



Questions Lead to More HSA Guidance from the IRS

The recently enacted Health Savings Account (HSA) legislation has been creating quite a buzz lately. In the wake of a flood of inquiries to the IRS, Revenue Ruling 2004-45 was issued on May 11, 2004 to answer the main question: How can an employer offer an HSA, a Health FSA, and an HRA program and still comply with every law surrounding these benefits?

As just a little background, HSAs are individually owned healthcare payment accounts that allow the participant to contribute untaxed dollars. Interest or dividends accumulate tax-free; and when an individual pays for qualified medical expenses, there will be no additional tax consequences.

In order to have an HSA, individuals must be covered by a qualified, high-deductible health plan (HDHP). The HDHP must satisfy minimum deductible amounts with certain out-of-pocket maximums. Account holders may not be covered by any other insurance plan that is not an HDHP or that covers benefits provided by the HDHP. But they may obtain narrowly defined “permitted insurance” or “permitted coverage” products, such as policies that provide dental, vision, accident, disability, and long-term care benefits. The HDHP may also provide “preventive care” reimbursement that is below the minimum deductible amount or without a deductible.

This latest set of guidance (the third since last Fall) deals with “other” insurance coverage. Specifically – health coverage provided through a Section 125 Health Flexible Spending Account (HFSA) or a Health Reimbursement Arrangement (HRA).

The IRS uses five scenarios to lead us through the complexities of combining these benefits and coins new benefit names for simplicity. This article will cover Limited-Purpose FSAs and HRAs, Suspended HRAs, Post-Deductible FSAs and HRAs, and Retirement HRAs.

Limited-Purpose Health FSA or HRA

In this program the HFSA and the HRA are limited to payment of only permitted coverage items like vision and dental expenses – whether or not the minimum annual deductible of the HDHP has been met. The limited-purpose HRA could also compensate for permitted insurance plans that cover a specific disease or illness or that provides a fixed amount per day of hospitalization.

This range of benefits does not breach the “no other insurance” rule of HSAs. It was also noted that the limited-purpose programs could pay for preventive care. The definition of preventive care was described in IRS Notice 2004-23 earlier this year.

Suspended HRA

A suspended HRA is portrayed as an employer-funded HRA that pays all qualified healthcare expenses for eligible employees. For an otherwise HSA-eligible employee, an election is made before the beginning of the HRA coverage period to forgo, or suspend, all payments from the plan that are not for permitted coverage, permitted insurance, or preventive care expenses. Thus, barring reimbursement then, or at any time, of otherwise eligible expenses, and retaining entitlement to make tax-free contributions to the HSA.

The employer would continue to “fund” this employee’s HRA account although the employee has elected to “suspend” full usage of the arrangement. When the suspension period ends, employees are no longer eligible to make HSA contributions, because they are free to receive reimbursement of all healthcare expenses from the HRA.

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Post-Deductible HFSA or HRA

With these benefits, the HFSA and HRA are also considered to be high-deductible insurance products. Remember the rule about no other insurance coverage? These HFSA/HRA plans won't kick off until after the minimum deductible is met. Participant reimbursement from the HFSA or HRA doesn't have to wait until the HDHP's deductible amount is met, but the "minimum" deductible standard must be met.

The Revenue Ruling states, "In addition, although the deductibles of the HDHP and the other coverage may be satisfied independently by separate expenses, no benefits may be paid before the minimum annual deductible, which is \$1,000 for single coverage and \$2,000 for family coverage in 2004."

Are HFSAs and HRAs "Family" Coverage?

Most HFSA and HRA plans are written to allow for payment of suitable healthcare expenses for the employee and the employee's spouse and dependents. That means they provide family coverage. This begs the question, "If an employee has a qualifying single-coverage health plan with a deductible of \$1,000, would the HFSA and the HRA have to maintain deductible amounts of \$2,000 or more?" We will undoubtedly see more clarification on this issue from the IRS.

Other questions that come to mind include... If a participant elects to enroll in a "single coverage" HRA one year, and not the next – how could this be reconciled when payments are made out of the HSA? No one else sees these receipts, except the IRS – upon audit. Is the IRS going to contact the employer to see what other coverage this employee had? Will they contact the spouse's employer to check on coverage there? What if the investigation goes back several years? How long and complicated should this trail be?

Retirement HRA

The retirement HRA can accumulate funds during an employee's working years and make those dollars available to the individual upon retirement. It may not reimburse any healthcare expenses, except for permitted coverage, permitted insurance, and preventive care expenses during an individual's period of employment – only after retirement. When the retirement HRA begins, the participant is ineligible to make further contributions to their HSA.

The only scenario that did not pass muster with the IRS was situation one. It ponders the question of eligibility to make contributions to an HSA of an individual who is also covered by an HFSA and an HRA for all 213(d) medical expenses that could be incurred. The IRS example includes expenses not covered by the HDHP such as co-payments, coinsurance, deductible items under the HDHP, plus otherwise eligible expenses not covered by the HDHP.

You can probably guess the answer– this individual is not eligible to contribute to the HSA because of the "other" insurance rule under HSA code section 223. Both the HFSA and the HRA are considered health coverage. HSA account holders may not contribute to their HSAs if they have any other insurance coverage that pays medical expenses before the minimum deductible is met. Only permitted insurance, permitted coverage, or preventive care expenses are allowed in conjunction with the HDHP.

Mix and Match

Combinations of the above plans can also work. For instance, an employee could be covered by a limited-purpose HFSA and a retirement HRA and still be eligible to make contributions to an individual HSA arrangement.

Contributions vs. Disbursements

Don't confuse being "eligible to make contributions" to an HSA with "eligible to receive payments" from the HSA. The HSA can pay for the qualified medical expenses of the account

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holder, his or her spouse, and their dependents even though the account holder is no longer eligible to make contributions to their HSA. Another note – the spouse and dependents do not need to be covered by the underlying HDHP, HFSA, or HRA in order to have their healthcare expenses reimbursed from the HSA.

A Duty to Educate

Employee education is a must when blending benefits with so many special rules. Start with the employer's offering. Try to keep educational material simple and to the point. And don't be afraid to ask the IRS for answers to your questions. As we've seen before, your questions may just instigate some solid guidance! ■

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