An Introduction to Health Savings Accounts For Employers
Contents

- **Background**
  - How does an HSA work?
  - What’s a High Deductible Health Plan?
  - What are the benefits of an HDHP and HSA?

- **Contribution Issues**
  - Can all employees have an HSA?
  - Can employers make HSA contributions?
  - Can employees contribute through payroll?
  - Are owners treated differently?
  - What’s a Section 125 plan?
  - How do employees contribute?
  - How much can employees contribute?

- **Tax Benefits of HSAs**
  - How do employees/employer get the tax benefits?
  - What’s medical expenses are covered?
  - Can the HSA be used for other purposes?

- **Administration**
  - How does the employer administration work?
  - How do employees manage their HSAs?
  - How do employees track expenses?

- **Employer Issues**
  - How do employees and employers enroll?
  - Are other employer services available
  - What does the HSA offer?
  - What does it cost?

- **Contact Information**
HSA Background

- **Introduced in 2004 to support Consumer Driven Health Care**
  - Provide consumers greater control over health care dollars
  - Reduce health care costs by putting consumers in charge
  - Give employers struggling to pay health care insurance a lower cost alternative and to encourage employers that do not offer health insurance to do so

- **Benefits to Employers**
  - Provide employers an alternative to traditional health care coverage
  - **Lower initial cost and lower annual cost increases**
  - Cover employees for catastrophic health issues
  - Offer employees a health plan that gives them choices

- **Explosive Growth in 2005**
  - Over 3,000,000 people had HSAs by January 2006\(^1\)
  - 15-25 million HSAs expected by 2010\(^3\)

- **Initial Results Positive**
  - HSA owners are more value conscious of health care expenses\(^4\)
  - HSA owners engage in improved wellness behavior
  - HSA insurance plans are not increasing in cost as much as other plans

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\(^1\)HSAs Triple in 10 Months, Study released by America’s Health Insurance Plans (AHIP) January 26, 2006
\(^2\)HSA Deposits Top $460 Million, ICDC Finds; 50,000+Accounts Are Opened Each Month, Inside Consumer Directed Health Care, Vol. 3, #9, May 2005.
\(^3\)Seizing the HSA Opportunity, Study by Diamond Cluster Research 2005
\(^4\)Consumer-Directed Health Plan Report – Early Evidence is Promising, McKinsey & Company, June 2005
How does an HSA work?

HSAs work in combination with a High Deductible Health Plan (HDHP), also referred to as “catastrophic” insurance or major medical. The HSA pays for the day-to-day medical expenses while the HDHP pays for major expenses (above the deductible amount). The law is designed so that you can put roughly the amount of your deductible in your HSA – see the next slide for details.

Deferred Savings Growth

Health Savings Account for:
- Doctors visits
- Prescriptions
- Minor medical expenses

High Deductible Health Plan for:
- Major medical expenses
- Serious illness
- Major surgery
- Post deductible expenses

- Excess HSA funds grow tax-free to protect against future expenses
- HSA contains funds for day-to-day expenses
- Health plan provides insurance against significant expenses
What’s a High Deductible Health Plan?

- **High Deductible Health Plan (HDHP).** Employees must be covered under an HDHP plan to qualify for an HSA. Ask your insurance provider if your plan qualifies. Generally, HDHPs require a minimum annual deductible and place a limit on the total out-of-pocket payments allowed:

<table>
<thead>
<tr>
<th>HDHP Requirements</th>
<th>Individual</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Deductible</td>
<td>At least $1,100 for 2007</td>
<td>At least $2,200 for 2007</td>
</tr>
<tr>
<td>Out-of-Pocket Max</td>
<td>Not more than $5,500 for 2007</td>
<td>Not more than $11,000 for 2007</td>
</tr>
</tbody>
</table>

- **No Other Insurance allowed – Except “Permitted” Insurance.** To prevent people from obtaining the benefits of an HSA while protecting themselves with other health insurance plans, the law restricts the other coverage you may have. Listed below are some of the big exceptions:
  - Auto and life insurance
  - Accident insurance
  - Insurance for a specific disease or illness
  - Insurance that pays for a fixed amount per day for hospitalization
What are the benefits of an HDHP and HSA?

- **Lower Insurance Premiums.** Insurance premiums for high deductible plans are lower than premiums for more traditional forms of insurance because the deductible is higher, therefore the employee is taking on more of the initial cost of the insurance.
  - EX: A medical doctors office recently decided to see how much they could save by simply adding an HDHP to their health care plans, *this company stood to save almost $1,000 annually per individual and nearly $3,000/yr per family plan* that switched to the HDHP.

- **Broader Healthcare Alternatives.** HSAs provide employees with an unlimited choice of medical providers because they are not as locked into a particular network. Additionally, HSA funds can be used to pay for employee wellness (obesity and smoking cessation), dental, vision and even alternative care providers such as chiropractors.

- **Employee Safety Net Between Jobs.** For employees covered under a group high deductible plan, the HSA can be used to pay for COBRA while unemployed and also used to pay for medical expenses.

- **Tax Savings.** Employers that establish Section 125 plans to allow employees to make payroll contributions to their HSAs will save approximately 8% via reduced payroll taxes on the contributions and employees making contributions will save between 15-40% by avoiding Federal (and possibly state) Income Taxes and FICA and FUTA on their contributions.
Can all my employees have an HSA?

- **General HSA Requirements**
  - Covered under an HDHP
  - Not be covered under another health plan
    - For example, if spouse has a traditional plan that also covers your employee, the employee is not eligible.
  - Not a dependent on another’s tax return
    - For example, children are generally not eligible.
  - Under age 65 (or not covered by Medicare)
    - Employees over age 65 are generally not eligible.

- **Eligibility Worksheet**
  The Eligibility and Contribution worksheet to the right can help your employees determine if they are eligible.

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**2007 HSA Eligibility and Contribution Worksheet**

<table>
<thead>
<tr>
<th>Purpose: Use this form to verify your eligibility for an HSA and determine the amount you may contribute. You are responsible for properly determining your eligibility and contribution amount. This worksheet is simply a tool to aid you in that effort. If you have any questions, please consult with your tax or legal counsel. Caution: The forms changed for 2007 and this worksheet does not apply to contributions made in 2007 for 2006.</th>
</tr>
</thead>
</table>

**1 HSA Eligibility:** You must answer “True” to each of the following in order to be eligible for an HSA. See definitions and tools for help.
- a. I am covered under an HDHP
- b. I am not covered by another non-HDHP health plan other than “permitted insurance”
- c. I am not eligible for Medicare (age 65) or if I am eligible, I am not enrolled in Part A or B.
- d. I am not a dependent on another person’s tax return.

**2 Contribution Amount:** Use the table below to determine your amount.

<table>
<thead>
<tr>
<th>Contribution Worksheet</th>
<th>Individual</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>B. Catch Up Contribution* – if Age 55 to 65 + $500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C. Total (add Federal Limit + Catch-Up)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note: The 2007 Federal Limit is $2,550 for individuals and $5,100 for families. The 2007 maximum catch-up contribution is $500 for individuals age 55 and older. The total contribution limit for families is $7,650 for 2007. Contributions may be split among multiple HSA accounts. For family coverage, the amount may be split among multiple family members. Contributions paid by an employer or third party are not considered when determining the amount of contributions an employee may make. Contributions made by an employer or third party are considered to be the same as employee contributions for determination of the maximum amount an employee may contribute.

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Can employers make HSA contributions?

Employers can make pre-tax contributions into employees HSAs subject to “comparability” rules. See the next slide for employee payroll deferrals.

- **Comparable Contributions.** An employer can make “comparable” contributions on behalf of all eligible employees.
- **Same Amount or % of Deductible.** Contributions are “comparable” if they are the same dollar amount or the same percentage of the deductible for the HDHP.
- **Categorize Employees.** Employers are allowed to treat different categories of employees differently:
  - Part time v. full time
  - HSA eligible v. not eligible
  - Single v. family
- **35% Penalty.** Failure to comply with these rules can result in a 35% penalty.

Call us with questions, we offer a free employer consultation to review issues such as “comparability”.
Can employees contribute through payroll?

Employees can contribute through payroll deferral if you offer a Section 125 plan.

- **Pre-Tax.** With a Section 125 plan that provides for HSA contributions, the employer can allow pre-tax payroll deferral. This approach has the following advantages:
  - **15.3% FICA/FUTA Savings.** The payroll deferrals are not subject to payroll taxes.
  - **No Comparability Testing.** HSA contributions made pursuant to a Section 125 plan are not subject to comparability testing.
  - **Insurance Premiums.** A Section 125 plan will also allow employees to pay any employee portion of the insurance premium on a pre-tax, pre-FICA/FUTA basis.

- **After-Tax.** Employers can also allow payroll deferral on an after-tax basis. This method is treated the same as if you paid the employee and the employee put the money into the HSA on his or her own. The benefit to the employee is the administrative convenience and the automatic nature of savings.

- **On Their Own.** Employees can also contribute independent of the employer, by (1) simply writing a check or (2) through automatic contribution from the employee’s personal bank account.

**Employer HDHP and HSA Funding Guide**

**Purpose:** This form reviews a variety of alternatives for funding High Deductible Health Insurance Plans (HDHPs) and Health Savings Accounts (HSAs). Please consult with your tax counsel for assistance in designing and implementing your particular plan.

**Funding of Insurance Premiums:**

Employers have the option to offer HSA contributions made pursuant to a Section 125 plan on a pre-tax basis (subject to the limitations noted in the following types of plans).

- **Pre-Tax.** Employers can allow payroll deferral on a pre-tax basis. This approach has the following advantages:
  - **15.3% FICA/FUTA Savings.** The payroll deferrals are not subject to payroll taxes.
  - **No Comparability Testing.** HSA contributions made pursuant to a Section 125 plan are not subject to comparability testing.
  - **Insurance Premiums.** A Section 125 plan will also allow employees to pay any employee portion of the insurance premium on a pre-tax, pre-FICA/FUTA basis.

- **After-Tax.** Employers can also allow payroll deferral on an after-tax basis. This method is treated the same as if you paid the employee and the employee put the money into the HSA on his or her own. The benefit to the employee is the administrative convenience and the automatic nature of savings.

- **On Their Own.** Employees can also contribute independent of the employer, by (1) simply writing a check or (2) through automatic contribution from the employee’s personal bank account.
What is a Section 125 plan?

- **Section 125 Plan Defined.** A Section 125 plan allows employers to establish a payroll deferral system where the employer is allowed to deduct the amounts contributed to an HSA without including the amount as income to the employees. A “Premium Only Plan” or “POP” allows the employees to defer a portion of their income to pay for the insurance premiums with pre-tax dollars. A POP plan with an HSA option allows employees to defer pay for the insurance premiums and also to make a contribution to an HSA on a pre-tax basis.

- **FSA Defined.** A Flexible Spending Account (FSA) is part of a Section 125 plan that allows employees to defer a portion of their income to use to pay for medical expenses. Employees are not allowed to have both an FSA and an HSA, except in very limited circumstances.

- **Comparison Chart.** Please see the comparison chart to see the differences between HSAs, FSAs, and Health Care Reimbursement Accounts (HRAs).

![Comparison Chart](image)
Are the owners treated differently?

- **Partners/2% S-Corp Owners.** Partners and 2% S-Corp owners are treated differently than other employees for the purposes of HSA contributions. Basically, the contributions are treated as distributions to the partner or 2% owner and then the partner or 2% owner can take an HSA deduction on their personal tax return.

- **Sole Proprietors.** For sole proprietors, the HSA deduction is not taken into consideration in determining net earnings from self-employment. Instead, the deduction is an adjustment to gross income on the individual’s personal income tax return.
How do employers contribute?

- **Employer Contribution Spreadsheet.** The employer simply sends us a spreadsheet showing the employee allocations. Employers can do this by using our PDF form (shown), an Excel spreadsheet available on our website, or using their own spreadsheet.

- **Check.** The employer can write a check and send that along with the spreadsheet. An employer can do this just once to get the employees started, annually, or monthly.

- **ACH.** The easier way to set up employer contributions is automatically through the ACH system. We collect the employer’s bank routing information and debit the employer’s account for the amount.

- **Changes/List Bill.** The employer is responsible for providing a new spreadsheet either with each contribution or anytime there is a change. For employers that desire a reminder, we offer a List Bill service, where we will send a monthly reminder of the amount and the allocation. This service costs $5 a month.
How much can employees contribute?

- **General guidelines**
  - Employees may contribute the lesser up to:
    - $2,850 for individuals (2007 limits)
    - $5,650 for families (2007 limits)
    - PLUS Catch-up Contribution of $800 for those age 55-65 Prorated for those not covered by an HDHP for the entire year

- **Contribution Worksheet.** The Eligibility and Contribution worksheet to the right can help employees determine how much they can contribute.
How do employees get the tax benefit?

- **Contributions**
  - **Payroll deductions.** Employers must report contributions on the W-2. Pre-tax amounts are not included as income as the W-2 so the employees cannot deduct the amount. (Most states also allow state tax deductions for HSAs – but not all)
  - **Personal contributions.** Amounts contributed directly by employees (including after-tax payroll deferral amounts), may be taken as an “above the line” deduction (federal taxes). Meaning the employees do not have to itemize to get the tax benefit. (No FICA/FUTA benefits)

- **HSA Account**
  - Earnings growth in the HSA are tax-exempt
  - Distributions are tax-free when used for qualified medical expenses

- **Tax Savings Worksheet** - The Tax Savings Worksheet to the right can help your employees estimate potential tax savings.
What medical expenses are covered?

- **Most medical expenses covered**
  - Doctor visits
  - Hospital expenses
  - Prescription drugs
  - Optical care
  - Dental

- **Who is covered**
  - The employee (self)
  - Spouse and dependents (regardless of whether they are covered under your insurance plan – the HSA can be used for a spouse even if covered under a different health plan)

- **Qualified Medical Expense Listing.** The Listing to the right can help you employees determine which expenses are qualified and which are not. The list is on the Employee Resource Center.

![Qualified Medical Expenses](image-url)
Can the HSA be used for other purposes?

- **Savings Rolled Over.** Unused funds remain in the HSA and continue to grow, tax-free, year after year.
- **Pay COBRA if you become unemployed.** Employees that separate from service may pay for COBRA insurance premiums through their HSA.
- **Long term care insurance.** Subject to certain limitations, the HSA can be used to pay for long term care insurance.
- **Pay insurance premiums at age 65.**
- **Use as Retirement Fund at Age 65.** At age 65, you can take money out of the HSA for non-medical reasons without penalty.

The Distribution Worksheet gives your employees a step-by-step guide to determine how they can use their HSA and what are the consequences.

**HSA Distribution Worksheet**

1. **Is your distribution for an "eligible" medical expenses?** The primary purpose of an HSA is to use the funds to pay for the health care expenses of yourself and dependents. Distributions for eligible medical expenses are tax-free and penalty-free.
   - **a.** Was the expense incurred by yourself or a family member? HSA funds may only be used for the expenses of yourself, your spouse and your dependents. Note: There is no requirement that you or your family member be currently covered by a HDHP. Coverage under aHDHP is only important when contributing to an HSA, not in being allowed to use the funds. See "Eligibility and Contribution Requirements" for details on contributing to an HSA.
   - **b.** Was the expense incurred inside the HSA? You must open your HSA before you incur the medical expense. This is a great incentive to save your HSA when your HDHP is off. Once your HDHP is open, you can use your HSA funds to pay for eligible medical expenses incurred now or in the future. You can even pay for current expenses out of future contributions or reimburse yourself for eligible medical expenses you paid for with out-of-pocket funds, just like any other retirement plan. Your HSA Contributions are governed by your employment plan, not HSA contributions.
   - **c.** Is your expense "eligible"? Most traditional medical expenses such as doctor visits and prescriptions are covered, see page 2 for a list of eligible expenses. Note: HSA distributions do not reduce your medical expenses for eligibility. You should check exceptions and keep a tax record in case of an IRS audit. See "Medical Expenses" (on previous page) for more details.

2. **Does your distribution qualify for another tax-free and penalty-free exception?**
   - **Long Term Care** Long term care insurance is an eligible expense subject to certain limitations — see page 2.
   - **Cosmetic Surgery** Cosmetic surgeries that are for non-medical reasons are also eligible — see page 2.
   - **Insuranced Service** Health coverage for all eligible persons that are eligible for the same plan or group of persons covered by the same plan (see below for details).
   - **Medicare Premiums** Medicare insurance premiums are deductible from gross income/benefits. An HSA distribution to reimburse the premiums effectively reduces the tax liability, providing a net incentive to pay the premiums as a qualified medical expense.
   - **Rollover/Transfer** A rollover or transfer to another HSA is not limited or penalized as long as the rollover is completed within 60 days and you have not unrolled other rollovers within the previous 12 months.

3. **Does your distribution qualify for a taxable, but penalty-free exception?**
   - **Age 65 or over** Non-medical distributions after age 55 are not penalized but are taxable similar to IRAs and 401(k)s.
   - **Distributions to Federal Trusts** Distributions to federal trusts are not penalized but are taxed. Special terminations can treat the HSA as if the amount was subject to tax or penalty — see page 2.
   - **Disability** Distributions taken or deemed persons are not penalized.

4. **If you do not meet any of the above you are subject to taxes plus a 10% penalty.**

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How does the employer administration work?

- **Limited Employer Involvement.**
  - **No Review of Claims.** The employer is not responsible to review employee receipts or claims.
  - **No Reimbursement Checks.** Employers are not responsible to reimburse employees for eligible medical expenses.
  - **No Liability for Wrongful Distributions.** Employers are not liable if an employee uses funds for non-eligible expenses.
  - **Contributions.** Employers are not required to make HSA contributions, but if you do, you do need to follow rules (see previous slides).

- **We Provide:**
  - Government Reporting
  - Statements to Employees
  - Account balance recordkeeping

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**HSA Resource Center**

**Employer Overview**

Welcome to the Employer Resource Center. You can find everything you need here to understand, establish and maintain Health Savings Accounts. Before we dive into an overview of HSAs (below), we want to point out this Center’s key features for employers:

- **Education** - a variety of materials to help you better understand HSAs, including education materials, a proposal detailing our services, FAQs, and articles.
- **Enrollment** - step-by-step instructions for employers opening HSAs, links to obtain HSA assistance and materials to help educate employees.
- **Administration** - details the administration services we provide to service your employees’ HSAs.
- **Forms and Tools** - direct access to our extensive list of tools and forms both for initial setup as well as ongoing administration.
- **Employee Resource Center** - a place for employees to conduct HSA business such as: changing beneficiaries, requesting withdrawals, looking up account balances, or conducting other HSA business.

**What is an HSA?**

Health Savings Accounts are savings accounts that allow individuals to pay for qualified out-of-pocket medical expenses using pre-tax dollars. Unlike more traditional health care accounts, the funds in an HSA belong to the individual, not the employer or the insurance company, and travel with the individual. In order to take advantage of this tax deferred savings new benefit, individuals must purchase a specific type of health insurance coverage called a High Deductible Health Plan (HDHP).

**Click on form for more details**

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How do employees manage their HSAs?

- **Employer Resource Center.** The Resources Employee Resource Center provides answers and tools for your employees.
- **Change Personal Information.** Employees self-administer changes in name, address, beneficiary information, etc. through tools available on our web site or by calling.
- **Contribution Changes.** If the employee is making automatic contributions from his or her own banking account, then that change can be made through tools available on the Employee Resource Center.
- **HSA Questions.** The Employee Resource Center provides tools to answer key HSA questions
  - Contribution Amount
  - Tax Deduction
  - Distribution Reasons
  - Eligible Medical Expenses
  - Frequently Asked Questions
How do employees keep track of expenses?

- **Employees are responsible for their medical expenses.**
  - **Pay Directly with Check or Debit Card.** Employees pay expenses directly with a check or debit card connected to the HSA.
  - **Recordkeeping.** Employees need to keep a record for their own tax purposes. If they use the debit card, the monthly statements partially fulfill the recordkeeping requirement. Otherwise, employees should keep receipts in case they are audited by the IRS.
  - **Keep Medical Receipts Private.** Employees like this because they can keep their medical bills private – no more sending copies of receipts to the employer.

- **Qualified Medical Expense Tracking Worksheet** - The Worksheet to your right can be used to help employees keep track of expenditures.

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How do employers and employees enroll?

If the employer will be making contributions for employees either directly or by allowing payroll deferral, the following steps are necessary. Otherwise, skip to step 3.

1. **Complete the Employer Information Sheet and Spreadsheet**
   The Employer Contribution Worksheet gathers basic information about the employer and asks questions about how you will run your HSA program.

   The Employee Contribution Worksheet (the last page in this excel file) collects information necessary to allocate the employer contribution to employees' HSAs. You can send your own allocation sheet if you prefer.

2. **Have your Employees Complete Their Applications**
   Each employee needs to complete and sign an HSA Application. If the employer will be making contributions – employees can skip all of section 2. Note: if your employees are transferring funds from another HSA custodian they need to complete and sign a Transfer Form in addition to their HSA Application.

3. **Submit Completed Applications**
   Congratulations you're done. Send your completed documents to:
   HSA Resources, PO Box 7338, St. Cloud, MN 56302

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**Employer Information Sheet**

1. **Company Information**
   - Company Name:
   - Street Address:
   - Contact Name:
   - Contact phone:
   - Contact email:

2. **Plan Information**
   - Number of Employees:
   - No. HSA participants:
   - Individual Deductible Levels:
   - Family Deductible Levels:
   - HSA Start Date:
   - Health Insurance Agent:

3. **Employer Contributions to HSA (pick all that apply)**
   - Payroll Deferral or Employer Contributions throughACH (for employer or employee via payroll)
   - Date:
   - 1st of the Month
   - 10th of the Month
   - 20th of the Month
   - 30th of the Month

   - A representative from our ACH department will contact you to complete the ACH process. (1) complete application, (2) verify amounts and process, and (3) to answer any questions you have. Please call your HSA custodian if you have any questions.

   - Employer Contributions by check (make checks payable to HSA Resources)

   - Employer should make additional contributions on a monthly, annual or periodic basis at its discretion. Check may be sent to your HSA custodian at any time but must be accompanied by an Employer Contribution Spreadsheet.

   - To open accounts please submit form for the Initial Contribution plus any application fees.

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**Click on form for more details**
Any other employer services available?

- **Employer Consult.** HSA Resources provides a consultation to discuss HSA plan related issues.
- **Employee Education Tools.** We provide a variety of tools for employers to distribute to employees.
  - Right Choice Brochure
  - HSA Overview Brochure
  - HSA Guide
- **Enrollment Meeting Participation.** HSA Resources will participate in an enrollment meeting via telephone at your request.
- **Section 125 Plan.** We offer a Section 125 plan for employers and/or employees seeking to may pre-tax payroll HSA contributions.
- **Telephone Support.** We support employers.

**When is a section 125 plan the right approach?**
- You want employees to make contributions through payroll deferral on a pre-tax basis
- You want to take advantage of the Pre-FICA/FUTA nature of employee contributions
- You have enough employees to cover the small cost of a Section 125 plan (generally 3 or more)
- Your employees will be paying a portion of the premium expense - the Section 125 plan lets you do it on a pre-tax, pre-FICA/FUTA basis
- We offer a special “limited” administration Section 125 plan to accomplish these objectives.