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March 20, 2018

Health Savings Accounts: Congress and the IRS Team Up to Throw Us a Curve

Spring training is still underway and Opening Day is two weeks away, but the first curveball of the 2018 employee benefits season has just been thrown.

The dollar limits for contributions to a Health Savings Account ("HSA") are adjusted each year for increases in the cost-of-living. Normally, the new dollar limits are announced well in advance of annual enrollment. In fact, Congress actually requires the Internal Revenue Service to announce the adjusted dollar limits by June 1 of the previous year.

The IRS did what it was supposed to do. On May 4, 2017, the IRS announced the new limits for 2018. The announcement stated that, for 2018, the annual contribution limit for eligible individuals with self-only coverage under a high deductible health plan would be $3,450. For eligible individuals with family coverage under a high deductible health plan, the limit for 2018 would be $6,900. Additionally, eligible individuals who would be age 55 or older by the end of 2018 could make a "catch up" contribution of up to an additional $1,000.

But, as we all know, Congress is not required to follow its own rules and it didn't do so here. When Congress enacted the Tax Cuts and Jobs Act of 2017 on December 20, 2017, it changed the way cost-of-living adjustments are made and, instead of making this change effective in 2019, it made it effective for 2018.

The change did not affect most of the HSA limits for 2018. For example, the annual contribution limit for eligible individuals with *self-only coverage* is still the same (i.e., $3,450). But, earlier this month, the IRS announced that, under the revised cost-of-living formula that was included in the Tax Cuts and Jobs Act of 2017, the annual contribution limit for eligible individuals with *family coverage* for 2018 is now only $6,850, and not the $6,900 that had previously been announced.

What does that mean? Here are a few thoughts:

(1) If an individual has already contributed more than $6,850 to an HSA for 2018, both the excess contribution and the earnings on that excess contribution must be returned to the individual. This is probably not a common situation, but it does happen.

(2) If an individual is contributing to an HSA through the individual's employer, the employer needs to cut off deductions when the total contributions reach $6,850, even if the pre-tax salary election made by the individual would have resulted in total contributions of $6,900.

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(3) In fact, rather than waiting until the end of the year to cut off an employee's HSA contributions, it would be better if the employer could adjust the employee's HSA election for the year to get the employee "back on track." That's because an individual who ceases to be HSA eligible in the middle of a year is only allowed to contribute a prorated portion of the annual dollar limit.

(a) For example, if an employee who is being paid each month elected to make an HSA contribution for 2018 of $6,900 and the contribution is being taken out of each paycheck in equal installments, a total of $1,725 will have been taken out by the end of March.

(b) But, if the employee loses HSA eligibility – for example, because the employee becomes enrolled in a traditional PPO plan – the prorated dollar limit will actually be $1,712.50. So, in this situation, the employee will have an excess contribution of $12.50.

(c) That excess contribution, along with earnings, will need to be removed from the employee's HSA by the due date of the employee's 2018 tax return – for most taxpayers, April 15, 2019 – or else the employee will become subject to an ongoing 6% excise tax.

(4) The reduction in the 2018 annual contribution limit has caught almost everyone by surprise, perhaps even including the IRS. The IRS is already getting a lot of questions about it.

(a) For example, existing IRS rules allow employees to change their HSA elections at any time as long as the change is made on a prospective basis. So, if employees know about and understand the change in the 2018 HSA contribution limit, they can change their HSA election in a way that will get them back on track for the year.

(b) But is an employer permitted to make this change to an employee's HSA elections on its own? We can argue that an employer ought to be permitted to do this since the change is being made as a result of a change in the governing law, but it would be nice if the IRS would come out and say that, in this particular situation, an employer is permitted to change an employee's election on its own.

(c) It would also be nice if the IRS could come up with a simplified method of calculating the earnings that must be removed at the same time that an excess contribution is removed from an HSA. Allowing individuals to calculate lost earnings by using the Department of Labor's online "lost earnings" calculator would be one step the IRS might be able to take. Otherwise, the cost of calculating "lost earnings" on an excess contribution is likely to be more than the amount of the excess contribution itself.

(5) It is hoped that the IRS will provide answers to these questions soon. So, getting back to our baseball metaphor, we can't take our eye off of the ball until we're sure that the last out has been recorded.

In the meantime, if you have any questions about the new HSA contribution limit for 2018 or about HSAs in general, please feel free to contact Brad Schlozman, Eric Namee, or Steven Smith at (316) 267-2000.

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