benefit strategies LLC

HSA GPS Fact Sheet Series

HSAs and Certain Business Owners

The Internal Revenue Service (IRS) applies special rules to specific business entities, depending on whether the business is owned directly by individuals or indirectly by investors. The paper is designed to help you navigate the confusion at the intersection of Health Savings Account (HSA) rules and business structure so that you can keep your HSA program, and your personal tax situation, in compliance.

1. What business structures face HSA restrictions?

Owners of certain business entities face restrictions on HSA funding. Affected owners include the following:

- Members of a Limited Liability Company, or LLC.
- Partners in a partnership.
- 2% or greater owners of a Subchapter S corporation.

Note: These restrictions aren't unique to these owners' participation in an HSA program. These same principles are allied to other tax-advantaged programs as well, including Health FSAs and Health Reimbursement Arrangements (HRAs).

2. What restrictions do these owners face with respect to employer contributions?

The business can't give owners a tax-free contribution. Any contributions to these owners' HSAs from the business are considered taxable income to the owner (and tax-deductible to the business as a compensation expense).

3. **Can these businesses make tax-free contributions to *employees'* HSAs?**

Yes. The restrictions are placed on contributions to owners, not on the business itself or its employees. These businesses can make tax-free contributions to their employees' HSAs consistent with IRS regulations on employer contributions.

4. **What restrictions do these owners face on personal contributions?**

They aren't eligible to participate in a Cafeteria Plan, the vehicle that allows individuals to receive a portion of their total compensation in the form of untaxed benefits. Thus, these owners can't make pre-tax contributions to their HSAs.

5. **Can these owners make *post*-tax payroll contributions to their HSAs?**

Yes. They can contribute up to the maximum contribution allowed by law. Post-tax payroll deductions are a convenient means of contributing regularly to an HSA.

6. **Do they lose the tax advantages of HSA contributions because they can't make pre-tax payroll contributions?**

No. These owners can make personal (post-tax) contributions and then deduct those contributions on Page 1 of their personal income tax return (Form 1040). In doing so, they recoup the federal (and, if applicable, state) income taxes paid on those funds. The personal income tax return doesn't allow for crediting FICA taxes paid. This tax amounts to 15.3% (employee and business combined) on income below $132,900 in 2019 (up from $128,400 in 2018 figure) and 2.9% on higher income.

7. **Can these owners allow *employees* to make pre-tax payroll contributions?**

Yes. These restrictions affect owners only. The business can allow employees to make pre-tax payroll contributions by creating a new (or amending an existing) Cafeteria Plan document to include HSA contributions.

8. **Do these owners face any other restrictions on the use of their HSAs?**

No. Their only restriction is on the initial tax treatment of contributions to their accounts. They can contribute up to the same annual maximum as any other similarly situated HSA owner, reimburse tax-free the same qualified expenses incurred by the same family members, invest their balances and pass their HSAs along to their heirs just as any other HSA owner can.

9. Do these contribution restrictions apply to employees of a Subchapter S corporation who receive an ownership share of the company through a profit-sharing program?

The restriction applies only to owners of more than 2% of these entities only. The law is designed to exempt employees who earn a small stake in the company through profit-sharing or other bonus plans. Only individuals whose ownership position exceeds the 2% threshold is subject to the contribution restrictions.

10. Do these rules apply to family members? If a spouse works for the company as an employee, can the owner designate her spouse as the medical plan subscriber to avoid these restrictions?

The IRS imposes "attribution rules," which essentially define an owner's spouse and certain other family members as owners of the business. Thus, an owner can't designate her husband working in the firm as the medical plan subscriber to make a tax-free employer HSA contribution or allow the family to make pre-tax payroll contributions through a Cafeteria Plan. We recommend that business owners consult with their tax professionals with respect to a business owner's spouse's enrollment in company benefits.

This information is accurate as of Nov. 5, 2018. Please note that this discussion is for informational purposes only and is based on current regulations. It doesn't represent, and shouldn't be construed as, a substitute for professional advice. Please consult your personal legal, financial, or tax counsel to discuss your personal situation and refer to IRS Publication 969.

Stay current on HSAs through our HSA GPS blog at *www.benstrat.com/blog/*

Benefit Strategies, LLC
www.benstrat.com