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Answers To Employer Questions About HSAs

Q. Can all employers participate in an HSA program?

A. Any C-Corp, S-Corp, or LLC business entity can participate, along with their owners and employees. However, S-Corp owners cannot contribute to a personal HSA through pre-tax deductions. Instead, S-Corp owners can make direct contributions to their HSA and then take a tax credit on their personal income tax return at the end of the year.

Q. What is the minimum requirement for opening an HSA?

A. The employee must be enrolled in a Qualified High Deductible Health Plan (QHDHP), which is generally defined as a health plan having a deductible of at least $1,650 for Employee Only coverage and at least $3,300 for Family coverage.

Q. As an employer, I currently offer the Flexible Spending Account (FSA) to my employees. I plan to switch to a QHDHP in the middle of the FSA plan year. When can FSA participants enroll in the HSA?

A. An employee cannot contribute to both an FSA and an HSA at the same time. Employees who have an FSA can change to the QHDHP in the middle of the FSA plan year, but must wait until FSA plan year ends before they can begin contributing to an HSA account.

Q. As an employer, I currently offer the FSA with a 2.5-month grace period to my employees. At the end of the current plan year, we are adding a QHDHP with HSA to our available health plan options. How does the FSA grace period affect the ability of my employees to enroll in the HSA?

A. FSA participants who do not have any balance left in their account at the end of the current plan year can enroll immediately into an HSA plan after the year ends and start making HSA contributions. If they do have a balance in their FSA at the end of the plan year, though, and will be accessing those funds during the grace period, then they cannot enroll in and begin contributing to an HSA until they have spent their remaining FSA balance or the grace period ends, whichever comes first.

Q. As an employer, I currently offer the FSA with Carryover option to my employees. At the end of the current plan year, we are adding a QHDHP with HSA to our available health plan options. How does the FSA Carryover affect the ability of my employees to enroll in the HSA?

A. FSA participants who do not have any balance left in their account at the end of the current plan year can enroll immediately into an HSA plan after the year ends and start making HSA contributions. Employees with carryover balances would be ineligible to contribute to an HSA for the entire following plan year, even if the employee does not elect to make new FSA contributions for that year. One way to avoid this is to amend the plan to allow employees to decline the carryover before the beginning of the next plan year.

Another solution is to amend the plan to allow unused balances in general purpose FSAs to be carried over to a Limited Purpose FSA (LPFSA). If an unused balance from a general purpose FSA is carried over to the LPFSA, the amount carried over may still be used during the general purpose FSA's runout period to reimburse general purpose FSA expenses that were incurred during the previous plan year.

Employers that offer both HSAs and FSAs should contact their DataPath Administrative Services representative to discuss their plan design. This is to ensure the plans are compatible with one another in order to mitigate risk to employee participants.

Q. How much can an employee contribute to their HSA each year?

A. Contribution limits are based on the IRS tax year for individuals (calendar year). The annual limit for 2025 is $4,300 for employees enrolled in a QHDHP with Employee Only coverage, and $8,550 for Family coverage. Employees have until April 15th of the following year (tax filing deadline) to make contributions for a given tax year.

Q. Is the amount of money an employee can contribute to their HSA limited or prorated by the date that they enroll in the QHDHP plan?

A. Yes. Although an employee can contribute the full amount ($4,300 for Individual coverage/$8,550 for Family coverage) as long as they stay enrolled in the QHDHP for a full year, we recommend that employees who come on the plan mid-year prorate their contributions accordingly.

For example, with QHDHP plan year of 1/1-12/31, enrolling in January does not create an issue. If the employee enrolls in the QHDHP on 7/1, however, and then contributes the individual maximum $4,300 to an HSA, they would have to stay enrolled in the QHDHP through 6/30 of the following calendar year to avoid possible tax consequences. The employee would not be able to switch to the POS plan during that full year unless they were willing to pay back taxes on the funds contributed to their HSA in excess of the prorated limitation. The same situation would apply if the employee left the employer and went to another traditional, non-QHDHP plan before the full 12 months were up.

Q. What happens if an employee contributes too much to their HSA? How can they fix it?

A. An "excess contribution" is when an employee contributes more to their HSA than their maximum contribution limit for the tax year. The amount of the excess contribution is not eligible for pre-tax treatment or for a deduction on the employee's individual tax return. If the excess contribution is spent or otherwise distributed from the HSA by the filing deadline for that tax year (usually April 15 of the following calendar year), there is no tax on the distribution itself, although the associated net income is taxable. If the excess contribution is allowed to sit in the HSA beyond the tax filing deadline, the amount of excess contribution is subject to an excise tax for each tax year it remains in the account.

Q. Can employees invest the funds sitting in their HSA?

A. Yes, depending on the TPA or bank that holds the HSA bank account. In order to be able to invest, the money has to be held by an institution that has an investments or brokerage division.

Q. How much can an employee spend each year out of their HSA?

A. The only spending limit is the employee's HSA account balance. They can only withdraw up to the amount in their account at that point in time. Any unused funds roll over from year to year. Employees do not lose any funds if they have a balance left over at the end of the year.

Q. What types of expenses can employees use their HSA for?

A. In addition to eligible healthcare expenses, employees can use their HSA for certain insurance premiums, including COBRA, Medicare (if age 65 or older, but not including premiums for Medicare supplements), and Long-Term Care insurance (subject to limits based on age).

Q. Do HSAs have "catch-up" rules and withdrawal penalties like 401(k) accounts do?

A. Yes. If the employee is over 55, they can contribute an additional $1,000 to their HSA each year above the normal limits (in other words, a total of $5,300 if enrolled in Employee Only coverage or $9,550 if enrolled in Family coverage). If the employee has Family coverage and their spouse is over 55, the same provision applies, but their spouse would have to have his or her own HSA in which to make the catch-up contribution.

If the employee takes money out prior to age 65 for anything other than qualified expenses, they will pay taxes on the withdrawn amount as well as an early withdrawal penalty of up to 20 percent.

Once over the age of 65, or if disabled at the time of withdrawal, the employee can use their HSA funds for any purpose without penalty. They pay only income tax on the amount withdrawn each year.

Q. How long can employees contribute to an HSA?

A. As long as they are enrolled in a QHDHP, employees can contribute to an HSA account until they enroll in Medicare. Once enrolled in Medicare, they can use the balance remaining in their HSA but can no longer contribute additional funds to the account. (This applies to spouses also; there are special rules if one spouse enrolls in Medicare before the other does.) Employees also cannot participate in an HSA if enrolled in either TriCare or Medicaid.

Q. What are the rules on HSA inheritance?

A. Employees should choose a beneficiary when opening their HSA. Inheritance rules differ based on whether the named beneficiary is their spouse or not. If their spouse is the beneficiary, then upon their death, the spouse inherits the HSA and for tax purposes it is treated as the spouse's HSA. If the employee names someone else as their beneficiary, that person will inherit the HSA, but the account will no longer be considered an HSA for tax purposes, and the account balance will be taxable to the beneficiary.

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