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## **I. Implementation of Final 403(b) Regulations.**

In July 2007 the final 403(b) regulations were issued.

### **A. Effective Date.**

The effective date for the final 403(b) regulations was generally January 1, 2009. In the case of a 403(b) plan maintained pursuant to one or more collective bargaining agreements that have been ratified and in effect on July 26, 2007, the new regulations do not apply before the earlier of:

1. The date on which the last collective bargaining agreement terminates (determined without regard to any extension thereof after July 26, 2007); or
2. July 26, 2010.

The IRS has extended the date for implementation of the written plan to December 31, 2009. The 403(b) plan must be operated in compliance with the regulations as of January 1, 2009.

### **B. Documents Needed for Implementation.**

1. Written plan document;
2. Summary plan description;
3. Salary Reduction Agreement;
4. Vendor Agreement;
5. Administrative Policy;
6. Board Resolution; and
7. Memorandum of Understanding.

**C. Written Plan Document.**

Amounts contributed by a District for the purchase of an annuity contract for an employee are excluded from the gross income of the employee under Internal Revenue Code § 403(b) only if the requirements of the new regulations are satisfied. Among the requirements of the new regulations is a requirement that there be a written 403(b) plan which in form and operation complies with the provisions of the new regulations. *Treas. Reg. § 1.403(b)-3(b)(3).*

1. The plan must contain all material terms and conditions for eligibility, benefits, applicable limitations, the contracts available under the plan and the time and form under which benefit distributions would be made. *Treas. Reg. § 1.403(b)-3(b)(3)(i).*
2. The plan may contain certain optional features that are consistent with but not required under § 403(b), such as hardship withdrawal distributions, loans, plan-to-plan or annuity contract to annuity contract transfers, and acceptance of rollovers to the plan. Any optional provisions must meet in both form and operation the requirements of the new regulations. *Treas. Reg. § 1.403(b)-3(b)(3)(i).*

**D. Allocation of Responsibility.**

The plan may allocate responsibility for performing administrative functions, including functions to comply with requirements with § 403(b) and other tax requirements. Any such allocation must identify responsibility for compliance with the requirements of the Internal Revenue Code.

1. Allocation of responsibilities to vendors or third party administrators. Districts should review 403(b) or TSA provisions in collective bargaining agreements. A District may need the right to terminate certain vendors if responsibilities cannot be allocated reasonably and the vendor will not sign a hold harmless agreement acceptable to the District.
2. The District must make certain choices regarding a 403(b) plan and those choices may be subjects of bargaining.
  - a. Whether or not to provide for hardship withdrawal distributions;
  - b. Whether or not to provide for loans;

- c. Whether or not to provide for plan-to-plan or annuity contract to annuity contract transfers;
- d. Whether or not to accept rollovers from other plans; and
- e. The universal availability requirement that provides some choice to a school district to exclude certain employees and those requirements are detailed below.

**E. Required Provisions in a Written Plan Document.**

The following provisions are required in the written plan document:

- 1. Nonforfeitability. The rights of the employee under the annuity contract (disregarding rights to future premiums) are nonforfeitable. Employees' rights under the contract must be fully vested at all times. *Treas Reg. § 1.403(b)-3(a)(2)*.
- 2. The plan must provide for deferrals within the contribution limits.
  - a. Elective deferrals. Elective deferrals may not exceed the applicable dollar amount under § 402(g) of the Internal Revenue Code. This limitation is \$16,500 in 2009 (\$16,500 in 2010). The 402(g) limit is annually indexed to inflation and shall increase in \$500 increments.
  - b. Age 50 catch-up. The additional age 50 catch-up contributions are available for participants who reach age 50 by the end of the plan year. The 402(g) limitation is increased by \$5,510 in the year 2009 (\$5,500 in 2010). The additional age 50 catch-up contribution limit is annually indexed to inflation and shall increase in \$500 increments.
  - c. Special §403(b) catch-up. A qualified employee, meaning an employee who has completed at least 15 years of service, may make additional special catch-up elective deferrals in excess of the 402(g) limitation equal to the lesser of:
    - i. \$3,000; or
    - ii. the excess of \$15,000 less the total special catch-up elective deferrals made by the qualified employee for prior years; or

- iii. the excess of \$5,000 multiplied by the number of years of service of the employee with the organization less the total elective deferrals made by the employee for prior years. *Treas. Reg. § 1.403(b)-4(c)(3)*.
- d. Maximum annual contribution. The maximum contributions for any participant, including employer nonelective contributions, elective deferrals, and any after-tax contributions (Roth) cannot exceed the limitation under IRC § 415(c). The 415(c) limitation is the lesser of includable compensation or \$49,000 in 2009 (\$49,000 in 2010). The 415(c) limitation is annually indexed to inflation and increases in \$1,000 increments.
- e. Coordination of special catch-up and age 50 catch-up. Any catch-up amount contributed by an employee who is eligible for both the age 50 catch-up and the special catch-up is treated first as an amount contributed as a special catch-up to the extent special catch-up is permitted, and then an amount contributed as an age 50 catch-up.
- f. Former employee contribution limits. A former employee is deemed to have monthly includable compensation for the period through the end of the taxable year of the employee in which he or she ceases to be an employee and through the end of each of the next five years. The amount of the monthly includable compensation is equal to 1/12 of the former employee's includable compensation during the former employees most recent year of service.
  - i. Nonelective employer contributions for a former employee must not exceed the lesser of the 415(c) limitation or the former employees annual includable compensation based on the former employees average monthly compensation during his or her most recent year of service.
  - ii. Most recent year of service. In the case of a part-time employee or a full-time employee who is employed for only part of the year determined on the basis of the employee's annual work period, the employee's most recent periods of service are aggregated to determine his or her most recent one year period of service. *Treas. Reg. § 1.403(b)-4(e)*.

- g. Severance pay. Amounts paid after severance of employment may not be treated as compensation for deferral purposes unless that post-severance compensation is paid within 2½ months after severance of employment or the end of the limitation year in which the severance occurs, and one of the following applies:
  - i. The payment would have been paid to the employee, absent the severance, if the employee continued his or her employment and is regular compensation for services, commission, bonuses or similar compensation; or
  - ii. Payments for accrued bona fide sick, vacation, or other leave, but only if the employee would have been able to use the leave if employment had continued.
- h. Excess contributions or deferrals. Any contribution made for a participant to a 403(b) plan for the taxable year that exceeds the maximum annual contribution limit (415(c) limit) or the maximum elective deferred limit (402(g) limit) constitutes an excess contribution that is included in gross income for that taxable year. In addition, IRC § 4973 provides an excise tax of 6% on excess contributions.
  - i. A § 403(b) contract may provide that any excess deferral as a result of failure to comply with the limitation under 402(g) will be distributed to the participant, with allocable net income, no later than April 15 of the following taxable year.
  - j. If the excess contribution is in excess of the 415(c) limit and not an excess deferral amount, it cannot be returned to the employee. Instead the over contribution must be deposited in a separate account.

**F. Nondiscrimination Rules.**

Universal availability requirements. Generally all employees of the employer must be permitted to have 403(b) elective deferrals contributed on their behalf if any employee of the employer may have elective deferrals made. The employee's right to make elective deferrals includes the right to designate deferrals as Roth contributions. *Treas. Reg. § 1.403(b) – 5(b)(1)*.

1. Effective opportunity. Employee must be provided an effective opportunity to elect deferrals to a 403(b) plan. Whether or not an employee has an effective opportunity is determined based on the relevant facts and circumstances, including:
  - a. Notice of availability of election;
  - b. The period of time during which an election may be made; and
  - c. Any other conditions placed on elections. *Treas. Reg. § 1.403(b)-5(b)(1).*
2. Frequency. At least once per year, the employee must be provided with an effective opportunity to make (or to change) a cash or salary deferral election to the 403(b) plan. *Treas. Reg. § 1.403(b)-5(b)(2).*
3. Deferral amount. The employee must be allowed to make salary reduction contributions up to applicable limits. *Treas. Reg. § 1.403(b)-5(b)(2).*
4. Part-time employees. Effective opportunity and universal availability applies to part-time employees. *Treas. Reg. § 1.403(b)-5(b)(2).*

**G. Permitted Exclusions.**

The following employees may be excluded from participation in a 403(b) plan under the universal availability requirements:

1. Employees electing an annual deferral of \$200 or less. *Treas. Reg. § 1.403(b)-5(b)(3).*
2. Employees eligible to salary deferred to another 403(b) plan of the employer or a 457(b) plan of the employer. *Treas. Reg. § 1.403(b)-5(b)(4)(ii)(A).*
3. Employees eligible to salary defer under a 401(k) plan of the employer. *Treas. Reg. § 1.403(b)-5(b)(4)(ii)(B).*
4. Employees who are nonresident aliens. *Treas. Reg. § 1.403(b)-5(b)(4)(ii)(C).*
5. Employees who are students performing services, but only if all students performing services are excluded. *Treas. Reg. § 1.403(b)-5(b)(4)(ii)(D).*

6. Employees who normally work fewer than 20 hours per week. *Treas. Reg. § 1.403(b)-5(b)(4)(ii)(E)*. An employee normally works fewer than 20 hours per week if and only if:
  - a. The employer reasonably expects the employee to work fewer than 1,000 hours for the 12-month period beginning on the date of the employee's commencement of employment; and
  - b. For each plan year ending after the close of the 12-month period beginning on the employee's commencement of employment, the employee worked fewer than 1,000 hours. *Treas. Reg. § 1.403(b)-5(b)(4)(iii)(B)*.

**H. Wisconsin Law.**

Wis. Stat. § 40.81(2) provides that a school district may provide a 403(b) plan to its employees. If a school district does allow any employee to make salary deferrals to a 403(b) plan, the school district must allow all employees covered by a collective bargaining agreement to make salary deferrals to a 403(b) plan. *Wis. Stat. § 40.81(3)*.

**I. Distributions Allowed.**

A 403(b) contract is permitted to distribute benefits to the participant on the following events:

1. Severance of employment;
2. Retirement;
3. Death;
4. Disability;
5. Loan (if allowed); or
6. Hardship (if allowed).

**J. Distributions Required.**

Distributions are required beginning on April 1 of the year following the year in which the participant reaches age 70 ½.

**K. Funding.**

Contributions to a 403(b) plan must be transferred to the annuity provider within a period that is not longer than is reasonable for the proper administration of the plan. Transfer of §403(b) elective deferrals within 15 business days following the month in which these amounts would otherwise have been paid to the participant is reasonable. *Treas. Reg. § 1.403(b)-8(b)*.

**L. Fiduciary Duties.**

1. Not under the Internal Revenue Code.
2. Governmental entities are exempt from the Employee Retirement Income Security Act (ERISA).
3. Wisconsin law.
  - a. No 403(b) cases.
  - b. Wisconsin Retirement System cases and “public funds” cases.
4. Planning.
  - a. Range of investment options.
  - b. Fees.
  - c. Document due diligence in this regard.

**II. Cafeteria Plan and Flexible Spending Arrangement Refresher.**

The Cafeteria Plan, the Flexible Spending Arrangement (“FSA”) for health and dependent care are all provided for under Internal Revenue Code Section 125. As a result, sometimes all three of these plans are referred to as Section 125 plans. However, each plan has a different purpose.

**A. Cafeteria Plan.** A cafeteria plan allows an employee to elect between a taxable benefit and a nontaxable benefit without the employee who elects the nontaxable benefit being taxed on the taxable benefit that could have been elected. In other words, the Cafeteria Plan is used to avoid the constructive receipt problem.

1. Constructive receipt causes the employee electing a nontaxable benefit to be taxed as if he or she elected the taxable benefit. A cafeteria plan is the only way to avoid constructive receipt.

2. Cash in lieu
3. Employee portion of health insurance may be paid with pre-tax dollars under a cafeteria plan
4. No payroll tax withholding, including FICA (employer and employee 7.65%) on nontaxable amounts.
5. Benefits that can be offered
  - a. Health Insurance
  - b. Accidental Death and Dismemberment Insurance
  - c. Adoption Assistance
  - d. Dependant Care Assistance Program
  - e. Long Term and Short Term Disability, but benefits are then taxable.
  - f. Group Term Life Insurance, coverage in excess of \$50,000 is taxable.
  - g. Health Savings Account contributions

**B. Flexible Spending Account for Dependent Care.** The flexible spending account for dependent care allows the employee to defer on a pretax basis a certain amount of wages and receive reimbursement from that deferral for dependent care expenses without tax.

**C. Flexible Spending Account for Health Care.** The FSA for Health Care allows the employee to defer on a pretax basis a certain amount of wages and to receive reimbursement for health care expenses on a tax-free basis.

### III. Cafeteria Plan Update.

- A. One Time Election to Waive Retiree Health Benefits in Exchange for Higher Pay.** Where employees who irrevocably waived retiree health benefits by a fixed date in exchange for higher pay and future employees had 15 days from their first day of employment to make such an irrevocable election, the IRS ruled in a Private Letter Ruling, that employees electing the insurance would not be in constructive receipt of the higher rate of pay that could have been chosen. The higher rate of pay was only for future services.
- B. Nondiscrimination Rules..** Cafeteria Plans cannot discriminate in favor of highly compensated individuals (“HCI”) or Key Employees.
1. A HCI for this purpose is an employee with compensation in excess of \$110,000 in 2009.
    - a. Eligibility Test.
      - i. No employee must complete more than three years of employment to participate.
      - ii. Entry into the Cafeteria Plan is not delayed.
      - iii. The Plan meets a nondiscriminatory classification test.
    - b. Contribution and Benefits Test. Are employer contributions and benefits available on a nondiscriminatory basis?
    - c. Utilization Standard.
  2. A Key Employee is an Officer who received in excess of \$130,000 in compensation in 2009.
  3. If the cafeteria plan is discriminatory, then HCIs and Key employees will lose the tax benefits of the cafeteria plan.
  4. Benefits under a collectively bargained plan are exempted from nondiscrimination rules. Where the cafeteria plan provides benefits to union and nonunion employees, the exemption applies to the benefits provided to the union employees.

#### **IV. Health Reimbursement Arrangement (“HRA”).**

##### **A. HRA Definition.**

The IRS formally approved of HRAs in *Rev. Rul. 2002-41* and *IRS Notice 2002-45*. An HRA is an arrangement that:

1. is paid solely by the employer and not provided pursuant to salary reduction election or otherwise under IRC § 125;
2. reimburses the employee for medical care expenses (as defined by IRC § 213(d)); and
3. provides reimbursements up to a maximum dollar for a coverage period and any unused portion of the maximum dollar amount at the end of the coverage period may be carried forward to increase the maximum reimbursement amount in subsequent coverage periods.

##### **B. High Deductible Health Insurance.**

An HRA is often offered with high deductible health insurance. There is no requirement that an HRA be offered with high deductible health insurance.

##### **C. Taxation.**

To the extent that an HRA is an employer-provided accident or health plan, coverage and reimbursements of medical care of an employee and the employee’s spouse and dependents are generally excludable from the employee’s gross income under IRC §§ 106 and 105.

##### **D. Benefits under an HRA.**

HRAs may only provide reimbursement for substantiated medical expenses.

1. The HRA may not reimburse a medical care expense that is incurred before the date of the existence of the HRA. The HRA may not reimburse a medical expense incurred before the date the employee first becomes enrolled under the HRA.
2. Generally HRA reimbursement may not include expenses for qualified long term care expenses.
3. The HRA cannot provide any participants with the right to receive cash other than as reimbursement for health care expenses. For instance a retiree cannot receive a bonus calculated based on that retiree’s remaining HRA balance.

**E. Coverage under an HRA.**

1. The HRA may continue to reimburse former employees or retirees for medical expenses after termination of employment.
2. The HRA may provide that the retiree may only receive reimbursement for the balance of the HRA at retirement, that the HRA balance at retirement is reduced for administrative costs, or that the HRA balance will increase at retirement.
3. If reimbursement is provided to other than an employee, employee spouse or dependant, it is not excludible from gross income, and no amounts are excludible.

**F. HRAs and Cafeteria Plans.**

Employer contributions may not be attributed to salary reduction or otherwise to an IRC § 125 cafeteria plan.

1. For example, if an employer offers an HRA plus health insurance with actual cost of the family coverage for the health insurance being \$4,500 and the employee having a choice to salary reduce \$2,500 or 3,500 to fund the coverage. An employee who elects family coverage and \$2,500 salary reduction receives a \$1,000 maximum reimbursement arrangement for the coverage period and an employee who elects family coverage and \$3,500 salary reduction receives a \$2,000 maximum reimbursement amount for the coverage period. Employer contributions are attributed to salary reduction and the plan does not qualify as an HRA.
2. Similarly if the HRA amount is tied to an amount forfeited under an IRC §125 FSA, it will not qualify as an HRA.

**G. HRAs are not subject to the following FSA Rules.**

1. The prohibition against deferral of compensation (i.e., the HRA balance can roll forward year-to-year); or
2. The requirement that the maximum amount of reimbursement must be available during all times of the coverage period.

## **H. HRAs are subject to the Anti-Discrimination Rules.**

1. HRAs may not discriminate in favor of the highly compensated individuals (“HCI”) under IRC § 105(h). If the HRA does discriminate in favor of highly compensated individuals, the reimbursements to the highly compensated individuals will not be excluded from gross income.
  - a. IRC 105(h) has its own definition of highly compensated, which is the highest paid 25% of non-excludible employees.
  - b. The following may be excluded when identifying highly compensated individuals: (i) employees under age 25, (ii) employees with less than 3 years of service, (iii) part-time (35 hours per week or less, if other employees performing the same work generally work substantially more) or seasonal employees (less than 9 months, if other employees performing the same work generally work substantially more months) and (iv) bargaining unit members, to the extent they do not participate.
  - c. An employee that is a highly compensated individual prior to retirement is still considered a highly compensated individual in retirement.
2. The HRA must pass the following two tests to avoid discrimination in favor of highly compensated individuals:
  - a. The Eligibility Test. The plan does not discriminate in favor of highly compensated individuals as to eligibility to participate. Three optional tests:
    - i. The 70% Test. Does the plan benefit 70% or more of all employees?
    - ii. The 70%/80% Test. Are 70% or more of employees eligible? Do 80% of those eligible actually participate?
    - iii. Nondiscriminatory Classification Test. Does the plan benefit employees in such a way as not to be discriminatory in favor of highly compensated employees? For instance benefits under a collective bargaining agreement would generally pass this test.

b. The Benefits Test. The benefits provided under the plan do not discriminate in favor of participants who are highly compensated. Two tests must be passed:

i. No discrimination on the face of the plan.

i. No discrimination in operation of the plan.

Maximum benefits cannot vary based on age, years of service or compensation.

Are the same benefits provided to HCIs as to non-HCIs?

Are there disparate waiting periods for HCIs and non-HCIs?

**I. Interaction of HRA and Health FSA.**

If coverage is provided under both an HRA and an FSA for the same medical expense amounts available under an HRA must be exhausted first. Before the IRC § 125 FSA plan year begins, the HRA plan document may provide that coverage under the HRA is available only after expenses exceeding the dollar amount of the FSA have been paid.

**J. HRA and COBRA.**

An HRA is a group health plan subject to COBRA. If an individual elects COBRA, and the HRA complies with the COBRA requirements by providing for the continuation of the maximum reimbursement amount at the same time and by the same increment that it is increased for similarly situated non-COBRA beneficiaries (and by decreasing it for claims reimbursed).

Premiums are determined under IRC §4980B. For example, if the annual additional reimbursement amount credited under the HRA is \$1,000 and the maximum reimbursement amount for two similarly situated qualified beneficiaries at the time of their qualifying events is \$500 and \$5,000, the applicable premium is the same for each individual.

**K. HRA and HIPAA.**

HRAs must comply with HIPAA rules, including the requirement that a group health plan provide certificates of creditable coverage.

## V. Health Savings Account (“HSA”).

The Health Savings Account (“HSA”) was created by the Medicine Prescription Drug, Improvement and Modernization Act of 2003 (“The Act”). The Act created new Internal Revenue Code (“IRC”) §223. In many ways an HSA can be thought of as an Individual Retirement Account (“IRA”) for medical expenses. The HSA is intended to create an incentive for the ultimate consumer of health care services (i.e., the employee) to spend health care dollars wisely. The HSA became available, effective January 1, 2004.

### A. **HSA Requirements and Definitions**

1. Contributions to an HSA must be made in conjunction with a High Deductible Health Plan (“HDHP”). Specifically, an “eligible individual” may make income tax deductible contributions to an HSA. An “eligible individual” means, with respect to any month, any individual if:
  - a. Such individual is covered under an HDHP as of the first day of such month, and
  - b. Such individual is not, while covered under an HDHP, covered under any health plan that:
    - i. is not an HDHP, and
    - ii. provides coverage for any benefit which is covered under the HDHP. IRC §223(c)(1).

Example – A husband covered by his wife’s family non-HDHP is not an eligible person.
2. Individuals that can be claimed as a dependent on another’s tax return are not eligible for an HSA. IRC § 223(b)(6).
3. The term HDHP means a health plan
  - a. That has an annual deductible which is not less than
    - i. \$1,150 for 2009 (2010 amount is not yet available) for single coverage, and
    - ii. \$2,300 for 2009 (2010 amount is not yet available) for family coverage, and

- b. The sum of the annual deductible and the other annual out-of-pocket expenses required to be paid under the plan (other than for premiums) for covered benefits does not exceed
  - i. \$5,800 for 2009 (2010 amount is not yet available) single coverage, and
  - ii. \$11,600 for 2009 (2010 amount is not yet available) for family coverage.
  - iii. The above restriction applies only to in-network expenses. IRC § 223(c)(2).
- c. Out of pocket expenses applies only to covered benefits. Any restriction on benefits must be a reasonable restriction on benefits, meaning that there are significant benefits remaining under the plan after the restriction. IRS Notice 2004-50 Q&A-15.
  - i. There may be higher co-pay amounts where an employee has not pre-certified. The increased co-pay amount (over the in-network co-pay) is not an out-of-pocket expense. IRS Notice 2004-50 Q&A-19.
  - ii. Embedded deductibles (separate deductibles for each member of a family plan) must comply with the out-of-pocket limit. For example, a \$2000 per person deductible will not qualify as a HDHP if there are six or more people in the family. IRS Notice 2004-50 Q&A-20.
- 4. In general, the HDHP cannot provide benefits until the deductible has been satisfied.
- 5. The following are exceptions to the rule requiring satisfaction of the deductible prior to providing benefits under an HDHP.
  - a. A plan shall not fail to be treated as an HDHP by reason of failing to have a deductible for preventive care. IRC § 223(2)(c). Preventive care includes for example routine physicals, immunizations, tobacco cessation programs, and screening for cancer or mental health conditions and substance abuse. Treasury Notice 2004-23.

- b. An eligible individual can be covered by “permitted insurance” which includes worker’s compensation insurance, auto insurance, insurance for a specified disease or illness, and insurance paying a fixed amount per day (or other) of hospitalization. Further, vision, dental, accident and disability insurance do not count as impermissible coverage.
6. An individual entitled to benefits under Medicare ceases to be an eligible individual starting with the month he or she is entitled to benefits under Medicare. Entitled to benefits requires both eligibility and enrollment of the individual. IRS Notice 2004-50 Q&A-2.

Example - In August 2004, X attains age 65 and applies for and begins receiving Social Security benefits. X is automatically enrolled in Medicare. As of August 1, 2004, X is no longer an eligible individual and may not contribute to an HSA. IRS Notice 2004-50 Q&A-2.
7. Discount cards that entitle holders to obtain discounts for health care services or products will not disqualify an otherwise eligible person, so long as the deductible must be satisfied before benefits are provided. IRS Notice 2004-50 Q&A-9.
8. Co-pays for doctor visits and prescription drugs are not allowed, and must be subject to the annual deductible (no benefits before deductible is satisfied).
9. The employer may offer the employee choice between HDHP/HSA or other non-HDHP insurance. For purposes of HSA contributions, only the insurance coverage actually in force is considered. IRS Notice 2004-50 Q&A-1.

**B. Contributions.**

Contributions by an eligible individual, family member of the eligible individual, or any other person are tax deductible by the eligible individual. IRS Notice 2004-50 Q&A-28. Contributions by the employer are deductible to the employer but are not deductible to the employee. The deduction is not an itemized deduction. The contribution limit is calculated on a monthly basis and is for any month 1/12 of:

1. In the case of an eligible individual who has self-only coverage under an HDHP, as of the first day of such month, the lesser of
  - a. The annual deductible under such coverage,
  - b. or \$3,000 in 2009
2. In the case of an eligible individual who has family coverage under an HDHP as of the first day of such month, the lesser of
  - a. The annual deductible under such coverage, or
  - b. \$5,950 in 2009.
3. Contributions must be made in cash. IRC §23(d)(1)(A)(i).
4. The monthly limit on contributions is reduced by any employer contributions.
5. Employer contributions are non-forfeitable and are not subject to FICA or FUTA tax, and are not taxable income so long as distributions from the HSA are used for qualifying expenses.
6. An individual who has attained age 55 before the close of the tax year may make an additional contribution of

Tax Year	Additional Contribution Amount
2008	\$900
2009 and thereafter	\$1,000

7. Individuals own their HSAs and individuals are responsible for ensuring that they meet the eligibility requirements and the contribution limits.
8. Contributions may be made at any time of the year in one or more payments. The deadline for contributions is April 15 of the year following the year for which the contribution is made.
9. Funds in an HSA can be invested. Investment earnings on the contributions are not taxable, if withdrawn for qualifying medical expenses.
10. Contributions made that exceed the maximum contribution limit or are made when ineligible are subject to applicable income taxes plus a 6% excise tax and are not deductible.

### **C. Distributions.**

Distributions for qualified medical expenses are not included in the eligible individual's gross income. Any amount paid or distributed out of an HSA, which is not used exclusively to pay the qualified medical expenses of the account beneficiary, shall be included in the gross income of such beneficiary. IRC §223(f).

1. Eligibility status for HSA contributions is not important at time of distribution. IRS Notice 2004-50 Q&A-36.
2. Distributions may be made to pay the qualified medical expenses of the account beneficiary, the account beneficiary's spouse and dependents. However, distributions may not be made for expenses reimbursed under another health plan. IRS Notice 2004-50 Q&A-36.
3. Payment of long-term care premiums is a qualified medical expense, but is limited in amount based on age. IRS Notice 2004-50 Q&A-41.
4. Health insurance premiums are not qualified medical expenses for purposes of an HSA, unless the account beneficiary is age 65 or older. The payment of Medicare premiums deducted from social security may be reimbursed tax-free from an HSA for an individual age 65 or older. IRS Notice 2004-50 Q&A-45.
5. There is a penalty tax of 10 percent imposed on distributions from an HSA which are not used for qualified medical expenses.
6. Exceptions to the 10 percent excise tax:
  - a. An individual over age 65 may take distributions from the HSA for non-qualified medical expenses and include the distribution in taxable income, but the 10 percent penalty does not apply.
  - b. Upon becoming disabled distributions from the HSA for non-qualified medical expenses are not subject to the 10 percent penalty. Disabled means being unable to engage in any substantial gainful activity by reason of a physical or mental impairment which will result in death or be of an indefinite duration.
7. Qualified medical expenses are as defined in § 213, which is the same definition for itemized deduction purposes. Generally not including health insurance with the exception of COBRA premiums for those on unemployment and including qualified long-term care insurance within certain limits.

**D. Treatment of HSA after Death of Account Beneficiary.**

1. If the designated beneficiary is surviving spouse, such HSA shall be treated as if the spouse were the account beneficiary.
2. In all non-spouse beneficiary cases, such accounts shall cease to be an HSA as of the date of death, and the fair market value of the assets in the HSA shall be includable in the gross income of the beneficiaries.

**E. Comparability – Employer Contributions.**

All employees who are eligible individuals must receive comparable contributions to their HSAs from their employers.

1. Matching contributions are not comparable because employees may not contribute equal amounts to their HSAs and thus not receive comparable matching contributions.
2. Employer contributions are comparable if the differences in Contributions are based on coverage options which are (if offered)
  - a. self-only
  - b. self plus one
  - c. self plus two
  - d. self plus three or more. Treas. Reg. 54.4980G-1 Q&A 2.
3. If the employer does not satisfy the comparability rules for a calendar year, the employer is subject to an excise tax equal 35% of the aggregate amount contributed by the employer to HSAs for that period. Treas. Reg. 54.4980G-1, Q&A-4.
4. Employer contribution may be made on a:
  - a. Pre-funding basis (on January 1)
  - b. Pay-as-you-go (on a per month basis)
  - c. At the end of the year based on each month the employee is an eligible individual. Treas. Reg. 54.4980G-4, Q&A-4.

5. If contributions are made through a cafeteria plan to the HSA the comparability rules do not apply. However, contributions including matching contributions to an HSA made under a cafeteria plan are subject to the non-discrimination rules (eligibility rules, contributions and benefit tests and key employee contribution tests) under IRC § 125.
6. Employer contributions cannot be conditioned on a certain age of the employee. IRS Notice 2004-50 Q&A-50.
7. Employer contributions to HSA for employees who work full-time for less than 12 months may receive a pro rata share of HSA contributions on a month by month basis. IRS Notice 2004-50 Q&A-51.

**F. Flexible Spending Arrangements.**

A Flexible Spending Account if not limited to permissible benefits under an HDHP, is non-HDHP coverage that will disqualify an eligible individual.

**G. Trusts.**

HSAs are trusts and require a custodian, like an IRA, usually a bank or financial organization.

**H. Wisconsin Tax Law.**

In May 2004 the Governor vetoed a bill that would have established a Wisconsin tax deduction for contributions to HSAs. HSA contributions are not deductible for Wisconsin income tax purposes.