benefit strategies LLC

HSA GPS Fact Sheet Series

The Interaction of HSAs and Health FSAs

Individuals are required to meet certain eligibility criteria to open and contribute to a Health Savings Account (HSA). Enrollment in certain employer-sponsored benefits, whether offered by your own or your spouse's employer, may impact your HSA eligibility. In this paper, we look at the intersection of HSAs and Health FSAs to examine scenarios that may impact your eligibility to open and contribute to an HSA.

1. My employer offers a traditional Health FSA through which I can make pre-tax elections and then reimburse medical, dental, vision and over-the-counter equipment and supplies tax-free. Does my enrollment in this plan impact my HSA eligibility?

Yes. The Internal Revenue Service (IRS), which interprets HSA rules and issues regulations, defines a Health FSA as a group health plan. You pay an annual premium (your election) and receive a limited benefit (reimbursement up to your election amount). You may pay more in premium than you receive in benefits (thus forfeiting your balance), or you may receive more in benefits than you pay in premium (for example, by spending your entire election and then leaving your job before the end of the Health FSA plan year).

If you want to be HSA-eligible and are covered by more than one medical plan, all plans must be HSA-qualified. A traditional (first-dollar) Health FSA isn't an HSA-qualified medical plan because it starts to pay benefits before you've satisfied a minimum deductible. Therefore, you're not HSA-eligible for a month during which you're covered by a Health FSA.

2. If I spend my entire balance before the end of the year, can I become HSA-eligible as of the date that I have a zero balance?

No. You remain covered by your Health FSA during the entire Health FSA plan year, even if you exhaust your balance before the end of the year. You can't become HSA-eligible while you maintain coverage, even with no benefit (balance) remaining.

3. My employer runs our Health FSA on a calendar year, while our medical plan renews May 1. Can I disenroll from my Health FSA at the end of April so that I'm HSA-eligible May 1?

No. Enrolling in an HSA-qualified medical plan is not a qualifying event that allows you to disenroll from your Health FSA. You remain enrolled in the Health FSA until the end of the plan year (Dec. 31 in this example). While you can enroll in the HSA-qualified medical plan to take advantage of the lower premium, you can't open and contribute to an HSA before Jan. 1 at the earliest. In the meantime, you can continue to spend your Health FSA balances for qualified expenses, including your out-of-pocket expenses (deductibles, copays, and coinsurance) associated with your HSA-qualified medical plan. You can't increase your Health FSA election on your medical plan anniversary to reflect these higher out-of-pocket costs.

4. My spouse is enrolled in his employer's Health FSA program. That doesn't disqualify me from becoming HSA-eligible, does it?

Unfortunately, it does. The IRS considers a Health FSA a group health plan. Under federal tax law, the employee (subscriber), spouse and any children up to the last day of the month of their 26th birthday (whether or not they remain the parent's tax dependent) are enrolled in the Health FSA automatically and can reimburse their eligible expenses from the plan. You're covered under your spouse's Health FSA (unless that employer excludes spouses from coverage, which is extremely rare) and thus can't become HSA-eligible before the end of your spouse's Health FSA plan year. You can still enroll in your employer's HSA-qualified medical plan, and you and your spouse can reimburse any eligible expenses, including your medical plan cost-sharing, from his Health FSA.

5. What if my spouse uses all the money in his Health FSA to reimburse his vision-correction surgery or other non-medical expenses? What if I pledge not to reimburse any of my expenses from his Health FSA?

If the Health FSA covers you (typical) and allows reimbursement for expenses beyond dental and vision (typical), you're enrolled in disqualifying coverage. You can't become HSA-eligible when covered by your spouse's employer's (or your own employer's) Health FSA that reimburses a wide range of medical, dental and vision expenses. Because you have coverage that isn't HSA-qualified, you aren't HSA-eligible at any point during the Health FSA plan year. You can enroll in an HSA-qualified medical plan, but you can't open or contribute to an HSA.

6. I want to enroll in my employer's HSA program now, at open enrollment. My spouse's Health FSA renews at her employer's open enrollment in five months. What can we do?

Unfortunately, your spouse can't disenroll from her Health FSA. Here are your options:

A. Your spouse can leave her job and thus disenroll from the Health FSA.

B. You can enroll in the HSA-qualified plan, reimburse eligible expenses from your spouse's Health FSA and then make sure that she doesn't re-enroll in her Health FSA. At the end of her Health FSA plan year, you can begin to contribute to your HSA.

C. You can delay enrollment in the HSA program for a year and make sure your spouse doesn't re-enroll in her Health FSA. You won't have a tax-advantaged reimbursement account (Health FSA or HSA) for seven months between the end of her Health FSA plan year and your enrollment in your company's HSA program.

7. Are there any Health FSA plan designs that allow me to be eligible to open and contribute to an HSA?

Yes. An employer can offer a Limited-Purpose Health FSA (LP Health FSA). This design limits reimbursement to dental and vision services (plus select preventive services that aren't covered in full). Because you can be enrolled in dental and vision coverage without impacting HSA eligibility and select preventive services can be covered outside the deductible on an HSA-qualified plan, this Health FSA design meets the criteria of an HSA-qualified plan.

Some Health FSA administrators combine a LP Health FSA with a Post-Deductible FSA, a design that doesn't reimburse any expenses until you have met the statutory minimum annual deductible for your contract type, $1,300 for self-only coverage and $2,600 for family coverage in 2017 (projected to rise to $1,350 and $2,700 in 2018). Under this hybrid model, you can reimburse only dental, vision and select preventive services until you attest that you've satisfied the statutory minimum deductible (not your medical plan's minimum deductible, which may be higher) for services covered by the medical plan. At that point, you can begin to reimburse eligible medical and pharmacy expenses from the Health FSA as well.

LP Health FSAs have an election limit of $2,600 per plan participant in 2017 under current federal law. Your employer can impose a lower limit.

8. Why would I make an election to a LP Health FSA, since I can reimburse expenses tax-free from my HSA and not face any use-it-or-lose-it restrictions on HSA balances?

While participating in a LP Health FSA doesn't make sense for everyone, some employees can benefit. Here are possible reasons for making a LP Health FSA election:

- <u>You want to maximize tax savings</u>. You can reduce your taxable income by maximizing your HSA contribution and electing to defer up to $2,600 (or a lower figure set by your employer) into a LP Health FSA. For many taxpayers, this additional reduction in taxable income results in tax savings between $600 and $800.

- You anticipate high dental and vision costs early in the year: Since you can access your entire Health FSA election at any point in the plan year, you can use a LP Health FSA to ease cash-flow concerns if you expect to incur these expenses early in the year.

- You're responsible for dental and vision expenses incurred by children under age 26 who are no longer your tax dependents: The reimbursement rules for HSAs and Health FSAs are different. Once a child is no longer your tax dependent, you can't reimburse his or her eligible expenses tax-free from your has, even if you continue to cover the child on your insurance. By contrast, because a Health FSA is considered a medical plan, you can reimburse the same child's expenses, even if the child is not covered on your medical insurance – from your LP Health FSA. You can reimburse expenses with dates of service prior to the last day of the month of the child's 26th birthday.

- You want to maximize your HSA balances. You can reimburse eligible dental and vision expenses tax-free from your LP Health FSA rather than withdrawing HSA funds.

You gain an advantage when you participate in a LP Health FSA under these circumstances only if you actually incur dental and vision expenses. If you make your election and fail to incur expenses, you risk forfeiting your election. If you're not sure whether you'll incur these expenses during the year, you may be better off increasing your HSA contributions because HSA balances roll over automatically without limit if not used during the year.

9. My (or my spouse's) traditional Health FSA has a grace period. How does that feature impact my HSA eligibility?

The grace period provision allows you to continue to spend your election for up to two and a half months after the end of the 12-month Health FSA plan year. To ensure that you are HSA-eligible as of the first day following the end of the 12-month Health FSA plan year, you must exhaust your entire election and file for all reimbursements before the end of the 12-month plan year. In other words, if your plan ends Dec. 31 with a grace period through March 15, you must spend your entire election and file for all reimbursements by Dec. 31 to become HSA-eligible Jan. 1.

Another option is that your employer can alter the Health FSA plan to make the grace period a LP Health FSA for all participants. In that case, you could carry a balance into January 1 (in this example) and still be HSA-eligible, since you can use your election to reimburse only dental, vision and preventive services during the grace period. Many employers do not adopt this approach because the change impacts all employees, including those who don't want to become HSA-eligible and made elections to reimburse medical, prescription drug and over-the-counter equipment and supplies.

10. My (or my spouse's) traditional Health FSA allows a rollover of up to $500 into the following plan year. How does that feature impact my HSA eligibility?

Beware. This feature can lock you out of being HSA-eligible for a full 12 months! You can avoid issues by spending your entire balance during the plan year. If you carry a balance at the end of the Health FSA plan year, you can choose to forfeit the remaining balance. Alternatively, your employer can roll over your balance into a LP Health FSA for the following plan year, allowing you to spend the rollover balance on dental and vision expenses and thus become HSA-eligible immediately. Employers who offer HSA-qualified medical plans typically provide this option. Your spouse's employer may not offer this feature, especially if that company doesn't extend an HSA program to its employees, so you must spend the entire election before the end of the plan year to become HSA-eligible.

11. Does my election to a Dependent Care FSA impact my HSA eligibility?

No. Since Dependent Care FSAs (sometimes referred to as DCAs) don't provide reimbursement for medical expenses, they don't impact your HSA eligibility.

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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