Legal Aspects of Account-Based Plans—HSAs, HRAs and FSAs under the ACA

Benefit Advisors Network

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HSA Rules: Definitions

- FSA – Health Care Flexible Spending Account
- HDHP – Qualified High Deductible Health Plan
- HRA – Health Reimbursement Arrangement
- HSA – Health Savings Account

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HSA Background

- HSAs first became available to taxpayers in 2004 as part of Congress' attempt to expand health care coverage and control costs through consumer-directed programs
- HSAs are tax-favored investment accounts that may be used to pay for an individual's current or future health, vision and dental expenses
- To set up an HSA, an individual must be covered by an HDHP and satisfy certain other eligibility rules
- Within the statutory limits, employer contributions to an HSA are not taxable and the individual may make tax-deductible contributions to the HSA

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HSA Eligibility

- There are four basic HSA eligibility rules
- Individuals must be:

1. Covered by a qualified High Deductible Health Plan;
2. Not covered by any non-HDHP plan;
3. Not entitled to Medicare; and
4. Not eligible to be claimed as a dependent on another individual's federal tax return

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HSA Eligibility

1. In order to qualify, the HDHP must have an annual deductible at or above the statutory minimum, and contributions and out-of-pocket limits at or below the statutory maximum

	2016/17 Minimum Annual Deductible for HDHP	2016/17 Maximum Annual HSA Contribution	2016/17 Maximum Annual Out-of-Pocket
Individual	$1,300	$3,350 / $3,400	$6,550
Family	$2,600	$6,750	$13,100

- Only change for 2017: $50 increase to HSA contribution limit for individual HDHP coverage

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HSA Eligibility

1. (cont'd.) An HDHP may provide preventive care before the minimum annual deductible is satisfied, which includes:
    - Periodic health evaluations, including diagnostic procedures ordered in connection with routine examinations, such as annual physicals
    - Routine prenatal and well-child care
    - Child and adult immunizations
    - Tobacco cessation programs
    - Obesity weight-loss programs
    - Screening services for: cancer; heart and vascular diseases; infectious diseases; mental health conditions; substance abuse; metabolic, nutritional, and endocrine conditions; musculoskeletal disorders; obstetric and gynecological conditions; pediatric conditions; and vision and hearing disorders

IRS Notice 2013-57: HDHP may cover Preventive Care under ACA

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HSA Eligibility

2. In order to be eligible to contribute to an HSA, an individual must not be covered under any non-qualified health care plan, with two exceptions: permitted insurance and permitted coverage

   a) Permitted insurance: Worker's compensation, tort liability, ownership liability, specified disease coverage, per-diem indemnity insurance

   b) Permitted coverage: Accident coverage, disability, dental, vision, long-term care

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HSA Eligibility

3. Individuals who are entitled to Medicare are not eligible to establish or contribute towards an HSA
    - Entitled means actually covered under any part of Medicare: Part A, Part B, a Medicare Advantage Plan, or Part D
    - Individuals who are eligible for Medicare, but have not enrolled, may establish and contribute to an HSA
    - Note: Medicare entitlement is not automatic at age 65
        - Employees can maintain HSA eligibility by delaying enrollment in Medicare

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HSA Eligibility

4. Any individual who is eligible to be claimed as a dependent on another person's federal tax return is not eligible to establish or contribute to an HSA
    - Example: A student who is eligible for an HDHP, but whose parents claim her as a dependent because she meets the IRS definition of "qualifying relative" is not HSA eligible

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HSA Eligibility

- FSA grace period may not prevent HSA eligibility
- Generally, an individual may not participate in both an HSA and an FSA because FSA coverage is not an HDHP
- According to the IRS, this restriction included any FSA "grace period," even if there was no money left in the FSA
- However, individuals with a zero balance in their FSA at year end may contribute to an HSA at the start of the new year

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HSA Contributions

- Full-year contribution allowed for mid-year enrollees
- This provision allows individuals who first enroll in a high deductible plan after the start of the year to make a full HSA contribution for the year
- However, if the individual does not remain eligible for the HDHP during the testing period, then an amount equal to the HSA deduction during the period that the individual was treated as eligible is included in income, and an additional 10% tax applies to the amount includable
- The testing period begins with the last month of the taxable year and ending on the last day of the twelfth month following such month

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Employer Contributions to HSAs

- Employers may, but are not required to, contribute to their employees' HSAs
- If an employer contributes to an employee's HSA, the contributions are excludable from federal taxable income and are not taxable to the individual
- Employers can structure their contributions under one of two rule sets:
  - Comparable Contributions
  - Contributions through a Cafeteria Plan

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Comparable Employer Contributions

- Comparable employees are employees in the same category (full-time, part-time, former) who have the same tier of coverage
- Employers may use up to 4 tiers:
  - Single (self only)
  - Employee & 1 Dependent
  - Employee & 2 Dependents
  - Employee & 3 or more Dependents
- Restriction: contributions to each family tier must be equal to or greater than the tier below

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Comparable Employer Contributions

- Employees may be placed in the following categories only:
  - Full-time (30 hours)
  - Part-time (<30 hours)
  - Former Employees (does not include COBRA)
  - Union (collectively bargained health benefits)
- Note: the 30-hour threshold must be used
- Differences not permitted for: management, salaried, specific locations or subgroups (e.g., division or subsidiary)

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Comparable Employer Contributions

- Contributions will be comparable only if they are calculated using one of two methods:
  - Same dollar amount by tier (single or family); or
  - Same percentage of the HDHP deductible (single or family level)
- When HSA contributions are not comparable, the penalty is a 35% excise tax

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Employer Contributions Through Cafeteria Plan

- Employer contributions toward an employee's HSA offered under a cafeteria plan will generally be in one of 3 forms:
  1. Salary reductions;
  2. Employer credits (cashable or non-cashable); and/or
  3. Employer non-credit contributions such as:
     - Flat dollar amount
     - Specified percentage of deductible(s)
     - Matching contributions

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Employer Contributions Through Cafeteria Plan

- An employer's HSA contribution may not be considered to be "through" a cafeteria plan if the contribution is non-elective and non-cashable
- Example of a contribution not "through" a cafeteria plan:
  - Employees contribute to HDHP via salary reduction,
  - Employer contributes to HSA for all enrollees, and
  - Employer contribution is only for the HSA:
    - It can't be taken as cash,
    - It can't be used for other benefits, and
    - Employees cannot contribute pre-tax to HSAs
- Employer's HSA contribution is not through a cafeteria plan!

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HSA Distributions

- Distributions from an HSA are tax-free if used to pay or reimburse “qualified medical expenses” incurred after establishment of the HSA
- Distributions for non-qualified expenses are subject to income tax and an additional 20% tax (if the HSA holder is under age 65)

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HSA Distributions

- "Qualified medical expenses" are those expenses that would generally qualify for a tax deduction as medical and dental expenses (see IRS Pub. 502) AND which are incurred by:
  - You or your spouse (as determined under federal law)
  - All dependents you claim on your tax return
  - Anyone you could have claimed as a dependent except that:
    - the person filed a joint return;
    - the person had gross income of $4,050 or more (in 2016); or
    - you, or your spouse if filing jointly, can be claimed as a dependent on someone else's 2016 return

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HSA Distributions

- "Qualified medical expenses" do not include insurance premiums, unless they are for:
  - Long-term care insurance (amounts are limited)
  - COBRA continuation coverage
  - Health care coverage while receiving unemployment compensation under federal or state law
  - Medicare and other health care coverage if the HSA holder is age 65 or older (other than premiums for a Medicare supplemental policy, such as Medigap)

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HDHPs and Embedded Deductibles

- How do embedded individual deductibles work?
- A family HDHP cannot pay claims (other than preventive care) until the minimum annual deductible for family HDHP coverage is satisfied ($2,600 in 2016 and 2017)
- Many HDHPs have deductibles for family coverage that exceed $2,600 in aggregate; however, they allow individuals to satisfy a lower deductible
- As long as the embedded individual deductible is not lower than the minimum annual deductible for family HDHP coverage, HSA eligibility is not disrupted
- For example, a family HDHP with a $6,000 deductible could have an embedded individual deductible of at least $2,600 and not jeopardize HSA eligibility

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HDHPs and ACA Out-of-Pocket Limits

- 2016 HDHP OOP Limits: $6,550 / $13,100
  - Applies to all in-network claims
- 2016 ACA OOP Limits: $6,850 / $13,700
  - Applies to all in-network essential health benefits
  - Starting with 2016 plan years family coverage must have embedded individual OOP limit
  - 2017 limits released: $7,150 / $14,300
- New ACA Requirement: Embedded OOP limits
  - Embedded individual OOP limit rules should not negatively impact most HDHPs, unless family deductible exceeds $6,850
  - Under most plans, by the time the embedded individual OOP limit ($6,850) is satisfied, the employee will have reached the minimum annual deductible for HDHP coverage

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Coordination of HSAs with FSAs and HRAs

- Employers implementing qualified high deductible health plans to facilitate the use of HSAs should consider the following five plan design examples and their effect on an employee's eligibility to contribute to an HSA

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Hypothetical HDHP

- For the purpose of the following five examples, the HDHP has the following features:
  - 80%/20% coinsurance
  - $1,300 deductible for individual, $2,600 for family
  - Maximum out-of-pocket cost of $6,550 for individual, $13,100 for family
  - HDHP covers standard medical and Rx expenses, and does not cover dental or vision expenses

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1. HSA with "Traditional" FSA or HRA

- Both the FSA and HRA cover all qualified medical expenses not covered by the HDHP (co-payments, co-insurance, expenses not covered due to the deductible, any other medical expenses not covered by the HDHP)
- This individual is not eligible to contribute to an HSA
  - The FSA and HRA pay or reimburse medical expenses incurred before the annual deductible has been satisfied
  - The FSA and HRA are not limited to the exceptions for permitted insurance, permitted coverage, or preventive care
- Note: In this example, both the FSA and HRA are considered health plans that are NOT qualified HDHPs

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2. HSA with "Limited Purpose" FSA or HRA

- Both the FSA and HRA are "limited purpose" arrangements that cover only vision or dental expenses, as well as preventive care (without regard as to whether the HDHP deductible has been satisfied)
- This individual is eligible to contribute to an HSA
  - The FSA and HRA pay or reimburse medical expenses incurred before the annual deductible has been satisfied
  - However, the medical expenses paid by the FSA or HRA include only vision and dental benefits (which are permitted or disregarded coverage) and preventive care

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3. HSA with "Suspended" HRA

- The individual elects, before the beginning of the HRA coverage period, to suspend the payment of medical expenses during the upcoming HRA coverage period (permitted or disregarded coverage and preventive care is allowed)
- This individual is eligible to contribute to an HSA
  - The individual is eligible to contribute to an HSA until the individual is again entitled to receive, from the HRA, payments for medical expenses incurred after the suspension
  - Note: This allows an HRA and HSA to co-exist by permitting an individual to maintain an HRA (and to continue receiving accruals) and still be eligible to contribute to an HSA

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4. HSA with “Post Deductible” FSA or HRA

- Both the FSA and the HRA are “post deductible” arrangements that only pay or reimburse medical expenses after the HDHP deductible has been satisfied (permitted or disregarded coverage and preventive care is allowed)
- This individual is eligible to contribute to an HSA
  - The FSA and HRA do not reimburse medical expenses incurred before the annual deductible has been satisfied
  - Note: The post deductible HRA or FSA will not qualify as a HDHP; the individual will need to be covered by a qualified HDHP in order to contribute to an HSA

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5. HSA with “Retirement” HRA

- The HRA is a “retirement” HRA and only reimburses expenses incurred after the individual retires
- This individual is eligible to contribute to an HSA
  - The individual is eligible to contribute to an HSA before retirement because the HRA will only pay or reimburse medical expenses incurred after retirement
  - Note: This individual will not be eligible to make contributions to an HSA after retirement

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HRAs under the ACA

- IRS Notice 2013-54 indicates that the agencies are generally viewing HRAs, FSAs, and Employer Payment Plans as group health plans for purposes of the ACA
  - Amplified by Notices 2015-17 and 2015-87
- This means that these arrangements will qualify as “minimum essential coverage” for covered employees (i.e., it will preclude employees from receiving a premium credit), unless they are “excepted benefits” under HIPAA

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HRAs under the ACA

- This also means that these arrangements will need to comply with the ACA's annual limit and preventive care requirements, unless they are integrated with a compliant group health plan (or are "excepted benefits" under HIPAA)
- The guidance confirms that most health FSAs offered through a Section 125 cafeteria plan continue to be "excepted benefits"

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HRAs under the ACA

- When is an HRA "integrated" with a GHP?
- Method 1: Minimum Value (MV) Not Required
- An HRA is integrated with another GHP if
  1. the employer offers a GHP (other than the HRA) to the employee that is not just "excepted benefits";
  2. the employee is enrolled in a GHP (doesn't have to be sponsored by employer sponsoring the HRA);
  3. the HRA is available only to employees in a GHP;
  4. the HRA only reimburses copays, co-ins., deductibles or premiums under the GHP, or non-essential benefits; and
  5. the employee must be able to opt out of the HRA at least annually (and upon termination of employment)

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HRAs under the ACA

- When is an HRA "integrated" with a GHP?
- Method 2: Minimum Value (MV) Is Required
- An HRA is integrated with another GHP if
  1. the employer offers a GHP that provides Minimum Value;
  2. the employee is enrolled in a GHP that provides MV (doesn't have to be sponsored by employer sponsoring the HRA);
  3. the HRA is available only to employees in a GHP; and
  4. the employee must be able to opt out of the HRA at least annually (and upon termination of employment)

  - Employees must have the ability to opt-out because the HRA provides minimum essential coverage, which will preclude the individual from claiming a premium credit

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HRAs under the ACA

- The guidance provides that a group health plan, including an HRA, will not be considered "integrated" with an individual health insurance policy for purposes of satisfying the ACA's annual limit rules or preventive care rules
- This means that employers will not be permitted to reimburse employees for the cost of individual insurance premiums on a non-taxable basis
- In other words, the so-called "defined contribution HRA" model does not work if the HRA reimburses individual insurance policies

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HRAs under the ACA

- Employer Payment Plans
  - Employers may offer employees the choice of taxable compensation (cash) or an after tax payment to be applied to health coverage
  - The guidance also permits employers to establish a payroll practice of forwarding employee contributions to an insurance carrier without the arrangement being considered a group health plan; however, the arrangement generally must comply with the rules for "voluntary" plans under ERISA, with one such requirement being that the employees pay 100% of the cost of the coverage

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FSAs under the ACA

- Modification to the Use-It-Or-Lose-It Rule for Health Flexible Spending Accounts (health FSAs)
- Can carryover up to $500 to following plan year
- Plan cannot have a grace period and a carryover feature
- Employee contribution limit is $2,500 per year (as indexed, plus the $500 carryover)
  - 2015 and 2016 limits are $2,550
- Amendment will be required
- Question: What is more valuable—Grace Period or Rollover?

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FSAs under the ACA

- Health FSAs must be “excepted benefits”
- Health FSAs will be “excepted” if the employer also offers non-excepted group health plan coverage and the health FSA is structured so that the maximum benefit payable cannot exceed the greater of:
  a) two times the participant’s salary reduction election to the health FSA for the year; or
  b) $500 plus the participant’s salary reduction election
- If an employer provides a non-excepted health FSA, it is subject to the market reforms, including the preventive services requirements
- Because a non-excepted health FSA is not integrated with a group health plan, it will fail to meet the preventive services requirements

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FSAs under the ACA

- Health FSA exception in the annual limit rules
- How does it work?
- The IRS has made it clear that this exemption applies only to a health FSA that is offered through a cafeteria plan and thus subject to a separate annual limitation (i.e., $2,500)
- In other words, a health FSA that is not offered through a cafeteria plan will fail to comply with the rules prohibiting annual dollar limits
- The regulators intend to amend the annual dollar limit prohibition regulations to clarify this issue

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FSAs, COBRA and the $500 Carryover

- Notice 2015-87 provides guidance on Application of COBRA to Health FSAs with $500 Carryover Feature
- General rule: Employers that allow carryovers must also allow them for COBRA participants
  - This could extend COBRA past the end of the plan year
- <u>However</u>, an employer may limit the carryover to employees who elect to contribute to the FSA in the following year, in which case COBRA ends at the end of the plan year
- Employers may limit carryovers to a maximum period (e.g., one or more years)

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New Law Affecting Veterans' HSAs

- Surface Transportation and Veterans Health Care Choice Improvement Act of 2015
- Changes how veterans' health coverage affects HSA eligibility
- The "3-month" rule no longer applies to care received through the VA for a "service-connected disability"
  - In the past, an individual was not HSA-eligible for a month if he or she had received VA medical benefits during the previous three months
- This new rule only applies to VA coverage
- TRICARE coverage still disrupts HSA eligibility

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Future of HSAs?

- Proposed improvements include:
  - Permitting reimbursement of certain medical expenses incurred prior to establishment of HSA
    - HSA considered established on first day of HDHP coverage if established within 60 days of HDHP coverage
  - Permitting both spouses to make catch-up contributions to one HSA
    - If both spouses are eligible for catch-up contributions and either has family HDHP coverage, the annual contribution limit that can be divided between them includes both catch-up contribution amounts

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Future of HSAs?

- <u>Proposed</u> improvements include:
  - Changing definition of qualified medical expenses to include certain health coverage for pre-65 retirees
    - HSA funds could be used to pay for coverage under an employer-sponsored group health plan if the individual is between 55 and 65 and is enrolled by reason of being a former employee or a surviving spouse

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Questions?

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