Advanced HSAs

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Learning Objectives

At the completion of this course you will be able to

- identify each party's responsibility in determining contribution limits,
- recognize the different options for resolving excess contributions,
- understand beneficiary distribution options upon the HSA owner's death, and
- recognize the financial organization's and HSA owner's reporting responsibilities.

Icon Legend

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Contributions

Financial Organization Responsibilities

HSA Contribution Information

Financial organizations should document HSA contributions to obtain required elections and to serve as a record for generating reports. While the initial contribution to a new HSA may be captured on the HSA application, financial organizations should use separate contribution forms to obtain the necessary information when subsequent contributions are made. If any discrepancies arise between the financial organization and HSA owner, the documentation provides verification of what actually was requested.

To correctly report contributions on Form 5498-SA, *HSA, Archer MSA, or Medicare Advantage MSA Information*, two specific pieces of information must be obtained—the type of contribution being made (e.g., regular, transfer, rollover), and the tax year for which regular contributions are made. To treat contributions as prior-year contributions, HSA owners must make a written election. Obtaining the HSA owner's signature on these forms validates this election. In addition, HSA owners must make a written, irrevocable election to treat a contribution as a rollover.

Contribution Deadline

Regular HSA contributions must be made by the eligible HSA owner's tax return due date for the year, not including extensions (generally April 15). This deadline applies regardless of who makes the contribution. The IRS clarified in Notice 2008-59 that HSA owners who cease to be HSA-eligible during the year have until their tax return due date, not including extensions, to make HSA contributions for the months they were HSA-eligible.

Contributions that are made between January 1 and April 15 for the previous year are called "prior-year" contributions. HSA owners must make a written, irrevocable election to treat a contribution as a prior-year contribution. If the deadline for filing an individual's federal income tax return falls on a Saturday, Sunday, or legal holiday, the contribution is deemed timely if made by the following business day. The IRS has the authority to extend tax deadlines for taxpayers affected by a presidentially declared natural disaster or disaster because of terrorist or military action. Taxpayers are entitled to relief only if the IRS publishes a notice or other guidance specifically providing relief for a covered event. The extension sometimes will affect the HSA contribution deadline.

HSA contributions that are received by mail after the contribution deadline are considered timely made if the envelope carries a postmark date of on or before the applicable deadline and contains written direction to apply the contribution to the prior year. Financial organizations that choose to accept these contributions should save or image the envelope bearing the postmark in the client's file.

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Contribution Limits

Financial organizations must not accept annual contributions that exceed the current maximum contribution amount in effect for the year ($7,000 for 2019, $7,100 for 2020), plus the current catch-up contribution amount ($1,000 for 2019 and for 2020) if the HSA owner is age 55 or older by the end of the calendar year.

Financial organizations are responsible for tracking the HSA owner's age for purposes of accepting catch-up contributions. Financial organizations may rely on the HSA owner's representation as to his date of birth.

Customer Service

Certification of Eligibility

A financial organization may ask for proof or certification that a potential HSA owner is eligible to contribute to an HSA, even though this is not an IRS requirement. For example, the financial organization may ask individuals to complete an HSA contribution eligibility form that verifies that the individual is covered by an HSA-compatible high deductible health plan (HDHP) and addresses other eligibility questions. Requesting such documentation up front may help financial organizations reduce the risk and frustration of removing excess contributions later.

Accepting Transfers and Rollovers

While financial organizations are not allowed to restrict HSA distributions, they may refuse to accept transfers and rollovers (Notice 2004-50, Q&A 77 and 78).

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HSA Owner Responsibilities

Contribution Eligibility

HSA owners are responsible for determining their eligibility and if they exceed their contribution limit for the year.

HSA owners should take into account the type of coverage (i.e., self-only or family), the statutory contribution limit for the year, and eligibility for catch-up contributions. While financial organizations are not to accept more than the maximum contribution amount in effect for the year for family coverage, including catch-up contributions if applicable, HSA owners are responsible for determining their own contribution limits for the year.

Determining the annual HSA contribution limit can be difficult when the HSA owner changes the type of HDHP coverage (self-only or family) during the year or is not HSA-eligible for the entire year. The IRS released Notice 2008-52 to explain these requirements.

Not HSA-Eligible on First Day of Last Month

If an individual is not HSA-eligible on the first day of the last month of her tax year, her contribution limit for the year is the sum of the monthly limits determined separately for each month. The monthly limit is determined by eligibility and type of HDHP coverage on the first day of each month. The monthly limit is calculated by dividing the individual's annual limit, including catch-up contributions if eligible, by 12 months.

For example, if an individual under age 55 has self-only HDHP coverage and is HSA-eligible from January 1, 2019, through August 15, 2019, she is eligible for eight months of contributions, which equals $2,333.33 ($3,500/12 x 8).

HSA-Eligible on First Day of Last Month

If an individual is HSA-eligible on the first day of the last month of his tax year, his HSA contribution limit for the year is the *greater* of

- the sum of the limits determined separately for each month (defined in the preceding paragraph), or
- the maximum annual contribution amount for the type of HDHP coverage in effect on the first day of the last month of the tax year (December 1 for calendar year taxpayers).

The limit for the type of coverage in effect on the first day of the last month may be greater than the sum of the monthly limits only when the individual has family coverage on that day.

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Example 1

Mallory, age 48, enrolls in family HDHP coverage on January 1, 2019. She changes to self-only HDHP coverage on October 1, 2019, and retains self-only coverage for the rest of the year. The sum of Mallory's monthly limits for 2019 is $6,125 (($7,000/12 x 9) + ($3,500/12 x 3)).

The statutory limit for 2019 for self-only coverage is $3,500. The sum of Mallory's monthly limits is greater than the statutory contribution limit for self-only coverage, so Mallory's contribution limit for 2019 is $6,125.

Example 2

Rick, age 36, enrolls in self-only HDHP coverage on October 1, 2019, and is otherwise an eligible individual for the rest of the year. The sum of his monthly contribution limits is $875 ($3,500/12 x 3). The 2019 statutory contribution limit for self-only coverage is $3,500. Therefore, Rick's contribution limit for 2019 is $3,500 because the 2019 limit is greater than the sum of his monthly limits. But Rick must satisfy the testing period (described next) to qualify for this full annual contribution limit.

Testing Period

If an individual who is HSA-eligible on the first day of the last month of her tax year (December 1 for most taxpayers) was not eligible the entire year, she must satisfy a 13-month "testing period" requirement to qualify for the full-year annual contribution limit. If satisfied, she is treated as having the same HDHP coverage for the entire year as she had on the first day of the last month of her tax year. Such individuals may contribute the maximum annual contribution amount for the year rather than for the months of eligibility. The testing period runs from December 1 of the current year through December 31 of the following year. The IRS calls this the "last-month rule" in the instructions for Form 8889, *Health Savings Accounts (HSAs)*.

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Example 1

Susan, age 35, begins self-only coverage on July 1, 2019, under an HSA-compatible HDHP. Although Susan was not HSA-eligible the entire year, she may contribute the maximum amount for 2019 ($3,500) as long as she remains eligible from December 1, 2019, through December 31, 2020.

HSA owners who fail to maintain eligibility during the entire testing period must prorate the contribution limit for the number of months they were eligible. They also must include any ineligible contributions in their gross income and pay a 10 percent penalty tax (unless the failure is because of disability or death). Note that this penalty tax does apply to HSA owners over age 65.

Example 2

Suppose Susan (in Example 1) no longer has an HDHP as of January 1, 2020. Because she failed to remain HSA-eligible during the testing period, she must calculate her 2019 contribution limit for the 6 months that she was eligible. Susan's aggregated monthly limit is $1,750 ($3,500/12 x 6). Because Susan was eligible to contribute only $1,750 for 2019, she must include $1,750 ($3,500 – $1,750) in her gross income and pay a 10 percent penalty tax ($175) on the ineligible amount.

Although the ineligible contributions must be included in gross income, they do not have to be removed from the HSA (Notice 2008-52). Whenever an HSA distribution is not used for qualified medical expenses, the additional 20 percent penalty tax applies, regardless of whether some or all of the amount was included in the HSA owner's income and subject to the 10 percent penalty tax for failing the testing period. This means an HSA owner could be taxed and penalized twice on the same assets.

Financial organizations are not responsible for determining whether HSA owners meet the testing period requirement. HSA owners should consult with competent tax advisors to determine the tax consequences when these situations occur.

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Limit When One or Both Spouses Have HDHP Family Coverage

If one or both spouses have family HDHP coverage, the spouses may divide one maximum annual contribution amount for family coverage ($7,000 for 2019 and $7,100 for 2020) between their HSAs however they choose. If eligible (age 55 before the end of the tax year), one or both spouses also may make catch-up contributions ($1,000 each) to their own HSAs.

Limit When Both Spouses Have HDHP Self-Only Coverage

If each spouse has self-only HDHP coverage, each is eligible to contribute to the his or her own HSA up to the annual statutory limit for self-only coverage ($3,500 for 2019 and $3,550 for 2020), plus catch-up contributions, if eligible.

Limit When Not All Family Members Are HSA-Eligible

The contribution limit for an eligible individual with family HDHP coverage is not determined any differently if other family members covered by the HDHP are not HSA-eligible (Notice 2004-50, Q&A 31). The eligible individual, therefore, may make one family contribution limit ($7,000 for 2019 and $7,100 for 2020), plus catch-up contributions, if eligible.

Limit for Nondependent Child on Parent's HDHP

The Patient Protection and Affordable Care Act of 2010 requires health plans that provide dependent coverage to make such coverage available to children until they reach age 26, even if the adult child is not eligible to be claimed as a dependent on the parent's income tax return. Nondependent children, therefore, may be covered on their parents' family HDHP, and if the parents are not eligible to claim them as dependents, such children could meet the eligibility requirements to open their own HSA. There is no official guidance indicating what the contribution limit would be for such young adult children. But an IRS official commented to Ascensus that, assuming the nondependent child is otherwise HSA eligible, a separate family contribution limit ($7,000 for 2019 and $7,100 for 2020) would apply for the child, and thus, the child would not share in the separate combined family limit her married parents must share.

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Employer Contribution Responsibilities

Employers who make HSA contributions on behalf of employees are responsible for

- monitoring contributions,
- satisfying comparability rules or Internal Revenue Code Section (IRC Sec.) 125 nondiscrimination testing,
- determining whether to limit the number of financial organizations it will forward contributions to and how they will be forwarded, and
- reporting employer contributions to the employees and the IRS. Employers should seek competent business tax advice or legal advice to be sure they follow the compliance requirements when making HSA contributions for their employees.

Monitoring Contributions

For purposes of employee HSA eligibility and the contribution limit, employers are responsible for determining whether an employee is

- covered under an HDHP sponsored by the employer,
- covered under any other health plans offered by the employer that are not HDHPs (including health flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs)), and
- eligible for catch-up contributions (Notice 2004-50).

An individual who is covered by a general purpose health FSA or an HRA generally is not an HSA-eligible individual. The exceptions to this rule include limited-purpose health FSAs and HRAs, post-deductible health FSAs or HRAs, retirement HRAs, and suspended HRAs.

Following Comparable Contribution Rules

Employers are not required to contribute to employees' HSAs, but if they do, they generally must make comparable contributions on behalf of all comparable participating employees during the calendar year. The complexity of the business and work groups can make these rules complicated. Employers should seek advice from their business advisors or attorneys to make sure they are properly following the comparable contribution requirements.

If comparability rules are not satisfied for a calendar year, the employer generally is subject to an excise tax equal to 35 percent of the aggregate amount the employer contributed to its employees' HSAs for that period. The IRS may waive all or a portion of the excise tax in situations where failure to comply with the comparability rules is because of reasonable cause and not willful neglect. Employers must file Form 8928, *Return of Excise Taxes under Chapter 43 of the Internal Revenue Code*, to pay the excise tax.

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Calculating Comparable Contributions

Contributions are considered comparable if they are the same amount or the same percentage of the deductible amount under the HDHP for eligible employees within the same category of coverage. If an employer is making a comparable contribution of the same percentage, that percentage is determined by rounding to the nearest 1/100th of a percentage point or rounding the dollar amount to the nearest whole dollar.

An employer may not condition its HSA contributions on an employee's age or length of service with the employer. An employer may not make additional contributions to the HSA of employees who are eligible to make catch-up contributions.

Comparable Participating Employees

Comparable participating employees are defined as eligible individuals who have the same category of HDHP coverage (i.e., self-only or family) and are in the same category of employees.

The general categories of employees for comparability testing are

- current full-time employees (customarily employed 30 or more hours per week),
- current part-time employees (customarily employed fewer than 30 hours per week), and
- former employees (not including former employees covered under COBRA continuation coverage).

Remedy for Noncomparable Contributions

An owner's interest in his HSA is nonforfeitable. Employers generally may not recoup amounts contributed to employees' HSAs. As a result, when employers make contributions that are not comparable, they may not recover the excess amounts from the employees' HSAs to satisfy comparability rules. However, the employer has until April 15 of the following year to contribute additional amounts to the HSAs of other employees in the group to make the HSA contributions comparable. If an employer chooses to contribute additional amounts, the employer also must contribute reasonable interest.

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Contributions Under a Cafeteria Plan

Employers may allow employees to elect to have amounts contributed to an HSA on a salary-reduction basis through the cafeteria plan. In fact, an employer could include both an HSA and an HDHP as options under its cafeteria plan, thus allowing an employee to pay HDHP premiums and contribute to an HSA through salary reduction. If employer contributions are made through a cafeteria plan, the comparability rules do not apply. As a result, matching contributions on employee salary deferrals may be made to HSAs through a cafeteria plan. However, when employer contributions are made through the cafeteria plan, they will be subject to the IRC Sec. 125 nondiscrimination rules.

The salary reduction process allows HSA assets to be set aside or deferred into a cafeteria plan free from federal income taxes and other employment taxes (i.e., Social Security and Medicare taxes (FICA), federal unemployment tax (FUTA), and railroad retirement tax). This applies to both employee and employer HSA contributions made through a cafeteria plan. HSA owners do not take deductions on their income tax returns for contributions they make through a cafeteria plan.

Employer Establishing HSAs for Employees

Written IRS guidance on whether employers may establish HSAs on behalf of employees is limited. Notice 2004-50 states that employers may establish HSAs in connection with cafeteria plans that employ negative consent (automatic enrollment) for employer contributions. But there is no clear guidance on whether employers can establish HSAs on behalf of employees who are not covered under a cafeteria plan. An IRS representative commented to Ascensus that an employer is not prohibited from establishing an HSA on behalf of an eligible employee, reasoning that because employers may establish HSAs for their employees under a cafeteria plan, employers also should be able to establish HSAs outside of the cafeteria plan environment.

Employers May Limit HSA Providers

An employer may limit the forwarding of contributions through its payroll system to a single or a limited number of financial organizations as long as neither the employer nor the financial organization restricts the ability of the employee to move the assets to an HSA at another financial organization.

Alternatively, an employer may allow employees to establish HSAs to receive their HSA contributions at financial organizations of their own choosing, regardless of whether the financial organization has an existing relationship with the employer.

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Employer HSA Contributions Reported on Form W-2

Employer contribution amounts, including amounts deferred by an employee under the employer's cafeteria plan, must be reported on employees' Forms W-2, *Wage and Tax Statement*. Code W is entered in Box 12 to indicate that the dollar amount was contributed by an employer to an HSA.

Employers May Recoup Contributions

As mentioned previously, an HSA owner's interest is nonforfeitable. But there are instances when an employer may recoup contributions.

1. If an employer contributes to the HSA of an employee who was never eligible to receive an HSA contribution, the employer may ask the financial organization to return the contributed amount plus any earnings (IRS Notice 2008-59, Q&A 23).

2. If an employer erroneously contributes more than the statutory limit to an employee's HSA, the employer may ask the financial organization to return the excess amount to the employer (Notice 2008-59, Q&A 24).

3. If an employer has clear documentary evidence to support an administrative or process error, the employer may ask the financial organization to return the amounts to the employer, and make corrections to put all parties in the same position they were in had the error not occurred (IRS Letter 2018-0033).

The employer has until the end of the tax year in which the employer made the contribution to recover the ineligible or excess amount. The 2019 *Instructions for Forms 1099-SA and 5498-SA* indicate that financial organizations must suppress the reporting of the contribution and subsequent distribution. If the employer fails to recover the amount by the end of the tax year, the employer must include the amount on the employee's Form W-2 for the year in which the employer made the contribution.

If the excess is not timely removed, the HSA owner will owe a six percent IRS penalty tax on the amount of the excess for the year the excess was created and for each following year if the excess is not removed by December 31.

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Employer Recouping Contributions

Sunrise Company makes a $500 HSA contribution for each employee enrolled in the employer's HDHP on June 15 and again on December 15 for a total contribution of $1,000.

The accounting department was verifying the June contributions and realized that Sunrise contributed $500 on behalf of Kevin Jones who is not enrolled in the employer HDHP. Upon further examination, it is determined that the money was meant to be deposited into an HSA for an employee named Kevin Jonas. Sunrise Company is now contacting your financial organization to have the $500 contribution returned to Sunrise Company.

Can the financial organization return the contribution? Why?

Would it be different if Kevin was enrolled in the employer HDHP and received $1,000 because the accounting department accidentally transmitted the data twice?

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Death of an HSA Owner

The tax treatment of an HSA after the HSA owner's death depends on whether a spouse or nonspouse is designated as the death beneficiary of the account.

Spouse Beneficiary	If the beneficiary is a spouse, the HSA is treated as the surviving spouse's own HSA. Distributions to the surviving spouse for qualified medical expenses are exempt from federal income tax and penalties.
Nonspouse Beneficiary	If a nonspouse is the beneficiary, the HSA ceases to be an HSA as of the date of death. The nonspouse death beneficiary must include the HSA's fair market value (FMV) in his income for the year of death. **NOTE:** *The amount that a death beneficiary must include in income is reduced by any payments made by the HSA for the decedent's qualified medical expenses, if paid within one year after death.*
Estate Beneficiary	If the HSA owner's estate is the beneficiary, the HSA ceases to be an HSA as of the date of death. The estate must include the HSA's FMV as income on the HSA owner's final tax return.

Beneficiary Distributions Example

Donald died on October 1, 2018. The beneficiaries of his HSA are his wife, Abigail, and his son, Curt, who are each receiving 50 percent.

Because Abigail is a spouse beneficiary, her portion of the HSA becomes hers. If she removes money from her HSA it would be reported in her name and Social Security number.

Because Curt is a nonspouse beneficiary, his portion of the HSA ceases to be an HSA, and it is considered a full distribution to him. The distribution will be reported in Curt's name and Social Security number.

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Excess Contributions

When an HSA receives ineligible contributions or ineligible rollovers (e.g., rollover contributions that violate the 60-day rule or the one-per-12-month rule), an excess contribution occurs. Ineligible rollovers become regular HSA contributions and become an excess if the aggregate contributions exceed the HSA owner's contribution limit for the year.

HSA excess contributions generally are divided into two categories.

1. HSA contributions that exceed the HSA owner's regular (including catch-up) contribution limit for the year ($3,500 for 2019; $3,550 for 2020 for those with self-only HDHP coverage and $7,000 for 2019 and $7,100 for 2020 for family HDHP coverage, plus catch-up contributions of $1,000 if eligible)
2. HSA contributions made for an individual who is not eligible for HSA contributions.

Only actual excess contributions may be removed under the HSA excess rules. Unwanted HSA contributions may not be removed as an excess contribution.

Testing Period Failure

If an HSA owner does not maintain eligibility during the 13-month testing period, his annual contribution limit must be prorated for the number of months he was eligible to determine his limit for the year. Amounts in excess of that limit must be included in the HSA owner's gross income for the year and a 10 percent penalty tax applies. However, such amounts cannot be removed following the excess contribution rules to avoid taxation.

Excess Employer Contributions

An excess contribution also may occur if an employer contributes an amount to an employee's HSA that exceeds the statutory contribution limit. If an employer erroneously contributes more than the statutory limit to an employee's HSA, the employer may ask the financial organization to return the excess amount with the NIA to the employer. The employer has until the end of the tax year in which it made the contribution to recover the ineligible or excess amount. If the employer fails to recover the amount by the end of the tax year, the employer must include the excess amount as wages in Box 1 of the employee's Form W-2, *Wage and Tax Statement*, for the year in which the employer made the contribution.

IRS Publication 969, *Health Savings Accounts and Other Tax-Favored Health Plans*, explains that excess employer contributions are included in the HSA owner's gross income. If the excess contribution is not included on the HSA owner's Form W-2, then the excess must be reported as "other income" on the HSA owner's tax return.

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Excess Contributions Penalty Tax

HSA excess amounts cannot be claimed as an income tax deduction on the HSA owner's federal income tax return. HSA excess amounts are subject to a six percent excess contribution penalty tax if not corrected by the HSA owner's tax filing deadline, including any extensions.

The instructions for Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*, indicate that if an HSA owner timely files her tax return by the tax return due date, which may include extensions, she may still withdraw the excess no later than six months after the original due date of her tax return (so generally, by October 15). By removing the excess with earnings on or before the deadline, the HSA owner does not have to pay the six percent penalty tax.

Correcting Excess Contributions Before Tax Filing Deadline

If HSA owners remove excess contributions before their applicable tax filing deadline (tax return due date, plus extensions), they must

- remove the amount of excess from the HSA,
- remove any NIA to the excess amount, and
- include the NIA in income.

Although the HSA owner bears the burden of providing all the information necessary to report the removal of an excess contribution, financial organizations often help determine the amount that the HSA owner must withdraw to correct an excess contribution. Only the financial organization generally will have all the information necessary to determine the NIA.

Determining the Net Income Attributable

If an HSA owner chooses to timely correct an excess, the excess and the NIA must be removed from the HSA. The amount of NIA should be computed using the same method that is used to calculate the NIA for excess IRA contributions.

The NIA is determined by allocating to the contribution a pro rata portion of the net income earned on all assets in the HSA (whether positive or negative) during the period the HSA held the contribution. This method bases the calculation on a computation period beginning with the day the HSA excess contribution was made.

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Reporting Excess Removal Before the Applicable Deadline

Financial organizations must report the distribution of excess contributions on Form 1099-SA, *Distributions From an HSA, Archer MSA, or Medicare Advantage MSA*, but they should not reduce the contribution amounts that are reported on Form 5498-SA. The only instance in which the contribution report potentially would be revised is when an ineligible rollover is made. The ineligible rollover amount must be treated as regular HSA contributions, so financial organizations should report these ineligible amounts as regular contributions on Form 5498-SA.

For a distribution of excess contributions with NIA, the gross distribution (excess and NIA) is reported in Box 1, *Gross distribution*, on Form 1099-SA and only the NIA is reported in Box 2, *Earnings on excess contribution*. To indicate that the distribution is the removal of an excess contribution, code 2, *Excess contributions*, must be entered in Box 3. The Form 1099-SA instructions indicate that the HSA owners must include any earnings (NIA) distributed with the excess as income for the year the distribution is received.

If the distribution of an excess contribution occurs in the same year that other distributions are made, financial organizations must report the distribution of the excess on a separate Form 1099-SA.

Correcting Excess Contributions After Tax Filing Deadline

If the HSA owner does not remove the excess by his tax filing deadline (tax return due date, plus extensions), he will have to pay a six percent penalty tax on the excess contribution amount for each year that an excess remains in the HSA. The options for correcting an excess contribution after the HSA owner's tax return due date (plus extensions) are to remove the excess contribution or to carry it forward as a contribution for a future year.

Removing Excess After the Tax Filing Deadline

When removing an excess contribution after the tax filing deadline, the excess contribution may be removed, but the earnings should remain in the HSA. In addition to paying the six percent excess contribution penalty tax, the HSA owner must include the distribution of the excess contribution in income for the year of the distribution. While IRS guidance is unclear, it appears that HSA owners who remove excess contributions after their tax filing deadlines also may be subject to the additional 20 percent penalty tax if the assets are not used for qualified medical expenses (unless an exception applies). HSA owners should seek advice from competent tax advisors to be sure they pay the required taxes when filing their income tax returns.

Financial organizations must report the amount of the excess removed in Box 1 of Form 1099-SA and leave Box 2 blank. The appropriate distribution code for the distribution recipient (i.e., code 1, *Normal distribution*, code 3, *Disability*, or codes 4 or 6 as appropriate for beneficiaries) must be entered in Box 3.

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Death Distributions

When an HSA owner dies, the financial organization should check the HSA owner's application or beneficiary designation form to determine who the proper beneficiaries are. When an HSA owner has filed more than one beneficiary designation form, the most recent form generally should be used. If financial organizations find that the beneficiary documentation is unclear (e.g., it lacks a signature, is ambiguous) they should consult their legal counsel for an opinion.

If an HSA owner did not name beneficiaries or if none of the named beneficiaries are living at the time of the HSA owner's death, the financial organization should review the beneficiary language in its HSA agreement to determine the default beneficiary. This often is the deceased HSA owner's estate.

Procedures Upon Notification of Death

Financial organizations should follow these procedures when they receive notification of the HSA owner's death to help ensure a smooth transition of ownership transfer.

- Obtain a copy of the death certificate from the deceased HSA owner's personal representative.
- Stop any recurring contributions being made to the HSA.
- Stop any recurring distributions being made from the HSA.
- Examine the HSA documents to determine who the beneficiaries are and contact the beneficiaries.

Spouse as Death Beneficiary

If the death beneficiary is a spouse, the HSA is treated as the surviving spouse's own HSA as of the time of the original HSA owner's death. Distributions to the surviving spouse for qualified medical expenses would be exempt from federal income tax and penalties. The spouse beneficiary must complete Form 8889 as the new HSA owner.

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Procedures for Handling Spouse as Death Beneficiary

While a spouse beneficiary automatically becomes the HSA owner at the time of the original HSA owner's death, it may be some time before the financial organization learns of the death. The following procedures may help smooth the transition of transferring ownership to a spouse.

1. If the surviving spouse beneficiary does not have an existing HSA, an HSA should be established. Although the decedent's HSA automatically becomes the surviving spouse's own HSA, the assets should be held in an HSA established by a legal contract with the signatures of the surviving spouse and a representative of the financial organization.

2. The assets may be moved through a transfer to the surviving spouse' HSA. A transfer request form may be completed by the surviving spouse to initiate a transfer. This is particularly important if the assets are moving from one financial organization to another. The transfer request, which usually is initiated at the organization that will be receiving the transfer, should address the following items.

    - A check or payment should be made payable to the receiving organization as the HSA administrator for the spouse beneficiary.
    - The transfer request should indicate a dollar amount or percentage to be transferred.
    - Both the surviving spouse (as the HSA owner) and the receiving HSA administrator should sign and date.

Although this type of transfer may occur at one financial organization, Ascensus recommends that the surviving spouse (as the HSA owner) complete a transfer request or other similar form so that all the needed information is clearly documented.

1. The surviving spouse may deliver the payment to the receiving organization, or the payment may be sent directly to the receiving organization.

2. The financial organization may ask the surviving spouse to complete a contribution form (or the HSA application if opening a new HSA). This is particularly important if a transfer request form is not completed.

3. Financial organizations should retain copies of all the documentation for the transaction in the original HSA owner's file and the surviving spouse's HSA file, as appropriate.

4. Finally, financial organizations should remember that HSA-to-HSA transfers are not reported to the IRS. Once the assets are in the surviving spouse's HSA, all the normal reporting for an HSA owner applies.

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Nonspouse as Death Beneficiary

If a nonspouse beneficiary (person or entity) is the death beneficiary, the HSA assets must be paid out to the beneficiary. Federal law requires that the HSA ceases to be an HSA as of the date of death, and the nonspouse death beneficiary includes the HSA's fair market value (FMV) in his gross income for the year of the death. While the distribution generally is taxable, it is not subject to the additional 20 percent penalty tax for nonqualified distributions. Any interest earned in the HSA after the date of death should be reported as income on the nonspouse beneficiary's tax return.

The amount that must be included in the death beneficiary's income (unless the death beneficiary is the decedent's estate) is reduced by any payments made by the HSA for the decedent's qualified medical expenses if paid within one year after death. The nonspouse beneficiary must complete Form 8889, *Health Savings Accounts (HSAs)*, to report the date of death FMV and the amount of any qualified medical expenses of the deceased HSA owner that were paid within one year of death.

Reporting the Nonspouse Beneficiary Distribution

A financial organization must report all distributions from the HSA on Form 1099-SA. The instructions to Form 1099-SA state that for death distributions, financial organizations should report the amount distributed from an HSA in Box 1 of Form 1099-SA, the HSA's FMV on the date of death in Box 4, and one of two distribution codes in Box 3.

- Code 4, *Death distribution other than code 6*, is used for distributions to a deceased HSA owner's estate in any year and for distributions to a nonspouse beneficiary in the year of the HSA owner's death.
- Code 6, *Death distribution after year of death to a nonspouse beneficiary*, is used to report distributions to a nonspouse beneficiary, other than an estate, that take place in any year after the year of death.

Estate Beneficiary

When the estate is the named beneficiary or becomes the beneficiary by default, financial organizations must obtain the employer identification number (EIN) assigned to the estate and pay the death benefits to the estate, unless directed otherwise by the financial organization's legal counsel. Organizations may wish to obtain a certified copy of the formal document issued by the court that appoints the executor or administrator of the estate (for example, letters of testamentary or letters of appointment) before making payment to an executor or administrator of an estate.

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Trust Beneficiary

When a trust is the named the HSA beneficiary, financial organizations generally will pay the death benefits to the trust as directed by the trustee(s) of the trust, and will need the trust's tax identification number to report the distribution.

Beneficiary Who Is a Minor

When a minor is a named beneficiary, death benefits generally cannot be paid directly to the minor. The laws of the state in which the minor resides will govern the payment options. In most states, the age of majority is 18 years, but in a few states it is age 19 or 21.

Financial organizations should consult their legal counsel for direction on how to distribute HSA assets to minors.

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Reporting

Financial Organization Responsibilities

Form 5498-SA and Instructions

Financial organizations report HSA contributions, rollover amounts, and the year-end FMV on IRS Form 5498-SA by May 31 of the following year. Form 5498-SA generally must be filed with the IRS for each person for whom an HSA was maintained.

According the *Instructions for Forms 1099-SA and 5498-SA*, if a total distribution was made from an HSA during the year and no contributions were made for that year, Form 5498-SA is not required to be filed with the IRS nor provided to the participant to reflect that the FMV on December 31 was zero.

2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		**1** Employee or self-employed person's Archer MSA contributions made in 2019 and 2020 for 2019 $ **2** Total contributions made in 2019 $	OMB No. 1545-1518 **2019** Form **5498-SA**	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S TIN	PARTICIPANT'S TIN	**3** Total HSA or Archer MSA contributions made in 2020 for 2019 $		**Copy A For Internal Revenue Service Center**
PARTICIPANT'S name		**4** Rollover contributions $	**5** Fair market value of HSA, Archer MSA, or MA MSA $	**File with Form 1096.**
Street address (including apt. no.)		**6** HSA ☐ Archer MSA ☐ MA MSA ☐		For Privacy Act and Paperwork Reduction Act Notice, see the **2019 General Instructions for Certain Information Returns.**
City or town, state or province, country, and ZIP or foreign postal code				
Account number (see instructions)				

Form **5498-SA** Cat. No. 38467V www.irs.gov/Form5498SA Department of the Treasury - Internal Revenue Service

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Box 1 – No HSA information is reported in Box 1.

Box 2 – Enter the total HSA or Archer MSA contributions made in 2019. Include any contribution made in 2019 for 2018. Also include qualified HSA funding distributions (contribution from an IRA to an HSA) received during 2019.

Box 3 – Enter the total HSA or Archer MSA contributions made in 2020 for 2019.

NOTE: *Prior-year contributions to HSAs are reported twice. The first year in Box 3 and the following year in Box 2. For example, a contribution made on April 1, 2019, for 2018 is reported on a 2018 Form 5498-SA in Box 3 and is reported in Box 2 on the 2019 Form 5498-SA.*

Box 4 – Enter rollover contributions to the HSA or Archer MSA received by you during 2019. These amounts are not to be included in Box 2.

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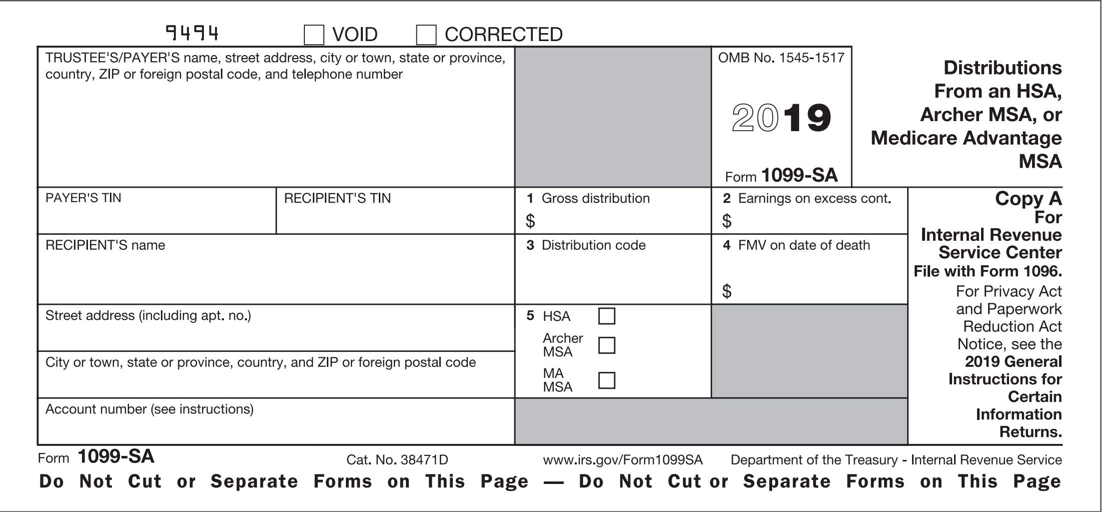
Box 5 – Enter the FMV of the account on December 31, 2019.

Box 6 – Check the box to indicate if this account is an HSA, Archer MSA, or MA MSA.

IRS Form 1099-SA and Instructions

IRS Form 1099-SA is filed to report HSA owner and beneficiary HSA distributions for the year. It generally is due to distribution recipients by January 31 of the following year, and to the IRS by February 28 if filing on paper and March 31 if filing electronically. While IRA distribution reports are not required if the total distribution for the year is less than $10, no such rule exists for HSA distributions.



9494 ☐ VOID ☐ CORRECTED

TRUSTEE'S/PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number			OMB No. 1545-1517 2019 Form 1099-SA	**Distributions From an HSA, Archer MSA, or Medicare Advantage MSA**
PAYER'S TIN	RECIPIENT'S TIN	1 Gross distribution $	2 Earnings on excess cont. $	**Copy A For Internal Revenue Service Center** **File with Form 1096.**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	For Privacy Act and Paperwork Reduction Act Notice, see the **2019 General Instructions for Certain Information Returns.**
Street address (including apt. no.)		5 HSA ☐ Archer MSA ☐ MA MSA ☐		
City or town, state or province, country, and ZIP or foreign postal code				
Account number (see instructions)				

Form **1099-SA** Cat. No. 38471D www.irs.gov/Form1099SA Department of the Treasury - Internal Revenue Service

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Box 1 – Enter the total amount of the distribution. Include any earnings separately reported in Box 2. You are not required to determine the taxable amount of a distribution.

Box 2 – Enter the total earnings distributed with any excess HSA or Archer MSA contributions returned by the due date of the account holder's tax return. Include this amount in Box 1.

Box 3 – Enter the appropriate distribution code from the following list that shows the type of distribution.

1, Normal distributions – Use this code for normal distributions to the account owner and any direct payments to a medical service provider. Use this code if no other code applies.

2, Excess contributions – Use this code for distributions of excess HSA or Archer MSA contributions to the account owner.

3, Disability – Use this code if you made distributions after the account owner was disabled (see IRC Sec. 72(m)(7)).

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4, Death distribution other than code 6 – Use this code for payments to a decedent's estate in the year of death. Also use this code for payments to an estate after the year of death. Do not use with code 6.

5, Prohibited transaction – Use code 5 for any distribution resulting from the HSA owner engaging the HSA in any transaction prohibited by IRC Sec. 4975. Code 5 also is used to report a distribution resulting from the HSA owner using the HSA or any portion of the HSA as security for a loan.

6, Death distribution – Use this code for payments to a decedent's nonspouse beneficiary, other than an estate, after the year of death. Do not use with code 4.

Box 4 – Enter the fair market value (FMV) of the account on the date of death.

Box 5 – Check this box to indicate if this distribution was from an HSA, Archer MSA, or MA MSA.

Reporting Corrections

When Forms 1099-SA and 5498-SA are filed with the IRS and an error is later discovered, the financial organization must correct the report as soon as possible following the discovery of the error. Corrected statements must be provided to the IRS, HSA owner, and death beneficiaries, as applicable.

NOTE: *An error of $100 or less on a distribution amount does not need to be corrected by issuing a revised Form 1099-SA, unless requested by the taxpayer. This applies to 2016 and later tax year forms.*

Financial organizations that send 250 or more corrections of any Forms 5498-SA or 1099-SA are required to electronically send the corrections to the IRS. The limit applies separately to each form. Less than 250 corrections of any one form may be submitted using paper copies. See IRS Publication 1220, *Specifications for Electronic Filing of Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G*, for more detail. Correction procedures for paper forms are contained in the *General Instructions for Certain Information Returns*.

Transmittal Form

Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, must be used to transmit paper corrections as well as original forms. (Do not use Form 1096 to transmit corrections electronically.) When using Form 1096 to transmit corrections, check the appropriate box denoting the type of return being corrected. Fill in the other requested information on the form.

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HSA Owner Responsibilities

Reporting Distributions

HSA owners must report their distributions on IRS Form 8889, *Health Savings Accounts (HSAs)*.

Reporting Contributions

HSA owners must report HSA contributions and figure their HSA deductions on Form 8889, which they file with their federal income tax returns.

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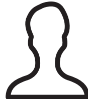

Exercise

Determine if each action is the responsibility of the financial organization or the HSA owner.

Action	Financial Organization	HSA Owner
Calculate the NIA on an excess contribution		
Submit Form 1099-SA to the IRS		
Submit Form 8889 to the IRS		
Determine eligible contribution amount		
Verify contribution type and tax year		
Report contributions to the IRS		
Determine who receives the HSA death benefits		
Determine taxable amount on any distribution		

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Exercise Answers

Exercise

Action	Financial Organization	HSA Owner
Calculate the NIA on an excess contribution	X	
Submit Form 1099-SA to the IRS	X	
Submit Form 8889 to the IRS		X
Determine eligible contribution amount		X
Verify contribution type and tax year	X	
Report contributions to the IRS	X	
Determine who receives the HSA death benefits	X	
Determine taxable amount on any distribution		X

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