HSAs & FSAs: Eligibility and Contribution

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Introduction

HSAs (Health Savings Accounts) and FSAs (Flexible Spending Accounts) are both accounts designed to help employees put aside money to pay for extra medical expenses on a pre-tax basis, both have rules around maximum contributions and permissible distributions, and both have remarkably similar-sounding acronyms. However, the similarities, for the most part, stop there.

Employers may be confused as to how these two types of accounts impact each other. Most of this confusion may be a result of misunderstanding HSA eligibility rules or applying these rules to FSAs. In this article, we will briefly discuss both HSAs and FSAs independently and discuss how they impact each other in terms of eligibility.

Health Savings Accounts (HSAs)

What is an HSA?

A Health Savings Account (HSA) is often referred to as a Consumer Driven Health Plan (CDHP). An HSA is an account through which eligible individuals can make contributions, and receive employer contributions, on a tax-free basis through an employer's cafeteria plan. Whether an individual is eligible to contribute to an HSA does not impact whether the individual is eligible for the underlying high deductible health plan. Further, the individual and his or her spouse and dependents do not need to be eligible to contribute to an HSA in order to take tax-free distributions from the HSA for qualified medical expenses. An HSA account is owned by the individual, not by the employer. Therefore, individuals continue to have the ability to access to the account after employment ends.

Eligibility

To be eligible to contribute to (or receive contributions to) an HSA, three things must be true: 1. The individual must be covered under a qualified high deductible health plan (QHDHP); 2. The individual must not be covered by disqualifying other coverage; and 3. The individual cannot be claimed as a dependent by any other person.

A high deductible health plan is considered qualified, and allows a person to contribute to an HSA, if it meets both the minimum annual deductible standards and the maximum out-of-pocket limit standards set by the IRS.

Qualified HDHP	2020	2021	2022
Minimum Annual Deductible	$1,400 for self-only coverage	$1,400 for self-only coverage	$1,400 for self-only coverage
	$2,800* for family coverage	$2,800* for family coverage	$2,800* for family coverage

**If the plan includes an embedded individual deductible for individuals with family coverage, that embedded individual deductible can be no lower than the minimum family deductible.*

Out-of-Pocket Limit	$6,900 for self-only coverage	$7,000 for self-only coverage	$7,050 for self-only coverage
	$13,800 for family coverage	$14,000 for family coverage	$14,100* for family coverage

**The individual limitation on cost-sharing under the ACA (Affordable Care Act) applies regardless of whether the individual is covered by a self-only plan or a plan that is other than self-only. The ACA individual cost-sharing limit is customarily lower than the QHDHP out-of-pocket limit for families. Annually, the United States Health and Human Services Department releases the inflation-adjusted cost-sharing limit for the upcoming year. For 2022, the inflation-indexed individual cost-sharing limit will be $8,700. Therefore, it may be necessary to embed an individual out-of-pocket maximum for individuals covered under a family HDHP, no higher than the ACA limit for individuals. In no case should this embedded limit be smaller than the family minimum annual deductible.*

In addition to being enrolled in a QHDHP, an individual may not be enrolled in any other health care plan that is not a QHDHP, before the minimum annual deductible is met, to be HSA eligible. Examples of other coverage that will cause a person to lose HSA eligibility are other major medical coverage, general purpose-health FSAs, HRAs (Health Reimbursement Arrangements), and enrollment in Medicare.

Maximum Annual Contribution

Contributions to an HSA are subject to limits set by the IRS. The limits are updated annually and are impacted by the number of people covered by the qualified HDHP, the number of months out of the year an individual is eligible for an HSA, and the individual's age. Both employee contributions and employer contributions count toward the maximum annual contribution.

In general, an individual's annual limit may be calculated by dividing the IRS-set annual limit by 12 and multiplying by the number of months the individual was eligible to contribute. An individual is eligible to contribute for a month, if they have HDHP coverage, and no disqualifying other coverage as of the first day of that month. As an exception to this general rule, if an individual is HSA eligible as of the first day of the last month of the taxable year (December 1st), the individual can contribute up to the annual maximum, if they remain HSA eligible for the rest of the month and the entire next year. This exception may be referred to as the "full-contribution" or "last month" rule.

An individual who is at least age 55 may make an extra $1,000 contribution for a given year. This additional contribution is calculated in the same manner as the base contribution. In other words, it is calculated monthly, unless the full-contribution rule applies. An individual does not have to be age 55 for every month in the year to make the full $1,000 contribution. Each spouse age 55 or older by the end of the tax year who has qualifying individual or family coverage high deductible health coverage (and no other disqualifying coverage) is eligible to make a full annual HSA catch-up contribution to his or her own account. In addition to eligible individuals, employers may also make catch-up contributions on an eligible employee's behalf.

HSA Contribution Limits*	2020	2021	2022
Self-Only HDHP	$3,550	$3,600	$3,650
Family HDHP (anything other than self-only coverage)	$7,100	$7,200	$7,300

**If both spouses have self-only HDHP coverage, both can contribute the self-only maximum. If one or both spouses have family coverage, the family annual limit is divided between them.*

Flexible Spending Accounts (FSAs)

What is an FSA?

A Flexible Spending Account (FSA) is an account through which eligible individuals can contribute amounts on a tax-free basis through an employer's cafeteria plan. An FSA account is often referred to as a Flex-Account. FSA funds can be distributed tax-free if used for qualifying medical expenses.

If an employee leaves employment with the employer plan sponsor before the account is emptied or does not use the amount elected by the end of the plan year, they will (with certain exceptions) lose the portion of their contribution remaining in the account.

Eligibility

Unlike HSAs, there are no requirements under the tax code about what other coverage an individual must be enrolled in to take advantage of an FSA. However, an employer may require an employee to be enrolled in one of their major-medical plans to enroll in the FSA. Further, unlike HSA eligibility, FSA eligibility is not conditioned on the individual not having disqualifying other coverage.

To qualify as an excepted benefit and be exempt from the ACA's group health plan mandates, a health FSA must meet both the availability and maximum benefit conditions under HIPAA. To satisfy the availability requirement, employers will typically design the plan so that only employees eligible for the employer's group medical plan can participate in the health FSA.

Maximum Annual Contribution

The maximum annual contribution an individual may make to an FSA is set by the employer and is subject to IRS regulations. The contribution limit is applicable to employee salary reductions. Employer contributions to a health FSA are only subject to the limit where an employee could have elected to receive that amount as taxable cash (or some other taxable benefit). All contributions to any FSA sponsored by an employer within the same controlled group will count toward the annual maximum. If an individual makes contributions to multiple FSAs, through employers who are not a part of the same controlled group, the entire contribution limit will apply separately to each of the FSAs.

If a single employer has both a limited-purpose and a general-purpose health FSA, the maximum contribution limit is shared between the two FSAs. Whether an individual is enrolled in self-only coverage, or coverage that includes any other individuals, does not impact the maximum annual contribution under a health FSA.

FSA Contribution Limits

2020	2021	2022
$2,750	$2,750	$2,850

HSAs & FSAs

Most of the confusion surrounding the way HSAs and FSAs impact each other are a result of misunderstanding HSA eligibility rules or applying these rules to FSAs. If an employer can remember a few simple things, most of this confusion can be alleviated.

1. HSA contributions do not impact eligibility for coverage under an FSA.
2. Coverage under an FSA results in ineligibility to contribute to or receive contributions to an HSA.
3. Coverage under a general-purpose FSA can come from unexpected places (such as a spouse's coverage, or an extension of the FSA coverage through a grace period or rollover).

FSA as Disqualifying Other Coverage

If an employee is enrolled in a general-purpose health FSA through his or her employer, that employee is not HSA eligible. However, if the health FSA is what we refer to as "limited-purpose," or in other words covers only certain excepted benefits such as dental and vision, it will not preclude HSA eligibility. Further, if the FSA is set up to be a "post-deductible FSA" so that it will not reimburse medical expenses until after the deductible has been satisfied, it will not preclude HSA eligibility.

One often overlooked source of disqualifying other coverage is a spouse's FSA. If a spouse is covered under a general-purpose FSA that reimburses expenses before the deductible is satisfied, it is likely that the employee's medical expenses could also be covered under that FSA. Where this is the case, neither the employee nor the spouse is HSA eligible. This is true even if the employee's spouse does not actually use his or her FSA on the employee's expenses.

In most cases, if an individual does not use his or her FSA funds by the end of the plan year, he or she will forfeit the amount remaining in the account. However, there are certain ways that a plan sponsor can design the account to give the individual extra time to use the left-over amount. Note:HSA eligibility is not precluded by a run-out period, where an individual has not elected an FSA for the subsequent plan year. A run-out period is a period of time designated into the next plan year, during which the individual can submit expenses for reimbursement that were incurred during the prior plan year.

The first option is to allow for what is called a "rollover." If an employer allows any amount to "rollover" into an FSA for the individual for the next plan year, that individual will be ineligible for an HSA for the entire next plan year, unless they opt out of receiving that rollover or the rollover is made to a limited-purpose FSA. The person remains ineligible for an HSA for the entire plan year, regardless of when the individual actually exhausts his or her FSA funds that rolled over.

Instead of a rollover, some employers allow for what is referred to as a "grace period." A grace period is a limited period of time after the close of the plan year (no longer than 2 ½ months), during which time individuals can continue to incur medical expenses for reimbursement from the balance remaining in their FSA account from the prior year. If an individual did not elect an FSA for a given plan year but has greater than a $0 balance on the last day of the prior plan year, he or she will be HSA ineligible for the duration of the grace period.

Conclusion

Plan sponsors might apply the following approach to help them ensure their employees' compliance with HSA eligibility provisions:

1. Ensure no employees enrolled in a general-purpose FSA may contribute to an HSA.
2. Ensure that any individual who will be taking advantage of a grace period or a rollover provision under an FSA is not also planning on contributing funds to an HSA.
3. Advise employees that if their spouse (or parent for dependent children) is covered under an FSA which could reimburse their medical expenses, they are not eligible to make or receive contributions to an HSA.
4. As always, it is important for Plan sponsors to consult with their own legal counsel and tax advisors before making any decisions relating to HSAs.

For more information on HSAs, please check out the following webinar: Making Sense of HSA's and HSAs & Their Tricky Rules.

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www.hayscompanies.com | info@hayscompanies.com

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