Ivins, Phillips & Barker
CHARTERED

Employee Benefits Update

March 2017

HIGHLIGHTS

In This Issue

Health Savings Accounts: Will They Replace Obamacare?

The Republican leadership has been talking about Health Savings Accounts (HSAs) as the future of healthcare. This article summarizes their primary tax advantages, compliance traps, and potential changes for 2017.

HSA TAX ADVANTAGES

HSAs are tax-exempt trusts created by Internal Revenue Code section 223 to offer three tax benefits:

1. Contributions are tax-deductible
2. Contributions can grow tax-free from year to year
3. Withdrawals aren't taxed, if used for qualified medical expenses

Contributions to an HSA can only be made by an individual enrolled in a high deductible health plan (HDHP) for the plan year, who does not have other coverage personally or through spousal coverage. The theory is that HSAs will encourage consumers to be more price-conscious and drive down the cost of health care.

HSA COMPLIANCE TRAPS

1. **Health FSA Carryovers:** HSAs do not play nicely with others. A participant is ineligible to contribute to an HSA if he or she has funds remaining in a health flexible spending account (FSA), unless it is a limited purpose FSA restricted to out-of-pocket vision and dental expenses.

   In the past, participants would forfeit unused FSA funds at year-end, under a "use it or lose it" system. At that time, the transition between an FSA and an HSA was relatively easy to manage. Now, many FSAs allow participants to carry over up to $500 from year to year, or to seek reimbursement for expenses incurred during a 2½-month grace period into the following plan year. These changes can make the transition between an FSA and HSA problematic.

   Employers have several options for switching a participant between a health FSA and an HSA, but they must employ these strategies proactively, before the end of the prior plan year.

   We expect this issue to worsen if Congress raises (or eliminates) the $2,600 dollar limit imposed on health FSAs under Code section 125(i). This change would make FSA carryovers more likely, thus disqualifying more potential HSA participants.

2. **Medicare Eligibility:** An HSA is not available to a participant who has other medical coverage for the

period before the HDHP deductible is reached. As a result, Medicare entitlement is treated as disqualifying coverage under IRC section 223(b)(7). "Entitlement" for this purpose means more than Medicare eligibility; it requires actual enrollment in Medicare.

3. **Correcting Errors:** At some point, an employee may elect to contribute to an HSA even though he or she is ineligible (i.e., due to a lingering FSA balance). Or an HSA participant may become ineligible mid-year (i.e., due to Medicare entitlement) and fail to notify the employer. Perhaps an eligible employee will contribute too much. These scenarios can be tricky to correct since HSA contributions are considered nonforfeitable.

   Counsel should review proposed corrections, to ensure that they satisfy the narrow parameters of IRS rules. For example, in some cases, improper contributions (plus earnings) can be returned to the employer from the trustee, as if the HSA had never existed. Ineligible contributions that are not returned by tax-year end must be reported on the employee's Form W-2 as gross income.

4. **Administrative Fees:** An HSA trustee or custodian typically will charge an annual administrative fee on each account (say, $50). If the fee is deducted directly from the account balance, it effectively reduces the amount a participant can contribute for the year. For example, a participant with self-only coverage is limited to a $3,400 contribution, reduced to $3,350 after deduction for the fee. If the participant pays the administrative fee directly to the custodian (outside the account), rather than having it withdrawn, then he or she can contribute the full $3,400 to the HSA.

5. **Comparability Testing & Nondiscrimination Testing:** An employer is not required to contribute to an individual's HSA. If the employer contributes, however, it must contribute to all similarly situated individuals on a comparable basis, in accordance with Code section 4980G. In other words, the same amount (or same percentage of deductible) must be contributed on behalf of all active full-time employees; the same comparability rule applies to contributions made for former employees. (This rule does not apply to employee contributions made through a cafeteria plan.)

   A health FSA is subject to a different – and more complex - set of nondiscrimination testing rules under Code section 125, designed to prevent a plan from favoring highly compensated employees. Although these 2007 rules remain in proposed form, they prohibit highly paid employees from electing FSA benefits disproportionately. An increase in the annual contribution limit for health FSAs may make it even more difficult for a plan to comply with this rule.

HSA POTENTIAL CHANGES

Republican leadership seems to agree that HSAs are a good thing, although the details of each legislative proposal vary widely. Below are HSA changes that we may see in 2017:

1. **Higher Limits:** The maximum annual contribution limit for HSAs could increase substantially. An early Republican draft bill would have raised the contribution limit for a participant enrolled in self-only coverage from $3,400 to $6,550 per year. The contribution limit for a participant enrolled in family coverage would have nearly doubled from $6,750 to $13,100 per year. (The higher limits are keyed to the maximum annual out-of-pocket costs for an HDHP.)

2. **Non-Prescription Drugs:** We expect Republican proposals to eliminate the limitations on over-the-counter medicine and drugs, for both HSAs and health FSAs. At present, only prescription drugs and insulin are considered "qualified medical expenses" under Code section 223(d)(2).

3. **Lower Penalties:** HSA withdrawals are subject to a 20% penalty if used for non-qualified medical expenses, under Code section 223(f)(4). We expect 2017 proposals to reduce this penalty from 20%, to make HSAs more attractive to employees.

4. **Catch-Up Contributions:** Presently, participants age 55 or older can contribute an extra $1,000 per year to an HSA. Proposals have included allowing the participant's spouse to make a catch-up contribution to the *participant's* HSA (without having to open a separate spousal account).

5. **Administrative Obstacles:** Congress may make it easier for employers to set up an HSA, by eliminating certain technical roadblocks. For example, expenses incurred during an initial grace period (after HDHP enrollment but before the HSA is established) could be considered qualified medical expenses. This type of liberalization also might make it easier for plan sponsors to change vendors without worrying about the impact of such disruption on HSA participants.

6. **Spillover Tax Credits:** Republican leadership disagrees over the use of federal tax credits to subsidize health care coverage. To the extent a legislative proposal offers such credits, however, it could allow a participant to transfer any unused credits to his or her HSA.

2017 Key Cost of Living Adjustment Figures

	2017	2016	2015
401(k), 403(b), Profit-Sharing and Pension Plans, etc.			
Annual Compensation 401(a)(17)	270,000	265,000	265,000
Elective Deferrals 402(g)	18,000	18,000	18,000
Catch-up Contributions 414(v)	6,000	6,000	6,000
Defined Contribution Limits 415(c)	54,000	53,000	53,000
Defined Benefit Limits 415(b)	215,000	210,000	210,000
HCE Threshold 414(q)	120,000	120,000	120,000
PBGC Premiums, flat rate (per participant)	69	64	57
PBGC Premiums, variable rate	34 per $1,000 UVB	30 per $1,000 UVB	24 per $1,000 UVB
PBGC Premiums, variable rate cap (per participant)	517	500	418
Health & Welfare Plans			
Flexible Spending Account Limit	2,600	2,550	2,550
HSA & HDHP Limits – Self	3,400 HSA contribution 1,300 deductible min. 6,550 OOP max.	3,350 HSA contribution 1,300 deductible min. 6,550 OOP max.	3,350 HSA contribution 1,300 deductible min. 6,450 OOP max.
HSA & HDHP Limits – Family	6,750 HSA contribution 2,600 deductible min. 13,100 OOP max.	6,750 HSA contribution 2,600 deductible min. 13,100 OOP max.	6,650 HSA contribution 2,600 deductible min. 12,900 OOP max.
ACA Out-of-Pocket Maximums	7,150 self 14,300 family	6,850 self 13,700 family	6,600 self 13,200 family
Other			
Social Security Taxable Wage Base	127,200	118,500	118,500
Key Employee	175,000	170,000	170,000
Qualified Transportation (parking or transit)	255	255	250

Who We Are

Ivins, Phillips & Barker, Chartered
1700 Pennsylvania Ave. NW, Suite 600
Washington DC, 20006
(202) 393-7600
http://www.ipbtax.com

Contact our Employee Benefits team at benefits@ipbtax.com

Carroll Savage
(202) 662-3405
csavage@ipbtax.com

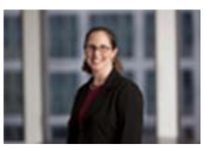
Kevin O'Brien
(202) 662-3411
kobrien@ipbtax.com

Laurie Keenan
(202) 662-3461
lkeenan@ipbtax.com

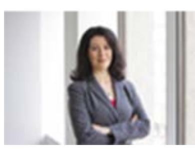
Steve Witmer
(310) 407-5460
switmer@ipbtax.com

Will Sollee, Jr.
(202) 662-3466
wsollee@ipbtax.com

Jeannie Leahy*
(202) 662-3414
jleahy@ipbtax.com



Jodi Epstein
(202) 662-3468
jepstein@ipbtax.com



Robin Solomon
(202) 662-3474
rsolomon@ipbtax.com

Spencer Walters
(202) 662-3459
swalters@ipbtax.com

Ben Grosz
(202) 662-3422
bgrosz@ipbtax.com

Percy Lee
(202) 662-3458
plee@ipbtax.com

Jon Holbrook*
(202) 662-3478
jholbrook@ipbtax.com

* Not admitted in the District of Columbia

Qualified Retirement Plans • Executive Compensation • Fringe Benefits • Health and Welfare Plans • Plan Terminations and Bankruptcy • Employment Taxes and Worker Classification

IPB In The News

Jodi Epstein and Doug Andre speak on Global Mobility – Practical Strategies at the TEI chapter in Charlotte NC (Feb. 24, 2017)

Ben Grosz interviewed on 401(k) fee litigation in PlanSponsor cover story "On Guard" (Jan/Feb 2017)

Ben Grosz served as featured panelist at Best of Plan Sponsor national conference in New York, on Lessons Learned from Litigation (Dec. 1, 2016)

Robin Solomon discussed the DOL Fiduciary Rule in Connections magazine, published by Alabama Society of CPAs (Nov/Dec 2016)

Ben Grosz was a guest speaker on a program for defined contribution plan advisors and consultants on fiduciary best practices (Nov. 21, 2016)

Upcoming Presentations

Kevin O'Brien to discuss Comprehensive Tax Reform at D.C. Bar Tax Section Conference (Apr. 20, 2017)

Robin Solomon and Spencer Walters to lead a workshop on "Surviving a DOL Audit" at the Mid-Sized Retirement and Healthcare Plan Mgmt Conference in Baltimore MD (Apr. 25, 2017)

Ivins attorneys to present at the TEI chapter in Raleigh NC (Apr. 28, 2017)

EB Update Archives

January 2016 EB Update

March 2016 EB Update

May 2016 EB Update: Wellness Plans

June 2016 EB Update: DOL Fiduciary Rule

Sept 2016 EB Update