

HEALTH SAVINGS ACCOUNTS: A GUIDE FOR EMPLOYERS

Employers that sponsor high deductible health plans (HDHPs) often facilitate employee participation in health savings accounts (HSAs) as a component of consumer-driven healthcare. HSAs are tax-advantaged accounts that allow individuals to save and pay for qualified medical expenses without federal tax liability at any time after the account is established, including during retirement. This publication provides a guide to HSAs at a high level. Employers with specific questions should work closely with their benefits consultants to develop strategic HSA-eligible plan designs and to implement effective employee communications and regulatory compliance practices. The topics addressed in the publication appear in the order shown below.

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Employers that sponsor qualified HDHPs or are considering adding an HDHP to their plan offerings in the future should be familiar with the range of HSA issues discussed in this publication.

1. OVERVIEW OF HSAs

An HSA is a government-regulated savings and investment account that allows eligible individuals to pay or reimburse themselves for qualified medical expenses for themselves, their spouses, and their tax dependents on a tax-advantaged basis at the federal level. Most states allow similar tax advantages, but taxation differs depending on the state. Employers that offer HSAs in connection with HDHPs should consult with their tax advisor to ensure that their payroll practices are compliant with federal tax laws and with state tax laws in the states in which they operate.

The federal tax advantages of HSAs are three-fold:

- Contributions to an HSA are tax-deductible (up to the maximum annual limit).
- HSA fund balances grow on a tax-deferred basis (the account holder does not pay federal taxes on capital gains, interest income, or dividends).
- HSA withdrawals that are used to pay for qualified medical expenses are 100% tax-free.

An HSA is an individually-owned account. In the employment context, this means that the employee, not the employer, is the owner and manager of the HSA. HSAs are “portable” and remain the vested property of the employee regardless of the employee’s employment or healthcare enrollment status. Thus, although an employee must meet certain conditions to be eligible to make or receive contributions to an HSA (see under Section 4 below), an employee can use HSA funds to pay for qualified medical expenses at any time after the HSA is established.

HSAs allow employees to invest their savings and to carry over unused account balances indefinitely. Employees who have relatively low current year healthcare expenses, or who are able to meet those expenses through current year earnings or accumulated after-tax savings, can use HSAs as tax-advantaged savings accounts to pay for medical expenses in future years, including during retirement.

The dollar limits on contributions to an employee’s HSA include contributions from all sources, including the employee, the employer, family members, and other individuals. There are no limits on the amount or timing of distributions from an HSA, except that distributions for non-qualified expenses are taxable and, if made before age 65, are also subject to a 20% tax penalty.

For employers, HSAs generally are not treated as a group health plan under ERISA or other employee benefits laws, such as COBRA, HIPAA, or the ACA. Consequently, ERISA plan documents, Form 5500 filings, and fiduciary obligations (other than those related to the timely remittance of contributions) do not apply to the HSA, although they likely apply to the underlying HDHP. Note, however, that Section 125 nondiscrimination rules apply to HSAs that are offered through an employer’s cafeteria plan (as is generally the case). These rules are discussed below under Nondiscrimination Rules in Section 5.

Lastly, to avoid the application of ERISA, employers must ensure that they have only limited involvement with the HSA program. Specifically, the establishment of the HSA must be completely voluntary on the part of employees. Employers must not limit the ability of employees to transfer their funds to another HSA, impose conditions on the use of HSA funds, or make or influence HSA investment decisions. Additionally, employers must take care not to represent that the HSAs are an employee welfare plan (e.g., in benefit communications or materials). Finally, employers must not receive any payment or compensation in connection with an HSA (e.g., more favorable business loan terms for selecting the custodian for the HSA program).

2. HSAs AND HDHPs

As background, gross premiums for HDHPs, as well as any employee cost-share contributions toward HDHP coverage that employers may require, are typically lower than those for more traditional preferred provider organization (PPO) or health maintenance organization (HMO) plans, but the annual deductibles for HDHPs are typically higher (hence the “high deductible” descriptor). The lower premiums available under HDHPs, combined with the opportunity afforded by HSAs for individuals to meet qualified medical expenses with tax-advantaged funds – both during and after employment – have contributed to the growing popularity of HDHPs over the past several years.

At a high level, an employee must be enrolled in a qualified HDHP to be eligible to make or receive HSA contributions. A qualified HDHP is a medical plan that meets the IRS statutorily prescribed single/family thresholds for minimum annual deductibles and maximum annual out-of-pocket expenses (exclusive of premiums), and that does not provide a significant benefit (other than for preventive care) before the statutory minimum annual deductible is met. The statutory HDHP thresholds are indexed annually (see Appendix A, **IRS Limits on Health Savings Accounts (HSAs) and High Deductible Health Plans (HDHPs)**). Note that the statutory HDHP limits do not apply to deductibles and out-of-pocket expenses for out-of-network services if the plan uses a provider network.

Importantly, single (or self-only) HDHP coverage refers to coverage exclusively for the employee; family HDHP coverage refers to coverage of the employee and at least one other individual, regardless of whether that individual is the employee’s tax dependent or is eligible to make contributions to, or receive distributions from, an HSA. The IRS releases the single/family contribution limits for HSAs annually, typically (although not always) in connection with other annual cost-of-living adjustments on or about June 1 for the following calendar year. For details of HSA contribution limits, see Appendix A.

The IRS definition of preventive care for purposes of HSA eligibility incorporates preventive services required by the ACA. Preventive care includes, but is not limited to, periodic health exams and related tests, routine prenatal and well-being child care, immunizations, tobacco cessation and weight loss programs, and certain screening devices. Plans may provide coverage of COVID-19 test kits with zero cost-sharing without impacting the qualified HDHP status of the plan or the employee’s HSA eligibility. Generally, preventive care does not include services or treatments intended to treat an existing illness, injury, or condition. However, IRS Notice 2019-45 allows specified expenses for certain chronic conditions (e.g., insulin for diabetes) to be

treated as preventive care benefits that can be provided on a no-deductible or low-deductible basis without any adverse effect on HSA eligibility. Note that the Inflation Reduction Act of 2022 amended the IRS definition of preventive care for plan years beginning on or after January 1, 2023, to provide for coverage of selected insulin products in any dosage form (vial, pump, or inhaler) of any insulin type (rapid-acting, short-acting, etc.). Employers interested in expanding their plan's definition of preventive care will need to amend the plan accordingly and should confer with insurers and stop loss carriers regarding possible impact on rates.

Although HDHPs generally may not pay non-preventive benefits prior to the participant satisfying the statutory minimum HDHP deductible, there is an exception for benefits required by the CAA No Surprises Act or similar state surprise billing protections. For example, if pursuant to the CAA a plan covers benefits for emergency services, coverage must be provided without prior authorization, regardless of whether the provider/facility is in-network and regardless of other plan terms/conditions (other than exclusions, COBs, waiting periods). Accordingly, for plan years beginning on or after January 1, 2022, plan payments made pursuant to the CAA surprise billing rules do not cause plans to lose HDHP status or individuals to lose HSA eligibility, even if expenses are paid before the statutory minimum HDHP deductible is satisfied. For more information on the CAA No Surprises Act, see the NFP publication [Transparency and CAA 2021 Obligations of Group Health Plans](#).

Prescription drug plans, whether integrated into an HDHP or provided as a separate plan or rider, must require that the statutory minimum HDHP deductible is met before benefits are paid. In addition, there is a lack of guidance regarding whether the ACA requires drug manufacturer financial assistance (such as discounts through coupons or rebates) to apply towards an HDHP participant's cost-sharing limits. Some state laws, although generally applicable only to fully insured plans, require such financial assistance to be credited towards the participant's cost-sharing limits. However, IRS guidance specifies that only medical expenses incurred by the individual can be counted towards the HDHP statutory deductible. Therefore, any arrangement that allows drug manufacturer coupons to be credited towards satisfaction of the deductible, even if required by state law, could potentially jeopardize the qualified status of the HDHP. In the absence of clear and consistent guidance from the various federal and state regulators regarding the application of drug coupons, employers that make any drug manufacturer financial assistance available to HDHP participants should consult with legal counsel for guidance.

Employers that currently sponsor a qualified HDHP, or that are considering adding this benefit to their existing medical plan offerings, should consider the ways in which coverage under other common benefits plans (such as health FSAs, HRAs, and certain other benefits) may affect HSA eligibility. These issues are discussed in greater detail in Section 4 below. For a side-by-side comparison of key differences among HSAs, FSAs, and HRAs, see the NFP publication [Quick Reference Chart: HSAs, Health FSAs, and Traditional HRAs](#).

3. ESTABLISHING AN HSA

Enrollment in an HDHP is a prerequisite for use of an HSA, but HDHP enrollment does not automatically constitute establishment of an HSA. Employers that sponsor qualified HDHPs should work closely with their benefits consultants to ensure that they engage a reputable HSA vendor and deliver robust employee communications regarding the HSA establishment process. An HSA-eligible employee can open and fund an HSA at any time on and after their initial HSA eligibility date.

The date on which an HSA bank account is considered to be "established" is determined by state law. Most state trust laws require that for a trust to exist, an asset must be held in trust. With respect to HSAs, this means that in most states, the account holder (or the employer on behalf of the account holder) must fund the account in order for the account to be considered established. However, some states deem an HSA to be established as of the date on which the account holder executes the relevant banking agreement, regardless of whether the account is funded.

Importantly, only the qualified expenses incurred on and after the HSA establishment date are eligible for reimbursement, even if the employee was enrolled in a qualified HDHP as of an earlier date. As an example, Employee A enrolled in a qualified HDHP effective January 1 and made their first HSA deposit approximately two weeks later on January 15. If Employee A lives in a state where an HSA is deemed established as of the date of the first deposit, only the qualified medical expenses incurred on or after January 15 are eligible for reimbursement from the HSA.

Qualified expenses incurred on and after the HSA establishment date are eligible for reimbursement regardless of whether funds sufficient to meet the entire expense are available in the account at the time the expense is incurred. The tax-free reimbursement can be postponed until a later date when sufficient funds become available. Also, if an employee has an HSA (whether from the same or a previous employer) that had a positive balance within the last 18 months, the establishment date of the prior non-dormant HSA is considered the establishment date for purposes of incurring new expenses.

Employers should be aware that employees are permitted to have more than one HSA account; however, employers are not required to remit contributions to HSA administrators other than the employer's chosen administrator. The availability of multiple HSA accounts does not alter the annual HSA contribution limits, which are cumulative (not per account). Most HSA administrators permit employees to transfer funds to other HSA accounts without penalty, although transfer fees may apply. See below under Section 5 for further information about processing contributions into an HSA.

Note that employers have certain notification and contribution obligations with respect to HSA-eligible employees who have not established an HSA account. However, these obligations apply only if the HSA contributions are made on a post-tax basis (i.e., outside of a Section 125 cafeteria plan), which is rarely the case.

Investment Options. HSA vendors (banks, brokers, and other financial companies) generally allow HSA account holders to invest fund balances above a specified limit in an array of mutual funds or through a self-directed brokerage account. If investment opportunities are made available to account holders, employers should ensure that the HSA vendor offers an appropriate range of investment options and that the investment fees are reasonable.

Beneficiary Designations. During the lifetime of the HSA account holder, the account holder is the de facto account beneficiary. Account holders must designate a beneficiary to receive the HSA account balance after they die. If the HSA beneficiary is the surviving spouse, the spouse becomes the HSA account holder, and any future distribution of the HSA balance is made at the discretion of the surviving spouse. If the designated beneficiary is a party other than the surviving spouse, the account ceases to be an HSA on the date of the account holder's death. The HSA administrator is then required to distribute the account balance to the named beneficiary as taxable earnings and to report to the IRS the fair market value of the account as of the account holder's date of death.

4. HSA ELIGIBILITY AND IMPERMISSIBLE COVERAGE

In broad terms, an individual is eligible to make or receive contributions to an HSA if they are covered by a qualified HDHP and are not covered by any other plan that provides medical benefits prior to satisfaction of the IRS minimum HDHP deductible, subject to certain exceptions (such as coverage for preventive services, as described above in Section 2).

Specifically, to be eligible to establish and contribute to an HSA (hereafter their "HSA-eligible status"), the individual must:

- Be covered under a qualified HDHP as of the first day of the calendar month
- Not have "impermissible health coverage" (see explanation below)
- Not be enrolled in Medicare
- Not be claimed as a dependent on someone else's tax return

In all cases, an individual's HSA eligibility is determined based on whether the *individual* meets the HSA eligibility criteria, regardless of whether the individual also enrolls one or more HSA-ineligible parties on their HDHP. Note further that an individual's HSA eligibility only affects the ability to make or receive contributions to an HSA; it has no bearing on the ability to distribute funds *from* an HSA.

Coverage Under an HDHP as of First Day of Calendar Month. HSA eligibility is determined on the first day of the calendar month. An individual must have qualified HDHP coverage (and no impermissible coverage) as of the first day of the calendar month – even if this falls on a weekend or holiday – in order to contribute to their HSA for that month.

Impermissible Health Coverage. In the context of HSA eligibility, impermissible coverage (often called "other health coverage") refers to any non-HDHP health coverage that provides "first dollar coverage" — coverage provided before the statutory minimum HDHP deductible is met. Examples of impermissible coverage include other major medical coverage (such as through a spouse), stand-alone prescription drug plans, general-purpose HRA or FSA coverage (including through a spouse's general-purpose HRA or FSA), and point solution programs that provide medical services without participant cost-sharing. For more information about point solution programs, see the NFP publication [Point Solution Programs: A Guide for Employers](#). Medicare, including any single part of Medicare (such as exclusively Medicare Part A), is also impermissible coverage.

Based on that, an employee's enrollment in an employer's non-HDHP medical plan (not including a dental or vision plan; see exceptions below), or as a dependent in the non-HDHP medical plan of a spouse or domestic partner, constitutes impermissible coverage. Non-HDHP coverage would include PPO or HMO coverage, among other things. Note that continuation of non-HDHP coverage with a former employer (e.g., COBRA) will jeopardize HSA eligibility. Further, medical plan designs that require a copay

for services such as office visits, urgent care, clinical laboratory tests, or imaging services constitute impermissible coverage unless the copay formula applies only after the statutory minimum HDHP deductible is satisfied. Note, however, that plans may provide coverage of COVID-19 test kits with zero cost-sharing without impacting the qualified HDHP status of the plan or the employee's HSA eligibility.

In addition, note that the Consolidated Appropriations Act of 2023 (CAA 2023) provides a two-year extension of relief that allows HDHPs to provide first-dollar coverage for telehealth services without negatively impacting HSA eligibility. Under the CARES Act COVID-19 legislation from 2020, telehealth services could be treated as disregarded coverage (i.e., not causing a loss of HSA eligibility) for plan years beginning on or before December 31, 2021. The Consolidated Appropriations Act of 2022 (CAA 2022) included a temporary extension of this relief from April 1, 2022, to December 31, 2022. The CAA 2023 further extends the optional telehealth relief for plan years beginning after December 31, 2022, and before January 1, 2025. Plan sponsors that wish to take advantage of this relief must coordinate with their carrier (if fully insured) or third-party administrator (if self-insured) and ensure the pre-deductible telehealth coverage is reflected in the plan and any changes are communicated to participants (e.g., via a Summary of Material Modification).

An employee's enrollment of an HSA-ineligible spouse or domestic partner (such as a Medicare-enrolled individual) as a dependent on the employee's qualified HDHP does not affect the employee's eligibility to make or receive contributions to an HSA. Similarly, an HSA-ineligible employee's enrollment of an HSA-eligible spouse on the employee's qualified HDHP does not affect the spouse's eligibility to make or receive contributions to an HSA, but any such contributions cannot be made or received through the employer's cafeteria plan. An HSA-eligible spouse who is enrolled as a dependent in an HSA-ineligible employee's qualified HDHP is permitted to make HSA contributions into an HSA account in the spouse's name up to the HSA limit that pertains to family coverage.

There are exceptions to the "other health coverage" designation for certain types of coverage, including stand-alone dental or vision plans, disability, long-term care, specific illness or disease (e.g., cancer) or hospital indemnity plans, and accident insurance. Generally, to qualify as disregarded coverage, hospital indemnity coverage must pay a fixed amount per day (or other period) for hospitalization and not provide significant other medical benefits. Similarly, accident coverage must be limited to medical expenses triggered by accidents or injuries and not include coverage for general medical services. Additionally, an HRA or FSA that provides reimbursement for expenses after the statutory HDHP deductible is satisfied (often called "post-deductible coverage") is permissible coverage. Further, coverage to satisfy workers' compensation laws is permissible coverage and does not jeopardize an employee's HSA eligibility. Employers should review the benefits provided under each type of coverage carefully to determine if an exception applies.

Prescription Drug Plans. An employee's enrollment in an employer's prescription drug plan, whether the plan is part of a qualified HDHP or is a separate plan or rider, constitutes impermissible coverage if the plan provides benefits before the statutory minimum HDHP deductible is satisfied. Likewise, an employee's enrollment as a dependent in the non-HDHP prescription drug plan of a spouse or domestic partner also constitutes impermissible coverage. Also, plans may provide coverage of COVID-19 test kits with zero cost-sharing without impacting the qualified HDHP status of the plan or the employee's HSA eligibility.

Flexible Spending Accounts (FSAs). An employee's enrollment in a general-purpose FSA, including a spouse's FSA, constitutes impermissible coverage. Note that an employee is deemed to be covered by a spouse's FSA regardless of whether the employee actually requests or receives reimbursements from the spouse's FSA, and regardless of whether the employee is enrolled as a dependent on the spouse's medical plan. By contrast, a domestic partner's FSA does not constitute impermissible coverage because an employee is not eligible to be reimbursed for expenses from a domestic partner's FSA. Note that an employee's enrollment in a dependent care FSA has no impact on the employee's HSA eligibility. All references to FSAs in this publication are therefore understood to be references to a health FSA, not a dependent care FSA, unless otherwise indicated.

An employee's prior coverage under a former employer's FSA will not jeopardize the employee's HSA-eligible status with a current employer unless the employee remains covered under the former employer's FSA (such as through COBRA). An employee who enacts an FSA COBRA right under a former employer's FSA remains a participant in the former employer's FSA, and hence ineligible to make or receive HSA contributions with a current employer, throughout the period for which they are remitting FSA COBRA premium payments. When the FSA COBRA participant stops remitting premium payments, they cease to be covered by the impermissible coverage (the former employer's FSA) even if they have an unspent or unclaimed balance in the FSA account.

For a non-terminated employee, FSA coverage exists for the entire FSA plan year for any year in which the employee (or spouse) makes an FSA election, regardless of the FSA balance at any point during the plan year. The employee's FSA coverage may further extend into some or all of the following plan year, depending on whether the applicable FSA plan also includes an optional grace period or carryover feature. FSA plans are permitted (but are not required) to have either a grace period or a carryover provision but are not permitted to have both simultaneously.

- **FSA Grace Period:** An FSA grace period is a designated time period after the end of the plan year during which participants can incur services and be reimbursed with funds remaining from the prior plan year election. The grace period cannot be longer than 2-1/2 months but it can be shorter. For FSA plans with a grace period, an employee who has an undistributed cash balance in the FSA plan on the last day of the FSA plan year (regardless of whether qualified expenses have been incurred) is deemed to have impermissible coverage until the first day of the first month following the end of the grace period. Pending claims, claims submitted, claims received, or claims under review that have not been paid as of the plan year end date are not taken into account.

FSA participants are not permitted to forfeit any portion of their year-end FSA balance in order to achieve a zero dollar balance as of the start of the new plan year. However, an employee with a zero dollar balance at the end of the plan year under an FSA with a grace period is considered HSA-eligible during the grace period (assuming the employee is otherwise HSA-eligible), as the IRS permits FSA coverage during a grace period to be disregarded under these “zero dollar” circumstances for the purpose of determining HSA-eligibility. Additionally, an FSA with a grace period can be amended such that the FSA becomes a limited-purpose FSA during the grace period (see under Limited-Purpose FSAs below). Note, however, that this conversion of a general-purpose FSA to a limited-purpose FSA during the grace period must apply to all FSA enrollees, not just those who seek to be HSA-eligible in the subsequent plan year.

- **FSA Carryover:** An FSA carryover provision (also referred to as a rollover provision) allows a plan participant to carry over into the next plan year up to 20% of the FSA salary reduction contribution maximum. The carryover limit for a plan year starting in 2023 to a plan year starting in 2024 is \$610. The carryover limit for a plan year starting in 2024 to a plan year starting in 2025 is \$640. The carryover funds are added to the elected amount for the new plan year and can be used to reimburse expenses incurred in the new plan year. An employee who carries over FSA funds will be ineligible for HSA contributions for the entire plan year into which the FSA funds are carried over, even after the carryover funds are exhausted and even if the employee does not make an FSA election for the new plan year.

There are no circumstances under which an employee can transfer a year-end FSA balance directly into an HSA. However, an FSA with a carryover provision can be amended to allow employees to decline or waive their carryovers prior to the beginning of the following plan year. This exception is consistent with that applicable to “zero dollar” circumstances in plans with grace periods, as referenced above. Additionally, an FSA with a carryover provision can be amended such that the FSA becomes a limited-purpose FSA during the following plan year (see under Limited-Purpose FSAs below). Similarly, the cafeteria plan can provide that employees who elect HDHP coverage for the following year are automatically enrolled in the HSA-compatible FSA, and any unused general-purpose amounts will be automatically carried over to that HSA-compatible FSA.

Limited-Purpose FSAs. A limited-purpose FSA (also referred to as an HSA-compatible FSA) reimburses expenses exclusively for dental care, vision care, and preventive care; it can also (or instead) include a post-deductible feature, which reimburses medical expenses after the statutory HDHP deductible has been satisfied.

Employers that sponsor FSA plans and that also sponsor (or are considering adding) a qualified HDHP should carefully review their FSA plan documents to ensure proper administration of the participation rules, including the impact of a grace period or carryover provision on an employee's earliest HSA eligibility date. Employers that do not currently sponsor an HSA-compatible FSA may wish to add this option via a cafeteria plan amendment to maximize the opportunities for employees covered by an FSA in Year 1 to become HSA-eligible in Year 2, and to increase the opportunities of HSA-eligible HDHP participants to pay for qualified dental and vision expenses and/or post-deductible medical expenses (depending on which features are adopted) on a tax-advantaged basis.

Note that HDHP participants who are HSA-ineligible (such as participants who are enrolled in any part of Medicare or who are covered under a spouse's general-purpose FSA) are eligible to enroll in an employer's general-purpose FSA (if eligible under the FSA plan terms). Such HDHP participants need not be limited exclusively to participation in an employer's limited-purpose FSA (if available) when the participant is already deemed HSA-ineligible due to having other impermissible coverage.

Note Regarding Midyear Election Change Events: Note that a midyear election change event or special enrollment right that may enable an FSA-covered employee to newly enroll in an employer's HDHP may not automatically permit the employee to terminate their FSA plan participation, even if the midyear election change event permits the employee to reduce their FSA election to zero for the remainder of the plan year. Consequently, a midyear HDHP plan entrant who is concurrently covered by an FSA remains HSA-ineligible until the FSA coverage end date.

Health Reimbursement Arrangements (HRAs). An employee's coverage under an employer's general-purpose HRA, including a spouse's general-purpose HRA, constitutes impermissible coverage. Note that an employee is deemed to be covered by a spouse's HRA if the employee's claims are eligible to be reimbursed under the spouse's HRA, regardless of whether the employee

actually requests or receives reimbursements from the spouse's HRA. By contrast, a domestic partner's HRA does not constitute impermissible coverage because an employee is not eligible to be reimbursed for expenses from a domestic partner's HRA. In addition, an employee's coverage under their own or a spouse's limited-purpose (dental/vision) or post-deductible HRA does not constitute impermissible coverage.

An employee's prior coverage under a former employer's HRA will not jeopardize the employee's HSA-eligible status with the current employer unless the employee remains covered under the HRA (such as through COBRA or an HRA spend-down provision).

Veterans Administration (VA) and TRICARE Coverage. Employees who have received VA benefits, except for preventive care services, for a non-service-connected disability within the past three months are not eligible to contribute to an HSA. While VA coverage previously rendered veterans ineligible for contributing to an HSA, beginning in 2016, employees who receive VA hospital care or medical services "for a service-connected disability" are considered HSA-eligible, regardless of when the VA care or services were provided. A "service-connected disability" is a disability that was incurred or aggravated in the line of duty in the active military, naval, or air service. Additionally, per the IRS, any hospital care or medical services received from the VA by a veteran with a disability rating from the VA may be disregarded for purposes of determining HSA eligibility.

Furthermore, individuals who receive health benefits under TRICARE (the healthcare program for active duty and retired members of the uniformed services, including their families and their survivors) are not eligible to contribute to an HSA.

Other Employer Provided Benefits (On-Site Clinics and EAPs). Other types of employer benefits, such as on-site clinics and EAPs, may or may not be considered impermissible coverage. If the plan provides significant medical benefits prior to the satisfaction of the HDHP deductible, the availability of these benefits (regardless of whether they are used) may adversely impact HSA eligibility. However, arguably, if the EAP or on-site clinic requires participants to pay the fair market value for services, the coverage may be permissible and not prevent HSA eligibility. In the absence of any formal rules that address this issue, employers should consult with counsel for guidance. (See above under Impermissible Health Coverage for a detailed discussion of exceptions that apply to no-cost telehealth coverage.)

Overall, employers that make an HSA program available to employees in connection with their qualified HDHP should design their other employer-provided benefits with careful attention to the issue of impermissible coverage, particularly if the other benefits are offered separately from the HDHP. For a more detailed discussion of how to determine whether a benefit (such as an EAP benefit) provides "significant benefits in the nature of medical care", see the NFP publication [Point Solution Programs: A Guide for Employers](#).

Enrolled in Medicare. An employee's enrollment (sometimes also referred to as "entitlement") in any part of Medicare (Parts A, B, C, and/or D) renders the employee ineligible to make or receive contributions to an HSA. An employee who is eligible for Medicare but who is not enrolled in Medicare can continue to make or receive contributions to an HSA, assuming the employee is otherwise HSA-eligible. The employee's coverage of a Medicare-enrolled spouse, domestic partner, or child on their qualified HDHP does not adversely affect the employee's HSA eligibility. Similarly, an HSA-ineligible employee's enrollment of an HSA-eligible spouse on the employee's qualified HDHP does not affect the spouse's eligibility to make or receive contributions to an HSA, but any such contributions cannot be made or received through the employer's cafeteria plan.

Employers that sponsor HDHPs should ensure that their Medicare-eligible employees have access to comprehensive information regarding the impact of Medicare enrollment on HSA eligibility so that such employees can make informed decisions about potentially delaying enrollment in Medicare, including no-cost Medicare Part A, in order to remain HSA-eligible. (See the *Medicare & You* handbook available from [medicare.gov](https://www.medicare.gov).) A Medicare-eligible employee's considerations will likely differ based on personal factors as well as the size of the employer. Note that the employer's health coverage will remain primary for a Medicare-enrolled active employee if the employer has 20 or more employees; however, Medicare will become primary for a Medicare-enrolled active employee if the employer has fewer than 20 employees. Employers are not permitted to consider the Medicare eligibility or enrollment status of an employee or any of the employee's dependents when determining eligibility for the employer's health plan(s) or any related employer-paid HSA contributions.

Employers should especially note that an active employee who delays enrollment in Medicare Part A at age 65 and enrolls at a later date (such as within the three-month enrollment window immediately following the initial eligibility date, or during a subsequent special enrollment period) may have a retroactive Medicare effective date of up to six months (but not earlier than the first of the month in which the employee turned 65). Employers should strongly advise employees to contact Medicare directly to verify their Medicare eligibility and enrollment effective date and should avoid making specific representations regarding Medicare eligibility.

Any HSA contributions that are made for the year in which the employee becomes Medicare enrolled and that exceed the employee's pro-rated annual maximum HSA contribution for that year due to a period of retroactive Medicare enrollment are subject to taxation and penalties unless they are reversed in a timely manner (see below under Contributions in Excess of Annual limits in Section 5). HSA contributions can be made after an employee is enrolled in Medicare if the contributions pertain to a period of time when the employee was HSA-eligible and provided the contributions are made by the contribution deadline for the applicable calendar year (i.e., the tax filing deadline – generally April 15 – that pertains to the applicable calendar year).

Note Regarding Medicaid: Employees who also receive health benefits under Medicaid (government-provided medical assistance for individuals with low incomes and resources) are not eligible to contribute to an HSA.

Note Regarding Disability: Employees on disability are automatically enrolled in Medicare after their 25th disability check from Social Security. Although disability payments stop when the employee returns to work, the Medicare entitlement extends for an additional 93 months following the employee's return. Under these circumstances, an employee who returns from disability would be ineligible to make or receive HSA contributions unless the employee expressly opts out of Medicare Part A.

Note Regarding Social Security Retirement Benefits: Employees who choose to delay Medicare enrollment in order to remain HSA-eligible must also postpone collecting Social Security retirement benefits, as employees cannot decline Medicare Part A while at the same time collecting Social Security benefits.

Claimed as a Dependent on Someone Else's Tax Return. An employee who is entitled to be claimed as a dependent on someone else's tax return is not eligible to make or receive contributions to an HSA. This is true even if the other tax filer does not receive an exemption deduction for the employee (i.e., even if the employee is not actually claimed on the other tax filer's return). Employers should ensure that employees are aware of this limitation, but employers are not responsible for confirming the employee's tax dependency status.

5. HSA CONTRIBUTIONS

General Information

IRS rules regarding HSAs provide that an HSA may receive contributions from an eligible individual or any other person, including an employer or family member, on behalf of an eligible individual. Employee and employer HSA contributions made via an employer's cafeteria plan on a pre-tax basis are not subject to federal income and payroll taxes. Per IRS instructions, such pre-tax cafeteria plan HSA contributions are reported in Box 12 of Form W-2 with Code W. Any such contributions are not also separately deducted by the employee on the employee's tax return. However, self-employed individuals, such as sole proprietors, partners, and more than 2% shareholders in an S corporation (who are eligible to contribute to an HSA but not eligible to participate in a cafeteria plan), may be able to make a post-tax HSA contribution and take an above-the-line deduction on their personal income tax returns. W-2 employees, self-employed individuals, and employers should consult with their tax advisors for specific advice and guidance regarding proper tax reporting. Additionally, employers should promptly correct any Form W-2 reporting errors to minimize situations in which affected employees may need to file amended tax returns.

The IRS establishes annual HSA contribution limits, including catch-up contribution limits for individuals who are or will be minimally age 55 as of the end of the calendar year. Annual HSA limits are inclusive of contributions from all sources (employee, employer, family member, or any other person) and are measured per calendar year, regardless of the employer's ERISA medical plan year and regardless of whether the employee has more than one employer in the same calendar year. For details of HSA contribution limits, see Appendix A.

Generally, all HSA contributions, including employer contributions (if any), vest immediately; that is, they become the irrevocable property of the employee when they are deposited in the employee's HSA. It is impermissible for an employer to withdraw its HSA contribution (if any) from an employee's account, even if the contribution was paid in an annualized lump sum amount and the employee leaves the employer prior to the end of the applicable calendar year. (See under Contributions in Excess of Annual Limits below for narrow exceptions to the prohibition on removing employer contributions from employee accounts.)

Monthly Contribution Rule. It is important to note that although HSA contribution limits are expressed as annual (calendar year) dollar amounts, an employee's eligibility to make or receive HSA contributions up to the applicable annual contribution limit is determined anew as of the first day of each calendar month based on the employee's then-current HSA eligibility status and HDHP enrollment tier (single/family). An employee's actual annual HSA contribution limit is therefore the sum of the applicable monthly limits for single or family coverage, subject to the full-contribution rule that applies if the employee is HSA-eligible specifically as

of December 1 and remains HSA-eligible for the entirety of the following calendar year. For example, an employee who has single coverage in a qualified HDHP (and has no impermissible coverage) for January through September in a calendar year, and then has family coverage in a qualified HDHP (and has no impermissible coverage) for October through December of the calendar year, is eligible to make or receive HSA contributions equal to 9/12 (or 3/4) of the annual HSA limit for single coverage, plus 3/12 (or 1/4) of the annual HSA limit for family coverage.

Full-Contribution Rule. Under the full-contribution rule (also referred to as the “last-month rule”), an employee can make the full (not pro-rated) annual HSA contribution for the current year based on the HSA-eligible employee’s HDHP coverage tier as of December 1, regardless of whether they had HDHP coverage earlier in the year. However, if the employee fails to remain HSA eligible through the end of the following calendar year, then the amount that exceeds the sum of the monthly limits must be included in the employee’s gross income for the following year and is subject to an additional 10% tax. For example, the employee in the example above could contribute the full family maximum relying on the full-contribution rule. However, if the employee failed to remain HSA-eligible through the end of the following calendar year, or remained HSA-eligible but failed to remain enrolled for family tier HDHP coverage through the end of the following calendar year, the amount exceeding the sum of the monthly limits described above would be subject to income taxes and an additional 10% tax.

Note Regarding Enrolled Family Members: Note that the family HSA contribution limit pertains to an employee with family coverage even if none of the covered family members (other than the employee) is HSA-eligible, and even if none of the family members (other than the employee) is eligible to receive distributions from the HSA. To the extent that an employee’s family tier HDHP coverage includes family members other than the employee’s spouse or tax-dependent children (for example, if the coverage includes a domestic partner, the child of a domestic partner, or the employee’s child who is not the employee’s tax dependent, such as a child over age 24 as of the end of the calendar year), any one or more of those parties who is otherwise HSA-eligible can establish their own HSA and can make or receive HSA contributions into that separate HSA up to the statutory maximum HSA contribution limit for family coverage.

By contrast, an employee’s spouse and any dependent child(ren) who are the employee’s tax dependents cannot collectively contribute more than the statutory maximum HSA contribution limit for family coverage, although they can have separate HSA accounts (and may wish to do so if the spouse is eligible to make a catch-up contribution as described immediately below). Similarly, an HSA-eligible spouse who is enrolled as a dependent on an HSA-ineligible employee’s qualified HDHP would need to have a separate HSA account in the spouse’s name in order to make or receive HSA contributions outside the employer’s cafeteria plan.

Age 55 Catch-Up Contributions. The HSA annual contribution limit is increased by an additional \$1,000 for HSA-eligible individuals who have attained age 55 by the end of the calendar year. If the employee is not HSA eligible for the entire calendar year, as with the general HSA contribution limit, the catch-up contribution limit must be pro-rated based upon the employee’s actual months of HSA eligibility.

If an employee’s spouse is eligible to make a catch-up contribution, the spouse can make a catch-up contribution in addition to the employee’s catch-up contribution (or instead of the employee’s contribution if the employee is not eligible to make a catch-up contribution); however, the spouse’s catch-up contribution must be made into a separate HSA in the spouse’s name; it cannot be comingled with the employee’s HSA.

Gap Between HDHP Enrollment Date and HSA Eligibility Date. Because HSA eligibility is always measured as of the first day of the calendar month, employers whose medical plan eligibility rules provide that health coverage commences on date of hire (i.e., no waiting period) should ensure that no HSA contributions, whether made by the employee or the employer, are processed for effective dates prior to the first day of the calendar month coinciding with or next following the effective date of the employee’s enrollment in a qualified HDHP.

Front-Loading and Back-Loading HSA Contributions. Contributions to an HSA can be made in increments of any size, up to the annual limit; that is, the HSA can be front-loaded or back-loaded as the contributors see fit, provided the contributions do not precede the employee’s HSA eligibility date. Employees have until the tax filing deadline for the calendar year (generally April 15 of the following calendar year) to make or receive HSA contributions for the year. (There are certain risks associated with front-loading HSAs, as employees may not remain HSA-eligible for the required period of time. See below under Contributions in Excess of Annual Limits for information regarding corrective measures for excess contributions.)

Employee Contributions

Employers that wish to allow employees to make HSA contributions on a pre-tax basis – as most employers do – must adopt (or amend as necessary) a Section 125 cafeteria plan to provide details of the HSA program, including eligibility to participate, the amount and timing of employer contributions (if any), and the restrictions (if any) on the frequency of employee contribution changes. Although most cafeteria plan elections, such as health FSA and premium cost-share contributions, are irrevocable for the entire plan year (or the balance thereof for midyear plan entrants) except due to bona fide midyear election change events, an employee who elects to make HSA contributions under a cafeteria plan may start or stop their election or increase or decrease their election prospectively (but not retroactively) at any time during the plan year. Also, as with other employee pre-tax or other contributions, employers must promptly transmit all HSA contributions to the account holders' HSAs. (Failure to do so could create prohibited transaction and Section 125 issues.)

Employers may restrict the frequency of employee HSA election changes, provided the same restrictions apply uniformly to all employees; however, employers must permit HSA election changes at least monthly – a time period that correlates with the HSA monthly eligibility rules – and upon a loss of HSA eligibility. The circumstances under which midyear HSA election changes will be allowed should be addressed in the cafeteria plan document and in participant communications. Most employers allow open-ended prospective HSA election changes.

It is important to note that making a midyear HSA election change, including starting or stopping an HSA election in its entirety, does not trigger an employee's right to change or revoke other cafeteria plan elections, except to the extent that such changes are otherwise permitted based on the underlying facts and circumstances. For example, an employee cannot revoke an FSA election midyear to render the employee HSA-eligible unless the permitted election change rules would otherwise allow such a change to the FSA election.

Employer Contributions

Employers are permitted, but are not required, to make HSA contributions to the accounts of HSA-eligible employees, provided the employee is HSA-eligible as of the contribution date and regardless of whether the employee subsequently remains HSA eligible for any future months. Employer contributions to an employee's HSA are generally excluded from the employee's gross income for purposes of federal withholding and employment taxes (FICA/FUTA), provided they do not exceed the maximum annual limit.

In general, employers are not responsible for determining whether an employee is HSA-eligible; however, employers should have a reasonable belief when they contribute to an employee's HSA that the employee is eligible to make or receive HSA contributions. Accordingly, the employer is required to verify whether the employee is enrolled in the employer's HDHP and is not enrolled in any of the employer's other health coverage options, as described in Section 4 under Other Health Coverage. Employers can rely on their personnel records to confirm the employee's age eligibility to make HSA catch-up contributions, as applicable. It is permissible for employers to make HSA contributions to employees who have waived the employer's medical coverage altogether, but this practice is generally discouraged because of the administrative challenge of confirming the employee's HSA eligibility. Although not required, most employers work with their HSA vendors to provide educational materials and resources to help employees determine for themselves if they are HSA eligible.

Employers that choose to make HSA contributions have discretion to determine the amount of the contribution, subject to nondiscrimination rules; in addition, they have discretion to determine the frequency of the contribution, subject to the employer's cash flow considerations and the goals of its HSA contribution program. Note that there are certain comparability rules that apply if HSA contributions are not made via a cafeteria plan, as discussed later in this section under Nondiscrimination Rules.

Here are some examples of HSA contribution models that are made pre-tax through a Section 125 plan:

- **Matching HSA Contributions:** The employer contributes an amount equal to (or a percentage of) the participant's pre-tax salary reduction amount.
- **Incentive-based HSA Contributions:** The employer contributes a specified amount to the HSAs of participants who participate in health risk assessments, disease-management programs, or wellness programs.
- **Seed Money Contributions:** The employer makes non-elective "seed" money HSA contributions either automatically to all HSA-eligible employees (regardless of employee HSA contribution) or exclusively to employees who make pre-tax salary reduction contributions.

- **Cashable Flex Credits:** The employer funds “cashable” flex credits, which are non-elective contributions that the employer makes available to each HSA-eligible employee; the employee then chooses either to receive the flex credit as taxable income or to fund it towards their HSA. However, an employer subject to the ACA employer mandate should understand that employer-provided credits that can be used to pay for non-health benefits (such as an HSA) or received in cash generally will not reduce the employee’s required medical premium contribution for affordability purposes (and thus would not help the employer satisfy the ACA affordability requirements).

Employer Contribution Amount

Employers that choose to make HSA contributions to HSA-eligible employees can provide a uniform contribution amount regardless of the employee’s HDHP enrollment tier, or they can provide different contribution amounts based on single versus family HDHP coverage. Employers that adopt a two-tier (single/family) contribution model must make a family contribution to any HSA-eligible employee with family coverage, regardless of whether any of the enrolled family members are eligible to make contributions to, or receive distributions from, the employee’s HSA.

Employers also have broad discretion to vary their contribution model according to a number of other factors, including date of hire, job classification or other bona fide business-based classifications. However, employers must ensure that the plan does not intentionally or unintentionally favor highly compensated employees (HCEs), as described in greater detail under Nondiscrimination Rules below. Overall, the employer’s HSA contribution policy should be documented in a writing that explains the contribution eligibility, timing, and amounts, including for employees who enroll in the HDHP or change coverage tiers mid-year. Once established, the policy should be clearly communicated to employees.

Employers should also be aware that insurers may apply a rate load factor (i.e., a premium increase) if the employer’s HSA contribution exceeds a specific percentage of the HDHP’s deductible. Generally a rate load will not apply if the employer’s contribution is less than 50% of the HDHP deductible, but practices vary and should be confirmed on a case by case basis with the insurer.

Nondiscrimination Rules. Under a cafeteria plan, employer HSA contributions and employee pre-tax HSA contributions are collectively referred to as employer contributions. All such contributions are subject to Section 125 nondiscrimination rules, which prohibit the favoring of HCEs. Under Section 125, an HCE is any officer, a more-than-5% shareholder/owner or any individual with compensation in excess of an IRS-indexed annual amount (see Appendix B, **IRS Limits on Retirement Benefits and Compensation**).

An employer can discriminate in favor of (but not against) non-HCEs. At a high level, the nondiscrimination tests focus on eligibility (who may participate), contributions and benefits (the benefits available to participants), and utilization (who is actually benefiting). If the employer makes the same dollar amount of employer HSA contributions available to all employees regardless of HDHP enrollment tier or based exclusively on HDHP enrollment tier, then the employer likely passes both the eligibility and contributions and benefits nondiscrimination tests but would need to review actual employee contributions under the utilization test. If the employer varies employer HSA contributions on a basis other than enrollment tier, then additional non-discrimination tests should be performed. Employers should review their proposed HSA contribution model with the party responsible for performing their nondiscrimination testing to ensure it passes all applicable tests.

When a plan fails the nondiscrimination test, the HCE participants generally lose the tax advantages associated with Section 125. Employers are encouraged to perform nondiscrimination testing early in the plan year so that plan failures can be corrected by reducing the pre-tax payroll deductions of HCEs as necessary prior to the end of the calendar year. Affected employees can instead make personal (after-tax) contributions to their HSAs. Employees can deduct any such after-tax HSA contributions from their taxable income when they file their personal income tax returns. This process allows the affected employees to recover any federal and state (if applicable) income taxes they paid on their HSA contributions, but it does not permit them to recover FICA taxes.

For further information about Section 125 nondiscrimination rules, see the NFP publication [Sections 105 and 125 Nondiscrimination Rules: A Guide for Employers](#).

Comparability Rules. If the HSA contributions are made post-tax (which is rarely the case), then the contributions are subject to the comparability rules. The comparability rules are stricter than the Section 125 nondiscrimination rules. These rules require that comparable employer contributions, calculated on a monthly basis, are made to comparable participating employees (HSA-eligible employees who are in the same category of non-collectively bargained employees and who have the same HDHP coverage tier), and permit employers to vary contributions based on only three specific categories: active full-time employees

(those who customarily work 30 or more hours per week), active part-time employees (those who customarily work fewer than 30 hours per week), and former employees. Note that HSA-eligible employees are excluded from comparability testing even if they are enrolled in an HDHP. Employers considering making contributions outside of a cafeteria plan should review these rules carefully to ensure they comply with all applicable requirements, including related notices.

Employer Contribution Frequency (Lump Sum versus Pro Rata HSA Contributions)

Employers that contribute to an eligible employee's HSA can determine the amount and timing of their contributions, subject to annual limitations and nondiscrimination considerations. Employers can make lump sum contributions at regular intervals (such as per pay period, monthly, quarterly, semi-annually, or annually), or they can make contributions ratably throughout the year according to the payroll schedule for processing employee HSA contributions, or they can devise hybrid variations on these approaches to suit their budgetary and program goals as described below.

Up-Front Lump-Sum Contributions. This HSA contribution strategy gives employees immediate access to an HSA balance at the start of the plan year (or upon plan entry date, if later), which provides cash flow relief to employees who incur qualified unreimbursed expenses early in the year and may not have accumulated an HSA balance from prior years. Employers should consider the cash flow consequences (for the employer) of such lump sum contributions as well as the fact that some employees might leave employment prior to the end of the applicable plan year. (Because employer contributions are non-forfeitable, employers cannot recoup any portion of their contribution to an employee's HSA.) Employers that otherwise make HSA contributions in annual lump-sum amounts are permitted (but not required) to pro rate the lump sum exclusively for midyear new hires, provided they memorialize this practice in the plan document and administer it consistently for all new hires.

If the employer makes an annual lump sum HSA contribution in an amount that exceeds one-twelfth of the employee's annual limit, there is a risk that the contribution will exceed the allowable annual limit. An excess contribution could occur, for example, if the employee does not remain HSA-eligible for a sufficient number of future months. Because it is impossible for the employer to know whether the employee will remain HSA eligible in future months, the most cautious practice is to make employer contributions (if any) ratably in amounts not greater than one-twelfth of the annual limit and based on an employee's actual HSA-eligible status as of the first day of each calendar month.

Ratable Contributions. This HSA contribution strategy allows employers to manage cash flow more effectively and eliminates the risk of providing a disproportionately large cash benefit to employees who terminate employment prior to the end of the applicable plan year. Employees that incur eligible expenses early in the plan year, and who have not otherwise accumulated an HSA balance from prior years, may initially need to pay such eligible expenses with after-tax dollars and later reimburse themselves as their HSA balance grows (whether from the employer's HSA contributions or their own).

Hybrid Lump-Sum and Ratable Contributions. This HSA contribution strategy, in which a portion of the annual employer contribution is made on a lump-sum basis and the remainder is paid ratably throughout the year, allows employers to achieve a measure of the more employee-friendly approach while limiting the cash flow impact as well as the risk of contributing to the HSAs of employees who leave employment during the plan year.

Periodic Lump-Sum Contributions. Some employers make their HSA contributions in quarterly or semi-annual lump-sum increments. This approach protects the employer from some of the cash flow challenges and risks of annual lump-sum contributions.

Matching Contributions. If employee HSA contributions are made through a cafeteria plan, employers can make matching HSA contributions, where the employer match is conditioned on the employee contribution and is expressed as equal to or a denominated ratio of the employee's contribution. This approach provides an obvious incentive to employees to make elective HSA contributions and may be of special interest to employers that also provide a matching contribution formula in connection with a defined contribution retirement plan.

Contributions in Excess of Annual Limits

It is generally the responsibility of the account holder, not the employer, to correct contributions in excess of annual limits. Employees should contact their HSA institution to correct most errors. To avoid a 6% excise tax penalty on excess contributions, errors must be corrected by the employee's individual federal income tax filing deadline (including extensions) for the prior calendar year. Employees should seek guidance from their tax adviser regarding corrective actions to their HSA contributions. (Further instructions about correcting errors and avoiding penalties are available in IRS Form 8889 and IRS Form 5329.)

Generally, employer HSA contributions are non-forfeitable. Meaning, contributions to an employee's HSA belong to that employee and cannot be returned to the employer. This can cause issues for employers who experience an error in contributions. There are very limited exceptions to this rule, which include, at a high-level, instances where the individual was never HSA-eligible, clear and convincing evidence of administrative or process error, and mistakenly contributing more than the maximum permitted by the IRS.

In the event that an exception applies, an employer should contact the HSA institution regarding the recoupment process. (Note that an HSA institution is not legally required to permit an employer to recoup contributions, so the HSA institution would have to agree to this.) The contribution recoupment must be made by the end of the calendar year in which the error occurred. If recoupment is not made, the amount of any excess contribution will need to be included in the employee's gross income. Importantly, this is largely a tax matter and employers should seek guidance from their tax adviser or counsel when considering corrective actions regarding HSA contributions.

Reporting Obligations

Employer Reporting Obligations: Generally speaking, employers do not have HSA-related reporting obligations at a federal level; there are no specific IRS forms or reports that must be completed or filed. That said, HSA contributions that are made through a cafeteria plan, including both employer contributions (if any) and employee pre-tax payroll contributions (if any), are reported collectively by the employer as employer contributions in Box 12 of Form W-2 (Wage and Tax Statement) with code W.

Custodian Reporting Obligations: The HSA custodian reports all contributions to the account for the year on Form 5498-SA, which is filed with the IRS and sent to the account holder by May 31 of the following year. Additionally, the custodian reports all distributions from the account in the year on Form 1099-SA, which is provided to account holders by January 31 of the following year.

Account Holder Reporting Obligations: All individuals who had HSA contributions or distributions must report the activity on Form 8889, which is included with the individual tax return (Form 1040). As noted above, in some cases, Form 5329 must also be completed to report excess contributions and earnings.

6. HSA DISTRIBUTIONS

HSA funds that are distributed for qualified medical expenses of the employee and any of their tax dependents are not subject to federal tax. Medical expenses are defined as "the costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and for the purpose of affecting any part or function of the body." These can include expenses paid toward deductibles, copays, or coinsurance as well as amounts paid for prescription drugs, imaging services, and out-of-network provider services that are above the applicable "usual, customary, and reasonable" (UCR) amount. They can also include the costs of equipment, supplies, and diagnostic devices needed for legal medical services rendered by physicians, surgeons, dentists, and other medical practitioners.

In addition, HSA funds can be used for mileage to and from doctor visits and parking fees for medical appointments. Over-the-counter (OTC) supplies such as bandages, reading glasses, contact lens solution, sunscreen, athletic braces and supports, breast pumps, and glucose monitors are qualified expenses. Effective January 1, 2020, OTC drugs purchased without a prescription are qualified expenses, as are menstrual products. Further, effective January 1, 2020, personal protective equipment to prevent the spread of COVID-19 (e.g., face masks, hand sanitizer, sanitizing wipes, etc.) are reimbursable expenses.

HSA funds can also be used to pay insurance premiums for policies that cover medical care, including COBRA, Medicare, and long-term care premiums, provided the individual is not otherwise claiming a tax credit or deduction for such premiums and the premiums are not being paid through a pre-tax payroll deduction. Note that premiums for Medicare Part B, Part D, and Medicare Advantage plans (often called Part C), and premiums for employer-sponsored health insurance (such as retiree medical coverage for the account holder and spouse/dependents), are qualified expenses only if the HSA account holder is aged 65 or older; they are not qualified expenses if the account holder (or spouse/dependent) is enrolled in Medicare prior to age 65, such as due to disability/ESRD. Also note that an account holder who is under age 65 cannot use HSA funds to cover a spouse's healthcare premium costs, even if the spouse is age 65 or older. Importantly, note that HSA funds cannot be used to pay for a Medicare supplemental policy, such as Medigap.

Lastly, note that medicines and drugs from other countries, cosmetic surgery, cosmetic procedures (such as teeth whitening), and health club memberships are not qualified expenses. For further information on medical expenses that are reimbursable from an HSA, see the NFP publication [Qualified Medical Expenses](#) as well as IRS Publication 502, *Medical and Dental Expenses*.

HSA funds do not need to be withdrawn in the same year expenses were incurred. On the contrary, HSA balances can be invested and saved for future expenses, including post-retirement healthcare expenses, and can be withdrawn without respect to whether the individual is eligible to make HSA contributions at the time of the HSA withdrawal. There is no time limit on an HSA account holder receiving reimbursement for HSA-eligible expenses, provided the account was established prior to the date on which the expense was incurred. Note that HSA funds can be used to reimburse any eligible medical expenses, even if the expenses are incurred under a health plan that is not a qualified HDHP.

Employers that sponsor qualified HDHPs should remind employees regarding the importance of saving receipts for qualified medical expenses. In what is often referred to as the “shoebox rule” (because account holders can save receipts and reimburse themselves later), the IRS requires HSA account holder to keep records that are sufficient to show that distributions from the HSA were used exclusively to pay for or reimburse qualified medical expenses. The account holder must also be able to demonstrate that the expenses were not previously paid or reimbursed from another source and that they were not taken as an itemized deduction in any prior calendar year.

Tax Dependents

HSA funds, like health FSA and HRA funds, can be used to reimburse qualified healthcare expenses of an employee, the employee’s spouse, or the employee’s tax dependents, regardless of whether the spouse or tax dependents are enrolled on the employee’s healthcare plan (or on any other healthcare plan). For health FSAs and HRAs, funds can be used to reimburse the qualified medical expenses of a child up to the end of the year in which the child turns age 26 (regardless of whether the child is the employee’s tax dependent). In contrast, generally for HSAs, funds can be used to reimburse the qualified medical expenses of a child only if the child is the employee’s tax dependent (i.e., can be claimed as a tax dependent on the employee’s tax return) and therefore generally only up to age 24. (See IRS Publication 969 for additional information on the definition of “tax dependent”).

Withdrawal Penalties and Tax Consequences: HSA fund withdrawals by individuals under age 65 for any purpose other than qualified healthcare expenses are subject to income tax on the withdrawal amount plus a 20% tax penalty, regardless of the age of the party on whose behalf the withdrawal is made. HSA distributions made after age 65 are penalty-free but are taxable if the withdrawal is for purposes other than qualified medical expenses. These withdrawal penalties and tax consequences pertain regardless of the account holder’s employment status at the time the withdrawal is made.

7. COBRA CONSIDERATIONS

HSAs are not group health plans, and are therefore not subject to COBRA continuation rules. Employers that make HSA contributions to active employees are permitted (but not required) to make HSA contributions to former employees who continue qualified HDHP health coverage through COBRA, regardless of whether the COBRA premium is paid by the participant or the employer. An employer’s HSA contributions to a former employee do not constitute taxable earnings to the former employee.

8. RETIREE HEALTH PLAN CONSIDERATIONS

Employers that make HSA contributions to active employees are permitted (but not required) to make HSA contributions to former employees who continue qualified HDHP health coverage through the employer’s retiree health plan, regardless of whether the retiree health premium is paid by the participant or the employer. The details regarding retiree health benefits, including eligibility for employer contributions to a retiree’s HSA (if applicable), should be included in the retiree health plan document. As discussed in the HSA Contributions section above, note that there are certain comparability rules that apply if HSA contributions are not made via a cafeteria plan, as would be the case for contributions made to retirees. An employer’s HSA contributions to a retiree, as with any such contributions to a former employee, do not constitute taxable earnings to the retiree.

9. SUMMARY

The significant tax advantages of HSAs, and the portability of HSA balances from employer to employer as well as post-employment, have contributed to the increased popularity of HSAs in connection with qualified HDHPs in recent years. While HSAs generally pose fewer administrative and regulatory challenges than other types of employee benefit plans, employers that sponsor qualified HDHPs or are considering adding an HDHP to their plan offerings in the future should be familiar with the range of HSA issues discussed in this publication. To discuss your HSA compliance considerations and other aspects of your employee benefits program, or for copies of NFP publications, contact your NFP benefits consultant. For further information regarding NFP’s full range of consulting services, see [NFP.com](https://www.nfp.com).

10. RESOURCES

IRS Publication 502, Medical and Dental Expenses

IRS Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans

Medicare & You, The Official U.S. Government Medicare Handbook

Chief Counsel Advice 201413005

IRS Form 8889, Health Savings Accounts (HSAs)

IRS Form 5329, Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts

IRS Notice 2019-45, Additional Preventive Care Benefits Permitted to be Provided by a High Deductible Health Plan Under §223

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APPENDIX A

IRS Limits on Health Savings Accounts (HSAs) and High Deductible Health Plans (HDHPs)

	2025	2024	2023
HSA maximum contribution*			
Single	\$4,300	\$4,150	\$3,850
Family	\$8,550	\$8,300	\$7,750
HSA catch-up contribution (age 55 and older)*	\$1,000	\$1,000	\$1,000
Minimum high deductible health plan (HDHP) deductible			
Single	\$1,650	\$1,600	\$1,500
Family**	\$3,300	\$3,200	\$3,000
HDHP out-of-pocket (OOP) maximum			
Single	\$8,300	\$8,050	\$7,500
Family***	\$16,600	\$16,100	\$15,000

See www.irs.gov for more information.

*For calendar year beginning in year indicated, regardless of plan year start date.

**An embedded individual deductible can be no less than the minimum family deductible.

***Must include an embedded individual (single) OOP maximum not greater than the non-HDHP single OOP maximum.

IRS Limits on Non-HDHP Out-of-Pocket (OOP) Expenses

	2025	2024	2023
Non-HDHP OOP maximum*			
Single	\$9,200	\$9,450	\$9,100
Family**	\$18,400	\$18,900	\$18,200

*Applies exclusively to in-network covered essential health benefits. This includes participant cost-sharing for medical expenses subject to the CAA, 2021 surprise medical billing in-network cost-sharing requirements, even when incurred out-of-network.

**Must include an embedded individual (single) OOP maximum not greater than the non-HDHP single OOP maximum.

The charts above are excerpted from the NFP publication **Employee Benefits Annual Limits**. See that publication for other annual limits that affect group health plans.

APPENDIX B

IRS Limits on Retirement Benefits and Compensation

	2025	2024	2023
401(k) and 403(b) plan elective deferrals	TBD	\$23,000	\$22,500
Catch-up contributions (age 50 and older)	TBD	\$7,500	\$7,500
Annual compensation limit	TBD	\$345,000	\$330,000
Highly compensated employee threshold*	TBD	\$155,000	\$150,000
Key employee compensation threshold*	TBD	\$220,000	\$215,000
Defined contribution 415 limit	TBD	\$69,000	\$66,000
Defined benefit 415 limit	TBD	\$275,000	\$265,000
SIMPLE employee contribution limit	TBD	\$16,000	\$15,500

See www.irs.gov for more information.

*In general, compensation means total compensation from the employer, including bonuses or commissions as well as contributions made through a 401(k) plan (or similar retirement plan) or through a cafeteria plan or qualified transportation benefit plan.

The chart above is excerpted from the NFP publication **Employee Benefits Annual Limits**. See that publication for other annual limits that affect group health plans.