NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS – FLORIDA
1836 Hermitage Blvd, Suite 200, Tallahassee, FL 32308
Contact: Paul S. Brawner **(850) 422-1701** brawner@faifa.org

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Health Savings Accounts: Year Seven

1 Hour of Self-Study CE

Course Reading Assignment

INTRODUCTION

This course is designed to give you a thorough overview of Health Savings Accounts (HSA), including some historical background, functions and purpose, features as compared to other types of accounts, applicability and use of the funds contained within those accounts, and rules and regulations concerning setup and disposition of HSA funds. The material also briefly explores the recent legislative changes and their impact on these types of accounts.

SECTION 1

A. BACKGROUND

As a “refresher”, Health Savings Accounts (HSA) were created in Section 1201 of the Medicare Prescription Drug, Improvement & Modernization Act of 2003, signed into law by President Bush, and effective on January 1, 2004. The US Treasury defines an HSA as an “alternative to traditional health insurance. It is a savings product that offers a different way for consumers to pay for their healthcare. HSA’s enable you to pay for current health expenses and save for future qualified medical and retiree health expenses on a tax free basis.”

In reviewing an article that was written right after the passage of the bill, we are reminded why HSA’s were created. The original intent of the design was to help provide greater access to affordable health care while increasing the public’s awareness of the true cost of treatment. Former Florida Governor Jeb Bush, who actively worked to promote this legislation, stated “HSA’s will be a critical component in a consumer driven health care market, creating competition, lowering prices and increasing access.” In a society that had been accustomed to a third party paying the bill and had virtually little to no knowledge of the cost of services, it was a step to change a mindset and instill “personal responsibility.” We have all used the common phrase that “it is always easier to spend someone else’s money.” When we become responsible for the initial cost of care, we tend to proceed with more questions and increased caution.

So, here we are nearly seven years later, and have the predictions come true? Let’s look at Florida for example. There is no confirmed evidence to demonstrate increased competition in the availability of new carriers. Additionally, there is evidence to prove conclusively that HSA’s lowered our overall Health Care Cost. The conventional wisdom was that the trend would be lower on these products. However, the actual loss ratios on the severely under-priced $1500/$3000 deductible, 100% co-insurance plans were extremely high – and most were promptly pulled from the market. Rate increases for lesser benefits have followed the trends of copayment plans, narrowing the pricing gap that was so appealing when HSA’s were first introduced. Has our uninsured population shrunk as a result of these products? It appears the percentage of uninsureds has remained steady and not decreased as a result of this legislation.

When first introduced, the premium savings on qualified high deductible plans were as much as 25 percent or more compared to a typical low deductible plan. The premium differential in the beginning was often more than the out of pocket expenditure! The process was easy. Either give the insurance carrier the money in the event you have a claim or, redirect those premium dollars into a savings account that you own. If you get sick, the money is there. If you don’t, you keep the money. It was a slam dunk.

B. HSA APPLICABILITY AND USE OF FUNDS

Now, when the savings are far less, which type of consumer wants this product, and what can the funds be used for? Well, for starters, consumers who are in higher tax brackets and need additional sources to set aside pre-tax dollars. There are no income requirements or top-heavy testing as with pension plans. One of the most appealing aspects of a Health Savings Account is

its triple tax advantage. In 2011, a consumer can set aside up to $3050 for self-only coverage and $6150 for family coverage. Up until 2011, these figures had been adjusted upward annually by the Treasury Department for inflation.

Married couples, who are enrolled separately (often in a group insurance situation) may not contribute more than the combined allowable “family” amount. Individuals who are age 55 and older can make additional annual “catch-up” contributions of $1000. Contributions must be made in cash and cannot be made with stock or property.   Participants do not pay federal, FICA or FUTA taxes on these contributions. Under the last-month rule, you can make a full years contribution, so long as you were covered by an HSA on the first day of the last month of the tax year, typically December for most taxpayers. However, to avoid taxation on the contribution, the high deductible plan must remain in effect until the end of the tax year.

For example, if the member started an HSA on December 1st of 2010, they can contribute the full amount for 2010 and again the full amount for 2011, so long as they remain insured on a HDHP through December 31, 2011. Participants may make the full IRS allotted amount, even if their deductible is less! They even have up until their tax filing deadline to fund for the previous calendar year as with IRA contributions.

For employers who offer these deductions through a Section 125 plan, the employer also saves the FICA match and FUTA taxes. If the money is contributed directly to the bank or qualified trustee by the participant, it is an above the line tax deduction. Considering how few people with insurance get a medical deduction under the current IRS rule of 7.5% of AGI and when it raises to 10% of AGI in 2013, even fewer people will be qualify - the tax advantages of the H.S.A become very appealing.   The beauty is that the participant gets the deduction simply by making the contribution to their HSA account. If the account earns interest, it is tax free and so long as the funds are used for qualified medical, dental or vision expenditures, it is a tax free withdrawal. These expenses are described in Section 213(d) of the IRS code. There are no “use it or lose it rules” as with an FSA, however, distributions can only be made for expenses that were incurred after the HSA is established. The money rolls over year after year.

There are even times when you can use the money for other purposes. It is permissible to use the funds to pay for health premiums in the event you are receiving unemployment compensation. You can also use it to pay for COBRA continuation premiums. People who are 65 or over can use the funds to pay for any type of health insurance except for Medicare supplement policies. Additionally, the money can be used to purchase Qualified Long Term Care Insurance. If a member reaches age 65 and has money remaining, the now 20% penalty for early withdrawal, increased from 10% in the PPACA legislation, is waived and they can use the money to supplement retirement, subject to ordinary income taxation on the withdrawal amount. If you contribute more than the allowed amount to an HSA, there is a 6% excise tax plus income tax for Excess Contributions (unless funds are returned prior to April 15th.)

C. <u>ROLLOVER ELIGIBILITY FOR HSA</u>

Rollovers may be made from an Archer MSA to an HSA. From 2007 through 2011, employers

can transfer funds from HRA's and health FSA's into an HSA account for employees switching to a Qualified HDHP. The rollover amounts are above and beyond the amounts allowed as annual contributions. This provision is limited to one rollover and if the individual does not remain on the Qualified HDHP for 12 months following the month of contribution, the transfer amount is taxable as income and subject to an additional 20% tax.

In 2007, the law was changed to allow for a one-time transfer from an IRA to an HSA, but it must be in the form of a direct trustee-to-trustee transfer. This particular type of transfer will not be includable in income or subject to the early withdrawal tax. It is however, limited to the maximum HSA contribution limit that year and is not deductible. Again, if the individual does not remain insured on the Qualified HDHP for at least 12 months, the transfer amount is subject to income tax as well as a 20% additional tax.

D. USE OF HSA FUNDS

Consumers should also be reminded that funds can be used to cover the qualified expense of their legal spouse or dependents, even if they are not enrolled on the Qualified High Deductible Health Plan. Reminder also that one can only make contributions to an HSA on behalf of those who are enrolled and are legal dependents as defined by IRS rules. Now, where does this get tricky? Well, often times, the insurance carriers or employers will allow the enrollment of Domestic Partners. They may be enrolled on the High Deductible plan as a "spouse," but since the IRS does not recognize them as such, you cannot contribute money to or use funds from an HSA for domestic partners. The domestic partner is permitted in this instance to open their own Health Savings Account.

What about dependent children? Well, fortunately with the Patient Protection and Affordable Care Act (PPACA), the IRS did change the official definition of a child to match that as defined in the legislation. The legislation basically allows for the enrollment of a "child" under the age of 26, regardless of marital, financial, student or residential status. They did this so that people who pre-tax their "dependent" premiums or have funds in FSA's, HRA's or HSA's don't violate rules by using tax-free mechanisms on people who are not "legal dependents." However, in Florida we have a twist. The state definition of a "child" extends all the way to age 30! So, if you have an insured "child" who is 26 to 30 – outside of the Feds definition of a child – and you try to pretax those premiums or fund or use funds from an FSA, HSA or HRA for that "child" (if the parent does not claim them on their tax return) they could get in trouble with the IRS!

SECTION REVIEW - QUESTION 1 (check answer at end of reading assignment)
(Ref: Section IA, Page 1, Para 1)

In what year were Health Savings Accounts (HSA) created?

a. 2000
b. 2002
c. 2003
d. 2009

SECTION REVIEW - QUESTION 2 (check answer at end of reading assignment)
(Ref: Section I, Page 3, Para 2)

If a member started an HSA on December 1st of 2010, and remained insured on a HDHP through December 31, 2011, what amount of contribution can they make for 2010 and 2011?

a. They can contribute half the amount for 2010 and then half the amount for 2011
b. They can contribute the full amount for 2010 and then the full amount for 2011
c. They can contribute one third the amount for 2010 and then one third the amount for 2011
d. They can contribute half the amount for 2010 and then the full amount for 2011

SECTION 2

A. DEFINITION OF A QUALIFIED HIGH DEDUCTIBLE HEALTH PLAN

In 2011, a self-only HDHP plan must have a deductible of at least $1200 and an out-of-pocket maximum of no more than $5950. A family HDHP must have a deductible of at least $2400 and a maximum out-of-pocket of no more than $11,900. These figures are for in-network benefits only. There are no specific deductibles or out-of-pocket guidelines if the plan offers out-of-network benefits.

Deductibles are either embedded or non-embedded. An embedded deductible is one in which each covered family member only needs to satisfy her or his individual deductible, not the entire family deductible before coinsurance applies. A non-embedded deductible is one that requires the entire family deductible be met, either by one or any number of family members, before coinsurance applies. Most of the products being marketed in Florida are non-embedded deductible plans. A qualified plan can be either an individual or group plan. If a service is considered “preventative” in nature, the deductible can be waived. Coinsurance or copayments for preventative care are permissible.

B. ELIGIBILITY TO CONTRIBUTE TO AN HSA

To contribute to an HSA an individual must first be covered by a Qualified High Deductible Health Plan. They cannot be enrolled in any other major medical plan including a spouse’s group or Medicare, whether it’s due to age, End Stage Renal Disease or Disability. Dental, vision, disability, specific illness, long term care and coverage that pays a fixed amount for hospitalization does not disqualify the contributor from opening a Health Savings Account. Money can be contributed by the account holder, the employer or any other person.

C. EMPLOYER CONTRIBUTIONS AND DISCRIMINATION RULES

The accounts are owned and maintained by the employee or participant. Should the employer choose to contribute to the employee’s account, the money immediately becomes the property of

the employee.   Employers must make "comparable" contributions. They should be the same amount for all employees or same percentage of the annual deductible. However, as of January 1, 2007, the rules were relaxed somewhat to allow employers to contribute more to the HSA accounts of non-highly compensated individuals. The definition of a non-highly compensated employee is based on the same definition used for qualified retirement plans.

The contributions made by employers are non-taxable to the employee and a business deduction to the corporation. If it is determined that the employer has not made comparable contributions, there is a 35% excise tax assessed. Employers must report contributions and deductions on the W-2, Box 12, coded with a W. Employers may not use corporate funds to fund the accounts of anyone who is not considered an "employee."   Owners, officers, partners of corporations other than C-Corporation officers are not considered "employees."   Since LLC's are taxed like a sole proprietorship and LLP's are taxed like a partnership, there are no special tax advantages for either of these entities under an HSA program.

D. DISPOSITION OF HSA FUNDS IN THE EVENT OF DEATH OR DIVORCE

In the event of divorce, the spouse may become the account holder.

In the event of death, it is a non-taxable event and the spouse-beneficiary becomes the account holder. If it is a non-spouse who is the beneficiary, the estate is taxed on the fair market value of the account and the HSA account must be closed. Distributions within one year (after death) for eligible expenses incurred by the deceased are non-taxable.

E. DISPOSITION OF FUNDS IF NO LONGER PARTICIPATING IN A HDHP

Once the participant is no longer covered by a Qualified HDHP, they can no longer make contributions to the savings account. However, they can continue to use the funds in exactly the same manner as if they were still a participant. The account can be drawn down whenever future qualified expenses are incurred.

F. RESPONSIBILITY FOR VALIDATING EXPENSES AND DISTRIBUTIONS FROM HSA

The account holder is solely responsible for maintaining receipts and ensuring the distributions meet the IRS 213(d) guidelines. Neither the employer nor the bank trustee is responsible for determining if the distributions are qualified expenses. The custodial bank will issue two tax documents at year end which will report the contributions and distributions from the account. The trustee reporting includes a Form 1099-SA and Form 5498-SA. Withdrawals from the H.S.A account do not have to occur simultaneously with the medical expense. Distributions may occur even after the employee is no longer eligible to contribute to the account.

SECTION REVIEW - QUESTION 3 (check answer at end of reading assignment)
(Ref: Section 2C, Page 6, Para 1)

Should an employer choose to contribute to an employee's HSA account who is the lawful owner of the funds?

a. The funds immediately belong to the employee
b. The funds are shared equally by employer and employee
c. The funds always belong to the employer
d. The employee takes owners ship of the funds after a minimum vesting period

SECTION REVIEW - QUESTION 4 (check answer at end of reading assignment)
(Ref: Section 2F, Page 6, Para 5)

Which of the following is responsible for determining if HSA distributions are qualified expenses?

a. Insurance company
b. Employer
c. Bank Custodian
d. Employee

SECTION 3

A. PAIRING AN FSA OR HRA WITH AN HSA

It is permissible to have an FSA or HRA and an HSA so long as the FSA or HRA is for limited purposes, such as dental, vision or preventative care. If the employer or the employees wish to have an FSA or HRA and still be able to fully fund their HSA, then the FSA or HRA cannot provide for any reimbursements for medical expenses before the minimum HSA deductible has been satisfied by the employee.

When is it desirable to have both plans? Many employers want to help employees who might have to meet their deductible, but if they make contributions to their HSA accounts, the money is spent whether the employee has a claim or not and the money immediately becomes the property of the employee upon deposit - a feature many employers do not like. With an HRA, they can still meet their objective of assisting the employee when a large claim hits, but the employer only spends money when a claim is actually incurred, thereby lessening the potential financial exposure to the employer. It should be noted, however, funds remaining in an HRA account are subject to distribution if the person elects COBRA Continuation. HSA accounts are not subject to COBRA continuation. HSA's are also not subject to Section 419, and are not considered welfare benefit funds.

B. GROWTH OF HEALTH SAVINGS ACCOUNTS

For anyone working in the insurance industry in 2004 when HSA's were first introduced, it was difficult to find a local bank representative who even knew about HSA accounts, let alone dealt with them. The insurance carriers had to locate and contract with national banks to have a location to deposit the funds. Certainly times changed, and in short time the popularity of HSA accounts grew to the point where most every agent, and bank representative, knew of their existence. According to a Wall Street Journal report, the number of banks offering Health Savings Accounts has more than tripled since 2005. According to the Association of Health Insurance plans, there are currently over 10 million people insured on High Deductible Health Plans.

C. FUTURE OF HEALTH SAVINGS ACCOUNTS UNDER HEALTH CARE REFORM

There are a number of changes contained within the Patient Protection and Affordable Care Act (PPACA) legislation that could negatively impact the favorability of Health Savings Accounts as a choice for consumers. For starters, the US Treasury website is no longer providing information for consumers, negating a great, easy to find quick link to educational material about health savings accounts. While the site still holds some relevant information on HSAs, it's been relocated to other areas of the website and as such is now much tougher to find. Additionally, the popular tri-fold informational brochure last updated in 2009 is no longer available. Some changes are much more significant. For the first time since the legislation passed, the annual contribution amounts were not indexed for inflation. Also, as of January 2011, the ability to use the funds for over the counter drugs and medicines without a prescription was removed, and the penalty for withdrawing non-qualified funds will double from 10% to 20%. These changes are definite, and appear to signal the passing of the era of "personal responsibility", as consumers head toward a much more heavily regulated plan design, with strong premium and out-of-pocket subsidies for a larger part of the population.

D. UNAUTHORIZED ENTITIES

Unauthorized entities engaging in insurance are a serious and growing problem in Florida for consumers and agents. Consumers are substantially harmed with these entities failing to pay claims and defrauding through deception. Agents are unwittingly (sometimes knowingly) representing these entities and placing clients and themselves at risk. Florida law is violated under the guise of these unauthorized entities claiming to be ERISA exempt or some type of association plan that claims to not be insurance or to be exempt from Florida regulation. All of this is simply not true! This is a problem in the state of Florida and other states.

The problem of unauthorized entities selling unauthorized products originated in the health insurance arena, although the problem now seems to be spreading into property-casualty arena as well. These unauthorized entities promised low health insurance premiums, a promise fueled by skyrocketing health insurance premiums with legitimate health insurance carriers. In the current market, low health insurance rates just do not exist. The public and certain agents, apparently, were ripe for the picking by these scam artists. Remember, these are scams and the intent is to collect as much premium as possible without having to pay claims, or very few claims.

Unsuspecting licensed insurance agents are also vulnerable to this type of scam because representatives of the unauthorized entity will contact the licensed agents and send them (or give them in person) printed marketing materials touting the unauthorized entity and their bogus products which, again, gives the impression of legitimacy and credibility.

Maybe the agent is asking too many questions of the representative – is just a little too inquisitive – about who they are, where they're located, how long they've been in business, etc. The agent may even question the legitimacy of the product. Some scam artists tell agents their products do not have to be authorized by the Department because it is an ERISA plan, or that the plan is part of a MEWA (multiple employer welfare arrangement) or it's to be sold to labor unions – all the while stating that under any of these previously-mention circumstances, the products do not have to be approved or authorized by the Department.

The representative of the unauthorized entity might say, "It doesn't require approval, because this is an ERISA plan." Or, "It doesn't require approval because this is plan is part of a MEWA plan." Or "This plan doesn't require approval because it's for labor unions." None of this is correct! Any product which contains an insurance component is required, by law, to receive authorization of that component by the Department before it can be sold in Florida. Any legitimate company representative who approaches you about selling and representing their products should not mind the scrutiny you put them under by verifying their status with the Department.

626.902 Penalty for representing unauthorized insurer

(1) In addition to any other penalties provided in the insurance code:

(a) Any agent licensed in this state who in this state represents or aids an unauthorized insurer in violation of s. 626.901 commits a felony of the third degree, punishable as provided in s. 775.082 or s. 775.083.

(b) Any person other than an insurance agent licensed in this state who in this state represents or aids an unauthorized insurer in violation of s. 626.901 commits a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084.(2) In addition to the penalties provided for in subsection (1), such violator shall be liable, personally, jointly and severally with any other person or persons liable therefore, for payment of taxes payable on account of such insurance under s. 626.938.

Agents or any other persons are prohibited from representing or aiding an unauthorized insurer. If an agent or any other person represents an unauthorized insurer, they are subject to severe penalties, including possible civil and criminal action. Agents are subject to suspension or revocation of their licenses and/or monetary penalties for violation of the unauthorized insurer law. Agents can be held liable for claims and losses not paid by unauthorized insurers. Agents who represent or aid an unauthorized insurer commit a felony of the third degree.
Don't be fooled by phony products that sound too good to be true! Investigate before you sell or buy these plans. Check to see if an entity or plan is an authorized insurer by calling the Department of Financial Services at 877-693-5236 or 850-413-3089.

SECTION REVIEW - QUESTION 5 (check answer at end of reading assignment)
(Ref: Section 3A, Page 8, Para 1)

Funds remaining in an HRA account are subject to distribution if the person

a. leaves the employers company
b. elects to retire and collect Social Security
c. elects COBRA continuation
d. divorces and re-marries

SECTION REVIEW - QUESTION 6 (check answer at end of reading assignment)
(Ref: Section 3F, Page 9, Para 6)

Any agent licensed in this state who in this state represents or aids an unauthorized insurer in violation of s. 626.901 commits what level of violation?

a. Felony of the 3rd degree
b. Felony of the 1st degree
c. Misdemeanor of the 2nd degree
d. Misdemeanor of the 3rd degree

Review Exercise Answer Key

1. C
2. B
3. A
4. D
5. C
6. A