



PAYFLEX®

An Employer's Guide to the Health Savings Account (HSA)

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Publisher's Note

Recognized as a valuable resource by millions of Americans since 2004, HSA Road Rules is an easy-to-understand guidebook that gives you the information you need to know about HSAs. The information in HSA Road Rules may not necessarily apply to your specific plan. It also may not take into account your employee benefits situation. For specific tax or legal advice, please consult with your own tax or legal advisor.

About PayFlex®

PayFlex is part of the Aetna® family and one of the nation's leading account-based third party administrators providing innovative benefits administration and technology solutions for health care spending and saving accounts, COBRA and commuter benefit programs. The company powers the development and delivery of complete health care banking services for both consumers and businesses.

PayFlex pioneered the first platform that combines benefit financial accounts, wellness and eligibility management all in one. This platform houses nearly one million participants and several million eligible lives, combines over two decades of tax-advantaged account administration experience with a suite of wellness and engagement services that are integrated together to form a powerful solution. Our complete solution is designed to educate employees on health care issues, engage them in wellness activities through customized programs and incentives, and empower employees to make their own health care decisions.

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Introduction to Health Savings Accounts (HSAs)

An HSA is like a 401(k) for health care. It is a tax-favored, interest-bearing account that your employees use to pay for qualified medical expenses, now or in the future. Employees can save or invest the account funds. Paired with a qualified high deductible health plan (HDHP), an HSA is a powerful financial tool that gives your employees more control of their health care decisions.

Unlike other savings vehicles (Roth IRA, Traditional IRA, 401(k), etc.), an HSA offers triple tax savings.

- Pre-tax or tax-deductible contributions ⁽¹⁾
- Tax-free interest or investment earnings ⁽²⁾
- Tax-free distributions, when used for qualified medical expenses

You can contribute to your employees' HSAs. The employees are also able to contribute to their HSAs. Employees can make tax-free withdrawals to pay for qualified medical expenses. This includes expenses for the employee and his or her spouse and tax dependents. This is true even if the employee has a self-only HDHP.

HSAs are also portable. This means that employees keep their HSAs when they change employers or stop working. Unlike an FSA, there is no "use-it-or-lose-it" rule with HSAs. Unused contributions remain in the account each year, earning tax-free interest. If the employee invests HSA funds, those funds remain in the investment account, very similar to an IRA or 401(k). HSAs offer the potential for long-term, tax-free savings that can be used for future health care expenses. These include out-of-pocket expenses after retirement, Medicare and long-term care (LTC) premiums, up to Internal Revenue Service (IRS) limits and certain LTC expenses.

There are no income limitations.

⁽¹⁾Employers should consult a tax advisor. Tax references are at the federal level. State taxes may vary.

⁽²⁾Investment products are not FDIC insured, have no bank guarantee and may lose value.

HSA Trends

Market trends continue to show adoption of account-based health plans (ABHP), and specifically HSAs.

The number of HSAs continues to rise

HSAs have been growing annually at a rate of 15% year over year, with nearly 14 million HSAs in the marketplace today, totaling \$24 billion in assets. As of year-end 2014, the number of HSAs rose to 13.8 million. This is an increase of 29% since year-end 2013.

Employers continue to fuel Consumer Directed Health Plans (CDHPs) & HSAs

Sixty-seven percent of employers offered High Deductible Health Plans (HDHPs) in 2014. Of those, 47% offer an HSA alongside their HDHP (this is up from 39% in 2013). According to Health and Well-being Touchstone Survey results, only 15% offer a Health Reimbursement Account (HRA) with their HDHP and HRAs are decreasing in popularity (down from 20% in 2013).

Employer HSA contributions

The average employer contribution for 2015 was \$923, and the average employee contribution was \$1,700. This is according to Devenir's 2015 Year-End HSA Marketing Research Report.

Spenders, Savers, Investors

According to Devenir:

- 68% are deemed to be spenders, those who spend most if not all of their funds on out-of-pocket health care costs
- 23% are said to be savers, with balances between \$1K - \$5K
- 9% use their HSA as an investment vehicle and have an average investment balance of \$9,700 and an average annualized return of 12.5% over the past 3 years

Devenir Research 2016 Year-End HSA Market Statistics & Trends

Read the [full report here](#). Below are some key findings:

- **HSA accounts now exceed 20 million.** The number of HSA accounts rose to 20 million, holding almost \$37 billion in assets, a year over year increase of 22% for HSA assets and 20% for accounts for the period of December 31st, 2015 to December 31st, 2016.
- **More unfunded accounts.** More HSAs (24 percent) were unfunded at the end of 2016, compared to 20 percent at the midyear point of 2016.
- **HSA investments see continued growth.** HSA investment assets reached an estimated \$5.5 billion in December, up 29% year over year. The average investment account holder has a \$14,971 average total balance (deposit and investment account).
- **Health plans remain the largest driver of account growth.** Health plan partnerships continued as the leading driver of new account growth, accounting for 37% of new accounts opened in 2016.

Universal HSA Principles for Employers

Qualified HDHPs

- Employees must have a qualified HDHP to contribute to an HSA. They also cannot be enrolled in Medicare or Tricare; be someone else's tax dependent; or have any non-permitted coverage.
- Switching to an HDHP from a traditional health plan may substantially lower your company's health plan contributions. You can then use some of that savings for contributions to your employees' HSAs. This can make for a win-win situation for both employer and employees.

HSA Ownership

- All funds in an HSA, including employer contributions, are the property of the employee. This is true even if an employee changes jobs or stops working.
- Employees become empowered when they elect an HSA. Since employees own their HSA funds, they are typically more careful in making their health care decisions. This makes them better health care consumers. HSA account owners are more likely to inquire about the cost of their health care costs.

HSA Withdrawals

- There is no time limit as to when employees can reimburse themselves for qualified medical expenses. Employees should be encouraged to keep all receipts and records in case the IRS audits them.
- Employees decide if, when and how much to spend from the HSA. Employees also decide whether to use the funds now or to save them for the future. Just like a 401(k), earnings that compound tax-free for several years have the potential to grow into a retirement health care nest egg. After age 65 or in the event of a disability, an employee may even withdraw funds for non-qualified expenses without paying a tax penalty. The employee would still pay income taxes for this withdrawal.

HSA Contributions

You can make tax-free contributions to your employees' HSAs through a Section 125 cafeteria plan. You may also let employees contribute with pre-tax payroll deductions.

HSA Road Rules for Employers

The employee owns the contributions in the HSA. You cannot restrict the use of an employee's HSA funds.

Employee Contributions

- If you offer an HSA through a Section 125 cafeteria plan, employees may contribute to the HSA with pre-tax payroll deductions. Employees may also contribute on an after-tax basis. If they contribute after-tax, they would take an "above-the-line" deduction on their tax returns.
- Employees may prospectively change their HSA contributions through a cafeteria plan without a family status change. However, you may put reasonable limits on how often they can change their contributions. You must allow them to make changes at least monthly.

HSAs and ERISA

- An HSA is generally not an "employee welfare benefit plan" under the Employee Retirement Income Security Act (ERISA). Generally, the HSA must meet the following requirements for it to not be governed by ERISA.
 - The employees have the option to open an HSA. This is voluntary for the employees.
 - The employer does not prevent employees from moving their funds to another HSA.
 - The employer does not impose conditions on how employees can use the funds.
 - The employer does not influence or make the investment decisions.
 - The employer does not represent that the HSA is an employee welfare benefit plan which is established or maintained by the employer.
 - The employer does not receive any payment or compensation in regard to the HSA.

Employer Contributions

- HSAs may be funded on a pay-as-you go, look back or pre-funded basis.
 - **Pay-as-you-go:** You fund the HSAs based on the paycheck schedules (bi-weekly, monthly, etc.).
 - **Look back:** You contribute to HSAs for each full month that an employee was enrolled in the HDHP.
 - **Pre-funded:** You fully fund the HSAs on the first day of the plan year.
- Employer contributions are tax-free. They are not part of the employee's income.
- You might employ a married couple. If they have a family HDHP that covers both of them, you only have to contribute to one of the HSAs.
- You may require your employees to complete a wellness or disease-management program or risk assessment to receive employer contributions.
- If you do not provide your employees with health coverage you may still contribute to their HSAs. Employees may buy HDHP coverage on their own. You may offer to make HSA contributions through a Section 125 plan. If you do this, you must also adhere to the Section 125 plan's non-discrimination rules.

- Sometimes employees have medical costs that are more than what they contributed to date into their HSAs. You may accelerate HSA contributions for these employees. If you do this, you must do it equally for all eligible employees throughout the plan year.

Comparability Rules

If you offer the HSA through a Section 125 cafeteria plan, you can disregard this section. Comparability rules apply only to an HSA plan that is not part of your cafeteria plan.

- Employer contributions must be comparable. This means that all employer contributions must be either the same dollar amount or the same percentage of the deductible. You may apply this within certain defined employee categories. These include lines of coverage (family vs. self-only); type of employment (part-time, full-time and former employees); and level of compensation (hourly vs. salary; highly compensated vs. non-highly compensated).
 - If you use the highly vs. non-highly compensated category, you must contribute more to the non-highly compensated employees.
 - Part-time employees are typically those who work under 30 hours. Full-time employees are typically those who work 30 hours or more.
- You may further break down the coverage levels (self-only vs. family). You may have subcategories based on the number of dependents (employee plus one dependent, employee plus two, etc.). You may not fund differently within these subcategories. For example, a family with more covered dependents can never receive a lower amount than a family with less covered dependents.
- An employer can provide a higher contribution to non-highly compensated employees than to a highly compensated employees, but not the reverse. An employer cannot contribute more to a highly compensated employees than to non-highly compensated employees. By doing so, an employer risks breaking comparability rules. It is possible that you have employees in your HDHP who have their HSAs somewhere else. If you contribute to the HSA of one of these employees then you must do so for all similarly situated employees.
- If you will be making employer contributions, you must let all eligible employees know that you will contribute for that year. You can do this in a written or electronic notice. Employees who have not yet opened an HSA or who have not yet told you that they have an HSA have until February of the following year to notify you that they have an HSA. You would then have to make the contributions.
- If you make a contribution that is not in line with the comparability rules, you may not take back any excess contribution. Instead, you have until the tax filing deadline to correct the contribution so that it is comparable by making additional contributions plus reasonable interest (up to an employee's annual contribution limit).
- An employer can make contributions to the HSAs of terminated employees. However, you must give the same contribution to all employees within the same category (i.e. full time, part time, non-active). If an employer funds employee contributions at the beginning of the year, and an employee terminates employment after the beginning of the year, the employee does not have to

return those employer contributions. If an employer funds on a quarterly basis, the employer has to give the same amount to everyone in the same category at the time of the funding. Comparability rules do not apply to collectively bargained or union employees.

Non-Discrimination Rules

- Employer contributions through a Section 125 plan are subject to non-discrimination rules.
- These rules generally state that you may not contribute more for higher-paid employees than you do for lower-paid employees. You may however, contribute more for lower-paid employees.

Allowable Other Coverage

Generally, to be eligible for an HSA, the account owner may not have any medical coverage other than the HDHP. However, there are some exceptions. These include workers' compensation; medical liability for personal property (for example, car insurance); coverage for a specific illness or disease; or a daily fixed amount for a hospital stay.

Allowable other coverage also includes those listed below.

- You may offer a Limited Purpose FSA (LPFSA) or a Limited Purpose HRA (LPHRA). These accounts reimburse for dental, vision and preventive care.
- You may offer a post-deductible HRA or a post-deductible LPFSA. They reimburse expenses incurred after meeting the deductible.
- You may offer a combination of limited purpose and post-deductible.

Non-Permitted Coverage

- An employee can't have other health coverage that pays for out-of-pocket health care expenses before they meet their plan deductible.
- An employee and/or their spouse can't have a health care Flexible Spending Account (FSA) or Health Reimbursement Account (HRA) in the same year.
- An employee enrolled in Medicare or Medicaid, isn't eligible for an HSA. If they had an HSA when they enrolled in Medicare or Medicaid they can still use the funds. They just can't contribute to the account. **Note:** If an employee is eligible for Medicare but not yet enrolled, they can still contribute to the HSA.
- If an employee is enrolled in Tricare they aren't eligible for an HSA. (Tricare is health coverage for people in the military.) If they had an HSA when started on Tricare, they can still use the funds. They just can't contribute to the account.
- An employee can't have used Veterans Affairs (VA) medical benefits in the prior three months. Except in cases where the hospital care or medical services were for a service-connected disability.
- An employee can't be claimed as a dependent on another person's tax return.

COBRA

COBRA rules apply to the HDHP. They don't apply to the HSA.

Recoupments

HSAs are individually owned accounts. This means that much of the responsibility for corrections is with the account owner. The regulations do permit you, the employer, to recover contributions in only two circumstances: (i) when the employee was never eligible for the HSA, and (ii) for excess contributions beyond IRS guidelines.

- You may recoup HSA contributions if the employee was never eligible to contribute to an HSA. If the employee was not eligible to have an HSA, then no HSA exists. You may correct the error. You may ask the bank or administrator to return to you the funds that you have contributed. However, you may only do this in the same year that you sent the contributions. If you do not do this in the same year, then you must include the amounts contributed in the employee's income. You would also have to report this on the employee's Form W-2 for that year.
- If you contribute an amount to an employee's HSA that is more than what that employee may contribute for the year that is an excess contribution. You may be able to correct the error. You may ask the bank or administrator to return to you the excess amount. If you do not recover the excess amount by the end of the taxable year in which the contributions were made, then you must include the amount in the employee's income. You would also have to report this on the employee's Form W-2 for that year.

You aren't able to recoup funds for any other reason. The IRS guidance does not allow for recoupments based on employer reporting error. This means that if you contribute to the HSA of an employee who is no longer eligible or erroneously to the wrong employee, you can't recoup the amounts from the HSA.

HSA Eligibility Road Rules

To be eligible for an HSA, the employee must be enrolled in a qualified HDHP.

- An HDHP has a higher deductible than most health plans. With this type of plan, the employee typically first pays a deductible. The deductible is based on coverage level (self-only vs. family). A self-only HDHP covers just the employee. A family HDHP covers the employee and at least one other person. A qualified HDHP has the following characteristics.
 - Minimum deductibles
 - Limit on out-of-pocket expenses
 - Allowance to cover preventive care

Minimum deductibles

A qualified HDHP must have minimum deductibles. If the plan has a deductible that is lower than this minimum, it is not a qualified plan for the HSA.

Minimum Annual Deductible	2018	2019
Self-only coverage	\$ 1,350	\$ 1,350
Family coverage	\$ 2,700	\$ 2,700

Limit on out-of-pocket expenses

A qualified HDHP is limited to what the employee pays out-of-pocket in the plan year. This includes deductibles, co-payments and co-insurance. **Note:** These apply to in-network only services. This does not include premiums, expenses that the plan does not cover and lifetime limits.

Maximum Out-of-Pocket Limit	2018	2019
Self-only coverage	\$ 6,650	\$6,750
Family coverage	\$ 13,300	\$13,500

Preventive care

The HDHP may cover preventive care while the employee is still meeting the deductible. As described in the Affordable Care Act and in IRS Notice 2004-23, this could include regular checkups as well as routine gynecological and well-child exams. It also includes counseling to prevent illness, disease or other health problems. For your reference, a listing of recommendations and guidelines can be found at:

www.HealthCare.gov/center/regulations/prevention.html.

Grace Period

- If you offer an FSA with a grace period, then the mechanics of how reimbursements are made during the grace period will determine when employees are eligible for the HSA.
- If the FSA reimburses dental, vision and preventive care only during the grace period, then the employees are eligible for the HSA on the first day they have the HDHP. **Note:** Your plan must restrict all FSA reimbursements during the grace period.
- If the FSA reimburses all qualified medical expenses during the grace period, then employees enrolled in the HDHP are not eligible to open an HSA until the first of the month following the end of the grace period.

Note: If an employee starts the grace period with a zero balance and also starts the HDHP that day, the employee is eligible to contribute to the HSA on the first day of the new plan year.

Veterans Administration (VA) health benefits

You may have some employees receiving Veterans Administration (VA) health benefits. If they receive care from the VA, this may affect their HSA eligibility. Members can't have used Veterans Affairs (VA) medical benefits in the prior three months. Except in cases where the hospital care or medical services were for a service-connected disability.

HSA Contribution Road Rules

General Contribution Rules

- An employee must have a qualified HDHP to contribute to an HSA.
- An employee may make a deposit any time after the HSA is opened. They may deposit funds into the HSA in any amount or at any frequency up to their annual limit.
- Employees may contribute up to the tax filing deadline for the year. For most people, that is April 15 of the next year.
- The bank or trustee may set minimum deposit and balance amounts.
- Anyone may contribute to the employee's HSA. This includes the employee, his or her spouse, the employer and any other person. Though anyone may contribute, all of the contributions belong to that employee. All contributions count toward the annual limit.
- An employee that is no longer enrolled in the HDHP generally cannot contribute to the HSA. However, he or she can still contribute up to their annual limit for the time they were eligible for the HSA. This means they may contribute for the months that they had the HDHP. See the Proration Rule section below. The employee may continue to spend the funds for qualified medical expenses.
- Each year the IRS sets the annual contribution limits. These limits are for HDHP coverage (self-only vs. family). These amounts may change each year for the cost-of-living adjustment.

Maximum Contribution Per Year	2018	2019
Self-only coverage	\$ 3,450	\$ 3,500
Family coverage	\$ 6,900	\$ 7,000

- Deposits to an HSA must be made in cash.
- For married people, if either spouse has a family HDHP then both spouses have family coverage. This is true even if one spouse has a family HDHP and the other spouse has a self-only HDHP. Each spouse can have an HSA. However, between the two of them they are limited to the family contribution limit.
- If each spouse has a self-only HDHP, then each spouse may contribute up to the self-only limit.
- If an employee has a family HDHP with per-person deductibles, he or she is still limited to the contribution limit for family coverage. For example, an employee has an HDHP with a \$4,000 per person deductible. The employee and his or her spouse are on the HDHP. The contribution limit for the two of them is the family limit for the year.

Last-month rule

Some employees will not have a HDHP for the entire year. They may start their HDHP at some point after January 1. This would be true for late enrollees, new hires and for plan years that do not start on January 1.

- If an employee has an HDHP on December 1, the employee may contribute to the HSA as if he or she is eligible for the entire year. The employee would have to remain in the HDHP through the “testing period.” The testing period starts with the month of December and continues through the end of the following year. This is a total of 13 months. If the employee does not stay in an HDHP through the testing period, then the contributions for the months that he or she did not have the HDHP are no longer tax-free. The employee would also have to pay a 10% penalty on that amount.
- If an employee has a self-only HDHP on January 1 and ends the year with a family HDHP, the last-month rule applies. Since the employee would have a family HDHP on December 1, he or she can contribute as if he or she had family coverage for the entire year. The employee would then have to meet the testing period requirement and he or she must have an HDHP through the end of the next tax year.

Proration

If an employee has an HDHP for part of the year but not on December 1, then the Proration rule applies.

- Proration means that the employee contributes to the HSA just for the months that he or she is eligible. To prorate, the employee would calculate the contributions on a monthly basis. How much he or she can contribute for each month is based on having the HDHP on the first day of the month.
- If an employee has a family HDHP on January 1 and ends the year with a self-only HDHP, he or she would have to prorate contributions for the year. The employee would have to prorate the months when he or she had a family HDHP. The employee would then prorate the months for a self-only HDHP. When you add the two together, you have the amount that the employee can contribute for the year. There is no testing period.

Rollovers

- The term “rollover” has several meanings.
 - Funds in the HSA “rollover” from year to year.
 - An employee can rollover the funds from one HSA to another HSA.
 - An employee can rollover funds from an IRA to an HSA.
- Funds remain in the HSA from year to year. There is no use-it-or-lose-it rule for HSAs.
- An employee may roll over funds from an Archer Medical Savings Account (MSA) into an HSA. The employee may also rollover from one HSA to another HSA. An employee must complete this within 60 days of withdrawing the funds.
- An employee may make a one-time transfer from an IRA to an HSA. This is a tax-free, trustee-to-trustee transfer. The amount of this transfer is limited to the employee’s contribution limit for the year, based on the coverage level he or she has in the month of the transfer. If the employee changes from a self-only HDHP

to a family HDHP, he or she can transfer up to the difference for the contribution limit.

- This transfer amount does count toward the annual contribution limit.
- There is a “testing period.” The employee must remain in the HDHP through the testing period. The testing period starts in the transfer month. It continues through the next 12 months, for a total of 13 months.
- If the employee does not have an HDHP through the testing period, he or she will have to pay income taxes on the transfer amount. The employee may also have to pay a 10% penalty tax.

Note: This transfer is not allowed for a Simplified Employee Pension (SEP) IRA or a Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) IRA.

Trustee-to-Trustee Transfers

If an employee instructs one bank or trustee to move HSA funds to another HSA with a different bank or trustee, this is a trustee-to-trustee transfer. This is not a rollover. The employee may do this as often as he or she wants.

Catch-up contributions

An employee that is 55 and older can contribute an additional \$1,000. This is a “catch-up” contribution. The employee may do this each year he or she is eligible for the HSA, until he or she enrolls in Medicare.

- If an employee has to prorate contributions for the year, then he or she would also prorate the catch-up contribution.
- If the employee has a family HDHP that covers a spouse, and the spouse is age 55 or older, the spouse may make a catch-up contribution. If the spouse wants to do this, he or she would have to open up his or her own HSA. Only one person may own an HSA. This means that the spouse cannot contribute his or her catch-up contribution to the employee's HSA. **Note:** This is assuming that the spouse has not yet enrolled in Medicare.

HSAs and Medicare

- If an employee has a family HDHP, and the spouse is enrolled in Medicare, the employee may contribute up to the family limit.
- If the employee enrolls in Medicare, he or she is no longer eligible to contribute to the HSA. Regardless of what day of the month that the employee starts on Medicare, for that month and going forward the employee is no longer eligible to contribute toward their HSA, however the employee may continue to use their HSA funds.

Excess Contributions

The amount that an employee may contribute to an HSA each year is based on a number of factors. These include the level of HDHP coverage (self-only or family); how long the employee had the HDHP; and his or her age. If the contributions to the HSA total more than what the employee can contribute for the year, the employee has an “excess contribution.”

- If an employee has an excess contribution, he or she may withdraw that amount as well as any earnings on that amount. The employee has until the tax filing deadline to do this. For most people, the tax filing deadline is April 15 of the following year. The employee will have to pay income taxes on this amount. However, he or she will not have to pay a tax penalty.
- If an employee does not withdraw the excess contribution by the tax filing deadline, he or she must also pay a six percent excise tax on that amount. This includes any interest earned on the excess amount. The employee will have to pay this excise tax each year that the excess amount remains in the HSA. If, in the next year, the employee uses the excess amount toward the annual contribution limit, the employee will not have to pay the excise tax again.
- If the employee fails to meet a testing period (for last-month rule or rollover from an IRA), he or she cannot withdraw that amount as an excess contribution.

COBRA

COBRA continuation applies to the HDHP. If a former employee elects COBRA and continues on the HDHP, you do not have to continue making deposits into the HSA. In addition, you are not required to continue to make HSA contributions during the COBRA continuation period.

HSA Spending Road Rules

Qualified Expenses

- Employees use their HSAs to pay for qualified medical care expenses. The medical care may be for the employee and his or her spouse and tax dependents. This is true even if the employee has a self-only HDHP.
- Qualified expenses include what the employee pays out-of-pocket for medical care. Medical care is the diagnosis, cure, mitigation, treatment or prevention of disease. This includes the cost of equipment, supplies and diagnostic tests.
- Employees may use the HSA funds to pay for specific insurance premiums.
 - Long-term care (LTC) insurance⁽³⁾
 - COBRA health care continuation
 - Health care coverage while receiving unemployment benefits
 - Medicare and other health insurance if age 65 and older, not including Medicare supplement

⁽³⁾The premiums for long-term care insurance that employees can treat as qualified medical expenses are subject to limits based on age and are adjusted annually.

- Employees may use the HSAs for expenses incurred on or after the date the HSA is opened.
- Please refer to IRS Publications 969 and 502 for more information. IRS Publication 502 provides a list of qualified medical expenses. Both are on the IRS website at www.irs.gov (please see Table C for a sample list of qualified medical expenses and Table D for a sample listing of non-qualified medical expenses). Please note that Publication 502 contains guidance on what medical expenses are deductible on an individual's federal income tax form based on Internal Revenue Code Section 213(d), but that some expenses such as insurance premiums, that would be deductible under IRC 213(d) cannot be reimbursed from an HSA.

Non-Qualified Medical Expenses

An employee may use HSA funds for a non-qualified medical expense. However, the employee will have to pay income taxes on that amount. He or she may also have to pay a 20% tax penalty. If an employee is age 65 or older or disabled at the time of the withdrawal, he or she will not have to pay the 20% penalty. He or she would still have to pay the income taxes.

Mistaken Distribution

If an employee used HSA funds for a non-qualified medical expense, he or she may return the money to the HSA. The employee would have to do this before the tax filing deadline for the year in which the employee knew, or should have known, that the withdrawal was a mistake. If the employee returned the money before the deadline, they would not have to pay a penalty for this.

Record Keeping

Employees with an HSA should keep all their receipts showing how they used their HSA funds. There are two key reasons to do this – to show that they used the funds for qualified medical expenses and in case the IRS audits them.

Beneficiaries of the HSA

An employee should choose a beneficiary when they set up an HSA. If the spouse is named as the designated beneficiary of the HSA, the account will become the spouse's HSA after the employee's death. If someone other than the employee's spouse is designated as the beneficiary, then upon the employee's death, the account will cease to be an HSA and the fair market value of the HSA becomes taxable to the designated beneficiary in the year in which the employee died. If there is no designated beneficiary, the HSA will become an asset of the account owner's estate and the fair market value will be included on the final income tax return.

HSA Tax Road Rules

Tax reporting is required for HSAs. Contributions to and distributions from the HSA are reported to the IRS. Each account owner will use IRS Form 8889 to report HSA activity. They will file this form with Form 1040.

Who	What	When	Why
Employers	<p>Sends Form W-2 that includes HSA contribution information.</p> <p>HSA contributions made through a cafeteria plan are included in Box 12 using a code of "W."</p>	In January (for the prior tax year).	<p>Employee contributions made pre-tax through a cafeteria plan are considered employer contributions. These pre-tax cafeteria plan contributions should be combined with any contributions made by your company.</p> <p>Note: Some employers don't offer pre-tax contributions via payroll or employer contributions.</p>
Custodian	<p>Sends Form 1099-SA to account owners.</p> <p>Sends Form 5498-SA to account owners.</p> <p>We also send copies to the IRS.</p>	In January (no later than the end of May).	<p>Reports annual distribution information for use in tax preparation and filing</p> <p>Note: Many custodians send Form 5498-SA at the end of May. This will include HSA contributions made through the tax filing deadline.</p>
HSA Account Holder	Completes Form 8889 and submits with	Prior to the annual tax filing deadline.	Documents contributions and

	<p>income tax return.</p> <p>If any excess contributions, completes Form 5329.</p>		<p>distributions for tax reporting purposes.</p> <p>Only needed if excess contributions have been made and not withdrawn from the HSA.</p>
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Tax Reporting – Employers

The IRS defines employee contributions made pre-tax through a cafeteria plan as employer contributions. You should combine these pre-tax contributions with any contributions from your company on Form W-2. You will report these in Box 12 with a code of "W."

Tax Reporting – Custodians

- HSA custodians must report contributions to the HSA. They report these on Form 5498-SA. This form also includes the Fair Market Value (FMV) of the HSA as of December 31 of that year. The custodian has until May 31 of the following year to mail this form to account owners. This form will include contributions through the tax filing deadline. This is generally April 15 of the following year.
 - The custodian will also report any excess contributions on Form 5498-SA. This is true even if they returned the funds to the account owner.
- HSA custodians must also report distributions from the HSA. They report these on Form 1099-SA. The custodian must mail this form by January 31 to each account owner. It will include distributions through December 31 of the previous year. Distributions include:
 - Withdrawals
 - Debit card purchases
 - Check payments to providers
 - Bill payment transactions
 - Return of net income on excess contributions

Tax Reporting – Account owners

- Account owners must report HSA contributions and distributions on Form 8889. They will include this form as part of their federal income tax filing (Form 1040).
- If an account owner has to report excess contributions, he or she will do so on Form 5329.
- Account owners can get Forms 8889 and 5329 on the IRS website (www.irs.gov). They can also get instructions for these forms. They may also call the IRS at 1-800-TAX-FORM or visit an IRS office in person.

Excess Contributions

- If an account owner does not correct excess contributions by the tax filing deadline, then he or she must calculate the excess amount. The account owner will do this on Form 8889. He or she will then report that amount and any excise tax on Form 5329.
- If the account owner corrects the excess contribution in a timely manner, he or she will not owe any excise tax on such excess contribution; however the account owner will have to report that excess amount plus any net interest as "Other Income" on Form 1040.

Trustee-to-Trustee Transfers

An account owner does not have to report a trustee-to-trustee transfer. With a trustee-to-trustee transfer, the funds must pass directly from one custodian to the other. If the account owner accepts the payout from the HSA and then directs the funds to another custodian, that is not a trustee-to-trustee transfer. That is a rollover.

Rollover

Account owners are permitted one rollover per year. The account owner must complete this within 60 days of withdrawing the funds.

State Taxation

Most states provide favorable income tax treatment for HSA contributions. They generally follow the federal tax law for pre-tax contributions. This means that employees who contribute to an HSA do not pay federal and state income taxes on those amounts. However, some states do not follow federal tax laws. For those states, employees would still have to pay state income taxes on their HSA salary contributions. An employee should consult with their tax advisor or their state department of revenue to determine how state taxes may impact their HSA.

Table A

Allowable HSA Investments

Allowable HSA Investments
Bank Accounts
Annuities
Certificates of Deposit
Stocks
Bonds
Mutual Funds

Note: An HSA custodian or trustee may limit or restrict certain types of investments.

Not Allowable HSA Investments

Collectables – including any work of art, antique, metal, gem, stamp, coin, alcoholic beverage or other personal property as described in Section 408(m)(3) of the Internal Revenue Code

Life Insurance Contracts

Table B**Allowable Expenditures on Long-Term Care Insurance**

In order to use HSA funds for Long-Term Care (LTC), the LTC insurance contract must meet the following requirements.

1. Be guaranteed renewable
2. Not provide for cash surrender value or other money that can be paid, assigned, pledged, or borrowed
3. Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract, must be used only to reduce future premiums or increase future benefits
4. Generally may not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer, or the contract makes per diem or other periodic payments without regard to expenses

Account owners are limited to the amount of HSA funds they can use to pay for qualified LTC premiums. These amounts may be adjusted annually for inflation. The amounts issued by the IRS are below.

Allowable Long-Term Care Premium Amounts		
Age	2017	2018
Age 40 or under	Up to \$410	Up to \$420
Age 41 to 50	Up to \$770	Up to \$780
Age 51 to 60	Up to \$1,530	Up to \$1,560
Age 61 to 70	Up to \$4,090	Up to \$4,160
Age 71 or over	Up to \$5,110	Up to \$5,200

Source: IRS Revenue Procedure: 2017-58

Table C**Sample List of HSA Qualified Medical Expenses from your HSA**

Account owners use the HSA funds to pay for qualified medical expenses. The IRS defines medical care as the diagnosis, cure, mitigation, treatment or prevention of

disease, and the cost for treatments affecting any part of function of the body. When an account owner uses HSA funds to pay for a qualified medical expense, he or she has to determine if the medical care meets this definition. Generally speaking, medical care is for the prevention or alleviation of a physical or mental defect or illness. It is not for general health. See IRS Publications 969 and 502 for more information.

Sample List of Qualified Medical Expenses from your HSA	
Note: This isn't a complete list	
Acupuncture	Alcoholism Treatment
Ambulance	Artificial Limb
Artificial Teeth	Bandages
Birth Control Pills (by prescription)	Breast Reconstruction Surgery (mastectomy)
Car, Special Hand Controls (for disability)	Certain Capital Expenses (for the disabled)
Chiropractors	Christian Science Practitioners
COBRA premiums	Contact Lenses
Cosmetic Surgery (if due to trauma or disease)	Crutches
Dental Treatment	Dermatologist
Diagnostic Devices	Disabled Dependent Care Expenses
Drug Addiction Treatment (inpatient)	Drugs (prescription)
Eyeglasses	Fertility Enhancement
Guide Dog	Gynecologist
Health Institute (if prescribed by physician)	Hospital Services
Hearing Aids	Home Care
Insulin	Laboratory Fees
Lasik Surgery	Lead-Based Paint Removal
Learning Disability Fees (prescription)	Legal Fees (if for mental illness)
Life-Care Fees	Lodging (for out-patient treatment)
Long-Term Care (medical expenses)	Long-Term Care Insurance (up to allowable limits)
Meals (associated with receiving treatments)	Medical Conferences (for ill spouse/dependent)
Medicare Premiums (except Medicare Supplement)	Medicare Deductibles
Nursing Care	Mentally Retarded (specialized homes)
Obstetrician	Nursing Homes
Operations – Surgical	Operating Room Costs
Optician	Ophthalmologist
Organ Transplant (including donor's expenses)	Optometrist
Orthopedic Shoes	Orthodontia
Osteopath	Orthopedist
Over-the-Counter Medicines or Drugs	Out-of-pocket expenses while enrolled

for which you have a prescription	in Medicare
Pediatrician	Oxygen and Equipment
Podiatrist	Personal Care Services (for chronically ill)
Prenatal Care	Post-Nasal Treatments
Prosthesis	Prescription Medicines
Psychiatric Care	PSA Test
Psychoanalysis	Psychiatrist
Psychologist	Psychoanalyst
Radium Treatment	Qualified Long-Term Care Services
Special Education for Children (ill or disabled)	Smoking Cessation Programs
Spinal Tests	Specialists
Sterilization	Splints
Telephones and Television for Hearing Impaired*	Surgery
Therapy	Transportation Expenses for Health Care
Transplant	Vaccines
Vitamins (if prescribed)	Weight Loss Programs
Wheelchair	Wig (hair loss from disease)
X-Rays	

*Only the cost above regular equipment is an eligible expense.

Table D

Sample List of Non-Qualified Medical Expenses from your HSA

Sample List of Non-Qualified Medical Expenses from your HSA	
Note: This isn't a complete list	
Advance Payment for Future Medical Expenses	Athletic Club Membership
Over-the-Counter Medicines or Drugs for which you do not have a prescription	Babysitting (for healthy children)
Boarding School Fees	Bottled Water
Commuting Expenses for the Disabled	Controlled Substances
Cosmetics and Hygiene Products	Dancing Lessons
Diaper Service	Domestic Help
Electrolysis or Hair Removal	Funeral Expenses
Hair Transplant	Health Programs at Resorts, Health Clubs, & Gyms
Household Help	Illegal Operations and Treatments

Illegally Procured Drugs	Maternity Clothes
Medigap premiums	Nutritional Supplements
Premiums for Life or Disability Insurance	Premiums for Accident Insurance
Premiums for your HSA-qualified health plan	Scientology Counseling
Social Activities	Special Foods/Beverages
Swimming Lessons	Teeth Whitening
Travel for General Health Improvement	

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There may be fees associated with a Health Savings Account ("HSA"). These are the same types of fees you may pay for checking account transactions. Please see the HSA fee schedule in your HSA enrollment materials for more information.

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