The Interaction of HSAs and Health FSAs

Individuals are required to meet certain eligibility requirements to open and contribute to a Health Savings Account (HSA). Enrollment in certain employer-sponsored benefits, whether offered by your own or your spouse’s employer, may impact your HSA eligibility. In this paper, we help you navigate the intersection of HSAs and Health FSAs to examine scenarios that may impact your eligibility to open and contribute to an HSA.

1 My employer offers a traditional Health FSA through which I can make pre-tax elections and then reimburse medical, dental, vision, and over-the-counter equipment and supplies tax-free. Does my enrollment in this plan affect my HSA eligibility?

Yes. Health FSAs follow many of the same Internal Revenue Service (IRS) regulations as medical plans. When you participate in a Health FSA, you have an additional medical plan. Unless all your coverage is HSA-qualified, you’re disqualified from opening or contributing to an HSA.

You can’t open and contribute to an HSA during any month that you participate in a traditional Health FSA, even if you’re also enrolled in an HSA-qualified medical plan and meet all other eligibility requirements.

2 If I spend my entire balance before the end of the year, can I become HSA-eligible as of the date that I have a zero balance?

No. You remain covered by your Health FSA during the entire Health FSA plan year, even after you spend your entire election.

You can’t become HSA-eligible when you maintain disqualifying coverage, even with no benefit (balance) remaining in your Health FSA.

3 My employer runs our Health FSA on a calendar year. Our medical plan renews May 1. Can I disenroll from my Health FSA at the end of April so that I’m HSA-eligible May 1?

No. Enrolling in an HSA-qualified medical plan is not a qualifying event that allows you to disenroll from your Health FSA. You remain enrolled in the Health FSA until the end of the plan year (Dec. 31 in this example). You can enroll in the HSA-qualified medical coverage to take advantage of the lower premium, but you can’t open and contribute to an HSA before Jan. 1 (in our example) at the earliest.

In the meantime, you can continue to spend your Health FSA balances for qualified expenses, including your out-of-pocket expenses (deductibles, copays, and coinsurance) associated with your HSA-qualified medical plan. You can’t increase your Health FSA election on your medical plan anniversary to reflect these higher out-of-pocket costs.

4 My spouse is enrolled in his employer’s Health FSA program. That doesn’t disqualify me from becoming HSA-eligible, does it?

It does. Health FSAs follow the same federal eligibility rules as medical plans. Under federal tax law, the employee (subscriber), spouse, and children to age 26 (whether or not they remain the parent’s tax dependent) are enrolled in the Health FSA automatically and can reimburse their qualified expenses from the plan. You’re covered under your spouse’s Health FSA (unless that employer excludes spouses from coverage, which is extremely rare) and thus can’t become HSA-eligible before the end of his Health FSA plan year.

You can still enroll in your employer’s HSA-qualified medical plan, and you and your spouse can reimburse any qualified expenses, including your medical plan cost-sharing, from his Health FSA.
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#### 5. What if my spouse submits only claims for dental and vision services? What if I pledge not to reimburse any of my expenses from his Health FSA?

If the Health FSA governing plan document allow reimbursement for medical services and prescription drugs, the Health FSA disqualifies you, your spouse, and your children under age 26 from opening and contributing to an HSA. In a moment, we review several Health FSA designs that don’t disqualify employees and family members from becoming HSA-eligible.

#### 6. I want to enroll in my employer’s HSA program now, at open enrollment. My spouse’s Health FSA renews at their employer’s open enrollment in five months. What can we do?

Unfortunately, your spouse can’t disenroll from their Health FSA. Below are your options.

| A | Your spouse can leave their job and disenroll from the Health FSA. You then become HSA-eligible immediately if you’re otherwise HSA-eligible. |
| B | You can enroll in the HSA-qualified plan, reimburse qualified expenses from your spouse’s Health FSA and then make sure that they don’t re-enroll in their Health FSA. At the end of their Health FSA plan year, you can begin to contribute to your HSA and begin to reimburse tax-free all qualified expenses that you, your spouse, and your children to age 26 incur after the date that you establish your HSA (usually the date of the first deposit into the account). |
| C | You can delay enrollment in the HSA program for a year and make sure your spouse doesn’t re-enroll in her Health FSA. You won’t have a tax-advantaged reimbursement account (Health FSA or HSA) for the seven-month period (in our example) between the end of her Health FSA plan year and your enrollment in your company’s HSA program. |

#### 7. Are there any Health FSA plan designs that allow me to be eligible to open and contribute to an HSA?

Yes. Your employer can offer a Limited-Purpose Health FSA (LP Health FSA). This design restricts reimbursement to dental and vision services (plus select preventive services that aren’t covered in full under federal law). Because you can be enrolled in dental and vision coverage without affecting HSA eligibility and select preventive services can be covered outside the deductible on an HSA-qualified plan, this Health FSA design is not disqualifying.

Some Health FSA administrators combine a Limited-Purpose Health FSA with a Post-Deductible FSA, a design that doesn’t reimburse any expenses until you have met the statutory minimum annual deductible for your contract type ($1,350 for self-only coverage and $2,700 for family coverage in 2019). Under this hybrid model, you can reimburse only dental, vision, and select preventive services until you attest that you’ve satisfied the statutory minimum deductible (not your medical plan’s minimum deductible, which may be higher) for services covered by the medical plan. At that point, you can begin to reimburse qualified medical and pharmacy expenses from the Health FSA as well.

LP Health FSAs have an election limit of $2,650 per plan participant. Your employer can impose a lower limit.

#### 8. Why would I make an election to a Limited-Purpose Health FSA, since I can reimburse expenses tax-free from my HSA and not face any use-it-or-lose-it restrictions on HSA balances?

Although participating in a Limited-Purpose Health FSA doesn’t make sense for everyone, some employees can benefit. Possible reasons to make a Limited-Purpose Health FSA election are located on the next page.
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You want to maximize tax savings.
You can reduce your taxable income by maximizing your HSA contribution and electing to defer up to $2,650 (or a lower figure set by your employer) to a Limited-Purpose Health FSA. For many taxpayers, this additional reduction in taxable income results in tax savings between $600 and $800.

You anticipate high dental and vision costs early in the year.
Since you can access your entire Health FSA election at any point in the plan year, you can use a Limited-Purpose Health FSA to ease cash-flow concerns if you anticipate incurring these expenses early in the year.

You’re responsible for dental and vision expenses incurred by children under age 26 who are no longer your tax dependents.
The reimbursement rules for HSAs and Health FSAs are different. Once a child is no longer your tax dependent, you can’t reimburse her qualified expenses tax-free from your HSA, even if you continue to cover her on your medical plan. In contrast, because a Health FSA follows federal coverage rules for medical plans, you can reimburse her qualified expenses from your Limited-Purpose Health FSA – even if she’s not covered on your medical plan. You can reimburse tax-free her qualified expenses with dates of service prior to her 26th birthday.

You want to maximize your HSA balances.
You can reimburse qualified dental and vision expenses tax-free from your Limited-Purpose Health FSA rather than withdrawing HSA funds. This strategy allows you to build medical equity – balances that grow and can be used to reimburse qualified expenses tax-free in retirement.

You gain an advantage when you participate in a Limited-Purpose Health FSA under these circumstances only if you actually incur qualified dental and vision expenses. If you make your election and fail to incur these expenses, you risk forfeiting your election. If you're not sure whether you'll incur these expenses during the year, you may be better off increasing your HSA contributions because HSA balances roll over automatically without limit if not used during the year.
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9 My (or my spouse’s) traditional Health FSA has a grace period. How does that feature impact my HSA eligibility?
If the Health FSA governing plan document allow reimbursement for medical services and prescription drugs, the Health FSA disqualifies you, your spouse, and your children under age 26 from opening and contributing to an HSA.

In a moment, we review several Health FSA designs that don’t disqualify employees and family members from becoming HSA-eligible.

11 Does my election to a Dependent Care FSA affect my HSA eligibility?
No. Since Dependent Care FSAs (sometimes referred to as DCAs) don’t provide reimbursement for medical expenses, they don’t impact your HSA eligibility.

Disclaimer
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.

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Note that this option is different from the grace period. Because the carryover provision rolls those funds into a new plan year (rather than an extension of the old plan year, as the grace period does), your employer can choose whether the funds carry over into a new general or new Limited-Purpose Health FSA.