What is a Health Savings Account (HSA)?

An HSA is a tax-exempt trust or custodial account established for the purpose of paying medical expenses in conjunction with a high-deductible health care plan.

What is the HSA's purpose?

The purpose of the federal law is to create tax incentives so one saves for future health and retirement needs. The HSA will primarily be used to accumulate funds to pay health expenses on a tax-preferred basis. However, the HSA can also be used to accumulate wealth on a tax-preferred basis. This will happen when the contributed funds and the earnings are not spent on health expenses. The person for whom the HSA is established is generally called an "account owner."

What requirements must be met in order to properly establish a Health Savings Account?

There must be a written plan agreement which creates a trust or custodial account. The HSA must be created or organized in the U.S. The HSA plan agreement must meet the following requirements:

1. The trustee or custodian must be a bank, an insurance company, or a nonbank trustee as defined for IRA purposes.
2. No part of the HSA assets may be invested in life insurance contracts.
3. The HSA assets cannot be commingled with other assets unless pursuant to a common trust fund or common investment fund.
4. The account owner's interest in the HSA is nonforfeitable.
5. The contributions must be in the form of cash unless a rollover or transfer contribution is made. It is permissible to roll over or transfer funds into an HSA from another HSA or an Archer Medical Savings Account (MSA).
6. The contributions for a given calendar year cannot exceed certain limits as discussed later.

Who is eligible to establish and contribute to an HSA?

An "eligible individual" can establish and contribute to an HSA. An "eligible individual" means, with respect to any month, any individual who:

1. Is covered under a high-deductible health plan (HDHP) on the first day of such month;
2. Is not also covered by any other health plan that is not an HDHP (with certain exceptions for plans providing certain limited types of coverage);
3. Is not enrolled in Medicare; and
4. May not be claimed as a dependent on another person's tax return.

An "eligible individual" also means a person who is eligible to make a rollover or transfer contribution from another HSA or an Archer MSA to an HSA. Such a rollover or transfer is permissible, even though the individual is ineligible to make an annual HSA contribution because he or she is no longer covered by an HDHP.

What are the favorable tax attributes of the HSA?

Contributions will be made to an HSA on behalf of the account owner, who is the individual on whose behalf the HSA was established.

A deduction will generally be able to be claimed by the account owner for the amount of the contributions. If the employer has made the contribution, then such contribution will generally be excluded from the account owner's income and not deductible by the account owner.

The earnings realized within the HSA are not taxed while held in the HSA.

Distributions to the account owner from the HSA will be tax free if the funds are used to exclusively pay for qualifying medical expenses. If the withdrawn funds are not used exclusively for qualifying medical expenses, then the person will have to include the distribution in his or her income. A 20% additional tax will also be owed unless the account owner is age 65 or older or is disabled.

What is a "high-deductible health plan" (HDHP) that makes someone eligible for an HSA?

An HDHP is a health care plan that contains certain minimum dollar limitations on the annual deductible, and maximum limitations on the out-of-pocket expenses listed under the plan. A health care plan that provides individual coverage will be considered a high-deductible plan if it has an annual deductible of at least $1,300 for 2017, and $1,350 for 2018. A health care plan that provides family coverage will be considered a high-deductible plan if it has an annual deductible of at least $2,600 for 2017, and $2,700 for 2018. Out-of-pocket expenses for 2017 may not exceed $6,550 for individual coverage, and $13,100 for family coverage. Out-of-pocket expenses for 2018 may not exceed $6,650 for individual coverage, and $13,300 for family coverage. Out-of-pocket expenses include deductibles, co-payments, and other amounts the participant must pay for covered benefits, but do not include premiums.

Can a person have any other health care coverage and still be eligible for an HSA?

A person is not eligible for an HSA if he or she is covered under a health plan (whether as an individual, spouse or dependent) that is not a high-deductible plan.

A person will remain eligible for an HSA if, in addition to the HDHP, the type of coverage he or she has is coverage for accidents, disability, dental care, vision care, long-term care, insurance for a specified disease or illness, insurance that pays a fixed amount per day (or other period) of hospitalization, or insurance under which substantially all of the coverage relates to liabilities from workers' compensation laws, torts, or ownership or use of property (such as auto insurance).

If I am an eligible individual, how do I establish an HSA?

An eligible individual can establish an HSA with a qualified HSA custodian or trustee. You will be required to complete a written HSA custodial or trust plan agreement.

Who can make an HSA contribution?

Any eligible individual may establish and contribute to an HSA for himself or herself. A person need not be an employee to contribute to an HSA. A person may be self-employed, unemployed, or employed and contribute to his or her own HSA. The IRS has also stated an employer, a family member, or any other person or entity may make contributions to an HSA on behalf of an eligible individual.

What are the contribution (and deduction) limits for 2017?

For 2017, there is an annual contribution (and deduction) limit equal to the sum of the monthly limitations that apply for any year during which the account owner is an eligible individual. Determining this limit is the responsibility of the eligible individual and his or her advisors. It is not the responsibility of the custodian or trustee. For calendar year 2017, the maximum monthly contribution for eligible individuals with self-only coverage under an HDHP is 1/12 of the maximum limit of $3,400 For eligible individuals with family coverage under an HDHP, the maximum monthly contribution is 1/12 of the maximum limit of $6,750. In addition to the maximum contribution amount, catch-up contributions may be made by or on behalf of eligible individuals who are age 55 or older.

All HSA contributions made by or on behalf of an eligible individual are aggregated for purposes of applying the limit. If an individual has more than one HSA, the aggregate annual contributions to all the HSAs are subject to the limit. The annual limit is decreased by the aggregate contributions to an MSA. The same annual contribution limit applies whether the contributions are made by an employee, an employer, a self-employed person, a family member, or any other person or entity.

What are the contribution and deduction limits for 2018?

The 2018 limit is $3,450, if you have self-only coverage under an HSA-qualifying HDHP, and $6,900, if you have family coverage under an HSA-qualifying HDHP.

What are the "catch-up contributions" for individuals age 55 or older?

These are special contributions. In the case of HSAs, these individuals are those who are age 55 and older and who are still eligible to contribute to an HSA. The maximum catch-up contribution amount for 2017 is $1,000, and for 2018, it is also $1,000. If both spouses are over age 55, then each is eligible to make his or her own catch-up contribution. Each spouse is required to make the catch-up contribution to his or her own HSA. That is, one spouse cannot make his or her catch-up contribution to the other spouse's HSA.

How is my contribution limit determined if I am not covered for a full year under the HDHP?

There are two different methods which may apply to determine your contribution limit for a given year. The first method is a "pro-rata" rule. The second method is an exception to the pro rata rule and allows the HSA owner to make a full year's contribution even though he or she was only eligible for part of the year. You will want to understand both methods.

The Pro Rata Calculation: Your contribution is the sum of the monthly limitations. For example, if you are covered by the HDHP on the first day of each month for 2017, then you are entitled to the full annual contribution amount (i.e. $3,400 or $6,750, as applicable). If you are not covered on the first day of every month, then you are only entitled to a pro rata contribution as follows. If you are covered for 1 month, then you would be entitled to contribute 1/12 of the applicable amount; if you are covered for 3 months, then you would be entitled to contribute 3/12 of the applicable amount; if you are covered for 11 months, then you would be entitled to contribute 11/12 of the applicable amount; etc.

Note that if you have coverage under an HDHP as of January 1, but you are not covered under an HDHP as of December 1, then the pro rata contribution rule will apply to you.

The Full Year Contribution Rule: Under this rule if you are an eligible individual on the first day of the last month of your tax year (December 1 for most taxpayers), you are considered an eligible individual for the entire year. You are treated as having the same HDHP coverage for the entire year as you had on the first day of the last month. In this case, you are allowed to contribute the full annual contribution amount, and it is not reduced on a pro rata basis for the months you were not covered.

This second method allows a person to contribute a larger amount. A financial incentive exists to set up an HSA later in the year. An individual is not required to use this second method.

There is a special penalty tax beyond the scope of this brochure which will apply if a person does not retain coverage under the HDHP for the entire subsequent calendar year.

If both spouses have family coverage, how is the contribution limit computed?

If each spouse has family coverage under a separate health plan, both spouses are treated as covered under the plan with the lowest deductible. Prior to 2007, the contribution limit for the spouses was the lowest deductible amount, divided equally between the spouses, unless they agreed on a different division. The contribution amount for a married couple is now the amount determined using either the pro rata calculation or the special calculation, as applicable, as reduced by any contribution to an MSA, and then such amount is divided equally between the spouses, unless they would agree on a different division. Each spouse could also contribute the catch-up amount, if applicable.

In what form must contributions be made to an HSA?

Annual contributions to an HSA must be made in cash. For example, contributions may not be made in the form of stock or other property unless it is a rollover or transfer.

What is the tax treatment of an eligible individual's HSA contributions?

Contributions made by an eligible individual to an HSA are deductible by the eligible individual in determining adjusted gross income. The contributions are deductible whether or not the eligible individual itemizes deductions.

What is the tax treatment of contributions made by a family member or other person on behalf of an eligible individual?

Contributions made to an HSA by any person or entity other than the HSA account owner's employer on behalf of an eligible individual are deductible by the eligible individual in computing adjusted gross income. The contributions are deductible whether or not the eligible individual itemizes deductions.

What is the tax treatment of employer contributions to an employee's HSA?

In the case of an employee who is an eligible individual, employer contributions (provided they are within the limits) to the employee's HSA are treated as employer-provided coverage for medical expenses under an accident or health plan and are excludable from the employee's gross income. The employer contributions are not subject to withholding from wages for Federal income tax or subject to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), or the Railroad Retirement Tax Act. Contributions to an employee's HSA through a cafeteria plan are treated as employer contributions. Employer contributions are not deductible by the HSA account owner.

What is the tax treatment of an HSA?

An HSA is generally exempt from tax (like an IRA or MSA). Earnings on amounts in an HSA are not includable in gross income while held in the HSA.

What is the deadline for making an HSA contribution?

The deadline for annual contributions to an HSA is the time prescribed by law for filing individual Federal income tax returns, excluding extensions. Normally this is April 15 of the following year.

Contributions for the taxable year can be made in one or more payments, at the convenience of the individual or the employer, at any time prior to the time prescribed by law (without extensions) for filing the eligible individual's federal income tax return for that year, but not before the beginning of that year. Although the annual contribution is determined monthly, the maximum contribution may be made on the first day of the year.

Are rollover and transfer contributions to HSAs permitted?

Rollover and transfer contributions from MSAs and other HSAs into an HSA are permitted. Rollovers and transfers into HSAs are subject to rules very similar to the rules applying to IRAs. Rollover and transfer contributions need not be in cash. Rollovers and transfers are not subject to the annual contribution limits. Except for the special one-time transfer discussed below, rollovers and transfers from an IRA, from a health reimbursement arrangement (HRA), or from a health flexible spending arrangement (FSA) to an HSA are not permitted.

Are special transfer contributions ever permitted?

Yes. HSA law changes enacted on December 20, 2006, allow an individual with funds in a traditional IRA (and, in limited cases, a Roth IRA), who is eligible to make an HSA contribution, to make a special election once during their lifetime to transfer funds from their IRA to their HSA. The amount transferred in such a direct trustee-to-trustee transfer will not be taxed. This amount shall not exceed the annual contribution limit for self-only or family coverage, as applicable, as based on the HDHP coverage as of the time of the special transfer, or, in some cases, the amount of an earlier qualified HSA funding distribution. Thus, the maximum amount eligible for this special transfer for 2017 is $3,400 for single coverage and $6,750 for family coverage and for 2018 is $3,450 for single coverage and $6,900 for family coverage. These contribution amounts will be increased by the catch-up amount of $1,000, if applicable.

This one-time transfer rule allows a person to change funds which would be taxable (money distributed from an IRA) to funds which will escape taxation if they are withdrawn from the HSA and used to pay qualified medical expenses.

When can an HSA distribution occur?

An individual can receive a distribution from his or her HSA at any time. The individual needs to understand the income tax consequences.

How will an HSA distribution be taxed?

A distribution from an HSA that is used to pay qualifying medical expenses not paid or covered by insurance will generally not be included in the account owner's gross income. Distributions that are used for nonmedical purposes will be included in gross income and may be subject to an excise tax. A 20% excise tax will apply to any distribution made for nonmedical purposes prior to the account owner's death, disability, or attainment of age 65. The fact that a person is no longer eligible to contribute to his or her HSA does not change how a distribution is taxed.

What "medical expenses" qualify for tax-free distributions?

Medical expenses for HSA purposes are defined in Code section 213. IRS Publication 502 should also be reviewed. Tax-free distributions generally include any medical expense that could qualify as a medical expense itemized deduction on an individual's tax return. However, the payment of most medical insurance premiums will not qualify for tax-free treatment. Note: If a distribution is made from an HSA for medical expenses, those same medical expenses cannot be itemized as a deduction on the individual's tax return.

An HSA owner will need to obtain a prescription for an over-the-counter medicine or drug in order to treat such expense as a qualified medical expense.

Who is responsible for determining if the distribution was used exclusively for qualifying medical expenses?

The IRS makes this determination. It is the HSA account owner's sole responsibility to explain the purpose and tax effect of any distribution from the HSA. Neither the custodian/trustee of the HSA nor the employer is required to determine whether HSA distributions are used for medical or nonmedical purposes.

Do the excess contribution rules and prohibited transaction rules apply to HSAs?

Yes. The rules are similar to the rules applying to IRAs. A 6% excise tax will be owed if an excess contribution is made and it is not corrected within a certain time deadline. If an HSA participates in a prohibited transaction, the HSA will cease to be an HSA as of the first day of such year. For more information on these subjects, review the IRS website, www.irs.gov, or contact your tax advisor.

What is Form 8889 (HSAs)?

You must file IRS Form 8889 with your federal income tax return to report your HSA contributions and distributions. Such contributions may be made by your employer, someone else on your behalf or you. You use it to figure your tax deduction. You also must report the distributions which are tax-fee, those which you must include in income, and when applicable, those which will be subject to the 20% tax.

What tax rules apply once the HSA account owner dies?

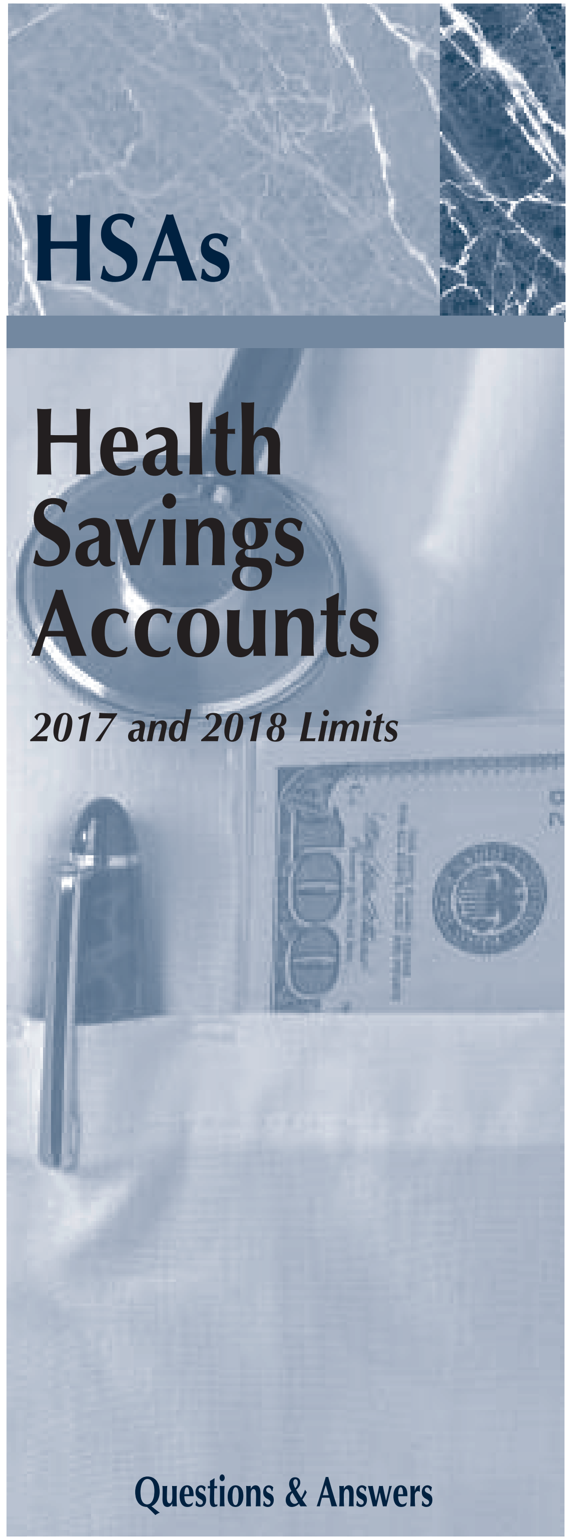
If a surviving spouse is the beneficiary of the deceased account owner's HSA, then that HSA is to be treated as the surviving spouse's HSA.

In general, if a surviving spouse is not the beneficiary of the deceased account owner's HSA, then the deceased account owner's HSA ceases to be an HSA as of the date of his or her death, and the fair market value of the assets of such HSA shall generally be included in the income of such beneficiary(ies) for the year the HSA owner died. This is true even if the beneficiary withdraws the inherited HSA funds in the year after the HSA owner died. A beneficiary should withdraw inherited HSA funds within a reasonable time period after the passing of the HSA owner. Any income earned after the date of death will be included in the beneficiary's income for the year distributed.

How do I establish an HSA?

Just come in and talk with us.

The information provided in this brochure is not intended to be legal or tax advice. You should consult your attorney or tax advisor for information that relates to your specific circumstances.



HSAs

Health Savings Accounts

2017 and 2018 Limits

Questions & Answers