May 2, 2018

About That Change in the HSA Dollar Limit - The IRS Just Said "Never Mind"

On March 2, 2018, the Internal Revenue Service ("IRS"), following the directions it had been given by Congress, threw a curve at nearly everyone by announcing that the dollar limit for 2018 contributions to a Health Savings Account ("HSA") by "eligible individuals" with family coverage had been changed and that the new dollar limit was $6,850. We wrote about this development in our Alert dated March 20, 2018.

When the IRS made this announcement, it probably didn't seem like a big change. The limit that had previously been announced for 2018 was $6,900, so the new limit was only $50 less. And, since we were barely more than two months into the new year, it probably didn't seem all that likely that too many people had already contributed more than the new limit into their HSA for the year.

But, as our previous Alert indicated, this mid-year change triggered a chain reaction of questions. The IRS acknowledged those questions in Revenue Procedure 2018-27, which was issued on Thursday of last week (April 26). The IRS wrote that it had been "informed … that implementing the $50 reduction to the limitation … for individuals with family coverage would impose numerous unanticipated administrative and financial burdens." These "unanticipated" problems included individuals who had made cafeteria plan elections for the entire year based on the previously announced limit as well as individuals who had already "maxed out" their HSA contributions for the year before the new limit was announced. Additionally, the IRS wrote that it had been informed "that the costs of modifying the various systems to reflect the reduced maximum, as well as the costs associated with distributing a $50 excess contribution (and earnings), would be significantly greater than any tax benefit associated with an unreduced HSA contribution (and in some instances may exceed $50)."

Based on this information, the IRS announced that it has "determined that it is in the best interest of sound and efficient tax administration to allow taxpayers to treat the $6,900 annual limitation" for 2018 that had originally been announced in May 2017 as being "the 2018 inflation adjusted limitation on HSA contributions for eligible individuals with family coverage under an HDHP."

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What does this mean?

- If you didn't change anything in response to our Alert from March 20, 2018, then you're in luck. Sometimes you don't want to get too far out in front of a curve and that has turned out to be the case here.

- If you lowered the dollar cutoff for HSA contributions for "eligible individuals" with family coverage from $6,900 to $6,850, you need to move the cutoff back up to $6,900.

- If you changed the rate at which HSA contributions were being taken out of your employees' pay through your cafeteria plan so that your employees' HSA contributions would not go over the limit, then you need to "undo" the change by increasing their HSA contributions going forward. This may mean not only going back to the old rate for taking out HSA contributions, but also taking out something extra so that you can make up any shortfall in their HSA contributions that was caused by your well-intentioned effort to do what the IRS had told you to do.

What about individuals who had already "maxed out" their HSA contribution for 2018 before the $6,850 limit was announced in early March and who have already taken a corrective distribution, with earnings, from their HSA in an effort to get below that limit? The IRS has officially said that individuals who are in this situation can repay the distribution, including earnings, to their HSA if they do so by April 15, 2019. If they don't want to repay it, that's OK too. The IRS has also said that, if individuals don't repay it, the amount that was returned to them will be treated as an "excess contribution" returned before the due date of their return, which means that it won't need to be included in their gross income (unless the money had been contributed to the HSA on a pre-tax basis) and it won't be subject to the 20% penalty tax that normally applies to distributions from an HSA that are not used for "qualified medical expenses."

In our last Alert, we wrote that you can't take your eye off of the ball until you're sure that the last out has been recorded. After reading the new IRS Revenue Procedure, we think that, insofar as the HSA dollar limits for 2018 are concerned, the last out has now been recorded and that particular game is now over.

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

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