Expanded Q&A on Health Savings Accounts

March 20, 2017

Medicare, Social Security, Veterans, Domestic Partners & End of Employment

This document is an addendum to the "VEHI Supplemental FAQ on HRAs & HSAs" (January, 2017). It is in response to additional questions raised by school employees, school officials and union leaders.

Most of this FAQ addresses HSA issues related to Medicare and Social Security. Shorter sections:

a) Cover new material related to employees who are veterans and have their non-veteran spouses on TRICARE, or who are not in TRICARE but receive medical services through the Veterans Administration;
b) Offer additional guidance pertinent to domestic partners;
c) Clarify annual contribution limits for couples who have more than one HSA; and
d) Clarify the use of HSAs after the end of employment, including COBRA.

We want to stress again that VEHI is not a source of expert or definitive guidance on HRAs, HSAs or FSAs. Our guidance is for general purposes only. Therefore, we urge the parties, if needed, to consult their TPAs and attorneys, to call or set up appointments at local Social Security offices and the Veterans Administration, or to visit the websites of the IRS and the Centers for Medicare and Medicaid Services for more comprehensive legal and regulatory guidance.

Please contact Mark Hage (mhage@vtnea.org) or Laura Soares (laura@vsbit.org) if you have questions about this document or need assistance that VEHI can offer.

Medicare & Social Security

1) How does signing up for Medicare Part A affect an HSA?

Under the tax code, individuals who are enrolled in Medicare **cannot** receive or make contributions to an HSA. Medicare-enrolled individuals can, however, draw on funds already in an HSA to reimburse qualified medical expenses, and, after age 65, have greater flexibility in how the funds can be used.

2) Can a Medicare-eligible employee make or receive contributions to an HSA if s/he has applied for either Social Security or Medicare?

No.

3) Can a Medicare-eligible individual who has not yet applied for Medicare or Social Security receive or make contributions to an HSA if still working and enrolled in an employer's CDHP?

Yes. If an individual is eligible for Medicare but **has not filed an application** for either Social Security retirement benefits or Medicare, s/he can contribute to an HSA after age 65 and postpone applying for Social Security and Medicare until no longer working. There is usually no penalty for this delay.

4) If an employee signs up for Social Security benefits, must s/he enroll in Medicare Part A?

Yes. In fact, such employees will be automatically enrolled in Medicare Part A.

5) What happens if an employee has applied for, or is already receiving, Social Security benefits and opts out of Medicare Part A?

First, an employee who has **applied for,** or **is already receiving**, Social Security benefits, can no longer make or receive contributions to an HSA.

The only way an individual could opt out of Part A after applying for or receiving Social Security benefits is to **pay back** to the government all the money received in Social Security payments, plus everything Medicare A spent on medical claims if applicable. These amounts must be repaid **before** an application to withdraw a Medicare Part A application can be processed.

6) If an employee disenrolls in Medicare Part A while drawing Social Security benefits, must s/he forego Social Security checks in the future until s/her re-enrolls in Medicare Part A.

A person drawing Social Security benefits who disenrolls from Medicare Part A will not receive any further Social Security checks until the point s/he re-enrolls in Medicare Part A.

7) Are there potential tax or penalty consequences for an employee with an HSA who signs-up for Social Security at least six months beyond full retirement age?

There may be. When an employee signs up for Social Security benefits, and is at least six months beyond full retirement age, Social Security will give this person six months of "back pay" in retirement benefits. This means the person's enrollment in **Part A** will also be backdated by six months.

Thus, the employee will have to **pro-rate** his/her HSA contributions for the year in which s/he was enrolled in Medicare Part A. For example, if you are greater than 6 months beyond full retirement age and sign up for Social Security benefits on 1/1/18, you will be retroactively enrolled in Medicare Part A as of 7/1/17. Therefore, you are limited to a pro-rated HSA contribution for **2017**.

If an employee does **not** pro-rate his/her HSA contributions, s/he must remove any excess contribution amount where applicable. **The monies that are withdrawn are taxable without penalty. Any excess HSA contributions left in the HSA account would be subject to a 6% penalty.**

To learn how the HSA pro-rating formula is calculated, contact Health Equity or your TPA.

8) What happens if a person has an HSA prior to Medicare-eligibility and then becomes eligible and enrolls in Medicare while still on his/her employer's CDHP?

S/he must stop all future contributions to the HSA and a **pro-rated contribution** must be determined for the year in which Medicare becomes effective.

REMINDER: The IRS determines eligibility for an HSA on a monthly basis. If contributions to an HSA in a given month are greater than 1/12th of the applicable annual limit, a change in eligibility for any reason will likely result in the individual over contributing and the need to remove excess contributions in a timely manner to avoid federal penalties. See IRS rules at https://www.irs.gov/publications/p969/ar02.html#en_US_2017_publink1000204045.

The amount that can be contributed to an HSA depends on the tier of CDHP coverage, age, the date an employee becomes an eligible individual, and the date the employee ceases to be an eligible individual. For 2017, an individual with self-only CDHP coverage can make or receive contributions up to $3,400. For other than self-only CDHP coverage, s/he can make or receive contributions up to $6,750, in combination with his/her employer or spouse. Individuals age 55 and older are eligible for an additional $1,000 catch-up contribution.

Veterans & HSA Contributions: TRICARE & V.A. Medical Benefits

For this section, bear in mind that TRICARE is a federal program for veterans who qualify. A veteran may <u>not</u> qualify for TRICARE but still be <u>eligible</u> for medical services through the Veterans Administration. There are implications for contributions to an HSA in both cases**.**

1) **An employee on TRICARE is NOT eligible to make or receive contributions to an HSA. But can a <u>non-veteran</u> employee with coverage under TRICARE through <u>a spouse</u> make or receive contributions to an HSA?**

   The <u>non-veteran employee</u> enrolled in TRICARE through <u>his/her spouse</u> is **not** entitled to make or receive contributions to an HSA.

2) **Does receiving V.A. medical benefits if one is NOT on TRICARE affect an employee's ability to make or receive HSA contributions?**

   It depends on the circumstances. There is one instance where eligibility to contribute to an HSA is impacted.

   An employee not on TRICARE who is eligible for V.A. medical benefits can receive or make contributions to an HSA, provided s/he does **not** receive V.A. services during the <u>preceding three months</u>. The exceptions to this three-month rule are as follows:

   - Using V.A. benefits **only** for <u>dental, vision, or preventive care</u> does **not** restrict an employee's ability to make or receive HSA contributions.

   - Receiving medical services at the V.A. for a <u>service-connected disability</u> does **not** restrict a person from making or receiving HSA contributions. The IRS has defined a "service connected disability" to apply to any person who has a <u>disability rating</u> from the V.A.

   However, an employee is **prohibited** from making or receiving contributions to an HSA for **three months** if s/he receives any other medical services at the V.A.

   For more information on veterans and HSAs, contact Health Equity or another TPA, consult IRS guidance, or speak with the Veterans Administration.

Domestic Partnerships & Eligibility for HSA Contributions

1) **Can an employee use their HSA to pay for the qualified medical expenses of domestic partners?**

Typically, domestic partners are not considered tax dependents by the IRS. Individuals are allowed to use their Health Savings Accounts to pay qualified medical expenses for tax dependents **only** (which includes their spouse, and themselves and children who qualify).

The IRS does **not** consider a domestic partner a spouse for tax purposes. If, however, a domestic partner meets the definition of a "qualifying relative," HSA funds can be used to pay for qualified medical expenses of the domestic partner.

To be a "qualifying relative," you must satisfy four tests. The most relevant of which for most employees is the "gross income" test. For more details, go to: https://www.irs.gov/publications/p17/ch03.html.

If the domestic partner is not a "qualifying relative," the employee cannot use their HSA funds to pay for their domestic partners' qualified medical expenses. The domestic partner can still be covered by the employee's HSA-qualified health plan and is eligible to open his/her own HSA account and fund the account to the maximum family contribution.

For more information on this topic, click on: https://www.irs.gov/uac/answers-to-frequently-asked-questions-for-registered-domestic-partners-and-individuals-in-civil-unions.

Clarification on Annual Contribution Limits for Spouses with More than One HSA

In 2017, the maximum annual contribution to one or more HSAs for a married couple is $6,750 **combined**.

If each spouse contributed to an HSA during 2017 and their **combined total** exceeded $6,750, one or both spouses would have had to withdraw the excess contribution, plus any earnings on the excess HSA contributions, by their tax due date, generally, April 15, 2017.

The monies that are withdrawn are taxable without penalty. Otherwise, any excess HSA contributions left in the HSA account would be subject to a 6% penalty.

COBRA & End of Employment

1.) If a school district is making contributions to an employee's HSA, is it required under law to continue making those contributions to the employee's HSA during any period the employee is eligible for and exercising COBRA rights?

No. An employer has <u>no legal obligation</u> to continue making payments to an HSA after employment ends, even if the individual remains enrolled in the employer health plan under COBRA. The employee still "owns" the HSA, and can use money already deposited in the account to cover reimbursements for qualified medical expenses.

2.) What happens to the HSA when an individual leaves employment?

The individual can continue to use their HSA for qualified medical expenses, and the account will remain open until s/he chooses to close it. Be aware that the HSA will no longer be associated with the former employer. The individual may also be responsible for any monthly administrative fee; however, s/he is free to move the HSA to another qualified institution.

If the individual remains enrolled in a qualifying health plan (CDHP), either through a new employer, a spouse, the former employer's plan via COBRA, or an individually-purchased insurance plan on Vermont Health Connect, then s/he will remain eligible to contribute to the HSA.

However, if the individual has no coverage, or enrolls in a health plan not compatible with an HSA, then s/he will no longer be eligible to <u>contribute</u> to the HSA. If no longer eligible to contribute, the individual should determine if s/he has already contributed more to the HSA than allowed in the calendar year and therefore must take action to avoid a penalty. See VEHI's January, 2017, memo or guidance from the IRS for more information.