributions to their employees' HSAs through a Section 125 cafeteria plan, as well as allow employees to make additional pre-tax account contributions through payroll deduction.
8. Employees decides which company will hold their HSA money (known as the trustee or custodian), and what type of investments to make within their account. Any investment allowed for IRAs is allowed for HSAs (see Table A).
9. IRS Publication 502 provides a list of most allowable HSA expenditures.

Please see Table D and E of this document for a partial and summary list of allowable (tax-free) and non allowable (not tax-free) expenditures for HSAs.

Section 2

HSA Road Rules for Employers

1. The employee owns the contributions within the HSA as soon as the funds are deposited.
2. You can no more restrict the use of the funds in the employee's HSA than you can restrict the employee's funds in the employee's personal checking account.
3. Employee contributions to their HSAs can be made on an after-tax basis and taken as an above-the-line deduction on their tax return (making such contributions tax-free) or employees can make pre-tax contributions to their Health Savings Account through a Section 125 (a.k.a. "salary reduction" or "cafeteria") plan.
4. HSAs do not generally constitute "employee welfare benefit plans" under ERISA (that is, you are not subject to the complex legal requirements of ERISA) as long as the establishment of the HSA is completely voluntary on the part of the employee and the employer does not prevent the employee from moving their funds to another HSA, impose conditions on how the funds can be used, influence the investment decisions made, represent that the HSA is an employee welfare benefit plan established or maintained by it, or receive any payment or compensation in connection with the HSA.
5. HSAs can be funded on a (1) pay as you go basis, (2) look back basis, or a (3) pre-funded basis. For (1), it is fine to fund employees' HSAs according to their paycheck schedules (bi-weekly, monthly, etc.), you can decide to make changes (such as quit payments at any point) and an employee hired after January 1 is not entitled to additional HSA contributions. For (2), you must contribute to employees' HSAs for every full month they had been employed. For (3), all eligible employees receive their year's HSA contributions on January 1 and all employees hired after January 1 must be compensated on the same basis (whether by pre-funding, pay as you go, or look back).
6. Employee contributions to their HSAs through a cafeteria plan can change on a month-by-month basis. However, you can put reasonable limits on how often those contribution amounts can change.
7. Employer contributions to an employee's HSA are always excluded from the employee's income (such contributions are made pre-tax).

Section 2

HSA Road Rules for Employers (continued)

8. Employer contributions must be comparable (subject to certain exceptions), meaning that all employer contributions to employees must be the same amount or percentage of the annual deductible within certain defined employee categories. Employees can be categorized along the lines of coverage (family vs. self), type of employment (part-time vs. full-time vs. former employment) and level of compensation (high vs. non-high compensation).
9. The comparability rule can be applied separately to employees in the following categories: (1) part time employees who work under 30 hours, (2) full time employees who work over 30 hours, and (3) former employees.
10. Comparability rules can be applied separately for self vs. family coverage. Though employees with family health coverage are considered one category, there are subcategories based on the number being covered (employee plus one dependent vs. employee plus two, etc.). There can be differences across, but not within, these subcategories. For comparability purposes, a “greater-numbered” family can never receive a lower amount than a “lesser-numbered” family.
11. If you contribute to any employee's non-employer high deductible health plan HSA then you must do so for all employees with non-employer high deductible health plan HSAs.
12. If you contribute to your employees' plans and there are spousal employees that both have HSAs, you only have to contribute to one of the HSAs if they have a family high deductible health plan that covers both spouses. However, if you contribute to a single employee's non-employer provided high deductible health plan HSA, then you must contribute to both spouse's HSAs.
13. If a non-comparable contribution is made, the excess cannot be recouped by the employer. Instead, the employer has until April 15th of the following calendar year to make the compensatory contributions (plus reasonable interest) to correct for the non-comparable contribution.

Section 2

HSA Road Rules for Employers (continued)

14. Comparability rules are likely being violated if “extra contributions” to any employee’s HSA (other than to non-highly compensated employees) are being made. For example, additional contributions to an employee’s HSA being made based on the employee’s seniority, length of service or giving “catch-up” contributions to those employees 55 years and older violate the comparability rules.
15. Employers are not in violation of comparability rules because fired employees in pre-funded or pay as you go contribution schemes may have received more HSA funding than their employment length warranted.
16. Collectively bargained or unionized employees are exempted from comparability rules.
17. Matching contributions by an employer through a Section 125 plan are not subject to the comparability rule, but are subject to the non-discrimination rules of 125 plans.
18. The non-discrimination rule for Section 125 plans, in general, is that contributions cannot be higher for higher-paid employees than they are for lower-paid employees. Contributions that favor lower-paid employees are allowed.
19. If you make HSA contributions through a cafeteria plan, you can make such contributions conditional to an employee’s participation in a health assessment, disease management or wellness program without violating comparability rules.
20. Under certain cafeteria plans, employees have the right to accept other benefits (cash or other taxable benefits) in lieu of part or all of the employer HSA contribution.
21. For employers who do not provide their employees with health insurance but whose employees purchase HSAs on their own, such employer may make pre-tax contributions to such employees’ HSA through a Section 125 plan, as long as the offer is open to all such employees, and the contribution amount follows the Section 125 plan’s non-discrimination rule.
22. Self-employed, partners and S corporation shareholders are not generally considered employees and cannot receive pre-tax employer contributions to their HSAs. Self-employed can only take an above-the-line deduction for their premiums and HSA contributions.

Section 2

HSA Road Rules for Employers (continued)

23. Regardless of how an S corporation or LLC is structured, these types of companies cannot make pre-tax contributions to its owners, shareholders, or partners.
24. You may transfer the balance of an FSA/HRA into an employee's HSA. See Section 4, Rule 8 for the policies governing this type of transfer.
25. A limited purpose FSA or a limited purpose HRA is allowed for expenditures like dental, vision or preventive care.
26. Post-deductible HRAs or post-deductible FSAs are allowed to pay for expenses above the minimum HSA deductible.
27. COBRA rules apply to the high deductible health insurance plan (HDHP) portion of an HSA plan, but not to the financial account (HSA).

Section 3

HSA Eligibility Road Rules

1. The employee desiring to open and/or contribute to an HSA must be enrolled in an HSA-qualified high deductible health plan (HDHP).
2. An HSA-qualified HDHP has the following characteristics:

a.

| <i>Minimum Deductible</i> | 2007 | 2008 |
|---------------------------|-------------|-------------|
| Self-only coverage | \$1,100 | \$1,100 |
| Family coverage | \$2,200 | \$2,200 |

The minimum deductible is indexed annually for inflation; this information is released no later than the preceding June 1st

b.

| <i>Maximum Out-of-Pocket Limit</i> | 2007 | 2008 |
|------------------------------------|-------------|-------------|
| Self-only coverage | \$5,500 | \$5,600 |
| Family coverage | \$11,000 | \$11,200 |

The maximum out-of-pocket limit includes deductibles and co-pays and is also indexed annually for inflation; non-covered expenses by the health plan do not count towards the out-of-pocket limit.

- c. The HSA-qualified HDHP typically offers first dollar coverage for many preventive care services, meaning that certain preventive care services for your employees are not subject to the deductible. Preventive care services may include: periodic health evaluations such as annual physicals, screening services like mammograms, routine prenatal and well-child care, child and adult immunizations, tobacco cessation programs, and obesity weight loss programs. Check with your health plan provider for specifics;
- d. Prescription drugs taken to prevent the onset of a condition for which an employee has developed risk factors may be considered preventive care, thus potentially allowing co-pays to apply, rather than the deductible;
- e. As a general rule of thumb, if the employee is treating an existing illness or condition with either a drug or procedure, that drug or procedure is not considered preventive care (an already existing condition cannot be prevented). If the employee is trying to stave off an illness or condition by taking a drug or with a procedure, that may be considered preventive care. Some drugs, such as cholesterol lowering ones, can be either preventive or non-preventive under HSA rules, depending on the health situation;
- f. Higher out-of-pocket (co-pays and co-insurance) may be incurred for out-of-network care. Consider this when selecting your company's health plan provider and educate your employees accordingly;
- g. Effective January 1, 2006, prescription drug coverage before the deductible is met is no longer allowed, unless the prescription drug use is preventive.

Section 3

HSA Eligibility Road Rules (continued)

3. Employees cannot be covered by any other health insurance that reimburses for health expenses they incur, unless it is another HSA-qualified HDHP. If a family has all its members covered under two HSA-qualified HDHPs, or some family members are on one qualified plan and the other family members are under another qualified plan, the maximum annual contribution to the account remains in force. Employees with coverage under two HSA-qualified HDHPs do not get to double their HSA contribution.
4. For those employees covered by two HSA-qualified HDHPs, it is a violation of the coordination of benefit rules to be paid by each plan for the same expense.
5. Flexible Spending Accounts (FSAs) and Health Reimbursement Arrangements (HRAs) may make your employees ineligible for an HSA unless these accounts are: (1) "limited purpose" (limited to dental, vision, child care, or preventive care) or (2) "post-deductible" (pay for medical expenses after the plan deductible is met). HRAs that set aside money only for retiree health expenses are also acceptable as are ones that are suspended.
6. An employer can restrict the type of expenditures an employee makes from their FSA during a two and a half month grace period that some employers may grant to employees for relief from the FSA "use-it-or-lose-it" rule. If an employer restricts the FSA expenditures to non-health items (such as is the case with a limited-purpose FSA) during this grace period, then such employee is eligible for an HSA, provided they have the proper high deductible health plan.
7. Employees who are enrolled in Medicare or Medicaid cannot open an HSA.
8. Tricare (military healthcare) does not currently offer an HSA-qualified high deductible health plan. Therefore, employees on Tricare cannot have HSAs.
9. Employees who have received any Veterans Administration health benefits in the last three months cannot have an HSA.
10. Employees who are Medicare-eligible, but not enrolled in Medicare, can open or contribute to an HSA if they have an HSA-qualified health insurance plan (please see Table B).
11. Your employees cannot establish separate HSA accounts for their minor dependent children.

Section 3

HSA Eligibility Road Rules (continued)

12. There is no earned income requirement for your employees to have an HSA.
13. Unlike an IRA, there are no income limits to having an HSA.
14. Your employees do not have to itemize their deductions on their federal income taxes to deduct their contributions to an HSA. HSA deductions are “above-the-line” before Adjusted Gross Income (AGI) is calculated.
15. Your employees can open an HSA and also have specific disease or illness, accident, disability, dental care, vision care, and long-term care insurance, and be enrolled in Employee Assistance, disease management, drug discount, and wellness programs.

NOTE: Reasonable benefit designs (lifetime limits on benefits, limits to usual, customary and reasonable amounts, limits on specific benefits, pre-certification requirements) are not counted toward the out-of-pocket maximum.

Section 4

HSA Contribution Road Rules

1. Employees must have an HSA-qualified HDHP to open or contribute to an HSA.
2. If the employee no longer has an HSA-qualified HDHP, that employee can no longer contribute to the HSA, but can still spend the already deposited funds as stipulated by law.
3. Beginning in 2007, the maximum HSA contribution is not limited to the annual deductible under the high deductible health plan. Prior to 2007, the annual HSA deposit could never exceed the insurance plan's deductible (except for those employees who were 55 or older and were making "catch-up" contributions.)

4.

| <i>Maximum Contribution Per Year</i> | <i>2007</i> | <i>2008</i> |
|--------------------------------------|-------------|-------------|
| Self-only coverage | \$2,850 | \$2,900 |
| Family coverage | \$5,650 | \$5,800 |

The maximum amount that can be contributed per year (by all sources combined) is indexed annually for inflation and excludes "catch-up" contributions for those 55 years and older.

5. Beginning in 2007, as long as the employee is enrolled in an HSA-qualified HDHP for at least the last full month of the year, the employee is eligible to make a full HSA contribution for that year, provided that the employee remains enrolled in an eligible HDHP for the full following calendar year. If the employee does not maintain HSA eligibility through the end of the following calendar year, the maximum contribution amount is pro-rated based on the number of full months the employee had the HDHP.

For example, let's say the employee becomes eligible on December 1, 2007. Even though the employee did not have HDHP coverage for the first 11 months of the year, he/she is still eligible to make a full-year HSA contribution of \$2,850, provided that HDHP coverage (and HSA eligibility) is maintained for a period beginning December 1, 2007, and ending December 31, 2008.

6. Deposits to an HSA must be made in cash or through a rollover from a Flexible Spending Account (FSA), Health Reimbursement Arrangement (HRA), Individual Retirement Account (IRA) or another HSA (HSA).
7. For FSA/HRA rollovers, contributions to an HSA must not exceed an amount equal to the lesser of (1) the balance in the health FSA or HRA as of September 21, 2006, or (2) the balance in the health FSA or HRA as of the date of the distribution. The distribution is not includible in income (or carry other penalties) and does not count against the maximum tax deductible contribution that can be made to the HSA.

Section 4

HSA Contribution Road Rules (continued)

8. For IRA rollovers, a direct trustee-to-trustee transfer can be made only one time per lifetime (the only exception being if a contributing individual goes from having self-only to family coverage during the tax year). The amount that can be distributed from the IRA and contributed to an HSA is limited to the otherwise maximum deductible contribution amount to the HSA based on the type of coverage under the high deductible health plan at the time of the contribution. Amounts distributed from an IRA under the provision are not includible in income to the extent they would otherwise be includible in income and are not subject to the 10-percent additional tax on early distributions. The provision does not apply to simplified employee pensions (SEPs) or to SIMPLE retirement accounts.
9. Employees who are 55 and older can make additional “catch-up” contributions until they enroll in Medicare. For a schedule of the increasing “catch-up” deposit amounts allowed, please see Table B.
10. In the year the employee enrolls in Medicare, the employee must pro-rate the “catch-up” contribution for the number of months the employee had HSA-qualified HDHP coverage, prior to the month that Medicare enrollment became effective.
11. If an employee has a family plan with multiple per-person deductibles, he/she cannot deposit more into the HSA than the maximum amount allowed for family coverage. For example, a family of two with a \$4,000 per person deductible cannot deposit \$8,000 into their 2008 family HSA; rather, the maximum contribution is \$5,800.
12. An employee or employer can “front load” or fully fund the HSA on day one of the employee’s HSA being in effect, provided the annual maximum amount is not exceeded.
13. If an employee becomes covered by a HDHP in a month later than January, full contributions can be made or “back loaded” into the HSA for the preceding months up to January. If, however, the employee falls out of qualifying insurance coverage (for reasons other than death or disability), all the back loaded months of HSA contributions for which the employee is not eligible is includible in the employee’s gross income, as well as a 10-percent additional tax to the amount includible.

Section 4

HSA Contribution Road Rules (continued)

14. Funds can be deposited into the HSA in a lump sum or in any amounts or frequency desired. However, the HSA trustee/custodian may impose minimum deposit and balance requirements.
15. Rollovers from an employee's Archer Medical Savings Account into a HSA are allowed if completed within 60 days of the employee withdrawing the funds from the Archer Medical Savings Account.
16. The term "rollover" has several meanings. Rollover of HSA funds from year to year of unspent balances is well understood. However, IRA and HSA rollovers have another meaning to the IRS: an accountholder is allowed to take any amount of the HSA funds out of the account out once a year, and there is no limitation on what those funds can be spent on. If the funds are returned to the HSA within 60 days, there is no tax or penalty. However, if those funds are not returned to the HSA within 60 days, then the accountholder must pay the taxes due on those funds, and the 10% penalty. Unofficially, this "rollover" rule is known as the "playing with fire" rule.
17. Unlimited HSA trustee to HSA trustee transfers are allowed, meaning your employees can move their HSA any number of times in a given year.
18. If a contribution is made into the HSA which exceeds the maximum allowable deposit, a withdrawal of the excess amount and any earnings on the excess amount can be made prior to April 15th of the following year without the employee incurring any tax penalty. However, the employee must pay income tax on the excess contributions and income tax on any earnings of the excess contribution.
19. If the employee does not withdraw the excess contribution to the HSA prior to April 15th of the following year, the employee must pay a 6% excise tax on the excess contribution, and on any earnings of the excess contribution. If in the next year the employee decreases the maximum contribution by the amount of the excess contribution made the year before, the 6% excise tax does not have to be paid again. If, however, the employee leaves the excess contribution in, and does not decrease the maximum contribution by the amount of the excess contribution made the year before, he/she will have to pay the 6% excise tax each year the excess contributions and earnings are in the HSA.
20. An employer paying COBRA for an employee with an HSA does not have to continue making deposits into the HSA. The employer does have to pay the continuing premium for the qualified HDHP.

Section 5

HSA Spending Road Rules

1. There is a wide range of allowable tax-free HSA expenditures, including vision and dental expenses, and, even braces for your employees' children. A description of qualified HSA expenditures can be found in IRS Publication 502, and is located at the web at: <http://www.irs.gov/pub/irs-pdf/p502.pdf>. Publication 502 has great examples, but it is not the definitive list (please see Table D for a partial list of allowable tax-free expenditures and Table E for non allowable expenditures).
2. If a distribution from the HSA is used for purposes other than a qualified health care expense as defined in IRS Publication 502, then the amount withdrawn is subject to both income tax and a 10% penalty, unless the person who makes such a withdrawal from their HSA is over the age of 65. If 65 years old or older, the amount withdrawn for non-medical purposes is treated as retirement income, and is subject to normal income tax, but is not subject to the 10% penalty.
3. Withdrawals that were made for what the HSA owner thought were qualified medical expenditures, but turned out not to be qualified medical expenditures, can be returned to the HSA if there is clear and convincing evidence that the expenditure was a mistake of fact. Such repayment to the HSA must be made on or before April 15th of the year following when the employee knew, or should have known, the expenditure was a mistake.
4. Other qualified expenses from an HSA include out-of-pocket health expenditures while enrolled in Medicare (including Medicare premiums, deductibles, coinsurance and co-pays but not "Medigap"), employee share of health insurance premiums for employer-based coverage, premiums for COBRA continuation health insurance coverage from a former employer, premiums for qualified long-term care insurance coverage subject to the age limits in the Internal Revenue Code (please see Table C), and medical services provided in other countries.
5. Employees with an HSA must keep all their receipts showing their expenditures from their account. There are two key reasons to do this: (1) if employees exceed their deductible, they may need the receipts to send to their insurer, and (2) in case they are audited by the IRS and need to explain their HSA expenditures.
6. Employees may use HSA funds to reimburse expenses from a previous year, but only if employee had an HSA at the time the expenses were incurred.
7. The employee's spouse will inherit the HSA upon employee's death, unless employee specifies otherwise ahead of time.

Section 5

HSA Spending Road Rules (continued)

8. Should the HSA owner have no spouse, the funds in the account shall no longer be treated as an HSA but part of the employee's estate and will be subject to estate taxes.
9. The employee cannot use HSA funds to pay for health insurance premiums, unless the employee becomes unemployed and starts receiving federal or state unemployment benefits.

Section 6

Why HSAs Were Designed this Way

1. **Why can't the out-of-pocket amount be tied to the maximum contribution?** Tying the maximum contribution rate to the out-of-pocket maximum is a viable policy, but the cost to the Federal government in lost taxable income made that idea politically unviable when the law was passed.
2. **Why not carve out prescription drugs and allow tiered co-pays?** Including prescription drugs as a benefit below the deductible will drive up the low cost of HSA-qualified HDHPs, and, as a result, reduce the amount of savings derived from switching to an HDHP. Likewise, tiered co-pays, or any other benefit that is paid outside the deductible, greatly diminish the effect of consumers spending their own money. When spending their own money, consumers spend it differently than if spending someone else's money. Think of going out for an all expenses paid meal, versus going to a restaurant where you are paying: you order differently.
3. **Why can't early retirees pay their HSA-qualified health insurance premium from their HSA?** This change in the law was suggested but the objection is that given that there are millions in the individual market who have health insurance but receive no tax break for their purchase, why should insured early retirees get special treatment?
4. **Why can't seniors use their HSA to pay for Medigap coverage?** The guiding principle of HSAs is for people to use their own money to meet a substantial deductible, thereby providing a financial incentive to spend the funds wisely and not to over consume. The main purpose of a Medigap policy is to insure the Medicare deductible.

Allowing HSA funds to pay for Medigap insurance would be akin to allowing HSA funds to buy insurance to cover the HSA deductible. In other words, it would be using HSA funds to defeat the entire purpose of an HSA.

5. **Why are the long-term care premium amounts that can be paid out of an HSA limited?** During the HSA legislation drafting process, there were other issues being negotiated that needed political capital more than allowing for unlimited amounts to be spent on long-term care premiums.

Section 6

Why HSAs Were Designed this Way (continued)

6. **Why can't HSA distributions be tax free upon death?** The revenue loss to the Federal government made the price tag for that suggestion too high.
7. **Why can't spouses have one joint HSA and still make "catch-up" contributions?** There can be only one primary account holder of the HSA. Both spouses may contribute. The practical effect of this restriction is not significant.
8. **Are "catch-up" contributions pro-rated when account holders turn 55 and 65?** Please see Table B.
9. **Can the self-employed contribute on a pre-tax basis? How about for partnerships or for S corporation owners who own more than 2% or for LLC owners?** Self-employed can only take an above-the-line deduction for their premium and HSA contribution. Regardless of how the S corporation or LLC is structured, the only way HSA contributions can be made is as an above-the-line deduction. The HSA legislation simply cited current law in this regard. It was a political impossibility in the HSA legislation to make the necessary change in law to allow pre-tax contributions for LLC owners, S corporation owners or the self-employed. For further guidance on partnerships and S corporations, see IRS Guidance 2005-8 at www.treas.gov/press/releases/reports/notice%2020058.pdf.
10. **What is an "above-the-line" deduction?** An above-the-line deduction reduces the account holder's Federal taxable income dollar for dollar by the amount contributed to the HSA. An account holder does not have to itemize to claim this deduction.
11. **Why can't health insurance premiums be paid with an HSA?** The money in the HSA is designed to meet an individual's out-of-pocket health care expenses, not to pay for health insurance premiums. What if people spent their entire HSA deposit on their insurance premiums, and found no funds left to meet their health care costs to meet their deductible? The only time an individual is allowed to pay the health insurance premium with HSA funds is when the individual is collecting Federal or State unemployment benefits or is on COBRA.
12. **Where can a list of qualified medical expenses be found?** See Tables D and E for a list of allowable and non allowable medical expenses. Please also see IRS Publication 502, which can be found in the U.S. Treasury section of this website, or at <http://www.irs.gov/pub/irs-pdf/p502.pdf>.

Table A

Allowable HSA Investments

| Allowable HSA Investments |
|-------------------------------------|
| → Bank Accounts |
| → Annuities |
| → Certificates of Deposit |
| → Stocks |
| → Bonds |
| → Mutual Funds |
| → Certain types of Bullion or Coins |

NOTE: The HSA custodian or trustee may restrict certain types of investments.

| Not Allowable HSA Investments |
|---|
| → Collectables: including any work of art, antique, metal, gem, stamp, coin, alcoholic beverage or other personal property as described in Section 408(m)(3) of the Internal Revenue Code |
| → Life Insurance Contracts |

Table B

Allowable “Catch-Up” Contributions

| Allowable “Catch-Up” Contributions | |
|------------------------------------|------------------|
| Tax Year 2004 | Up to \$500.00 |
| Tax Year 2005 | Up to \$600.00 |
| Tax Year 2006 | Up to \$700.00 |
| Tax Year 2007 | Up to \$800.00 |
| Tax Year 2008 | Up to \$900.00 |
| Tax Year 2009 and Beyond | Up to \$1,000.00 |

Each employee and spouse age 55 or older can contribute up to the maximum “catch-up” amount. If the employee did not have HDHP coverage for the full year, the employee must pro-rate the “catch-up” contribution for the number of full months that the employee was “eligible”, i.e., had HDHP coverage. If the employee had HSA-qualified HDHP coverage for the entire year, the employee can deposit the entire “catch-up” amount starting with the year the employee turned 55, regardless of when the employee turned 55 during the year. If both spouses want to make “catch-up” contributions, each spouse must have a separate HSA.

In the year the employee enrolls in Medicare, the employee must prorate the “catch-up” contribution for the number of months the employee had HSA-qualified HDHP coverage, prior to the month the employee’s Medicare enrollment became effective. The employee can delay enrollment in Medicare Part A only if the employee also delays taking Social Security. The employee can delay taking Social Security up until age 70 and one half years old.

Once either spouse enrolls in Medicare, that spouse can no longer contribute any funds, including “catch-up” amounts, to the HSA. If the employee is not enrolled in Medicare, the employee can contribute to the HSA and continue to make “catch-up” contributions.

NOTE: If the employee enrolls in Social Security, the employee also becomes automatically enrolled in Medicare Part A, which disqualifies the employee from making any more contributions to the HSA.

Table C

Allowable Expenditures on Long-Term Care Insurance

In order for your employees to spend money from the HSA on long-term care, the long-term care insurance contract must:

1. Be guaranteed renewable;
2. Not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed;
3. Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract, must be used only to reduce future premiums or increase future benefits;
4. Generally not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer, or the contract makes per diem or other periodic payments without regard to expenses.

The amount of qualified long-term care premiums that can be paid from an HSA is limited. Beginning in 2006, the below amounts can be included as a qualified medical expense. These amounts may be adjusted annually for inflation. For 2008, these inflation-adjusted amounts, as published in IRS Publication 502, are:

| 2008 Allowable Long-Term Care Premium Amounts | |
|---|---------------|
| Age 40 or Under | Up to \$290 |
| Age 41 to 50 | Up to \$550 |
| Age 51 to 60 | Up to \$1,110 |
| Age 61 to 70 | Up to \$2,950 |
| Age 71 or Over | Up to \$3,680 |

Table D

Allowable Expenditures from the HSA

There have been thousands of cases involving the many nuances of what constitutes “medical care” for purposes of section 213(d) of the Internal Revenue Code. A determination of whether an expense is for “medical care” is based on all the relevant facts and circumstances. To be an expense for medical care, the expense has to be primarily for the prevention or alleviation of a physical or mental defect or illness. The determination often hangs on the word “primarily”.

NOTE: If receiving federal or state unemployment insurance, the employee may pay for health insurance premiums with HSA funds. See next page for a list of most allowable expenditures.

Table D

Allowable Expenditures from the HSA (continued)

| Allowable Expenditures from the HSA | |
|--|---|
| Acupuncture | Alcoholism Treatment |
| Ambulance | Artificial Limb |
| Artificial Teeth | Bandages |
| Birth Control Pills (by prescription) | Breast Reconstruction Surgery (mastectomy) |
| Car Special Hand Controls (for disability) | Certain Capital Expenses (for the disabled) |
| Chiropractors | Christian Science Practitioners |
| COBRA premiums | Contact Lenses |
| Cosmetic Surgery (if due to trauma or disease) | Crutches |
| Dental Treatment | Dermatologist |
| Diagnostic Devices | Disabled Dependent Care Expenses |
| Drug Addiction Treatment (inpatient) | Drugs (prescription) |
| Eyeglasses | Fertility Enhancement |
| Guide Dog | Gynecologist |
| Health Institute (if prescribed by physician) | H.M.O. (certain expenses) |
| Hearing Aids | Home Care |
| Hospital Services | Laboratory Fees |
| Lasik Surgery | Lead-Based Paint Removal |
| Learning Disability Fees (prescription) | Legal Fees (if for mental illness) |
| Life-Care Fees | Lodging (for out-patient treatment) |
| Long-Term Care (medical expenses) | Long-Term Care Insurance (up to allowable limits) |
| Meals (associated with receiving treatments) | Medical Conferences (for ill spouse/dependent) |
| Medicare Premiums | Medicare Deductibles |
| Nursing Care | Mentally Retarded (specialized homes) |
| Obstetrician | Nursing Homes |
| Operations - Surgical | Operating Room Costs |
| Optician | Ophthalmologist |
| Organ Transplant (including donor's expenses) | Optometrist |
| Orthopedic Shoes | Orthodonture |
| Osteopath | Orthopedist |
| Over-the-Counter Medicines | Out-of-pocket expenses while enrolled in Medicare |
| Pediatrician | Oxygen and Equipment |
| Podiatrist | Personal Care Services (for chronically ill) |
| Prenatal Care | Post-Nasal Treatments |
| Prosthesis | Prescription Medicines |
| Psychiatric Care | PSA Test |
| Psychoanalysis | Psychiatrist |
| Psychologist | Psychoanalyst |
| Radium Treatment | Qualified Long-Term Care Services |
| Special Education for Children (ill or disabled) | Smoking Cessation Programs |
| Spinal Tests | Specialists |
| Sterilization | Splints |
| Telephones and Television for the Hearing | Surgeon |
| Therapy | Impaired |
| Treatment | Transportation Expenses for Health Care |
| Vitamins (if prescribed) | Vaccines |
| Wheelchair | Weight Loss Programs |
| X-Rays | Wig (hair loss from disease) |

Table E

Non-Allowable Expenditures from the HSA

| Non-Allowable Expenditures from the HSA | |
|---|---|
| Advance Payment for Future Medical Expenses | Athletic Club Membership |
| Automobile Insurance Premium | Babysitting (for healthy children) |
| Boarding School Fees | Bottled Water |
| Commuting Expenses for the Disabled | Controlled Substances |
| Cosmetics and Hygiene Products | Dancing Lessons |
| Diaper Service | Domestic Help |
| Electrolysis or Hair Removal | Funeral Expenses |
| Hair Transplant | Health Programs at Resorts, Health Clubs, & Gyms |
| Household Help | Illegal Operations and Treatments |
| Illegally Procured Drugs | Maternity Clothes |
| Medigap premiums | Nutritional Supplements |
| Premiums for Life or Disability Insurance | Premiums for Accident Insurance |
| Premiums for your HSA-qualified health plan | Scientology Counseling |
| Social Activities | Special Feeds/Beverages |
| Swimming Lessons | Teeth Whitening |
| Travel for General Health Improvement | Tuition in a Particular School for Problem Children |

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