NEWS

Weighing the Pros and Cons of HSAs

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When health savings accounts (HSAs) took effect more than 20 years ago, some initially thought HSAs would not be used by rank-and-file employees and would be used only by executives.

"That has not proven true," said Chris Keller, an attorney with Groom Law Group in Washington, D.C. "Financially savvy employees of all income levels have figured out that HSAs are an excellent vehicle for saving money for future medical expenses."

HSAs are a benefit that employers and employees should learn about to decide if they are right for their organizations or themselves, she added. Here are some pros and cons of HSAs for employees and benefits administrators.

What Are HSAs?

An HSA is a funded account, similar to an individual retirement account, Keller noted. Contributions may be made within specified limits by individuals who meet certain eligibility requirements and/or by employers or others on behalf of such individuals.

Amounts in an HSA grow on a tax-deferred basis. If used for qualified medical expenses, amounts in an HSA may be distributed tax-free. In order to contribute to an HSA, an individual must be covered under a high-deductible health plan (HDHP) and may not participate in any other non-HDHP.

There are contribution limits for HSAs that usually increase each year. **For 2024 - (https://www.shrm.org/topics-tools/news/benefits-compensation/irs-gives-big-boost-to-hsa-hdhp-limits-2024)** , the limit for self-only health coverage is $4,150, and the limit for family coverage is $8,300. **For 2025 - (https://www.shrm.org/topics-tools/news/benefits-compensation/irs-announces-2025-hsa--hdhp-limits)** , those figures rise to $4,300 and $8,550, respectively.

Advantages of HSAs for Employees

The tax advantages of an HSA can be attractive. But there are rules regarding HSA funding that account owners and employers should be aware of to maximize tax advantages and avoid tax penalties, Keller said.

The primary advantages of an HSA for an employee are its portability and its triple tax-advantaged status, said Marcia Wagner, an attorney with The Wagner Law Group in Boston.

Portability means that the money in the HSA is the employee's to keep, even if the employee changes employers or doesn't spend all the money in the account, noted Sara Taylor, senior director of employee spending accounts at WTW in Lincolnshire, Ill. Also, there is no "use-it-or lose-it" rule with HSAs as there is with flexible spending accounts (FSAs) because unused HSA funds automatically roll over to the following year.

HSAs are sometimes referred to as triple tax-advantaged because the account contributions are pretax, the growth is tax-free, and the money can be taken out tax-free. The employee's contributions to an HSA are exempt from federal income tax, the Federal Insurance Contributions Act, and the Federal Unemployment Tax Act, Wagner said.

HSAs can also be a **tax-efficient part of employees' retirement planning - (https://www.fidelity.com/viewpoints/wealth-management/hsas-and-your-retirement)** .

Distributions are tax-free if used to pay for qualified medical expenses, and earnings are not taxed, Keller added. Even if an employee changes coverage to non-HDHP coverage, the contributions already made to the HSA remain and continue to grow or be distributed on a tax-free basis to pay for qualified medical expenses, she said. The consequence of losing HSA-eligible status is that no additional contributions may be made to the HSA.

Advantages for Benefits Administrators

The role of the benefits administrator is simpler with an HSA than with a health care FSA, Wagner said.

Unless an employer fails to follow the U.S. Department of Labor's clearly defined safe-harbor rules, HSAs are not considered Employee Retirement Income Security Act employee welfare benefit plans, she noted. "That means, in a close case as to whether an item is a qualified medical expense, the HSA owner will make that call rather than the benefits administrator," she explained.

Distributions from HSAs are reported by the financial institution on a Form 1099-SA rather than as wages on Form W-2, Wagner added.

"From a reporting perspective, the only obligation of a benefits administrator, if it had any reporting responsibilities with respect to an HSA, would be to report the pretax deferrals to the HSA in Box 12 with a Code W," Wagner said.

A benefits administrator who obtains nonbank trustee (NBT) status from the IRS may find that administrating an HSA is lucrative, Keller said. "The NBT may be permitted to share in the revenue earned from interest on HSA cash balances," she said.

Disadvantages of HSAs for Employees

The main downside of an HSA for employees is that there is an increased risk of accruing medical debt because of the health plan associated with the HSA. In an HDHP, the deductible—$1,600 for self-only HDHP coverage and $3,200 for family HDHP coverage in 2024—generally must be paid before the plan covers medical expenses, Keller said. The deductibles for HDHP coverage will be raised in 2025 to $1,650 for self-only HDHP coverage and $3,300 for family HDHP coverage. (Employees, though, usually pay lower monthly premiums for HDHPs than they do for other traditional health plans, such as preferred provider organizations.)

"There is some evidence that individuals participating in high-deductible health plans forgo medical care because of the high deductible," Wagner said.

However, some employers help employees who open HSAs by providing "seed money," or a loan to the HSA that can be used when medical expenses are incurred and the deductible has not yet been satisfied, Keller said.

"Importantly, the network discount applies even if the deductible is not satisfied, so for an in-network provider, the cost of a service is contained in that way," she added.

Another disadvantage of HSAs is that failure to follow the tax rules could lead to taxes and penalties being imposed. For example, Keller noted, amounts distributed from an HSA that are not used to pay for qualified medical expenses are subject to federal income tax and, if the individual who owns the HSA is under age 65, may be subject to an additional 20% penalty.

Someone who establishes an HSA should be a good record keeper, Wagner added. "Although HSA accounts can be used to reimburse individuals for prior unreimbursed medical expenses, on IRS audit,

the taxpayer would need to establish the unreimbursed medical expense," she explained.

Disadvantages for Benefits Administrators

HSAs are simpler to administer than FSAs, but one disadvantage of HSAs for plan administrators is that they require reporting to the IRS, Keller said.

This reporting isn't extensive, according to Wagner.

However, when mistakes are made in administration, it may "be more difficult to unwind than is the case with other types of health accounts," Keller said.