HSA GPS Fact Sheet Series

HSAs and Certain Business Owners

The Internal Revenue Service (IRS) applies different rules to specific business entities, depending on whether the business is owned directly by individuals or indirectly by investors. The paper is designed to help you navigate the confusion at the intersection of Health Savings Account (HSA) rules and business structure so that you can keep your program, and your personal tax situation, in compliance.

1. What business structures face HSA restrictions?

Owners of certain business entities face restrictions on HSA funding. Impacted owners include the following:

- Members of a Limited Liability Company, or LLC
- Partners in a partnership
- 2% or greater owners of a Subchapter S corporation

2. What restrictions do these owners face with respect to employer contributions?

The business can't give owners a tax-free contribution. Any contributions to these owners' HSAs from the business are considered taxable income to the owner.

3. Can these businesses make tax-free contributions to employees' HSAs?

Yes. The restrictions are on the owners, not on the business itself or the employees. These businesses can make tax-free contributions to their employees' HSAs consistent with IRS regulations on such contributions.

4. What restrictions do these owners face on personal contributions?

They aren't eligible to participate in a Section 125 plan, the vehicle that allows individuals to receive a portion of their total compensation in the form of untaxed benefits. Thus, these owners can't make pre-tax contributions to their HSAs.

5. Can these owners make post-tax payroll contributions to their HSAs?

Yes. They can contribute up to the maximum contribution allowed by law.

6. Do they lose the tax advantages of HSA contributions because they can't make pre-tax payroll contributions?

No. These owners can make personal (post-tax) contributions and then deduct those contributions on Page 1 of their personal income tax return (Form 1040). In doing so, they recoup the federal (and, if applicable, state) income taxes paid on those funds. The personal income tax return doesn't allow for crediting FICA taxes paid. This tax amounts to 15.3% (employee and business combined) on income below $127,200 (2017 figure) and 2.9% on higher income.

7. Can these owners allow employees to make pre-tax payroll contributions?

Yes. These restrictions impact owners only. The business can allow employees to make pre-tax payroll contributions by creating a new (or amending an existing) Section 125 plan document to include HSA contributions.

8. Do these owners face any other restrictions on the use of their HSAs?

No. Their only restriction is on the initial tax treatment of contributions to their accounts. They can contribute up to the same annual maximum as any other similarly situated accountholder, reimburse tax-free the same eligible expenses incurred by the same family members, invest their balances and pass their HSAs along to their heirs just as any other accountholder can.

9. Do these contribution restrictions apply to employees of a Subchapter S corporation who receive an ownership share of the company through a profit-sharing program?

The restriction applies only to owners of more than 2% of these entities only. The law is designed to exempt employees who earn a small stake in the company through profit-sharing plans. An individual whose ownership position exceeds the 2% threshold is subject to the contribution restrictions.

10. Do these rules apply to family members? If a spouse works for the company as an employee, can the owner designate her spouse as the medical plan subscriber and avoid these restrictions?

No. The IRS imposes "attribution rules," which essentially define a spouse and certain other family members as owners of the business. Thus, an owner can't designate her husband working in the firm as the medical plan subscriber in order to make a tax-free employer contribution or allow the family to make pre-tax payroll contributions through a Section 125 plan.

This information is accurate as of April 1, 2017. Please note that this discussion is for informational purposes only and is based on current regulations. It doesn't represent, and shouldn't be construed as a substitute for professional advice. Please consult your personal legal, financial or tax counsel to discuss your personal situation and refer to IRS Publication 969.

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