Health Savings Accounts

3rd Edition

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Course Information

Course Title: Health Savings Accounts

Learning Objectives:
- Determine which type of plan may be contributed to only by an employer
- Discern how much additional tax is due on distributions from HSAs and MSAs that are not used for qualified medical expenses
- Identify qualified medical expenses for dental treatments
- Pinpoint the minimum annual deductible requirement for a self-only coverage high deductible health plans
- Identify the contribution limit to an HAS for an individual with family HDHP coverage
- Recognize a truth regarding excess contributions made to an HAS
- Determine the employee limit for Archer MSA eligibility
- Pinpoint the annual out-of-pocket limit for an Archer MSA
- Recognize a contribution requirement of Archer MSAs
- Identify a regulation related to Archer MSA distributions
- Recognize a truth regarding FSAs
- Discern when an employee must designate how much will be contributed to an FSA
- Pinpoint the portion of an FSA that can be carried over to the next plan year
- Identify who can be considered an employee under the requirements of an FSA
- Pinpoint the limit an employer can contribute to an HRA
- Recognize who reimbursements under an HRA are permitted to be made to
- Identify types of qualified medical expenses under an HRA
- Determine who is classified as a key employee under cafeteria plans
- Discern what an individual must do if the dollar amount of a health care provider's transaction equals the dollar amount for that service under a health FSA or HRA

Prerequisites: None

Program Level: Overview

Program Content: This course discusses the differences between tax-favored health plans, including Health Savings Accounts (HSAs), Archer Medical Savings Accounts (MSAs), Medicare Advantage Medical Savings Accounts (MSAs), Flexible Spending Arrangements (FSAs), and Health Reimbursement Arrangements (HRAs). This course further outlines the benefits of each plan, along with the guidelines set forth for eligibility, contributions, distributions, rollovers, filing requirements, and qualified medical expenses. Additionally, details concerning the procedure requirements under Revenue Ruling 2003-43 regarding using debit cards, credit cards, and stored value cards are identified.

Advance Preparation: None

Recommended CPE Credit: 5 hours

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Chapter 1
Tax-Favored Health Plans

Learning Objectives

- Determine which type of plan may be contributed to only by an employer
- Discern how much additional tax is due on distributions from HSAs and MSAs that are not used for qualified medical expenses
- Identify qualified medical expenses for dental treatments

Introduction

Various programs are designed to give individuals tax advantages to offset health care costs. This course explains the following programs:

- Health Savings Accounts (HSAs)
- Medical Savings Accounts (Archer MSAs and Medicare Advantage MSAs)
- Health Flexible Spending Arrangements (FSAs)
- Health Reimbursement Arrangements (HRAs)

Comparison of Tax-Favored Health Plans

Each of the health plans available has its own set of requirements regarding contributions, distributions, and the deductibility of contributions. *Exhibit 1* below provides details regarding the guidelines set forth under each plan.

Exhibit 1
Comparison of Tax-Favored Health Plans

HSA

- May receive contributions from an eligible individual or any other person, including an employer or a family member, on behalf of an eligible individual
- Contributions, other than employer contributions, are deductible on the eligible individual's return whether or not the individual itemizes deductions
- Employer contributions are not included in income
- Distributions from an HSA that are used to pay qualified medical expenses are not taxed

Archer MSA

- May receive contributions from an eligible individual and his or her employer, but not both in the same year
- Contributions by the individual are deductible whether or not the individual itemizes deductions.
- Employer contributions are not included in income
- Distributions from an Archer MSA that are used to pay qualified medical expenses are not taxed

Medicare Advantage MSA

- An Archer MSA designated by Medicare to be used solely to pay the qualified medical expenses of the account holder who is enrolled in Medicare
- Contributions can only be made by Medicare
- The contributions are not included in your income
- Distributions from a Medicare Advantage MSA that are used to pay qualified medical expenses are not taxed

FSA

- May receive contributions from an eligible individual
- Employers may also contribute
- Contributions are not includible in income
- Reimbursements from an FSA that are used to pay qualified medical expenses are not taxed

HRA

- Must receive contributions from the employer only
- Employees may not contribute
- Contributions are not includible in income
- Reimbursements from an HRA that are used to pay qualified medical expenses are not taxed

What's New

Federal tax benefits for same-sex married couples. For federal tax purposes, individuals of the same sex are considered married if they were lawfully married in a state (or foreign country) whose laws authorize the marriage of two individuals of the same sex, even if the state (or foreign country) in which they now live does not recognize same-sex marriage.

Health flexible spending arrangements (FSAs). The following rules apply to health FSAs for plan years beginning after December 31, 2012.

- Salary reduction contributions to your health FSA cannot be more than $2,500 a year (indexed for inflation).
- Your employer may choose to change your cafeteria plan to allow you to carry over up to $500 of unused amounts remaining at the end of the plan year in a health FSA to be paid or reimbursed for qualified medical expenses incurred during the following plan year. For more information, see *Balance in an FSA* under *Flexible Spending Arrangements (FSAs)*, later.

Qualified and Nonqualified Medical Expenses

What Are Medical Expenses?

Medical expenses are the costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and the costs for treatments affecting any part or function of the body. These expenses include payments for legal medical services rendered by physicians, surgeons, dentists, and other medical practitioners. They include the costs of equipment, supplies, and diagnostic devices needed for these purposes.

Medical care expenses must be primarily to alleviate or prevent a physical or mental defect or illness. They do not include expenses that are merely beneficial to general health, such as vitamins or a vacation.

Medical expenses include the premiums you pay for insurance that covers the expenses of medical care, and the amounts you pay for transportation to get medical care. Medical expenses also include amounts paid for qualified long-term care services and limited amounts paid for any qualified long-term care insurance contract.

What Medical Expenses Are Includible?
Following is a list of items that you can include in figuring your medical expenses for distributions. This list does not include all possible medical expenses. To determine if an expense not listed can be included in figuring your medical expense, see *What Are Medical Expenses*.

Exhibit 2
Qualified Medical Expenses

Qualified Medical Expense	Explanation of Expense
Abortion	You can include in medical expenses the amount you pay for a legal abortion.
Acupuncture	You can include in medical expenses the amount you pay for acupuncture.
Alcoholism	You can include in medical expenses amounts you pay for an inpatient's treatment at a therapeutic center for alcohol addiction. This includes meals and lodging provided by the center during treatment. You can also include in medical expenses amounts you pay for transportation to and from Alcoholics Anonymous meetings in your community if the attendance is pursuant to medical advice that membership in Alcoholics Anonymous is necessary for the treatment of a disease involving the excessive use of alcoholic liquors.
Ambulance	You can include in medical expenses amounts you pay for ambulance service.
Annual Physical Examination	See *Physical Examination*, later.
Artificial Limb	You can include in medical expenses the amount you pay for an artificial limb.
Artificial Teeth	You can include in medical expenses the amount you pay for artificial teeth.
Bandages	You can include in medical expenses the cost of medical supplies such as bandages.
Birth Control Pills	You can include in medical expenses the amount you pay for birth control pills prescribed by a doctor.
Body Scan	You can include in medical expenses the cost of an electronic body scan.
Braille Books and Magazines	You can include in medical expenses the part of the cost of Braille books and magazines for use by a visually impaired person that is more than the cost of regular printed editions.
Breast Pumps and Supplies	You can include in medical expenses the cost of breast pumps and supplies that assist lactation.
Breast Reconstruction Surgery	You can include in medical expenses the amounts you pay for breast reconstruction surgery, as well as breast prosthesis, following a mastectomy for cancer. See *Cosmetic Surgery*, later.
Capital Expenses	You can include in medical expenses amounts you pay for special equipment installed in a home, or for improvements, if their main purpose is medical care for you, your spouse, or your dependent. The cost of permanent improvements that increase the value of your property may be partly included as a medical expense. The cost of the improvement is reduced by the increase in the value of your property. The difference is a medical expense. If the value of your property is not increased by the improvement, the entire cost is included as a medical expense. Certain improvements made to accommodate a home to your disabled condition, or that of your spouse or your dependents who live with you, do

<table>
<tr><td></td><td>not usually increase the value of the home and the cost can be included in full as medical expenses. These improvements include, but are not limited to, the following items:
• Constructing entrance or exit ramps for your home
• Widening doorways at entrances or exits to your home
• Widening or otherwise modifying hallways and interior doorways
• Installing railings, support bars, or other modifications to bathrooms
• Lowering or modifying kitchen cabinets and equipment
• Moving or modifying electrical outlets and fixtures
• Installing porch lifts and other forms of lifts (but elevators generally add value to the house)
• Modifying fire alarms, smoke detectors, and other warning systems
• Modifying stairways
• Adding handrails or grab bars anywhere (whether or not in bathrooms)
• Modifying hardware on doors
• Modifying areas in front of entrance and exit doorways
• Grading the ground to provide access to the residence

Only reasonable costs to accommodate a home to a disabled condition are considered medical care. Additional costs for personal motives, such as for architectural or aesthetic reasons, are not medical expenses.</td></tr>
<tr><td>Car</td><td>You can include in medical expenses the cost of special hand controls and other special equipment installed in a car for the use of a person with a disability.
Special design: You can include in medical expenses the difference between the cost of a regular car and a car specially designed to hold a wheelchair.
Cost of operation: The includible costs of using a car for medical reasons are explained under Transportation, later.</td></tr>
<tr><td>Chiropractor</td><td>You can include in medical expenses fees you pay to a chiropractor for medical care.</td></tr>
<tr><td>Christian Science Practitioner</td><td>You can include in medical expenses fees you pay to Christian Science practitioners for medical care.</td></tr>
<tr><td>Contact Lenses</td><td>You can include in medical expenses amounts you pay for contact lenses needed for medical reasons. You can also include the cost of equipment and materials required for using contact lenses, such as saline solution and enzyme cleaner. See Eyeglasses and Eye Surgery, later.</td></tr>
<tr><td>Crutches</td><td>You can include in medical expenses the amount you pay to buy or rent crutches.</td></tr>
<tr><td>Dental Treatment</td><td>You can include in medical expenses the amounts you pay for the prevention and alleviation of dental disease. Preventive treatment includes the services of a dental hygienist or dentist for such procedures as teeth cleaning, the application of sealants, and fluoride treatments to prevent tooth decay. Treatment to alleviate dental disease include services of a dentist for procedures such as X-rays, fillings, braces, extractions, dentures, and other dental ailments. But see Teeth Whitening under What Expenses Are Not Includible, later.</td></tr>
<tr><td>Diagnostic Devices</td><td>You can include in medical expenses the cost of devices used in diagnosing and treating illness and disease.
Example: You have diabetes and use a blood sugar test kit to monitor your blood sugar level. You can include the cost of the blood sugar test kit in your medical expenses.</td></tr>
</table>

Disabled Dependent Care Expenses	Some disabled dependent care expenses may qualify as either: • Medical expenses, or • Work-related expenses for purposes of taking a credit for dependent care You can choose to apply them either way as long as you do not use the same expenses to claim both a credit and a medical expense deduction.
Drug Addiction	You can include in medical expenses amounts you pay for an inpatient's treatment at a therapeutic center for drug addiction. This includes meals and lodging at the center during treatment.
Drugs	See *Medicines*, later.
Eye Exam	You can include in medical expenses the amount you pay for eye examinations.
Eyeglasses	You can include in medical expenses amounts you pay for eyeglasses and contact lenses needed for medical reasons. See Contact Lenses, earlier, for more information.
Eye Surgery	You can include in medical expenses the amount you pay for eye surgery to treat defective vision, such as laser eye surgery or radial keratotomy.
Fertility Enhancement	You can include in medical expenses the cost of the following procedures to overcome an inability to have children. • Procedures such as *in vitro* fertilization (including temporary storage of eggs or sperm) • Surgery, including an operation to reverse prior surgery that prevented the person operated on from having children.
Founder's Fee	See *Lifetime Care—Advance Payments*, later.
Guide Dog or Other Service Animal	You can include in medical expenses the costs of buying, training, and maintaining a guide dog or other service animal to assist a visually impaired or hearing-impaired person, or a person with other physical disabilities. In general, this includes any costs, such as food, grooming, and veterinary care, incurred in maintaining the health and vitality of the service animal so that it may perform its duties.
Health Institute	You can include in medical expenses fees you pay for treatment at a health institute only if the treatment is prescribed by a physician and the physician issues a statement that the treatment is necessary to alleviate a physical or mental defect or illness of the individual receiving the treatment.
Health Maintenance Organization (HMO)	You can include in medical expenses amounts you pay to entitle you, your spouse, or a dependent to receive medical care from an HMO. These amounts are treated as medical insurance premiums. See *Insurance Premiums*, later.
Hearing Aids	You can include in medical expenses the cost of a hearing aid and batteries, repairs, and maintenance needed to operate it.
Home Care	See *Nursing Services*, later.
Home Improvements	See *Capital Expenses*, earlier.
Hospital Services	You can include in medical expenses amounts you pay for the cost of inpatient care at a hospital or similar institution if a principal reason for being there is to receive medical care. This includes amounts paid for meals and lodging. Also see *Lodging*, later.
Insurance Premiums	You can include in medical expenses insurance premiums you pay for policies that cover medical care. Medical care policies can provide payment for treatment that includes: • Hospitalization, surgical services, X-rays • Prescription drugs and insulin • Dental care • Replacement of lost or damaged contact lenses, and

	• Long-term care (subject to additional limitations) See Qualified Long-Term Care Insurance Contracts under Long-Term Care, later If you have a policy that provides payments for other than medical care, you can include the premiums for the medical care part of the policy if the charge for the medical part is reasonable. The cost of the medical part must be separately stated in the insurance contract or given to you in a separate statement. **Health coverage tax credit:** If you were an eligible trade adjustment assistance (TAA) recipient, alternative TAA (ATAA) recipient, reemployment TAA (RTAA) recipient, or Pension Benefit Guaranty Corporation (PBGC) pension recipient, you must complete Form 8885 before completing Schedule A. When figuring the amount of insurance premiums you can deduct on Schedule A, do not include: • Any amounts you included on Form 8885, • Any qualified health insurance premiums you paid to "U.S. Treasury–HCTC", or • Any health coverage tax credit advance payments shown on Form 1099-H, *Health Coverage Tax Credit (HCTC) Advance Payments*.
Employer-Sponsored Health Insurance Plan	Do not include in your medical and dental expenses any insurance premiums paid by an employer-sponsored health insurance plan unless the premiums are included in box 1 of your Form W-2, Wage and Tax Statement. Also, do not include any other medical and dental expenses paid by the plan unless the amount paid is included on your Form W-2. **Example:** You are a federal employee participating in the premium conversion plan of the Federal Employee Health Benefits (FEHB) program. Your share of the FEHB premium is paid by making a pre-tax reduction in your salary. Because you are an employee whose insurance premiums are paid with money that is never included in your gross income, you cannot deduct the premiums paid with that money. **Long-term care services:** Contributions made by your employer to provide coverage for qualified long-term care services under a flexible spending or similar arrangement must be included in your income. This amount will be reported as wages on your Form W-2. **Retired public safety officers:** If you are a retired public safety officer, do not include as medical expenses any health or long-term care insurance premiums that you elected to have paid with tax-free distributions from a retirement plan. This applies only to distributions that would otherwise be included in income. **Health reimbursement arrangement (HRA):** If you have medical expenses that are reimbursed by a health reimbursement arrangement, you cannot include those expenses in your medical expenses. This is because an HRA is funded solely by the employer.
Medicare A	If you are covered under social security (or if you are a government employee who paid Medicare tax), you are enrolled in Medicare A. The payroll tax paid for Medicare A is not a medical expense. If you are not covered under social security (or were not a government employee who paid Medicare tax), you can voluntarily enroll in Medicare A. In this situation you can include the premiums you paid for Medicare A as a medical expense.

Medicare B	Medicare B is a supplemental medical insurance. Premiums you pay for Medicare B are a medical expense. Check the information you received from the Social Security Administration to find out your premium.
Medicare D	Medicare D is a voluntary prescription drug insurance program for persons with Medicare A or B. You can include as a medical expense premiums you pay for Medicare D.
Prepaid Insurance Premiums	Premiums you pay before you are age 65 for insurance for medical care for yourself, your spouse, or your dependents after you reach age 65 are medical care expenses in the year paid if they are: 1. Payable in equal yearly installments or more often, and 2. Payable for at least 10 years, or until you reach age 65 (but not for less than 5 years)
Unused Sick Leave Used to Pay Premiums	You must include in gross income cash payments you receive at the time of retirement for unused sick leave. You also must include in gross income the value of unused sick leave that, at your option, your employer applies to the cost of your continuing participation in your employer's health plan after you retire. You can include this cost of continuing participation in the health plan as a medical expense. If you participate in a health plan where your employer automatically applies the value of unused sick leave to the cost of your continuing participation in the health plan (and you do not have the option to receive cash), do not include the value of the unused sick leave in gross income. You cannot include this cost of continuing participation in that health plan as a medical expense.
Insurance Premiums You Cannot Include	You cannot include premiums you pay for: • Life insurance policies • Policies providing payment for loss of earnings • Policies for loss of life, limb, sight, etc. • Policies that pay you a guaranteed amount each week for a stated number of weeks if you are hospitalized for sickness or injury • The part of your car insurance that provides medical insurance coverage for all persons injured in or by your car because the part of the premium providing insurance for you, your spouse, and your dependents is not stated separately from the part of the premium providing insurance for medical care for others • Health or long-term care insurance if you elected to pay these premiums with tax-free distributions from a retirement plan made directly to the insurance provider and these distributions would otherwise have been included in income Taxes imposed by any governmental unit, such as Medicare taxes, are not insurance premiums. **Coverage for nondependents:** Generally, you cannot deduct any additional premium you pay as the result of including on your policy someone who is not your spouse or dependent, even if that person is your child under age 27. However, you can deduct the additional premium if that person is: • Your child whom you do not claim as a dependent because of the rules for children of divorced or separated parents • Any person you could have claimed as a dependent on your return except that person received $3,900 or more of gross income or filed a joint return • Any person you could have claimed as a dependent except that you, or your spouse if filing jointly, can be claimed as a dependent on someone else's return

	Also, if you had family coverage when you added this individual to your policy and your premiums did not increase, you can enter on Schedule A (Form 1040) the full amount of your medical and dental insurance premiums.
Intellectually and Developmentally Disabled, Special Home for	You can include in medical expenses the cost of keeping a person who is intellectually and developmentally disabled in a special home, not the home of a relative, on the recommendation of a psychiatrist to help the person adjust from life in a mental hospital to community living.
Laboratory Fees	You can include in medical expenses the amounts you pay for laboratory fees that are part of medical care.
Lactation Expenses	See *Breast Pumps and Supplies*, earlier.
Lead-Based Paint Removal	You can include in medical expenses the cost of removing lead-based paints from surfaces in your home to prevent a child who has or had lead poisoning from eating the paint. These surfaces must be in poor repair (peeling or cracking) or within the child's reach. The cost of repainting the scraped area is not a medical expense. If, instead of removing the paint, you cover the area with wallboard or paneling, treat these items as capital expenses. See *Capital Expenses*, earlier. Do not include the cost of painting the wallboard as a medical expense.
Learning Disability	See *Special Education*, later.
Legal Fees	You can include in medical expenses legal fees you paid that are necessary to authorize treatment for mental illness. However, you cannot include in medical expenses fees for the management of a guardianship estate, fees for conducting the affairs of the person being treated, or other fees that are not necessary for medical care.
Lifetime Care – Advance Payments	You can include in medical expenses a part of a life-care fee or "founder's fee" you pay either monthly or as a lump sum under an agreement with a retirement home. The part of the payment you include is the amount properly allocable to medical care. The agreement must require that you pay a specific fee as a condition for the home's promise to provide lifetime care that includes medical care. You can use a statement from the retirement home to prove the amount properly allocable to medical care. The statement must be based either on the home's prior experience or on information from a comparable home. **Dependents with disabilities:** You can include in medical expenses advance payments to a private institution for lifetime care, treatment, and training of your physically or mentally impaired child upon your death or when you become unable to provide care. The payments must be a condition for the institution's future acceptance of your child and must not be refundable. **Payments for future medical care:** Generally, you cannot include in medical expenses current payments for medical care (including medical insurance) to be provided substantially beyond the end of the year. This rule does not apply in situations where the future care is purchased in connection with obtaining lifetime care of the type described earlier.
Lodging	You can include in medical expenses the cost of meals and lodging at a hospital or similar institution if a principal reason for being there is to receive medical care. See *Nursing Home*, later. You may be able to include in medical expenses the cost of lodging not provided in a hospital or similar institution. You can include the cost of such lodging while away from home if all of the following requirements are met: 1. The lodging is primarily for and essential to medical care 2. The medical care is provided by a doctor in a licensed hospital or in a medical care facility related to, or the equivalent of, a licensed hospital 3. The lodging is not lavish or extravagant under the circumstances

	4. There is no significant element of personal pleasure, recreation, or vacation in the travel away from home The amount you include in medical expenses for lodging cannot be more than $50 for each night for each person. You can include lodging for a person traveling with the person receiving the medical care. For example, if a parent is traveling with a sick child, up to $100 per night can be included as a medical expense for lodging. Meals are not included. Do not include the cost of lodging while away from home for medical treatment if that treatment is not received from a doctor in a licensed hospital or in a medical care facility related to, or the equivalent of, a licensed hospital or if that lodging is not primarily for or essential to the medical care received.
Long-Term Care	You can include in medical expenses amounts paid for qualified long-term care services and premiums paid for qualified long-term care insurance contracts.
Qualified Long-Term Care Services	Qualified long-term care services are necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, rehabilitative services, and maintenance and personal care services (defined later) that are: 1. Required by a chronically ill individual, and 2. Provided pursuant to a plan of care prescribed by a licensed health care practitioner **Chronically ill individual:** An individual is chronically ill if, within the previous 12 months, a licensed health care practitioner has certified that the individual meets either of the following descriptions: 1. He or she is unable to perform at least two activities of daily living without substantial assistance from another individual for at least 90 days, due to a loss of functional capacity. Activities of daily living are eating, toileting, transferring, bathing, dressing, and continence. 2. He or she requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment. **Maintenance and personal care services:** Maintenance or personal care services is care which has as its primary purpose the providing of a chronically ill individual with needed assistance with his or her disabilities (including protection from threats to health and safety due to severe cognitive impairment).
Qualified Long-Term Care Insurance Contracts	A qualified long-term care insurance contract is an insurance contract that provides only coverage of qualified long-term care services. The contract must: 1. Be guaranteed renewable 2. Not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed 3. Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract must be used only to reduce future premiums or increase future benefits 4. Generally not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer, or the contract makes *per diem* or other periodic payments without regard to expenses The amount of qualified long-term care premiums you can include is limited. You can include the following as medical expenses on Schedule A (Form

	1040): 1. Qualified long-term care premiums up to the amounts shown below a. Age 40 or under – $360 b. Age 41 to 50 – $680 c. Age 51 to 60 – $1,360 d. Age 61 to 70 – $3,640 e. Age 71 or over – $4,550 2. Unreimbursed expenses for qualified long-term care services **Note:** The limit on premiums is for each person. Also, if you are an eligible retired public safety officer, you cannot include premiums for long-term care insurance if you elected to pay these premiums with tax-free distributions from a qualified retirement plan made directly to the insurance provider and these distributions would otherwise have been included in your income.
Meals	You can include in medical expenses the cost of meals at a hospital or similar institution if a principal reason for being there is to get medical care. You cannot include in medical expenses the cost of meals that are not part of inpatient care. Also see Weight-Loss Program and Nutritional Supplements, later.
Medical Conferences	You can include in medical expenses amounts paid for admission and transportation to a medical conference if the medical conference concerns the chronic illness of yourself, your spouse, or your dependent. The costs of the medical conference must be primarily for and necessary to the medical care of you, your spouse, or your dependent. The majority of the time spent at the conference must be spent attending sessions on medical information. **Caution:** The cost of meals and lodging while attending the conference is not deductible as a medical expense.
Medical Information Plan	You can include in medical expenses amounts paid to a plan that keeps medical information in a computer data bank and retrieves and furnishes the information upon request to an attending physician.
Medicines	You can include in medical expenses amounts you pay for prescribed medicines and drugs. A prescribed drug is one that requires a prescription by a doctor for its use by an individual. You can also include amounts you pay for insulin. Except for insulin, you cannot include in medical expenses amounts you pay for a drug that is not prescribed. **Imported medicines and drugs:** If you imported medicines or drugs from other countries, see *Medicines and Drugs From Other Countries*, under *What Expenses Are Not Includible*, later.
Nursing Home	You can include in medical expenses the cost of medical care in a nursing home, home for the aged, or similar institution, for yourself, your spouse, or your dependents. This includes the cost of meals and lodging in the home if a principal reason for being there is to get medical care. Do not include the cost of meals and lodging if the reason for being in the home is personal. You can, however, include in medical expenses the part of the cost that is for medical or nursing care.
Nursing Services	You can include in medical expenses wages and other amounts you pay for nursing services. The services need not be performed by a nurse as long as the services are of a kind generally performed by a nurse. This includes services connected with caring for the patient's condition, such as giving medication or changing dressings, as well as bathing and grooming the patient. These services can be provided in your home or another care facility.

	Generally, only the amount spent for nursing services is a medical expense. If the attendant also provides personal and household services, amounts paid to the attendant must be divided between the time spent performing household and personal services and the time spent for nursing services. For example, because of your medical condition you pay a visiting nurse $300 per week for medical and household services. She spends 10% of her time doing household services such as washing dishes and laundry. You can include only $270 per week as medical expenses. The $30 (10% × $300) allocated to household services cannot be included. However, certain maintenance or personal care services provided for qualified long-term care can be included in medical expenses. See *Maintenance and personal care services* under *Long-Term Care*, earlier. Additionally, certain expenses for household services or for the care of a qualifying individual incurred to allow you to work may qualify for the child and dependent care credit You can also include in medical expenses part of the amount you pay for that attendant's meals. Divide the food expense among the household members to find the cost of the attendant's food. Then divide that cost in the same manner as in the preceding paragraph. If you had to pay additional amounts for household upkeep because of the attendant, you can include the extra amounts with your medical expenses. This includes extra rent or utilities you pay because you moved to a larger apartment to provide space for the attendant. **Employment taxes:** You can include as a medical expense social security tax, FUTA, Medicare tax, and state employment taxes you pay for an attendant who provides medical care. If the attendant also provides personal and household services, you can include as a medical expense only the amount of employment taxes paid for medical services as explained earlier.
Operations	You can include in medical expenses amounts you pay for legal operations that are not for unnecessary cosmetic surgery. See *Cosmetic Surgery* under *What Expenses Are Not Includible*, later.
Optometrist	See *Eyeglasses*, earlier.
Organ Donors	See *Transplants*, later.
Osteopath	You can include in medical expenses amounts you pay to an osteopath for medical care.
Oxygen	You can include in medical expenses amounts you pay for oxygen and oxygen equipment to relieve breathing problems caused by a medical condition.
Physical Examination	You can include in medical expenses the amount you pay for an annual physical examination and diagnostic tests by a physician. You do not have to be ill at the time of the examination.
Pregnancy Test Kit	You can include in medical expenses the amount you pay to purchase a pregnancy test kit to determine if you are pregnant.
Prosthesis	See *Artificial Limb* and *Breast Reconstruction Surgery*, earlier.
Psychiatric Care	You can include in medical expenses amounts you pay for psychiatric care. This includes the cost of supporting a mentally ill dependent at a specially equipped medical center where the dependent receives medical care. See *Psychoanalysis*, next, and *Transportation*, later.
Psychoanalysis	You can include in medical expenses payments for psychoanalysis. However, you cannot include payments for psychoanalysis that is part of required training to be a psychoanalyst.
Psychologist	You can include in medical expenses amounts you pay to a psychologist for medical care.
Special Education	You can include in medical expenses fees you pay on a doctor's recommenda-

	tion for a child's tutoring by a teacher who is specially trained and qualified to work with children who have learning disabilities caused by mental or physical impairments, including nervous system disorders. You can include in medical expenses the cost (tuition, meals, and lodging) of attending a school that furnishes special education to help a child to overcome learning disabilities. A doctor must recommend that the child attend the school. Overcoming the learning disabilities must be a principal reason for attending the school, and any ordinary education received must be incidental to the special education provided. Special education includes: • Teaching Braille to a visually impaired person • Teaching lip reading to a hearing-impaired person • Giving remedial language training to correct a condition caused by a birth defect
Sterilization	You can include in medical expenses the cost of a legal sterilization (a legally performed operation to make a person unable to have children). Also see *Vasectomy*, later.
Stop-Smoking Programs	You can include in medical expenses amounts you pay for a program to stop smoking. However, you cannot include in medical expenses amounts you pay for drugs that do not require a prescription, such as nicotine gum or patches, that are designed to help stop smoking.
Surgery	See *Operations*, earlier.
Telephone	You can include in medical expenses the cost of special telephone equipment that lets a hearing-impaired person communicate over a regular telephone. This includes teletypewriter (TTY) and telecommunications device for the deaf (TDD) equipment. You can also include the cost of repairing the equipment.
Television	You can include in medical expenses the cost of equipment that displays the audio part of television programs as subtitles for hearing-impaired persons. This may be the cost of an adapter that attaches to a regular set. It also may be the part of the cost of a specially equipped television that exceeds the cost of the same model regular television set.
Therapy	You can include in medical expenses amounts you pay for therapy received as medical treatment.
Transplants	You can include in medical expenses amounts paid for medical care you receive because you are a donor or a possible donor of a kidney or other organ. This includes transportation. You can include any expenses you pay for the medical care of a donor in connection with the donating of an organ. This includes transportation.
Transportation	You can include in medical expenses amounts paid for transportation primarily for, and essential to, medical care. You can include: • Bus, taxi, train, or plane fares or ambulance service • Transportation expenses of a parent who must go with a child who needs medical care • Transportation expenses of a nurse or other person who can give injections, medications, or other treatment required by a patient who is traveling to get medical care and is unable to travel alone • Transportation expenses for regular visits to see a mentally ill dependent, if these visits are recommended as a part of treatment **Car expenses:** You can include out-of-pocket expenses, such as the cost of gas and oil, when you use a car for medical reasons. You cannot include depreciation, insurance, general repair, or maintenance expenses. If you do not want to use your actual expenses for 2013 you can use the standard medical mileage rate of 24 cents a mile for miles driven. You can also include parking fees and tolls. You can add these fees and

	tolls to your medical expenses whether you use actual expenses or use the standard mileage rate. **Example:** In 2013, Bill Jones drove 2,800 miles for medical reasons. He spent $500 for gas, $30 for oil, and $100 for tolls and parking. He wants to figure the amount he can include in medical expenses both ways to see which gives him the greater deduction. He figures the actual expenses first. He adds the $500 for gas, the $30 for oil, and the $100 for tolls and parking for a total of $630. He then figures the standard mileage amount. He multiplies 2,800 miles by 24 cents a mile for a total of $672. He then adds the $100 tolls and parking for a total of $772. Bill includes the $772 of car expenses with his other medical expenses for the year because the $772 is more than the $630 he figured using actual expenses. **Transportation expenses you cannot include:** You cannot include in medical expenses the cost of transportation in the following situations: • Going to and from work, even if your condition requires an unusual means of transportation • Travel for purely personal reasons to another city for an operation or other medical care • Travel that is merely for the general improvement of one's health • The costs of operating a specially equipped car for other than medical reasons
Trips	You can include in medical expenses amounts you pay for transportation to another city if the trip is primarily for, and essential to, receiving medical services. You may be able to include up to $50 per night for lodging. See *Lodging*, earlier. You cannot include in medical expenses a trip or vacation taken merely for a change in environment, improvement of morale, or general improvement of health, even if the trip is made on the advice of a doctor. However, see *Medical Conferences*, earlier.
Tuition	Under special circumstances, you can include charges for tuition in medical expenses. See Special Education, earlier. You can include charges for a health plan included in a lump-sum tuition fee if the charges are separately stated or can easily be obtained from the school.
Vasectomy	You can include in medical expenses the amount you pay for a vasectomy.
Vision Correction Surgery	See *Eye Surgery*, earlier.
Weight-Loss Program	You can include in medical expenses amounts you pay to lose weight if it is a treatment for a specific disease diagnosed by a physician (such as obesity, hypertension, or heart disease). This includes fees you pay for membership in a weight reduction group as well as fees for attendance at periodic meetings. You cannot include membership dues in a gym, health club, or spa as medical expenses, but you can include separate fees charged there for weight loss activities. You cannot include the cost of diet food or beverages in medical expenses because the diet food and beverages substitute for what is normally consumed to satisfy nutritional needs. You can include the cost of special food in medical expenses only if: 1. The food does not satisfy normal nutritional needs 2. The food alleviates or treats an illness

	3. The need for the food is substantiated by a physician The amount you can include in medical expenses is limited to the amount by which the cost of the special food exceeds the cost of a normal diet. See also *Weight-Loss Program* under *What Expenses Are Not Includible*, later.
Wheelchair	You can include in medical expenses amounts you pay for a wheelchair used mainly for the relief of sickness or disability, and not just to provide transportation to and from work. The cost of operating and maintaining the wheelchair is also a medical expense.
Wig	You can include in medical expenses the cost of a wig purchased upon the advice of a physician for the mental health of a patient who has lost all of his or her hair from disease.
X-Ray	You can include in medical expenses amounts you pay for X-rays for medical reasons.

What Expenses Are Not Includible?

Following is a list of some items that you cannot include in figuring your medical expenses for distributions.

Exhibit 3
Unqualified Medical Expenses

Unqualified Medical Expenses	Explanation of Expense
Baby Sitting, Childcare, and Nursing Services for a Normal, Healthy Baby	You cannot include in medical expenses amounts you pay for the care of children, even if the expenses enable you, your spouse, or your dependent to get medical or dental treatment. Also, any expense allowed as a childcare credit cannot be treated as an expense paid for medical care.
Controlled Substances	You cannot include in medical expenses amounts you pay for controlled substances (such as marijuana, laetrile, etc.). Such substances may be legalized by state law. However, they are in violation of federal law and cannot be included in medical expenses.
Cosmetic Surgery	Generally, you cannot include in medical expenses the amount you pay for unnecessary cosmetic surgery. This includes any procedure that is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease. You generally cannot include in medical expenses the amount you pay for procedures such as face lifts, hair transplants, hair removal (electrolysis), and liposuction. You can include in medical expenses the amount you pay for cosmetic surgery if it is necessary to improve a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or a disfiguring disease. **Example:** An individual undergoes surgery that removes a breast as part of treatment for cancer. She pays a surgeon to reconstruct the breast. The surgery to reconstruct the breast corrects a deformity directly related to the disease. The cost of the surgery is includible in her medical expenses.
Dancing Lessons	You cannot include in medical expenses the cost of dancing lessons, swimming lessons, etc., even if they are recommended by a doctor, if they are only for the improvement of general health.
Diaper Service	You cannot include in medical expenses the amount you pay for diapers or diaper services, unless they are needed to relieve the effects of a particular

	disease.
Electrolysis or Hair Removal	See *Cosmetic Surgery*, earlier.
Flexible Spending Account	You cannot include in medical expenses amounts for which you are fully reimbursed by your flexible spending account if you contribute a part of your income on a pre-tax basis to pay for the qualified benefit.
Funeral Expenses	You cannot include in medical expenses amounts you pay for funerals.
Future Medical Care	Generally, you cannot include in medical expenses current payments for medical care (including medical insurance) to be provided substantially beyond the end of the year. This rule does not apply in situations where the future care is purchased in connection with obtaining lifetime care or long-term care of the type described at *Lifetime Care—Advance Payments* or *Long-Term Care* earlier under *What Medical Expenses Are Includible*.
Hair Transplant	See *Cosmetic Surgery*, earlier.
Health Club Dues	You cannot include in medical expenses health club dues or amounts paid to improve one's general health or to relieve physical or mental discomfort not related to a particular medical condition. You cannot include in medical expenses the cost of membership in any club organized for business, pleasure, recreation, or other social purpose.
Health Coverage Tax Credit	You cannot include in medical expenses amounts you pay for health insurance that you use in figuring your health coverage tax credit. For more information, see *Health Coverage Tax Credit*, later.
Health Savings Accounts	You cannot include in medical expenses any payment or distribution for medical expenses out of a health savings account. Contributions to health savings accounts are deducted separately.
Household Help	You cannot include in medical expenses the cost of household help, even if such help is recommended by a doctor. This is a personal expense that is not deductible. However, you may be able to include certain expenses paid to a person providing nursing-type services. For more information, see *Nursing Services*, earlier under *What Medical Expenses Are Includible*. Also, certain maintenance or personal care services provided for qualified long-term care can be included in medical expenses. For more information, see *Long-Term Care*, earlier under *What Medical Expenses Are Includible*.
Illegal Operations and Treatments	You cannot include in medical expenses amounts you pay for illegal operations, treatments, or controlled substances whether rendered or prescribed by licensed or unlicensed practitioners.
Insurance Premiums	See *Insurance Premiums* under *What Medical Expenses Are Includible*, earlier.
Maternity Clothes	You cannot include in medical expenses amounts you pay for maternity clothes.
Medical Savings Account (MSA)	You cannot include in medical expenses amounts you contribute to an Archer MSA. You cannot include expenses you pay for with a tax-free distribution from your Archer MSA. You also cannot use other funds equal to the amount of the distribution and include the expenses.
Medicines and Drugs from Other Countries	In general, you cannot include in your medical expenses the cost of a prescribed drug brought in (or ordered shipped) from another country. You can only include the cost of a drug that was imported legally. For example, you can include the cost of a prescribed drug the Food and Drug Administration announces can be legally imported by individuals. You can include the cost of a prescribed drug you purchase and consume in another country if the drug is legal in both the other country and the United States.
Nonprescription Drugs and Medicines	Except for insulin, you cannot include in medical expenses amounts you pay for a drug that is not prescribed.

	Example: Your doctor recommends that you take aspirin. Because aspirin is a drug that does not require a physician's prescription, you cannot include its cost in your medical expenses.
Nutritional Supplements	You cannot include in medical expenses the cost of nutritional supplements, vitamins, herbal supplements, "natural medicines," etc. unless they are recommended by a medical practitioner as treatment for a specific medical condition diagnosed by a physician. Otherwise, these items are taken to maintain your ordinary good health, and are not for medical care.
Personal Use Items	You cannot include in medical expenses the cost of an item ordinarily used for personal, living, or family purposes unless it is used primarily to prevent or alleviate a physical or mental defect or illness. For example, the cost of a toothbrush and toothpaste is a nondeductible personal expense. In order to accommodate an individual with a physical defect, you may have to purchase an item ordinarily used as a personal, living, or family item in a special form. You can include the excess of the cost of the item in a special form over the cost of the item in normal form as a medical expense. (See *Braille Books and Magazines* under *What Medical Expenses Are Includible*, earlier.)
Swimming Lessons	See *Dancing Lessons*, earlier.
Teeth Whitening	You cannot include in medical expenses amounts paid to whiten teeth. See *Cosmetic Surgery*, earlier.
Veterinary Fees	You generally cannot include veterinary fees in your medical expenses, but see *Guide Dog or Other Service Animal* under *What Medical Expenses Are Includible*, earlier.
Weight-Loss Program	You cannot include in medical expenses the cost of a weight-loss program if the purpose of the weight loss is the improvement of appearance, general health, or sense of well-being. You cannot include amounts you pay to lose weight unless the weight loss is a treatment for a specific disease diagnosed by a physician (such as obesity, hypertension, or heart disease). If the weight-loss treatment is not for a specific disease diagnosed by a physician, you cannot include either the fees you pay for membership in a weight reduction group or fees for attendance at periodic meetings. Also, you cannot include membership dues in a gym, health club, or spa. You cannot include the cost of diet food or beverages in medical expenses because the diet food and beverages substitute for what is normally consumed to satisfy nutritional needs. See *Weight-Loss Program* under *What Medical Expenses Are Includible*, earlier.

Review Questions

1. Which of the following is a general definition of medical expenses?
   A. Costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and the costs for treatments affecting any part or function of the body
   B. Reasonable cost to accommodate a home to a disabled condition
   C. Expenses paid for treatment prescribed by a physician
   D. Costs for inpatient care at a hospital or similar institution if a principal reason for being there is to receive medical care

2. Which of the following is a qualified medical expense that can be included in figuring your medical expenses for distributions?
   A. Cosmetic surgery
   B. Breast reconstruction surgery following a mastectomy for cancer
   C. Diaper service
   D. Flexible spending account

3. Which of the following are treated as medical insurance premiums?
   A. Costs for special equipment installed in a car for the use of a person with a disability
   B. Costs for dental treatment
   C. Amounts you pay to entitle you, your spouse, or a dependent to receive medical care from an HMO
   D. Costs for a hearing aid and batteries, repairs, and maintenance needed to operate it

4. Which of the following is a supplemental medical insurance?
   A. HRA
   B. Medicare A
   C. Medicare D
   D. Medicare B

5. What is paid for with an insurance premium but <u>cannot</u> be included in medical expenses?
   A. Replacement of lost or damaged contact lenses
   B. Life insurance
   C. Hospitalization
   D. Long-term care

6. What are legal fees that you can include in medical expenses?
   A. Fees you paid that are necessary to authorize treatment for mental illness
   B. Fees you paid for the management of a guardianship estate for a person being treated for mental illness
   C. Fees you paid for conducting the affairs of a person being treated for mental illness
   D. Fees you paid that are not necessary for medical care

7. Which of the following qualifies as an accepted medical expense?
   A. Cost of sending a problem child to a school where the availability of medical care in the school is not a principal reason for sending the student there
   B. Vacation taken merely for a change in environment, improvement of morale, or general improvement of health
   C. Fees you pay for membership in a weight reduction group as well as fees for attendance at periodic meetings
   D. The cost of diet food or beverages

8. Which of the following is an unqualified medical expense?
   A. Amount you pay for cosmetic surgery if it is necessary to improve a deformity arising from a congenital abnormality
   B. Contribution to an Archer MSA
   C. Cost of a prescribed drug you purchase and consume in another country
   D. Amount you pay for non-prescribed insulin

Review Answers

1. A. **Correct.** Costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and the costs for treatments affecting any part or function of the body is a general definition of medical expenses.
   B. Incorrect. A reasonable cost to accommodate a home to a disabled condition is not a general definition of medical expenses. Rather, this is a capital expense that can be included in medical expenses you pay for special equipment installed in a home, or for improvements, if their main purpose is medical care for you, your spouse, or your dependent.
   C. Incorrect. Expenses paid for treatment prescribed by a physician is not a general definition of medical expenses. Instead, this is a type of medical expense.
   D. Incorrect. Costs for inpatient care at a hospital or similar institution if a principal reason for being there is to receive medical care is not a general definition of medical expenses. Rather, this is a medical expense categorized under hospital services.

2. A. Incorrect. Cosmetic surgery is not a qualified medical expense that can be included in figuring your medical expenses for distributions. Generally, this includes any procedure that is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease.
   B. **Correct.** Breast reconstruction surgery following a mastectomy for cancer is a qualified medical expense that can be included in figuring your medical expenses for distributions.
   C. Incorrect. Diaper service is not a qualified medical expense that can be included in figuring your medical expenses for distributions. Instead, you cannot include in medical expenses the amount you pay for diapers or diaper services, unless they are needed to relieve the effects of a particular disease.
   D. Incorrect. A flexible spending account is not a qualified medical expense that can be included in figuring your medical expenses for distributions. Instead, this is an example of an unqualified medical expense.

3. A. Incorrect. Costs for special equipment installed in a car for the use of a person with a disability are not treated as medical insurance premiums. Instead, these costs can be included in medical expenses.
   B. Incorrect. Costs for dental treatment are not treated as medical insurance premiums. Rather, you can include in medical expenses the amounts you pay for the prevention and alleviation of dental disease.
   C. **Correct.** Amounts you pay to entitle you, your spouse, or a dependent to receive medical care from an HMO are treated as medical insurance premiums.
   D. Incorrect. Costs for a hearing aid, batteries, repairs and maintenance needed to operate it are not treated as medical insurance premiums. Rather, this is an example of a qualified medical expense.

4. A. Incorrect. An HRA is not a supplemental medical insurance. Instead, a Health Reimbursement Arrangement is funded solely by the employer – therefore, if you have medical expenses that are reimbursed by an HRA, you cannot include those expenses in your medical expenses.
   B. Incorrect. Medicare A is not a supplemental medical insurance. Rather, if you are covered under social security, you are enrolled in Medicare A.
   C. Incorrect. Medicare D is not a supplemental medical insurance. Instead, it is a voluntary prescription drug insurance program for persons with Medicare A or B.
   D. **Correct.** Medicare B is a supplemental medical insurance. Premiums you pay for Medicare B are a medical expense.

5. A. Incorrect. Replacement of lost or damaged contact lenses is paid for with an insurance premium and can be included in medical expenses.
   B. **Correct.** Life insurance is paid for with an insurance premium but cannot be included in medical expenses.
   C. Incorrect. Hospitalization is paid for with an insurance premium and can be included in medical expenses.
   D. Incorrect. Long-term care is paid for with an insurance premium and can be included in medical expenses.

6. A. **Correct.** Fees you paid that are necessary to authorize treatment for mental illness are legal fees that you can include in medical expenses.
   B. Incorrect. Fees you paid for the management of a guardianship estate for a person being treated for mental illness are legal fees that you cannot include in medical expenses.
   C. Incorrect. Fees you paid for conducting the affairs of a person being treated for mental illness are legal fees that you cannot include in medical expenses.
   D. Incorrect. Fees you paid that are not necessary for medical care cannot be included in medical expenses.

7. A. Incorrect. The cost of sending a problem child to a school where the availability of medical care in the school is not a principal reason for sending the student there does not qualify as an accepted medical expense. Rather, special education that qualifies as a medical expense includes teaching braille to a visually impaired person, teaching lip reading to a hearing-impaired person, and giving remedial language training to correct a condition caused by a birth defect.
   B. Incorrect. A vacation taken merely for a change in environment, improvement of morale, or general improvement of health does not qualify as an accepted medical expense. Instead, you can include in medical expenses amounts you pay for transportation to another city if the trip is primarily for receiving medical services.
   C. **Correct.** Fees you pay for membership in a weight reduction group as well as fees for attendance at periodic meetings qualify as accepted medical expenses.
   D. Incorrect. The costs of diet food or beverages do not qualify as an accepted medical expense. Rather, you can include the cost of special food in medical expenses only if the food does not satisfy normal nutritional needs, the food alleviates or treats an illness, or the need for the food is substantiated by a physician.

8. A. Incorrect. The amount you pay for cosmetic surgery, if it is necessary to improve a deformity arising from a congenital abnormality, is a qualified medical expense.
   B. **Correct.** A contribution to an Archer MSA is an unqualified medical expense.
   C. Incorrect. The cost of a prescribed drug you purchase and consume in another country, if the drug is legal in both the other country and the United States, is a qualified medical expense.
   D. Incorrect. Amounts you pay for non-prescribed insulin is a qualified medical expense.

Chapter 2
Health Savings Accounts (HSAs)

Learning Objectives

- Pinpoint the minimum annual deductible requirement for a self-only coverage high deductible health plans
- Identify the contribution limit to an HAS for an individual with family HDHP coverage
- Recognize a truth regarding excess contributions made to an HAS

Introduction

A health savings account (HSA) is a tax-exempt trust or custodial account that you set up with a qualified HSA trustee to pay or reimburse certain medical expenses you incur. You must be an eligible individual to qualify for an HSA.

No permission or authorization from the IRS is necessary to establish an HSA. You set up an HAS with a trustee. A qualified HSA trustee can be a bank, an insurance company, or anyone already approved by the IRS to be a trustee of individual retirement arrangements (IRAs) or Archer MSAs. The HSA can be established through a trustee that is different from your health plan provider. Your employer may already have some information on HSA trustees in your area.

Tip: If you have an Archer MSA, you can generally roll it over into an HSA tax free (see *Rollovers*, later).

HSA Benefits

- You can claim a tax deduction for contributions you, or someone other than your employer, make to your HSA even if you do not itemize your deductions on Form 1040
- Contributions to your HSA made by your employer (including contributions made through a cafeteria plan) may be excluded from your gross income
- The contributions remain in your account from until you use them
- The interest or other earnings on the assets in the account are tax free
- Distributions may be tax free if you pay qualified medical expenses (see *Qualified Medical Expenses,* later)
- An HSA is “portable” so it stays with you if you change employers or leave the work force

Qualifying for an HSA

To be an eligible individual and qualify for an HSA, you must meet the following requirements:

- You must be covered under a high deductible health plan (HDHP), described later, on the first day of the month
- You have no other health coverage except what is permitted under *Other Health Coverage*, later
- You are not enrolled in Medicare
- You cannot be claimed as a dependent on someone else’s 2013 tax return

Tip: Under the last-month rule, you are considered to be an eligible individual for the entire year if you are an eligible individual on the first day of the last month of your tax year (December 1 for most taxpayers).

If you meet these requirements, you are an eligible individual even if your spouse has non-HDHP family coverage, provided your spouse's coverage does not cover you.

Caution: If another taxpayer is entitled to claim an exemption for you, you cannot claim a deduction for an HSA contribution. This is true even if the other person does not actually claim your exemption.

Tip: Each spouse who is an eligible individual who wants an HSA must open a separate HSA. You cannot have a joint HSA.

High Deductible Health Plan (HDHP)

An HDHP has:

- A higher annual deductible than typical health plans
- A maximum limit on the sum of the annual deductible and out-of-pocket medical expenses that you must pay for covered expenses. Out-of-pocket expenses include copayments and other amounts, but do not include premiums.

An HDHP may provide preventive care benefits without a deductible or with a deductible less than the minimum annual deductible. Preventive care includes, but is not limited to the following:

1. Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals
2. Routine prenatal and well-child care
3. Child and adult immunizations
4. Tobacco cessation programs
5. Obesity weight-loss programs
6. Screening services. This includes screening services for the following:
    - Cancer
        - Breast cancer (e.g., mammogram)
        - Cervical cancer (e.g., pap smear)
        - Colorectal cancer
        - Prostate cancer (e.g., PSA test)
        - Skin cancer
        - Oral cancer
        - Ovarian cancer
        - Testicular cancer
        - Thyroid cancer
    - Heart and vascular diseases
        - Abdominal aortic aneurysm
        - Carotid artery stenosis
        - Coronary heart disease
        - Hemoglobinopathies
        - Hypertension
        - Lipid disorders
    - Infectious diseases
        - Bacteriuria
        - Chlamydial infection
        - Gonorrhea
        - Hepatitis B virus infection
        - Hepatitis C
        - Human immunodeficiency virus (HIV) infection

    - Syphilis
    - Tuberculosis infection
- Mental health conditions
    - Dementia
    - Depression
    - Drug abuse
    - Problem drinking
    - Suicide risk
    - Family violence
- Metabolic, nutritional, and endocrine conditions
    - Anemia, iron deficiency
    - Dental and periodontal disease
    - Diabetes mellitus
    - Obesity in adults
    - Thyroid disease
- Musculoskeletal disorders
    - Osteoporosis
- Obstetric and gynecological conditions
    - Bacterial vaginosis in pregnancy
    - Gestational diabetes mellitus
    - Home uterine activity monitoring
    - Neural tube defects
    - Preeclampsia
    - Rh incompatibility
    - Rubella
    - Ultrasonography in pregnancy
- Pediatric conditions
    - Child developmental delay
    - Congenital hypothyroidism
    - Lead levels in childhood and pregnancy
    - Phenylketonuria
    - Scoliosis, adolescent idiopathic
- Vision and hearing disorders
    - Glaucoma
    - Hearing impairment in older adults
    - Newborn hearing

Exhibit 1 and Exhibit *2* show the minimum annual deductible and maximum annual deductible and other out-of-pocket expenses for HDHPs for 2013 and 2014.

Exhibit 1
Minimum and Maximum Annual Deductible and
Other Out-of-Pocket Expenses for HDHPs for 2012

	Self-Only Coverage	Family Coverage
Minimum Annual Deductible	$1,250	$2,500
Maximum Annual Deductible and Other Out-of-Pocket Expenses*	$6,250	$12,500

*This limit does not apply to deductibles and expenses for out-of-network services if the plan uses a network of providers. Instead, only deductibles and out-of-pocket expenses for services within the network should be used to figure whether the limit applies.

Exhibit 2
Minimum and Maximum Annual Deductible and Other Out-of-Pocket Expenses for HDHPs for 2014

	Self-Only Coverage	Family Coverage
Minimum annual deductible	$1,250	$2,500
Maximum annual deductible and other out-of-pocket expenses*	$6,350	$12,700

*This limit does not apply to deductibles and expenses for out-of-network services if the plan uses a network of providers. Instead, only deductibles and out-of-pocket expenses for services within the network should be used to figure whether the limit applies.

Self-only HDHP coverage is an HDHP covering only an eligible individual. Family HDHP coverage is an HDHP covering an eligible individual and at least one other individual (whether or not that individual is an eligible individual).

Example
An eligible individual and his dependent child are covered under an “employee plus one” HDHP offered by the individual’s employer. This is family HDHP coverage.

Family Plans that Do Not Meet the High Deductible Rules

There are some family plans that have deductibles for both the family as a whole and for individual family members. Under these plans, if you meet the individual deductible for one family member, you do not have to meet the higher annual deductible amount for the family. If either the deductible for the family as a whole or the deductible for an individual family member is below the minimum annual deductible for family coverage, the plan does not qualify as an HDHP.

Example
You have family health insurance coverage in 2013. The annual deductible for the family plan is $3,500. This plan also has an individual deductible of $1,500 for each family member. The plan does not qualify as an HDHP because the deductible for an individual family member is below the minimum annual deductible ($2,500) for family coverage.

Other Health Coverage

You (and your spouse, if you have family coverage) generally cannot have any other health coverage that is not an HDHP. However, you can still be an eligible individual even if your spouse has non-HDHP coverage provided you are not covered by that plan.

You can have additional insurance that provides benefits only for the following items:

- Liabilities incurred under workers’ compensation laws, tort liabilities, or liabilities related to ownership or use of property
- A specific disease or illness
- A fixed amount per day (or other period) of hospitalization

You can also have coverage (whether provided through insurance or otherwise) for the following items:

- Accidents
- Disability
- Dental care
- Vision care
- Long-term care

Caution: Plans in which substantially all of the coverage is through the above listed items are not HDHPs. For example, if your plan provides coverage substantially all of which is for a specific disease or illness, the plan is not an HDHP for purposes of establishing an HSA.

Prescription Drug Plans

You can have a prescription drug plan, either as part of your HDHP or a separate plan (or rider), and qualify as an eligible individual if the plan does not provide benefits until the minimum annual deductible of the HDHP has been met. If you can receive benefits before that deductible is met, you are not an eligible individual.

Other Employee Health Plans

An employee covered by an HDHP and a health FSA or an HRA that pays or reimburses qualified medical expenses generally cannot make contributions to an HSA. Health FSAs and HRAs are discussed in Chapter 4 and Chapter 5.

However, an employee can make contributions to an HSA while covered under an HDHP and one or more of the following arrangements:

- **Limited-purpose health FSA or HRA.** These arrangements can pay or reimburse the items listed earlier under *Other Health Coverage,* except long-term care. Also, these arrangements can pay or reimburse preventive care expenses because they can be paid without having to satisfy the deductible.
- **Suspended HRA.** Before the beginning of an HRA coverage period, you can elect to suspend the HRA. The HRA does not pay or reimburse, at any time, the medical expenses incurred during the suspension period except preventive care and items listed under *Other Health Coverage.* When the suspension period ends, you are no longer eligible to make contributions to an HSA.
- **Post-deductible health FSA or HRA.** These arrangements do not pay or reimburse any medical expenses incurred before the minimum annual deductible amount is met. The deductible for these arrangements does not have to be the same as the deductible for the HDHP, but benefits may not be provided before the minimum annual deductible amount is met.
- **Retirement HRA.** This arrangement pays or reimburses only those medical expenses incurred after retirement. After retirement you are no longer eligible to make contributions to an HSA.

Health FSA – Grace Period. Coverage during a grace period by a general purpose health FSA is allowed if the balance in the health FSA at the end of its prior year plan is zero, or a qualified HSA distribution (discussed later) of any balance remaining is made to an HSA (see *Flexible Spending Arrangements (FSAs)*).

Contributions to an HSA

Any eligible individual can contribute to an HSA. For an employee's HSA, the employee, the employee's employer, or both may contribute to the employee's HSA in the same year. For an HSA established by a self-employed (or unemployed) individual, the individual can contribute. Family members or any other person may also make contributions on behalf of an eligible individual.

Contributions to an HSA must be made in cash. Contributions of stock or property are not allowed.

Limit on Contributions

The amount you or any other person can contribute to your HSA depends on the type of HDHP coverage you have, your age, the date you become an eligible individual, and the date you cease to be an eligible individual. For 2013, if you have self-only HDHP coverage, you can contribute up to $3,250. If you have family HDHP coverage, you can contribute up to $6,450.

> **Tip:** For 2014, if you have self-only HDHP coverage, you can contribute up to $3,300. If you have family HDHP coverage you can contribute up to $6,550.

If you were, or were considered (under the *last-month rule*, discussed later), an eligible individual for the entire year and did not change your type of coverage, you can contribute the full amount based on your type of coverage. However, if you were not an eligible individual for the entire year or changed your coverage during the year, your contribution limit is the greater of:

1. The limitation shown on the last line of the *Line 3 Limitation Chart and Worksheet* (see *Exhibits 3 and 4* below)
2. The maximum annual HSA contribution based on your HDHP coverage (self-only or family) on the first day of the last month of your tax year

> **Tip:** If you had family HDHP coverage on the first day of the last month of your tax year, your contribution limit for 2013 is $6,450 even if you changed coverage during the year.

Last-month rule

Under the last-month rule, if you are an eligible individual on the first day of the last month of your tax year (December 1 for most taxpayers), you are considered an eligible individual for the entire year. You are treated as having the same HDHP coverage for the entire year as you had on the first day of that last month.

Testing Period

If contributions were made to your HSA based on you being an eligible individual for the entire year under the last-month rule, you must remain an eligible individual during the testing period. For the last-month rule, the testing period begins with the last month of your tax year and ends on the last day of the 12th month following that month. For example, December 1, 2013, through December 31, 2014.

If you fail to remain an eligible individual during the testing period, other than because of death or becoming disabled, you will have to include in income the total contributions made to your HSA that would not have been made except for the last-month rule. You include this amount in your income in the year in which you fail to be an eligible individual. This amount is also subject to a 10% additional tax. The income and additional tax are shown on Form 8889, Part III (see *Exhibit 5*).

Exhibit 3 and *Exhibit 4* below consist of the Limitation Chart and Worksheet from the Instructions for Form 8889.

Exhibit 3
Line 3 Limitation Chart
Instructions for Form 8889

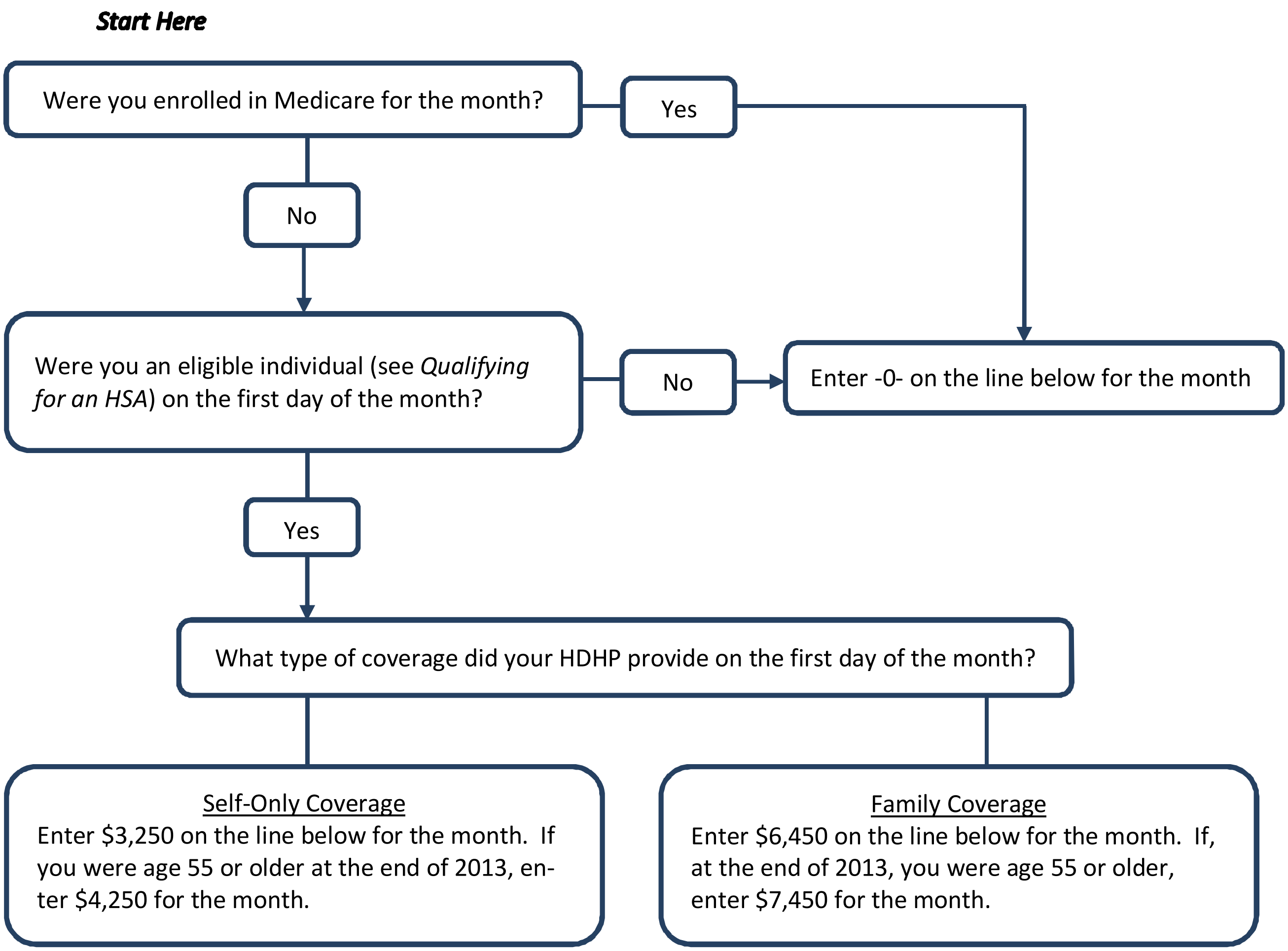


Exhibit 4
Line 3 Worksheet
Instructions for Form 8889

Month in 2013	Amount from Chart Above
January	____________________
February	____________________
March	____________________
April	____________________
May	____________________
June	____________________
July	____________________

August	____________
September	____________
October	____________
November	____________
December	____________
Total for all months	____________
Limitation. Divide the total by 12. Enter here and on line 3	____________

Exhibit 5
Part III of Form 8889

Part III **Income and Additional Tax for Failure To Maintain HDHP Coverage.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part III for each spouse.

18	Last-month rule	18	
19	Qualified HSA funding distribution	19	
20	**Total income.** Add lines 18 and 19. Include this amount on Form 1040, line 21, or Form 1040NR, line 21. On the dotted line next to Form 1040, line 21, or Form 1040NR, line 21, enter "HSA" and the amount	20	
21	**Additional tax.** Multiply line 20 by 10% (.10). Include this amount in the total on Form 1040, line 60, or Form 1040NR, line 59. On the dotted line next to Form 1040, line 60, or Form 1040NR, line 59, enter "HDHP" and the amount	21	

Form **8889** (2013)

Example
Chris, age 53, becomes an eligible individual on December 1, 2013. He has family HDHP coverage on that date. Under the last-month rule, he contributes $6,450 to his HSA.

Chris fails to be an eligible individual in June 2013. Because Chris did not remain an eligible individual during the testing period (December 1, 2013, through December 31, 2014), he must include in his 2014 income the contributions made in 2013 that would not have been made except for the last-month rule. Chris uses the worksheet in the Form 8889 instructions to determine this amount.

January	-0-
February	-0-
March	-0-
April	-0-
May	-0-
June	-0-
July	-0-
August	-0-
September	-0-
October	-0-
November	-0-
December	$6,450.00
Total for all months	$6,450.00
Limitation. Divide the total by 12	$537.50

Chris would include $5,912.50 ($6,40.00 – $537.50) in his gross income on his 2014 tax return. Also, a 10% additional tax applies to this amount.

Example
Erika, age 39, has self-only HDHP coverage on January 1, 2013. Erika changes to family HDHP coverage on November 1, 2013. Because Erika has family HDHP coverage on December 1, 2013, she contributes $6,450 for 2013.

Erika fails to be an eligible individual in March 2014. Because she did not remain an eligible individual during the testing period (December 1, 2013, through December 31, 2014), she must include in income the contribution made that would not have been made except for the last-month rule. Erika uses the worksheet in the Form 8889 instructions to determine this amount.

January	$3,250.00
February	$3,250.00
March	$3,250.00
April	$3,250.00
May	$3,250.00
June	$3,250.00
July	$3,250.00
August	$3,250.00
September	$3,250.00
October	$3,250.00
November	$6,450.00
December	$6,450.00
Total for all months	$45,400.00
Limitation. Divide the total by 12	$3,783.34

Erika would include $2,666.67 ($6,450 – $3,783.34) in her gross income on her 2014 tax return. Also, a 10% additional tax applies to this amount.

Additional Contribution

If you are an eligible individual who is age 55 or older at the end of your tax year, your contribution limit is increased by $1,000. For example, if you have self-only coverage, you can contribute up to $4,250 (the contribution limit for self-only coverage ($3,250) plus the additional contribution of $1,000) However, see *Enrolled in Medicare*, later.

Caution: If you have more than one HSA in 2013, your total contributions to all the HSAs cannot be more than the limits discussed earlier.

Reduction of Contribution Limit

You must reduce the amount that can be contributed (including any additional contribution) to your HSA by the amount of any contribution made to your Archer MSA (including employer contributions) for the year. A special rule applies to married people, discussed next, if each spouse has family coverage under an HDHP.

Rules for Married People

If either spouse has family HDHP coverage, both spouses are treated as having family HDHP coverage. If each spouse has family coverage under a separate plan, the contribution limit for 2013 is $6,450. You must reduce the limit on contributions, before taking into account any additional contributions, by the amount contributed to both spouse's Archer MSAs. After that reduction, the contribution limit is split equally between the spouses unless you agree on a different division.

Caution: The rules for married people apply only if both spouses are eligible individuals.

If both spouses are 55 or older and not enrolled in Medicare, each spouse's contribution limit is increased by the additional contribution. If both spouses meet the age requirement, the total contributions under family coverage cannot be more than $8,450. Each spouse must make the additional contribution to his or her own HSA.

> **Example**
> For 2013, Mr. Auburn and his wife are both eligible individuals. They each have family coverage under separate HDHPs. Mr. Auburn is 58 years old and Mrs. Auburn is 53. Mr. and Mrs. Auburn can split the family contribution limit ($6,450) equally or they can agree on a different division. If they split it equally, Mr. Auburn can contribute $4,225 to an HSA (one-half the maximum contribution for family coverage ($3,225) + $1,000 additional contribution) and Mrs. Auburn can contribute $3,225 to an HSA.

Employer Contributions

You must reduce the amount you, or any other person, can contribute to your HSA by the amount of any contributions made by your employer that are excludable from your income. This includes amounts contributed to your account by your employer through a cafeteria plan.

Enrolled in Medicare

Beginning with the first month you are enrolled in Medicare, your contribution limit is zero.

> **Example**
> You turned age 65 in July 2013 and enrolled in Medicare. You had an HDHP with self-only coverage and are eligible for an additional contribution of $1,000. Your contribution limit is $2,125 ($4,2500 × 6 ÷ 12).

Qualified HSA Funding Distribution

A qualified HSA funding distribution may be made from your traditional IRA or ROTH IRA to your HSA. This distribution cannot be made from an ongoing SEP IRA or SIMPLE IRA. For this purpose, a SEP IRA or SIMPLE IRA is ongoing if an employer contribution is made for the plan year ending with or within your tax year in which the distribution would be made.

The maximum qualified HSA funding distribution depends on the HDHP coverage (self-only or family) you have on the first day of the month in which the contribution is made and your age as of the end of the tax year. The distribution must be made directly by the trustee of the IRA to the trustee of the HSA. The distribution is not included in your income, is not deductible, and reduces the amount that can be contributed to your HSA. The qualified HSA funding distribution is shown on Form 8889 for the year in which the distribution is made.

You can make only one qualified HSA funding distribution during your lifetime. However, if you make a distribution during a month when you have self-only HDHP coverage, you can make another qualified HSA funding distribution in a later month in that tax year if you change to family HDHP coverage. The total qualified HSA funding distribution cannot be more than the contribution limit for family HDHP coverage plus any additional contribution to which you are entitled.

> **Example**
> In 2013, you are an eligible individual, age 57, with self-only HDHP coverage. You can make a qualified HSA funding distribution of $4,250 ($3,250 plus $1,000 additional contribution).

Funding Distribution – Testing Period

You must remain an eligible individual during the testing period. For a qualified HSA funding distribution, the testing period begins with the month in which the qualified HSA funding distribution is contributed and ends on the last day of the 12th month following that month. For example, if a qualified HSA funding distribution is contributed to your HSA on August 10, 2013, your testing period begins in August 2013, and ends on August 31, 2014.

If you fail to remain an eligible individual during the testing period, other than because of death or becoming disabled, you will have to include in income the qualified HSA funding distribution. You include this amount in income in the year in which you fail to be an eligible individual. This amount is also subject to a 10% additional tax. The income and the additional tax are shown on Form 8889, Part III.

Each qualified HSA funding distribution allowed has its own testing period. For example, you are an eligible individual, age 45, with self-only HDHP coverage. On June 18, 2013, you make a qualified HSA funding distribution of $3,250. On July 27, 2013, you enroll in family HDHP coverage and on August 17, 2013, you make a qualified HSA funding distribution of $3,200. Your testing period for the first distribution begins in June 2013 and ends on June 30, 2014. Your testing period for the second distribution begins in August 2013 and ends on August 31, 2014.

The testing period rule that applies under the *last-month rule* (discussed earlier) does not apply to amounts contributed to an HSA through a qualified HSA funding distribution. If you remain an eligible individual during the entire funding distribution testing period, then no amount of that distribution is included in income and will not be subject to the additional tax for failing to meet the last-month rule testing period.

Rollovers

A rollover contribution is not included in your income, is not deductible, and does not reduce your contribution limit.

Archer MSAs and Other HSAs

You can roll over amounts from Archer MSAs and other HSAs into an HSA. You do not have to be an eligible individual to make a rollover contribution from your existing HSA to a new HSA. Rollover contributions do not need to be in cash. Rollovers are not subject to the annual contribution limits.

You must roll over the amount within 60 days after the date of receipt. You can make only one rollover contribution to an HSA during a 1-year period.

Note: If you instruct the trustee of your HSA to transfer funds directly to the trustee of another HSA, the transfer is not considered a rollover. There is no limit on the number of these transfers. Do not include the amount transferred in income, deduct it as a contribution, or include it as a distribution on Form 8889.

When to Contribute

You can make contributions to your HSA for 2013 until April 15, 2014. If you fail to be an eligible individual during 2013, you can still make contributions, up until April 15, 2014, for the months you were an eligible individual.

Your employer can make contributions to your HSA between January 1, 2014, and April 15, 2014, that are allocated to 2013. Your employer must notify you and the trustee of your HSA that the contribution is for 2013. The contribution will be reported on your 2014 Form W-2.

Reporting Contributions on Your Return

Contributions made by your employer are not included in your income. Contributions to an employee's account by an employer using the amount of an employee's salary reduction through a cafeteria plan are treated as employer contributions. Generally, you can claim contributions you made and contributions made by any other person, other than your employer, on your behalf, as an adjustment to income.

Contributions by a partnership to a bona fide partner's HSA are not contributions by an employer. The contributions are treated as a distribution of money and are not included in the partner's gross income. Contributions by a partnership to a partner's HSA for services rendered are treated as guaranteed payments that are deductible by the partnership and includible in the partner's gross income. In both situations, the partner can deduct the contribution made to the partner's HSA.

Contributions by an S corporation to a 2% shareholder-employee's HSA for services rendered are treated as guaranteed payments and are deductible by the S corporation and includible in the shareholder-employee's gross income. The shareholder-employee can deduct the contribution made to the shareholder-employee's HSA.

Form 8889

Report all contributions to your HSA on Form 8889 (*Exhibit 6*) and file it with your Form 1040 or Form 1040NR. You should include all contributions made for 2013, including those made by April 15, 2014, that are designated for 2013. Contributions made by your employer and qualified HSA funding distributions are also shown on the form.

You should receive Form 5498-SA, HSA, Archer MSA, or Medicare Advantage MSA Information (*Exhibit 7*), from the trustee showing the amount contributed to your HSA during the year. Your employer's contributions also will be shown in box 12 of Form W-2, *Wage and Tax Statement*, with code W. Follow the instructions for Form 8889. Report your HSA deduction on Form 1040 or Form 1040NR, line 25.

Exhibit 6
Form 8889
Health Savings Accounts (HSAs)

Form **8889**

Department of the Treasury
Internal Revenue Service

Health Savings Accounts (HSAs)

▶ Information about Form 8889 and its separate instructions is available at *www.irs.gov/form8889*.
▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074
2013
Attachment Sequence No. 53

Name(s) shown on Form 1040 or Form 1040NR | Social security number of HSA beneficiary. If both spouses have HSAs, see instructions ▶

Before you begin: Complete Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, if required.

Part I **HSA Contributions and Deduction.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part I for each spouse.

1	Check the box to indicate your coverage under a high-deductible health plan (HDHP) during 2013 (see instructions). . . . ▶	☐ Self-only ☐ Family	
2	HSA contributions you made for 2013 (or those made on your behalf), including those made from January 1, 2014, through April 15, 2014, that were for 2013. **Do not** include employer contributions, contributions through a cafeteria plan, or rollovers (see instructions) . . .	2	
3	If you were under age 55 at the end of 2013, and on the first day of **every** month during 2013, you were, or were considered, an eligible individual with the **same** coverage, enter $3,250 ($6,450 for family coverage). **All others,** see the instructions for the amount to enter . . .	3	
4	Enter the amount you and your employer contributed to your Archer MSAs for 2013 from Form 8853, lines 1 and 2. If you or your spouse had family coverage under an HDHP at any time during 2013, also include any amount contributed to your spouse's Archer MSAs . . .	4	
5	Subtract line 4 from line 3. If zero or less, enter -0- . . .	5	
6	Enter the amount from line 5. But if you and your spouse each have separate HSAs and had family coverage under an HDHP at any time during 2013, see the instructions for the amount to enter . . .	6	
7	If you were age 55 or older at the end of 2013, married, and you or your spouse had family coverage under an HDHP at any time during 2013, enter your additional contribution amount (see instructions) . . .	7	
8	Add lines 6 and 7 . . .	8	
9	Employer contributions made to your HSAs for 2013 . . .	9	
10	Qualified HSA funding distributions . . .	10	
11	Add lines 9 and 10 . . .	11	
12	Subtract line 11 from line 8. If zero or less, enter -0- . . .	12	
13	**HSA deduction.** Enter the **smaller** of line 2 or line 12 here and on Form 1040, line 25, or Form 1040NR, line 25 . . .	13	
	Caution: *If line 2 is more than line 13, you may have to pay an additional tax (see instructions).*		

Part II **HSA Distributions.** If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part II for each spouse.

14a	Total distributions you received in 2013 from all HSAs (see instructions) . . .	14a	
b	Distributions included on line 14a that you rolled over to another HSA. Also include any excess contributions (and the earnings on those excess contributions) included on line 14a that were withdrawn by the due date of your return (see instructions) . . .	14b	
c	Subtract line 14b from line 14a . . .	14c	
15	Unreimbursed qualified medical expenses (see instructions) . . .	15	
16	**Taxable HSA distributions.** Subtract line 15 from line 14c. If zero or less, enter -0-. Also, include this amount in the total on Form 1040, line 21, or Form 1040NR, line 21. On the dotted line next to line 21, enter "HSA" and the amount . . .	16	
17a	If any of the distributions included on line 16 meet any of the **Exceptions to the Additional 20% Tax** (see instructions), check here . . . ▶ ☐		
b	**Additional 20% tax** (see instructions). Enter 20% (.20) of the distributions included on line 16 that are subject to the additional 20% tax. Also include this amount in the total on Form 1040, line 60, or Form 1040NR, line 59. On the dotted line next to Form 1040, line 60, or Form 1040NR, line 59, enter "HSA" and the amount . . .	17b	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 37621P Form **8889** (2013)

Form 8889 (2013) Page **2**

Part III **Income and Additional Tax for Failure To Maintain HDHP Coverage.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part III for each spouse.

18	Last-month rule	18	
19	Qualified HSA funding distribution	19	
20	**Total income.** Add lines 18 and 19. Include this amount on Form 1040, line 21, or Form 1040NR, line 21. On the dotted line next to Form 1040, line 21, or Form 1040NR, line 21, enter "HSA" and the amount	20	
21	**Additional tax.** Multiply line 20 by 10% (.10). Include this amount in the total on Form 1040, line 60, or Form 1040NR, line 59. On the dotted line next to Form 1040, line 60, or Form 1040NR, line 59, enter "HDHP" and the amount	21	

Form **8889** (2013)

Exhibit 7
Form 5498-SA
HSA, Archer MSA, or Medicare Advantage MSA Information

☐ CORRECTED (if checked)

TRUSTEE'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone number	1 Employee or self-employed person's Archer MSA contributions made in 2013 and 2014 for 2013 $ 2 Total contributions made in 2013 $	OMB No. 1545-1518 **2013** Form **5498-SA**	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S federal identification number / PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2014 for 2013 $		**Copy B**
PARTICIPANT'S name	4 Rollover contributions $	5 Fair market value of HSA, Archer MSA, or MA MSA $	**For Participant**
Street address (including apt. no.) City or town, province or state, country, and ZIP or foreign postal code	6 HSA ☐ Archer MSA ☐ MA MSA ☐		The information in boxes 1 through 6 is being furnished to the Internal Revenue Service.
Account number (see instructions)			

Form **5498-SA** (keep for your records) www.irs.gov/form5498sa Department of the Treasury - Internal Revenue Service

Excess Contributions

You will have excess contributions if the contributions to your HSA for the year are greater than the limits discussed earlier. Excess contributions are not deductible. Excess contributions made by your employer are included in your gross income. If the excess contribution is not included in box 1 of Form W-2, you must report the excess as "Other income" on your tax return.

Generally, you must pay a 6% excise tax on excess contributions. See Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts* (*Exhibit 8*), to figure the excise tax. The excise tax applies to each tax year the excess contribution remains in the account.

Exhibit 8
Part VII of Form 5329
Instructions for Additional Tax on Excess Contributions to HSAs

Part VII **Additional Tax on Excess Contributions to Health Savings Accounts (HSAs)**
Complete this part if you, someone on your behalf, or your employer contributed more to your HSAs for 2013 than is allowable or you had an amount on line 49 of your 2012 Form 5329.

42	Enter the excess contributions from line 48 of your 2012 Form 5329. If zero, go to line 47 . . .			42	
43	If the contributions to your HSAs for 2013 are less than the maximum allowable contribution, see instructions. Otherwise, enter -0-	43			
44	2013 distributions from your HSAs from Form 8889, line 16	44			
45	Add lines 43 and 44			45	
46	Prior year excess contributions. Subtract line 45 from line 42. If zero or less, enter -0-			46	
47	Excess contributions for 2013 (see instructions)			47	
48	Total excess contributions. Add lines 46 and 47			48	
49	**Additional tax.** Enter 6% (.06) of the **smaller** of line 48 **or** the value of your HSAs on December 31, 2013 (including 2013 contributions made in 2014). Include this amount on Form 1040, line 58, or Form 1040NR, line 56			49	

If you, someone on your behalf, or your employer contributed more to your HSAs for the year than is allowable or you had an amount on line 49 of your previous year's Form 5329, you may owe this tax. But you may be able to avoid the tax on any excess contributions (see below).

Line 43
If your contribution limit for your HSAs (line 12 of Form 8889, Health Savings Accounts (HSAs)) is greater than the contributions you made to your HSAs (or those made on your behalf) for 2013 (Form 8889, line 2), enter the difference on line 43. Also include on your Form 8889, line 13, the smaller of:

- Form 5329, line 43, or
- The excess, if any, of Form 5329, line 42, over Form 5329, line 44

Line 47
Enter the excess of your contributions (including those made on your behalf) to your HSAs (Form 8889, line 2) over your contribution limit (Form 8889, line 12). Also include on line 47 any excess contributions your employer made. However, you may withdraw some or all of the excess contributions and not pay the excise tax on the amount withdrawn if you meet the following conditions:

- You withdraw the excess contributions by the due date, including extensions, of your tax return for the year the contributions were made
- You withdraw any income earned on the withdrawn contributions and include the earnings in "Other income" on your tax return for the year you withdraw the contributions and earnings

Include the withdrawn contributions and related earnings on Form 8889, lines 14a and 14b.

If you timely filed your return without withdrawing the excess contributions, you can still make the withdrawal no later than six months after the due date of your tax return, excluding extensions. If you do, file an amended return with "Filed pursuant to section 301.9100-2" written at the top. Report any related earnings for the year on the amended return and include an explanation of the withdrawal. Make any other necessary changes on the amended return (for example, if you reported the contributions as excess contributions on your original return, include an amended Form 5329 reflecting that the withdrawn contributions are no longer treated as having been contributed).

Caution: If you fail to remain an eligible individual during any of the testing periods, discussed earlier, the amount you have to include in income is not an excess contribution. If you withdraw any of those amounts, the amount is treated the same as any other distribution from an HSA, discussed later.

Deducting an Excess Contribution in a Later Year

You may be able to deduct excess contributions for previous years that are still in your HSA. The excess contribution you can deduct for the current year is the lesser of the following two amounts:

- Your maximum HSA contribution limit for the year minus any amounts contributed to your HSA for the year
- The total excess contributions in your HSA at the beginning of the year

Amounts contributed for the year include contributions by you, your employer, and any other person. They also include any qualified HSA funding distribution made to your HSA. Any excess contribution remaining at the end of a tax year is subject to the excise tax. See Form 5329).

Distributions from an HSA

You will generally pay medical expenses during the year without being reimbursed by your HDHP until you reach the annual deductible for the plan. When you pay medical expenses during the year that are not reimbursed by your HDHP, you can ask the trustee of your HSA to send you a distribution from your HSA.

You can receive tax-free distributions from your HSA to pay or be reimbursed for qualified medical expenses you incur after you establish the HSA. If you receive distributions for other reasons, the amount you withdraw will be subject to income tax and may be subject to an additional 20% tax. You do not have to make distributions from your HSA each year.

Tip: If you are no longer an eligible individual, you can still receive tax-free distributions to pay or reimburse your qualified medical expenses.

Generally, a distribution is money you get from your health savings account. Your total distributions include amounts paid with a debit card that restricts payments to health care and amounts withdrawn from the HSA by other individuals that you have designated. The trustee will report any distribution to you and the IRS on Form 1099-SA, *Distributions from an HSA, Archer MSA, or Medicare Advantage MSA* (see *Exhibit 9*).

Exhibit 9
Form 1099-SA
Distributions from an HSA, Archer MSA, or Medicare Advantage MSA

☐ CORRECTED (if checked)

TRUSTEE'S/PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone number			OMB No. 1545-1517 2013 Form 1099-SA	**Distributions From an HSA, Archer MSA, or Medicare Advantage MSA**
PAYER'S federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess cont. $	**Copy B For Recipient**
RECIPIENT'S name Street address (including apt. no.) City or town, province or state, country, and ZIP or foreign postal code		3 Distribution code 5 HSA ☐ Archer MSA ☐ MA MSA ☐	4 FMV on date of death $	This information is being furnished to the Internal Revenue Service.
Account number (see instructions)				

Form **1099-SA** (keep for your records) www.irs.gov/form1099sa Department of the Treasury - Internal Revenue Service

Qualified Medical Expenses

Qualified medical expenses are those expenses that would generally qualify for the medical and dental expenses deduction. These are explained in detail in Chapter 1 under – *Tax-Favored Health Plans*.

Also, non-prescription medicines (other than insulin) are not considered qualified medical expenses for HAS purposes. A medicine or drug will be a qualified medical expense for HSA purposes only if the medicine or drug:

1. Requires a prescription,
2. Is available without a prescription (an over-the-counter medicine or drug) and you get a prescription for it, or
3. Is insulin.

For HSA purposes, expenses incurred before you establish your HSA are not qualified medical expenses. State law determines when an HSA is established. An HSA that is funded by amounts rolled over from an Archer MSA or another HSA is established on the date the prior account was established.

If, under the last-month rule, you are considered to be an eligible individual for the entire year for determining the contribution amount, only those expenses incurred after you actually establish your HSA are qualified medical expenses.

Qualified medical expenses are those incurred by the following persons:

1. You and your spouse
2. All dependents you claim on your tax return
3. Any person you could have claimed as a dependent on your return except that:
    a. The person filed a joint return
    b. The person had gross income of $3,900 or more
    c. You, or your spouse if filing jointly, could be claimed as a dependent on someone else's 2013 return

Tip: For this purpose, a child of parents that are divorced, separated, or living apart for the last 6 months of the calendar year is treated as the dependent of both parents whether or not the custodial parent releases the claim to the child's exemption.

Caution: You cannot deduct qualified medical expenses as an itemized deduction on Schedule A (Form 1040) that are equal to the tax-free distribution from your HSA.

Insurance Premiums

You cannot treat insurance premiums as qualified medical expenses unless the premiums are for:

1. Long-term care insurance
2. Health care continuation coverage (such as coverage under COBRA)
3. Health care coverage while receiving unemployment compensation under federal or state law
4. Medicare and other health care coverage if you were 65 or older (other than premiums for a Medicare supplemental policy, such as Medigap)

The premiums for long-term care insurance (item (1)) that you can treat as qualified medical expenses are subject to limits based on age and are adjusted annually (*Exhibit 10*).

Items (2) and (3) can be for your spouse or a dependent meeting the requirement for that type of coverage. For item (4), if you, the account beneficiary, are not 65 or older, Medicare premiums for coverage of your spouse or a dependent (who is 65 or older) generally are not qualified medical expenses.

Note: A qualified long-term care insurance contract is an insurance contract that provides only coverage of qualified long-term care services. The contract must:

1. Be guaranteed renewable
2. Not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed
3. Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract must be used only to reduce future premiums or increase future benefits
4. Generally not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer, or the contract makes *per diem* or other periodic payments without regard to expenses

Exhibit 10
Deductibility Limit on Long-Term Care Premiums
(Instructions for Schedule A)

The amount you can deduct for qualified long-term care insurance contracts (as defined above) depends on the age, at the end of 2013, of the person for whom the premiums were paid. See the chart below for details.

If the person was, at the end of 2013, age…	THEN the most you can deduct is…
40 or under	$360
41 – 50	$680
51 – 60	$1,360
61 – 70	$3,640
71 or older	$4,550

Health Coverage Tax Credit

You cannot claim this credit for premiums that you pay with a tax-free distribution from your HSA.

Deemed Distributions from HSAs

The following situations result in deemed taxable distributions from your HSA:

- You engaged in any transaction prohibited by section 4975 with respect to any of your HSAs, at any time in 2013. Your account ceases to be an HSA as of January 1, 2013, and you must include the fair market value of all assets in the account as of January 1, 2013, on Form 8889.
- You used any portion of any of your HSAs as security for a loan at any time in 2013. You must include the fair market value of the assets used as security for the loan as income on Form 1040 or Form 1040NR.

Examples of prohibited transactions include the direct or indirect:

- Sale, exchange, or leasing of property between you and the HSA
- Lending of money between you and the HSA
- Furnishing goods, services, or facilities between you and the HSA
- Transfer to or use by you, or for your benefit, of any assets of the HSA

Any deemed distribution will not be treated as used to pay qualified medical expenses. These distributions are included in your income and are subject to the additional 20% tax, discussed later.

Recordkeeping

You must keep records sufficient to show that:

- The distributions were exclusively to pay or reimburse qualified medical expenses
- The qualified medical expenses had not been previously paid or reimbursed from another source
- The medical expenses had not been taken as an itemized deduction in any year

Do not send these records with your tax return. Keep them with your tax records.

Reporting Distributions on Your Return

How you report your distributions depends on whether or not you use the distribution for qualified medical expenses (defined earlier).

- If you use a distribution from your HSA for qualified medical expenses, you do not pay tax on the distribution but you have to report the distribution on Form 8889. However, the distribution of an excess contribution taken out after the due date, including extensions, of your return is subject to tax even if used for qualified medical expenses. Follow the instructions for the form and file it with your Form 1040 or Form 1040NR.
- If you do not use a distribution from your HSA for qualified medical expenses, you must pay tax on the distribution. Report the amount on Form 8889 and file it with your Form 1040 or Form 1040NR. You may have to pay an additional 20% tax on your taxable distribution.

Tip: HSA administration and maintenance fees withdrawn by the trustee are not reported as distributions from the HSA.

Additional Tax

There is an additional 20% tax on the part of your distributions not used for qualified medical expenses. Figure the tax on Form 8889 and file it with your Form 1040 or Form 1040NR.

Exceptions

There is no additional tax on distributions made after the date you are disabled, reach age 65, or die.

Balance in an HSA

An HSA is generally exempt from tax. You are permitted to take a distribution from your HSA at any time; however, only those amounts used exclusively to pay for qualified medical expenses are tax free. Amounts that remain at the end of the year are generally carried over to the next year (see *Excess Contributions*). Earnings on amounts in an HSA are not included in your income while held in the HSA.

Death of HSA Holder

You should choose a beneficiary when you set up your HSA. What happens to that HSA when you die depends on whom you designate as the beneficiary.

Spouse is the Designated Beneficiary

If your spouse is the designated beneficiary of your HSA, it will be treated as your spouse's HSA after your death.

Spouse is Not the Designated Beneficiary

If your spouse is not the designated beneficiary of your HSA:

- The account stops being an HSA
- The fair market value of the HSA becomes taxable to the beneficiary in the year in which you die

If your estate is the beneficiary, the value is included on your final income tax return.

Tip: The amount taxable to a beneficiary other than the estate is reduced by any qualified medical expenses for the decedent that are paid by the beneficiary within one year after the date of death.

Filing Form 8889

You must file Form 8889 (*Exhibit 6*) with your Form 1040 or Form 1040NR if you (or your spouse, if married filing a joint return) had any activity in your HSA during the year. You must file the form even if only your employer or your spouse's employer made contributions to the HSA.

If, during the tax year, you are the beneficiary of two or more HSAs or you are a beneficiary of an HSA and you have your own HSA, you must complete a separate Form 8889 for each HSA. Enter "statement" at the top of each Form 8889 and complete the form as instructed. Next, complete a controlling Form 8889 combining the amounts shown on each of the statement Forms 8889. Attach the statements to your tax return after the controlling Form 8889.

Employer Participation

This section contains the rules that employers must follow if they decide to make HSAs available to their employees. Unlike the previous discussions, "you" refers to the employer and not to the employee.

Health Plan

If you want your employees to be able to have an HSA, they must have an HDHP. You can provide no additional coverage other than those exceptions listed previously under *Other Health Coverage*.

Contributions

You can make contributions to your employees' HSAs. You deduct the contributions on the "Employee benefit programs" line of your business income tax return for the year in which you make the contributions. If the contribution is allocated to the prior year, you still deduct it in the year in which you made the contribution. If you are filing Form 1040, Schedule C, this is Part II, line 14.

The following questions/answers and examples regarding employer contributions references portions of *Notice 2008-59, 2008-29 I.R.B. 123.*

Question 1
If an employer contributes to the account of an employee who was never an eligible individual, can the employer recoup the amounts?

If the employee was never an eligible individual under § 223(c)(1), then no HSA ever existed and the employer may correct the error. At the employer's option, the employer may request that the financial institution return the amounts to the employer. However, if the employer does not recover the amounts by the end of the taxable year, then the amounts must be included as gross income and wages on the employee's Form W-2 for the year during which the employer made the contributions.

Example
In February 2013, Employer L contributed $500 to an account of Employee M, reasonably believing the account to be an HSA. In July 2013, Employer L first learned that Employee M's account is not an HSA because Employee M has never been an eligible individual under § 223(c).

Employer L may request that the financial institution holding Employee M's account return the balance of the account ($500 plus earnings less administration fees directly paid from the account) to Employer L. If Employer L does not receive the balance of the account, Employer L must include the amounts in Employee M's gross income and wages on his Form W-2 for 2013.

Example
The same facts as in the above example except Employer L first discovers the mistake in July 2014. Employer L issues a corrected 2013 Form W-2 for Employee M, and Employee M files an amended federal income tax return for 2013.

Question 2
If an employer contributes amounts to an employee's HSA that exceed the maximum annual contribution allowed in § 223(b) due to an error, can the employer recoup the excess amounts?

If the employer contributes amounts to an employee's HSA that exceed the maximum annual contribution allowed in § 223(b) due to an error, the employer may correct the error. In that case, at the employer's option, the employer may request that the financial institution return the excess amounts to the employer. Alternatively, if the employer does not recover the amounts, then the amounts must be included as gross income and wages on the employee's Form W-2 for the year during which the employer made contributions.

If, however, amounts contributed are less than or equal to the maximum annual contribution allowed in § 223(b), the employer may not recoup any amount from the employee's HSA.

Question 3
If an employer contributes to the HSA of an employee who ceases to be an eligible individual during a year, can the employer recoup amounts that the employer contributed after the employee ceased to be an eligible individual?

No. Employers generally cannot recoup amounts from an HSA other than as discussed above in Q&A-1 and Q&A-2 above.

Example
Employee N was an eligible individual on January 1, 2013. On April 1, 2013, Employee N is no longer an eligible individual because Employee N's spouse enrolled in a general purpose health FSA that covers all family members. Employee N first realizes that he is no longer eligible on July 17, 2013, at which time Employee N informs Employer O to cease HSA contributions.

Employer O's contributions into Employee N's HSA between April 1, 2013 and July 17, 2013 cannot be recouped by Employer O because Employee N has a nonforfeitable interest in his HSA. Employee N is responsible for determining if the contributions exceed the maximum annual contribution limit in § 223(b), and for withdrawing the excess contribution and the income attributable to the excess contribution and including both in gross income.

Question 4
Are employer contributions to the HSA of an employee's spouse (who is not an employee of this employer) excluded from the employee's gross income and wages?

No. The exclusion under § 106(d)(1) is limited to contributions by an employer to the HSA of an employee who is an eligible individual. Any contribution by an employer to the HSA of a non-employee (*e.g.*, a spouse of an employee or any other individual), including salary reduction amounts made through a § 125 cafeteria plan, must be included in the gross income and wages of the employee.

Comparable Contributions
If you decide to make contributions, you must make comparable contributions to all comparable participating employees' HSAs. Your contributions are comparable if they are either:
- The same amount
- The same percentage of the annual deductible limit under the HDHP covering the employees

The comparability rules do not apply to contributions made through a cafeteria plan.

Comparable Participating Employees
Comparable participating employees:
- Are covered by your HDHP and are eligible to establish an HSA
- Have the same category of coverage (either self-only or family coverage)
- Have the same category of employment (part-time, full-time, or former employees)

To meet the comparability requirements for eligible employees who have not established an HSA by December 31 or have not notified you that they have an HSA, you must meet a notice requirement and a contribution requirement.

You will meet the notice requirement if by January 15 of the following calendar year you provide a written notice to all such employees. The notice must state that each eligible employee who, by the last day of February, establishes an HSA and notifies you that they have established an HSA will receive a comparable contribution to the HSA for the prior year. Regulation 54.4980G-4 A-14(c) provides sample wording that can be used as a basis in preparing employer notices. You will meet the contribution requirement for these employees if by April 15, 2014, you contribute comparable amounts plus reasonable interest to the employee's HSA for the prior year.

Note: For purposes of making contributions to HSAs of non-highly compensated employees, highly compensated employees shall not be treated as comparable participating employees.

Excise Tax
If you made contributions to your employees' HSAs that were not comparable, you must pay an excise tax of 35% of the amount you contributed.

Employment Taxes
Amounts you contribute to your employees' HSAs are generally not subject to employment taxes. You must report the contributions in box 12 of the Form W-2 you file for each employee. This includes the amounts the employee elected to contribute through a cafeteria plan. Enter code "W" in box 12.

Review Questions

1. What is an eligibility requirement for HSA benefits?
    A. You must not be covered under a high deductible health plan
    B. You must be claimed as a dependent on someone else's tax return
    C. You must not be enrolled in Medicare
    D. You must have any additional health coverage

2. Which of the following cannot make contributions to an HSA?
    A. An employee covered by an HDHP and a health FSA or an HRA that pays or reimburses qualified medical expenses
    B. An employee covered under an HDHP and a limited-purpose health FSA or HRA arrangement
    C. An employee covered under an HDHP and a suspended HRA
    D. An employee covered under an HDHP and post-deductible health FSA or HRA

3. Which of the following are treated as employer contributions on your return?
    A. All contributions made by your employer that are included in your income
    B. Contributions to an employee's account by an employer using the amount of an employee's salary reduction through a cafeteria plan
    C. Contributions by a partnership to a bona fide partner's HAS
    D. Contributions by an S corporation to a shareholder-employee's HSAs for services rendered

4. What term is used to describe money you get from your health savings account?
    A. Other income
    B. Distribution
    C. Qualified medical expense
    D. Insurance premium

5. What is required for a long-term care insurance contract to be treated as a qualified medical expense?
    A. Guaranteed renewable
    B. Provide for a cash surrender value
    C. Provide the same level of coverage regardless of age
    D. Pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare

Review Answers

1. A. Incorrect. An eligibility requirement for HSA benefits is that you must be covered under a high deductible health plan.
   B. Incorrect. An eligibility requirement for HSA benefits is that you cannot be claimed as a dependent on someone else's tax return.
   C. **Correct.** An eligibility requirement for HSA benefits is that you must not be enrolled in Medicare.
   D. Incorrect. An eligibility requirement for HSA benefits is that you have no other health coverage except what is permitted.

2. A. **Correct.** An employee covered by an HDHP and a health FSA or an HRA that pays or reimburses qualified medical expenses generally cannot make contributions to an HSA.
   B. Incorrect. An employee covered under an HDHP and a limited-purpose health FSA or HRA arrangement can make contributions to an HSA.
   C. Incorrect. An employee covered under an HDHP and a suspended HRA can make contributions to an HSA.
   D. Incorrect. An employee covered under an HDHP and post-deductible health FSA or HRA can make contributions to an HSA.

3. A. Incorrect. All contributions made by your employer that are included in your income are not treated as an employer contribution on your return. Rather, contributions made by your employer are not included in your income.
   B. **Correct.** Contributions to an employee's account by an employer using the amount of an employee's salary reduction through a cafeteria plan are treated as employer contributions on your return.
   C. Incorrect. Contributions by a partnership to a bona fide partner's HSA are not treated as an employer contribution on your return. Rather, the contributions are treated as a distribution of money and are not included in the partner's gross income.
   D. Incorrect. Contributions by an S corporation to a shareholder-employee's HSAs for services rendered are not treated as an employer contribution on your return. Instead, the contribution is treated as guaranteed payments and is deductible by the S corporation and includible in the shareholder-employee's gross income.

4. A. Incorrect. Other income is not the term used to describe money you get from your health savings account. Instead, any excess contribution made by your employer to your HSA for the year that is not included in box 1 of Form W-2, you must report the excess as other income on your tax return.
   B. **Correct.** Distribution is the term used to describe money you get from your health savings account. Your total distributions include amounts paid with a debit card that restricts payments to health care and amounts withdrawn from the HSA by other individuals that you have designated.
   C. Incorrect. Qualified medical expense is not the term used to describe money you get from your health savings account. Rather, qualified medical expenses are those incurred by you and your spouse, all dependents you claim on your tax return and any person you could have claimed as a dependent on your tax return per rules and guidelines.
   D. Incorrect. Insurance premium is not the term used to describe money you get from your health savings account. Instead, insurance premiums are treated as qualified medical expenses if the premiums are for long-term care insurance, health care continuation coverage, health care coverage while receiving unemployment under federal or state law, or Medicare and other health care coverage if you were 65 or older.

5. A. **Correct.** A long-term care insurance contract must be guaranteed renewable to be treated as a qualified medical expense.
   B. Incorrect. A long-term care insurance contract is not required to provide for a cash surrender value. Conversely, a long-term care insurance contract must not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed.
   C. Incorrect. A long-term care insurance contract is not required to provide the same level of coverage regardless of age. Instead, premiums for long-term care insurance are subject to limits based on age and are adjusted annually.
   D. Incorrect. A long-term care insurance contract is not required to pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare. Further, the only exception is in situations where Medicare is a secondary payer, or the contract makes per diem or other periodic payments without regard to expenses.

Chapter 3
Medical Savings Accounts (MSAs)

Learning Objectives

- Determine the employee limit for Archer MSA eligibility
- Pinpoint the annual out-of-pocket limit for an Archer MSA
- Recognize a contribution requirement of Archer MSAs
- Identify a regulation related to Archer MSA distributions

Introduction

Archer MSAs were created to help self-employed individuals and employees of certain small employers meet the medical care costs of the account holder, the account holder's spouse, or the account holder's dependent(s).

Caution: After December 31, 2007, you cannot be treated as an eligible individual for Archer MSA purposes unless:
1. You were an active participant for any tax year ending before January 1, 2008, or
2. You became an active participant for a tax year ending after December 31, 2007, by reason of coverage under a high deductible health plan (HDHP) of an Archer MSA participating employer

A Medicare Advantage MSA is an Archer MSA designated by Medicare to be used solely to pay the qualified medical expenses of the account holder who is eligible for Medicare.

Archer MSAs

An Archer MSA is a tax-exempt trust or custodial account that you set up with a U.S. financial institution (such as a bank or an insurance company) in which you can save money exclusively for future medical expenses.

Archer MSA Benefits

- You can claim a tax deduction for contributions you make even if you do not itemize your deductions on Form 1040 or Form 1040NR
- The interest or other earnings on the assets in your Archer MSA are tax free
- Distributions may be tax free if you pay qualified medical expenses (see *Qualified Medical Expenses*)
- The contributions remain in your Archer MSA from year to year until you use them
- An Archer MSA is "portable" so it stays with you if you change employers or leave the work force

Qualifying for an Archer MSA

To qualify for an Archer MSA, you must be either of the following:
- An employee (or the spouse of an employee) of a small employer (defined later) that maintains a self-only or family HDHP for you (or your spouse)
- A self-employed person (or the spouse of a self-employed person) who maintains a self-only or family HDHP

You can have no other health or Medicare coverage except what is permitted under *Other Health Coverage*, later. You must be an eligible individual on the first day of a given month to get an Archer MSA deduction for that month.

Caution: If another taxpayer is entitled to claim an exemption for you, you cannot claim a deduction for an Archer MSA contribution. This is true even if the other person does not actually claim your exemption.

Small Employer

A small employer is generally an employer who had an average of 50 or fewer employees during either of the last 2 calendar years. The definition of small employer is modified for new employers and growing employers.

Growing Employer

A small employer may begin HDHPs and Archer MSAs for his or her employees and then grow beyond 50 employees. The employer will continue to meet the requirement for small employers if he or she:

- Had 50 or fewer employees when the Archer MSAs began
- Made a contribution that was excludable or deductible as an Archer MSA for the last year he or she had 50 or fewer employees
- Had an average of 200 or fewer employees each year after 1996

Changing Employers

If you change employers, your Archer MSA moves with you. However, you may not make additional contributions unless you are otherwise eligible.

High Deductible Health Plan (HDHP)

To be eligible for an Archer MSA, you must be covered under an HDHP. An HDHP has:

- A higher annual deductible than typical health plans
- A maximum limit on the annual out-of-pocket medical expenses that you must pay for covered expenses

Limits

The following exhibit shows the limits for annual deductibles and the maximum out-of-pocket expenses for HDHPs for 2013.

Exhibit 1
Annual Deductible Limits and
Maximum Out-of-Pocket Expenses for HDHPs for 2013

	Self-Only Coverage	Family Coverage
Minimum Annual Deductible	$2,150	$4,300
Maximum Annual Deductible	$3,200	$6,450
Maximum Annual Out-of-Pocket Expenses	$4,300	$7,850

Family Plans That Do Not Meet the High Deductible Rules

There are some family plans that have deductibles for both the family as a whole and for individual family members. Under these plans, if you meet the individual deductible for one family member, you do not have to meet the higher annual deductible amount for the family. If either the deductible for the family as a whole or the deductible for an individual family member is below the minimum annual deductible for family coverage, the plan does not qualify as an HDHP.

Example
You have family health insurance coverage in 2013. The annual deductible for the family plan is $5,500. This plan also has an individual deductible of $2,000 for each family member. The plan does not qualify as an HDHP because the deductible for an individual family member is below the minimum annual deductible ($4,300) for family coverage.

Other Health Coverage

You (and your spouse, if you have family coverage) generally cannot have any other health coverage that is not an HDHP. However, you can still be an eligible individual even if your spouse has non-HDHP coverage provided you are not covered by that plan. However, you can have additional insurance that provides benefits only for the following items:

- Liabilities incurred under workers' compensation laws, torts, or ownership or use of property
- A specific disease or illness
- A fixed amount per day (or other period) of hospitalization

You can also have coverage (whether provided through insurance or otherwise) for the following items:

- Accidents
- Disability
- Dental care
- Vision care
- Long-term care

Contributions to an MSA

Contributions to an Archer MSA must be made in cash. You cannot contribute stock or other property to an Archer MSA.

Who Can Contribute to My Archer MSA?

If you are an employee, your employer may make contributions to your Archer MSA (you do not pay tax on these contributions). If your employer does not make contributions to your Archer MSA, or you are self-employed, you can make your own contributions to your Archer MSA. Both you and your employer cannot make contributions to your Archer MSA in the same year. You do not have to make contributions to your Archer MSA every year.

Caution: If your spouse is covered by your HDHP and an excludable amount is contributed by your spouse's employer to an Archer MSA belonging to your spouse, you cannot make contributions to your own Archer MSA that year.

Limits

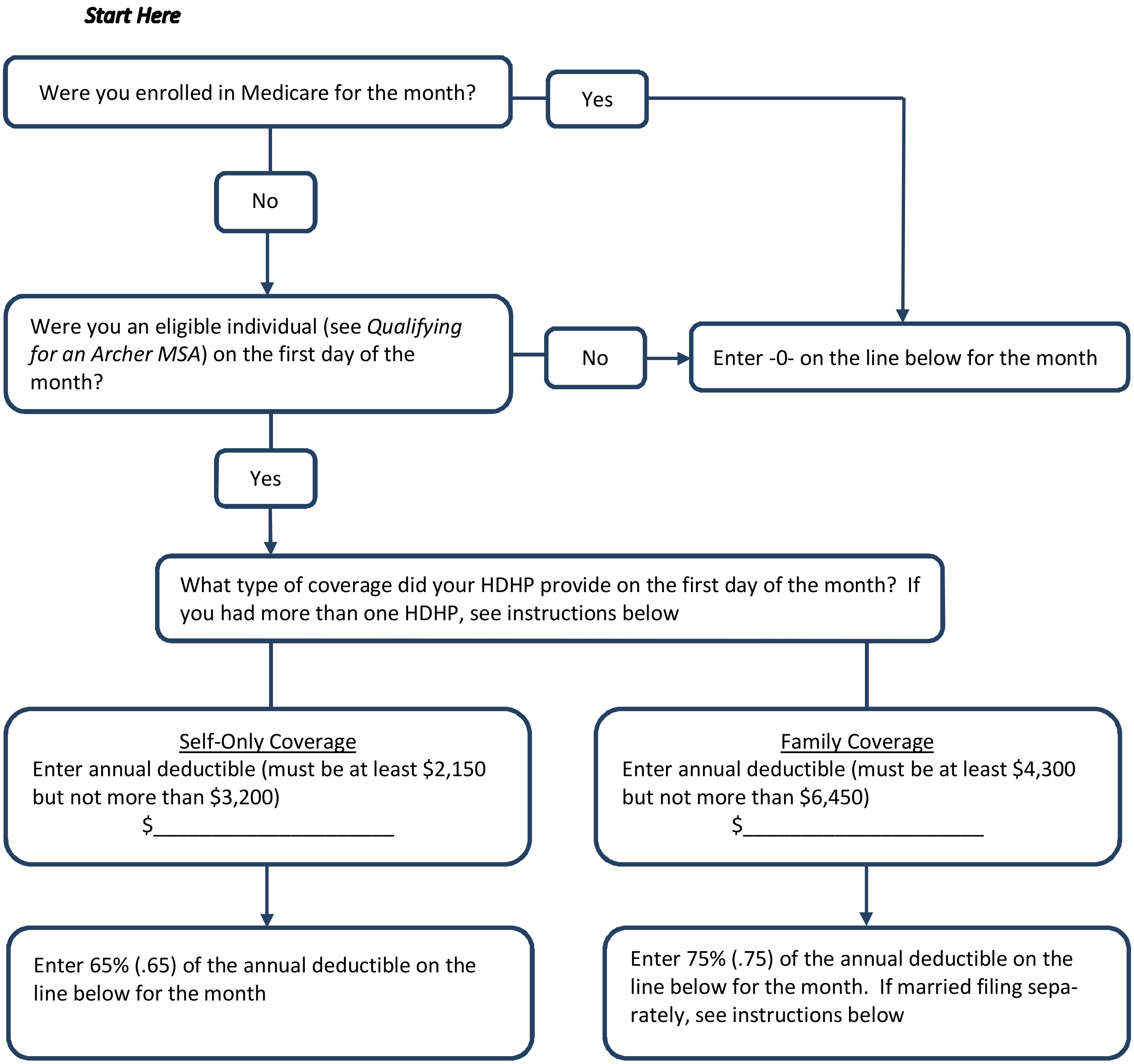
There are two limits on the amount you or your employer can contribute to your Archer MSA:

- The annual deductible limit
- An income limit

Annual Deductible Limit

You (or your employer) can contribute up to 75% of the annual deductible of your HDHP (65% if you have a self-only plan) to your Archer MSA. You must have the HDHP all year to contribute the full amount. If you do not qualify to contribute the full amount for the year, determine your annual deductible limit by using the worksheet for line 3 in the Instructions for Form 8853, Archer MSAs and Long-Term Care Insurance Contracts (*Exhibits 2 and 3*).

Exhibit 2
Line 3 Limitation Chart
Instructions for Form 8853



More Than One HDHP

If you and your spouse had more than one HDHP on the first day of the month and one of the plans provides family coverage, use the *Family Coverage* rules on the chart and disregard any plans with self-only coverage. If you and your spouse both have HDHPs with family coverage on the first day of the month, you both are treated as having only the family coverage plan with the lowest annual deductible.

Married Filing Separately

If you have an HDHP with family coverage and are married filing separately, enter only 37.5% (.375) (one-half of 75%) of the annual deductible on the worksheet; or, if you and your spouse agree to divide the 75% of the annual deductible in a different manner, enter your share.

Exhibit 3
Line 3 Worksheet
Instructions for Form 8853

Month in 2013	Amount from Chart Above
January	____________________
February	____________________
March	____________________
April	____________________
May	____________________
June	____________________
July	____________________
August	____________________
September	____________________
October	____________________
November	____________________
December	____________________
Total for all months	____________________
Limitation. Divide the total by 12. Enter here on line 3	____________________

Tip: If eligibility and coverage of both you and your spouse did not change from one month to the next, enter the same number you entered for the previous month. If eligibility and coverage did not change during the entire year, figure the number for January only, and enter this amount on Form 8853, line 3.

Example

You have an HDHP for your family all year in 2013. The annual deductible is $5,000. You can contribute up to $3,750 ($5,000 × 75%) to your Archer MSA for the year.

Example

You have an HDHP for your family for the entire months of July through December 2013 (6 months). The annual deductible is $5,000. You can contribute up to $1,875 ($5,000 × 75% ÷ 12 × 6) to your Archer MSA for the year.

Tip: If you and your spouse each have a family plan, you are treated as having family coverage with the lower annual deductible of the two health plans. The contribution limit is split equally between you unless you agree on a different division.

Income Limit

You cannot contribute more than you earned for the year from the employer through whom you have your HDHP.

If you are self-employed, you cannot contribute more than your net self-employment income. This is your income from self-employment minus expenses (including the deductible part of self-employment tax).

Example

Noah Paul earned $25,000 from ABC Company in 2013. Through ABC, he had an HDHP for his family for the entire year. The annual deductible was $5,000. He can contribute up to $3,750 to his Archer MSA (75% × $5,000). He can contribute the full amount because he earned more than $3,750 at ABC.

Example

Westley Lawrence is self-employed. He had an HDHP for his family for the entire year in 2013. The annual deductible was $5,000. Based on the annual deductible, the maximum contribution to his Archer MSA would have been $3,750 (75% × $5,000). However, after deducting his business expenses, Joe’s net self-employment income is $2,500 for the year. Therefore, he is limited to a contribution of $2,500.

Individuals enrolled in Medicare

Beginning with the first month you are enrolled in Medicare, you cannot contribute to an Archer MSA. However, you may be eligible for a Medicare Advantage MSA, discussed later.

When to Contribute

You can make contributions to your Archer MSA for 2013 until April 15, 2014.

Reporting Contributions on Your Return

Report all contributions to your Archer MSA on Form 8853 and file it with your Form 1040 or Form 1040NR. You should include all contributions you, or your employer, made for 2013, including those made by April 15, 2014, that are designated for 2013.

You should receive Form 5498-SA, *HSA, Archer MSA, or Medicare Advantage MSA Information,* (*Exhibit 4*), from the trustee showing the amount you (or your employer) contributed during the year. Your employer’s contributions should be shown in box 12 of Form W-2, *Wage and Tax Statement*, with code R. Follow the instructions for Form 8853 and complete the worksheet for line 3 (*Exhibit 2 and 3*). Report your Archer MSA deduction (line 5 of Form 8853) on Form 1040 or Form 1040NR.

Exhibit 4
Form 5498-SA
HSA, Archer MSA, or Medicare Advantage MSA Information

☐ CORRECTED (if checked)

TRUSTEE'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone number		1 Employee or self-employed person's Archer MSA contributions made in 2013 and 2014 for 2013 $ 2 Total contributions made in 2013 $	OMB No. 1545-1518 **2013** Form **5498-SA**	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S federal identification number	PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2014 for 2013 $		**Copy B** **For Participant**
PARTICIPANT'S name		4 Rollover contributions $	5 Fair market value of HSA, Archer MSA, or MA MSA $	
Street address (including apt. no.) City or town, province or state, country, and ZIP or foreign postal code		6 HSA ☐ Archer MSA ☐ MA MSA ☐		The information in boxes 1 through 6 is being furnished to the Internal Revenue Service.
Account number (see instructions)				

Form **5498-SA** (keep for your records) www.irs.gov/form5498sa Department of the Treasury - Internal Revenue Service

Excess Contributions

You will have excess contributions if the contributions to your Archer MSA for the year are greater than the limits discussed earlier. Excess contributions are not deductible. Excess contributions made by your employer are included in your gross income. If the excess contribution is not included in box 1 of Form W-2, you must report the excess as "Other income" on your tax return.

Generally, you must pay a 6% excise tax on excess contributions. See Form 5329 *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts,* (*Exhibit 5*), to figure the excise tax. The excise tax applies to each tax year the excess contribution remains in the account.

You may withdraw some or all of the excess contributions and not pay the excise tax on the amount withdrawn if you meet the following conditions:

- You withdraw the excess contributions by the due date, including extensions, of your tax return
- You withdraw any income earned on the withdrawn contributions and include the earnings in "Other income" on your tax return for the year you withdraw the contributions and earnings

Exhibit 5
Part VI of Form 5329
Instructions for Additional Tax on Excess Contributions to HSAs

Part VI **Additional Tax on Excess Contributions to Archer MSAs**
Complete this part if you or your employer contributed more to your Archer MSAs for 2013 than is allowable or you had an amount on line 41 of your 2012 Form 5329.

34	Enter the excess contributions from line 40 of your 2012 Form 5329 (see instructions). If zero, go to line 39		34	
35	If the contributions to your Archer MSAs for 2013 are less than the maximum allowable contribution, see instructions. Otherwise, enter -0-	35		
36	2013 distributions from your Archer MSAs from Form 8853, line 8	36		
37	Add lines 35 and 36		37	
38	Prior year excess contributions. Subtract line 37 from line 34. If zero or less, enter -0-		38	
39	Excess contributions for 2013 (see instructions)		39	
40	Total excess contributions. Add lines 38 and 39		40	
41	**Additional tax.** Enter 6% (.06) of the **smaller** of line 40 **or** the value of your Archer MSAs on December 31, 2013 (including 2013 contributions made in 2014). Include this amount on Form 1040, line 58, or Form 1040NR, line 56		41	

If you or your employer contributed more to your Archer MSA for the year than is allowable or you had an amount on line 41 of your previous year's Form 5329, you may owe this tax. But you may be able to avoid the tax on any excess contributions (see below).

Line 34
Enter the amount from line 40 of your previous year's Form 5329 only if the amount on line 41 of your previous year's Form 5329 is more than zero.

Line 35
If you contribution limit for your Archer MSAs (the smaller of line 3 or line 4 of Form 8853, *Archer MSAs and Long-Term Care Insurance Contracts)* is greater than the contributions to your Archer MSAs for the tax year, enter the difference on line 35. Also include on your Form 8853, line 5, the smaller of:

- Form 5329, line 35
- The excess, if any of Form 5329, line 34, over Form 5329, line 36

Line 39
Enter the excess of your contributions to your Archer MSA (from Form 8853, line 2) over your contribution limit (the smaller of line 3 or line 4 of Form 8853). Also include on line 39 any excess contributions your employer made. See the instructions for Form 8853 for details.

However, you can withdraw some or all of the excess contributions and not pay the excise tax on the amount withdrawn if you meet the following conditions:

- You withdraw the excess contributions by the due date, including extensions, of your tax return for the year the contributions were made
- You withdraw any income earned on the withdrawn contributions and include the earnings in "Other income" on your tax return for the year you withdraw the contributions and earnings

Include the withdrawn contributions and related earnings on Form 8853, lines 6a and 6b.

If you timely filed your return without withdrawing the excess contributions, you can still make the withdrawal no later than six months after the due date of your tax return, excluding extensions. If you do, file an amended return with "Filed pursuant to section 301.9100-2" written at the top. Report any related earnings for the year on the amended return and include an explanation of the withdrawal. Make any other necessary changes on the amended return (for example, if you reported the contributions as excess contributions on your original return, include an amended Form 5329 reflecting that the withdrawn contributions are no longer treated as having been contributed).

Deducting an Excess Contribution in a Later Year

You may be able to deduct excess contributions for previous years that are still in your Archer MSA. The excess contribution you can deduct in the current year is the lesser of the following two amounts:

- Your maximum Archer MSA contribution limit for the year minus any amounts contributed to your Archer MSA for the year
- The total excess contributions in your Archer MSA at the beginning of the year

Any excess contributions remaining at the end of a tax year are subject to the excise tax (see Form 5329).

Distributions from an MSA

You will generally pay medical expenses during the year without being reimbursed by your HDHP until you reach the annual deductible for the plan. When you pay medical expenses during the year that are not reimbursed by your HDHP, you can ask the trustee of your Archer MSA to send you a distribution from your Archer MSA.

You can receive tax-free distributions from your Archer MSA to pay for qualified medical expenses (discussed later). If you receive distributions for other reasons, the amount will be subject to income tax and may be subject to an additional 20% tax as well. You do not have to make withdrawals from your Archer MSA each year.

Tip: If you no longer qualify to make contributions, you can still receive tax-free distributions to pay or reimburse your qualified medical expenses.

A distribution is money you get from your Archer MSA. The trustee will report any distribution to you and the IRS on Form 1099-SA, *Distributions from an HSA, Archer MSA, or Medicare Advantage MSA*, (*Exhibit 6*).

Exhibit 6
Form 1099-SA
Distributions from an HSA, Archer MSA, or Medicare Advantage MSA

☐ CORRECTED (if checked)

TRUSTEE'S/PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone number			OMB No. 1545-1517 2013 Form 1099-SA	**Distributions From an HSA, Archer MSA, or Medicare Advantage MSA**
PAYER'S federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess cont. $	**Copy B For Recipient**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	
Street address (including apt. no.) City or town, province or state, country, and ZIP or foreign postal code		5 HSA ☐ Archer MSA ☐ MA MSA ☐		This information is being furnished to the Internal Revenue Service.
Account number (see instructions)				

Form **1099-SA** (keep for your records) www.irs.gov/form1099sa Department of the Treasury - Internal Revenue Service

Qualified Medical Expenses

Qualified medical expenses are those expenses that would generally qualify for the medical and dental expenses deduction. These are explained in detail in Chapter 1 under *Tax-Favored Health Plans*.

Also, non-prescription medicines (other than insulin) are not considered qualified medical expenses for MSA purposes. A medicine or drug will be a qualified medical expense for MSA purposes only if the medicine or drug:

1. Requires a prescription,
2. Is available without a prescription (an over-the-counter medicine or drug) and you get a prescription for it, or
3. Is insulin.

Qualified medical expenses are those incurred by the following persons:

1. You and your spouse
2. All dependents you claim on your tax return
3. Any person you could have claimed as a dependent on your return except that:
    a. The person filed a joint return
    b. The person had gross income of $3,900 or more
    c. You, or your spouse if filing jointly, could be claimed as a dependent on someone else's return

> **Tip:** For this purpose, a child of parents that are divorced, separated, or living apart for the last 6 months of the calendar year is treated as the dependent of both parents whether or not the custodial parent releases the claim to the child's exemption.

> **Caution:** You cannot deduct qualified medical expenses as an itemized deduction on Schedule A (Form 1040) that are equal to the tax-free distribution from your Archer MSA. This is the amount on line 7 of Form 8853.

Special Rules for Insurance Premiums

Generally, you cannot treat insurance premiums as qualified medical expenses for Archer MSAs. You can, however, treat premiums for long-term care coverage, health care coverage while you receive unemployment benefits, or health care continuation coverage required under any federal law as qualified medical expenses for Archer MSAs.

Health Coverage Tax Credit

You cannot claim this credit for premiums that you pay with a tax-free distribution from your Archer MSA.

Deemed Distributions from Archer MSAs

The following situations result in deemed taxable distributions from your Archer MSA:

- You engaged in any transaction prohibited by section 4975 with respect to any of your Archer MSAs at any time in 2013. Your account ceases to be an Archer MSA as of January 1, 2013, and you must include the fair market value of all assets in the account as of January 1, 201, on Form 8853.
- You used any portion of any of your Archer MSAs as security for a loan at any time in 2013. You must include the fair market value of the assets used as security for the loan as income on Form 1040 or Form 1040NR.

Examples of prohibited transactions include the direct or indirect:

- Sale, exchange, or leasing of property between you and the Archer MSA
- Lending of money between you and the Archer MSA

- Furnishing goods, services, or facilities between you and the Archer MSA
- Transfer to or use by you, or for your benefit, of any assets of the Archer MSA

Any deemed distribution will not be treated as used to pay qualified medical expenses. These distributions are included in your income and are subject to the additional 20% tax, discussed later.

Recordkeeping

You must keep records sufficient to show that:

- The distributions were exclusively to pay or reimburse qualified medical expenses
- The qualified medical expenses had not been previously paid or reimbursed from another source
- The medical expenses had not been taken as an itemized deduction in any year

Do not send these records with your tax return. Keep them with your tax records.

Reporting Distributions on Your Return

How you report your distributions depends on whether or not you use the distribution for qualified medical expenses (defined earlier).

- If you use a distribution from your Archer MSA for qualified medical expenses, you do not pay tax on the distribution but you have to report the distribution on Form 8853. Follow the instructions for the form and file it with your Form 1040 or Form 1040NR.
- If you do not use a distribution from your Archer MSA for qualified medical expenses, you must pay tax on the distribution. Report the amount on Form 8853 and file it with your Form 1040 or Form 1040NR. If you have a taxable Archer MSA distribution, include it in the total on Form 1040 or Form 1040NR, line 21, and enter “MSA” and the amount on the dotted line next to line 21. You may have to pay an additional 20% tax, discussed later, on your taxable distribution.

> **Caution:** If an amount (other than a rollover) is contributed to your Archer MSA this year (by you or your employer), you also must report and pay tax on a distribution you receive from your Archer MSA this year that is used to pay medical expenses of someone who is not covered by an HDHP, or is also covered by another health plan that is not an HDHP, at the time the expenses are incurred.

Rollovers

Generally, any distribution from an Archer MSA that you roll over into another Archer MSA or an HSA is not taxable if you complete the rollover within 60 days. An Archer MSA and an HSA can only receive one rollover contribution during a 1-year period.

Additional Tax

There is a 20% additional tax on the part of your distributions not used for qualified medical expenses. Figure the tax on Form 8853 and file it with your Form 1040 or Form 1040NR. Report the additional tax in the total on Form 1040 Form 1040NR.

Exceptions

There is no additional tax on distributions made after the date you are disabled, reach age 65, or die.

Balance in an Archer MSA

An Archer MSA is generally exempt from tax. You are permitted to take a distribution from your Archer MSA at any time; however, only those amounts used exclusively to pay for qualified medical expenses are tax free. Amounts that remain at the end of the year are generally carried over to the next year (see

Excess Contributions, earlier). Earnings on amounts in an Archer MSA are not included in your income while held in the Archer MSA.

Death of the Archer MSA Holder

You should choose a beneficiary when you set up your Archer MSA. What happens to that Archer MSA when you die depends on whom you designate as the beneficiary.

Spouse is the designated beneficiary

If your spouse is the designated beneficiary of your Archer MSA, it will be treated as your spouse's Archer MSA after your death.

Spouse is not the designated beneficiary

If your spouse is not the designated beneficiary of your Archer MSA:

- The account stops being an Archer MSA
- The fair market value of the Archer MSA becomes taxable to the beneficiary in the year in which you die

If your estate is the beneficiary, the fair market value of the Archer MSA will be included on your final income tax return.

Tip: The amount taxable to a beneficiary other than the estate is reduced by any qualified medical expenses for the decedent that are paid by the beneficiary within 1 year after the date of death.

Filing Form 8853

You must file Form 8853 (*see Appendix B*) with your Form 1040 or Form 1040NR if you (or your spouse, if married filing a joint return) had any activity in your Archer MSA during the year. You must file the form even if only your employer or your spouse's employer made contributions to the Archer MSA.

If, during the tax year, you are the beneficiary of two or more Archer MSAs or you are a beneficiary of an Archer MSA and you have your own Archer MSA, you must complete a separate Form 8853 for each MSA. Enter "statement" at the top of each Form 8853 and complete the form as instructed. Next, complete a controlling Form 8853 combining the amounts shown on each of the statement Forms 8853. Attach the statements to your tax return after the controlling Form 8853.

Employer Participation

This section contains the rules that employers must follow if they decide to make Archer MSAs available to their employees. Unlike the previous discussions, "you" refers to the employer and not to the employee.

Health Plan

If you want your employees to be able to have an Archer MSA, you must make an HDHP available to them. You can provide no additional coverage other than those exceptions listed previously under *Other Health Coverage.*

Contributions

You can make contributions to your employees' Archer MSAs. You deduct the contributions on the "Employee benefit programs" line of your business income tax return for the year in which you make the contributions. If you are filing Form 1040, Schedule C, this is Part II, line 14.

Comparable Contributions
If you decide to make contributions, you must make comparable contributions to all comparable participating employees' Archer MSAs. Your contributions are comparable if they are either:
- The same amount
- The same percentage of the annual deductible limit under the HDHP covering the employees

Comparable participating employees
Comparable participating employees include those that:
- Are covered by your HDHP and are eligible to establish an Archer MSA
- Have the same category of coverage (either self-only or family coverage)
- Have the same category of employment (either part-time or full-time)

Excise Tax
If you made contributions to your employees' Archer MSAs that were not comparable, you must pay an excise tax of 35% of the amount you contributed.

Employment Taxes
Amounts you contribute to your employees' Archer MSAs are generally not subject to employment taxes. You must report the contributions in box 12 of the Form W-2 you file for each employee. Enter code "R" in box 12.

Medicare Advantage MSAs

A Medicare Advantage MSA is an Archer MSA designated by Medicare to be used solely to pay the qualified medical expenses of the account holder. To be eligible for a Medicare Advantage MSA, you must be enrolled in Medicare and have a high deductible health plan (HDHP) that meets the Medicare guidelines.

A Medicare Advantage MSA is a tax-exempt trust or custodial savings account that you set up with a financial institution (such as a bank or an insurance company) in which the Medicare program can deposit money for qualified medical expenses. The money in your account is not taxed if it is used for qualified medical expenses, and it may earn interest or dividends.

An HDHP is a special health insurance policy that has a high deductible. You choose the policy you want to use as part of your Medicare Advantage MSA plan. However, the policy must be approved by the Medicare program.

Note: You must file Form 8853, *Archer MSAs and Long-Term Care Insurance Contracts*, with your tax return if you have a Medicare Advantage MSA.

Review Questions

1. Which of the following is a condition for contributing to an Archer MSA?
   A. Contributing only stock or other property
   B. Paying taxes on contributions made by your employer
   C. Agreeing to a yearly contribution contract
   D. Ensuring both you and your employer do not make contributions in the same year

2. Which of the following are not qualified medical expenses?
   A. Medical expenses incurred by you and your spouse
   B. Medical expenses incurred by all dependents you claim on your tax return
   C. Expenses for non-prescription insulin
   D. Medical expenses incurred by you, or your spouse if filing jointly, if either could be claimed as a dependent on someone else's return

3. Which of the following is taxable?
   A. The fair market value of the Archer MSA in the year in which you die
   B. Any distribution from an Archer MSA that you roll over into another Archer MSA
   C. Amounts used exclusively to pay for qualified medical expenses
   D. Medicare Advantage MSA

4. What should be made available by employers if they want employees to be able to have an Archer MSA?
   A. HDHP
   B. Opportunity to use the Archer MSA to lease property
   C. Opportunity to borrow money from the Archer MSA
   D. Opportunity to transfer assets of the Archer MSA

Review Answers

1. A. Incorrect. Contributing only stock or other property is not a condition for making contributions to an Archer MSA. Conversely, contributions to an Archer MSA must be made in cash.
   B. Incorrect. Paying taxes on contributions made by your employer is not a condition for contributing to an Archer MSA. Instead, you do not have to pay taxes on contributions made by your employer.
   C. Incorrect. Agreeing to a yearly contribution contract is not a condition for contributing to an Archer MSA. Rather, you do not have to make contributions to your Archer MSA every year.
   D. **Correct.** Ensuring both you and your employer do not make contributions to your Archer MSA in the same year is a condition for contributing to an Archer MSA.

2. A. Incorrect. Medical expenses incurred by you and your spouse are qualified medical expenses.
   B. Incorrect. Medical expenses incurred by all dependents you claim on your tax return are qualified medical expenses.
   C. Incorrect. Non-prescription insulin is a qualified medical expense.
   D. **Correct.** Medical expenses incurred by you, or your spouse if filing jointly, if either could be claimed as a dependent on someone else's return, are not qualified medical expenses.

3. A. **Correct.** The fair market value of the Archer MSA is taxable to the beneficiary in the year in which you die.
   B. Incorrect. Any distribution from an Archer MSA that you roll over into another Archer MSA or an HSA is not taxable.
   C. Incorrect. Amounts used exclusively to pay for qualified medical expenses are tax free.
   D. Incorrect. A Medicare Advantage MSA is a tax-exempt trust or custodial savings account that you set up with a financial institution in which the Medicare program can deposit money for qualified medical expenses.

4. A. **Correct.** An HDHP should be made available by employers if they want employees to be able to have an Archer MSA.
   B. Incorrect. The opportunity to use the Archer MSA to lease property should not be made available by employers if they want employees to be able to have an Archer MSA. Rather, the direct or indirect sale, exchange, or leasing of property between you and the Archer MSA is a prohibited transaction
   C. Incorrect. The opportunity to borrow money from the Archer MSA should not be made available by employers if they want employees to be able to have an Archer MSA. Instead, the lending of money between you and the Archer MSA is a prohibited transaction.
   D. Incorrect. The opportunity to transfer assets of the Archer MSA should not be made available by employers if they want employees to be able to have an Archer MSA. Rather, this is a prohibited transaction.

Chapter 4
Flexible Spending Arrangements (FSAs)

Learning Objectives

- Recognize a truth regarding FSAs
- Discern when an employee must designate how much will be contributed to an FSA
- Pinpoint the portion of an FSA that can be carried over to the next plan year
- Identify who can be considered an employee under the requirements of an FSA

Introduction

A health flexible spending arrangement (FSA) allows employees to be reimbursed for medical expenses. FSAs are usually funded through voluntary salary reduction agreements with your employer. No employment or federal income taxes are deducted from your contribution. The employer may also contribute.

Note: Unlike HSAs or Archer MSAs which must be reported on Form 1040 or Form 1040NR, there are no reporting requirements for FSAs on your income tax return.

For information on the interaction between a health FSA and an HSA (see *Other Employee Health Plans* under *Qualifying for an HAS,* earlier).

FSA Benefits

- Contributions made by your employer can be excluded from your gross income
- No employment or federal income taxes are deducted from the contributions
- Withdrawals may be tax free if you pay qualified medical expenses (see *Qualified Medical Expenses*)
- You can withdraw funds from the account to pay qualified medical expenses even if you have not yet placed the funds in the account.

Qualifying for an FSA

Health FSAs are employer-established benefit plans. These may be offered in conjunction with other employer-provided benefits as part of a cafeteria plan. Employers have complete flexibility to offer various combinations of benefits in designing their plan. You do not have to be covered under any other health care plan to participate.

Self-employed persons are not eligible for an FSA.

Caution: Certain limitations may apply if you are a highly compensated participant or a key employee.

Contributions to an FSA

You contribute to your FSA by electing an amount to be voluntarily withheld from your pay by your employer. This is sometimes called a salary reduction agreement. The employer may also contribute to your FSA if specified in the plan.

You do not pay federal income tax or employment taxes on the salary you contribute or the amounts your employer contributes to the FSA. However, contributions made by your employer to provide coverage for long-term care insurance must be included in income.

When to Contribute

At the beginning of the plan year, you must designate how much you want to contribute. Then, your employer will deduct amounts periodically (generally, every payday) in accordance with your annual election. You can change or revoke your election only if there is a change in your employment or family status that is specified by the plan.

Amount of Contribution

There is no limit on the amount of money you or your employer can contribute to the accounts; however, the plan must prescribe either a maximum dollar amount or maximum percentage of compensation that can be contributed to your health FSA.

Generally, contributed amounts that are not spent by the end of the plan year are forfeited (see *Balance in an FSA*). For this reason, it is important to base your contribution on an estimate of the qualifying expenses you will have during the year.

Distributions from an FSA

Generally, distributions from a health FSA must be paid only to reimburse you for qualified medical expenses you incurred during the period of coverage. You must be able to receive the maximum amount of reimbursement (the amount you have elected to contribute for the year) at any time during the coverage period, regardless of the amount you have actually contributed. The maximum amount you can receive tax free is the total amount you elected to contribute to the health FSA for the year.

You must provide the health FSA with a written statement from an independent third party stating that the medical expense has been incurred and the amount of the expense. You must also provide a written statement that the expense has not been paid or reimbursed under any other health plan coverage. The FSA cannot make advance reimbursements of future or projected expenses.

Debit cards, credit cards, and stored value cards given to you by your employer can be used to reimburse participants in a health FSA. If the use of these cards meets certain substantiation methods, you may not have to provide additional information to the health FSA. For information on these methods, see Chapter 6*, Revenue Ruling 2003-43*.

Qualified Medical Expenses

Qualified medical expenses are those specified in the plan that would generally qualify for the medical and dental expenses deduction. These are explained in detail in Chapter 1*, Tax-Favored Health Plans*.

Also, non-prescription medicines (other than insulin) are not considered qualified medical expenses for HAS purposes. A medicine or drug will be a qualified medical expense for HSA purposes only if the medicine or drug:

1. Requires a prescription,
2. Is available without a prescription (an over-the-counter medicine or drug) and you get a prescription for it, or
3. Is insulin.

Qualified medical expenses are those incurred by the following persons:

1. You and your spouse
2. All dependents you claim on your tax return
3. Any person you could have claimed as a dependent on your return except that:
    a. The person filed a joint return
    b. The person had gross income of $3,900 or more

c. You, or your spouse if filing jointly, could be claimed as a dependent on someone else's 2013 return

4. Your child under age 27 at the end of your tax year

You cannot receive distributions from your FSA for the following expenses:

- Amounts paid for health insurance premiums
- Amounts paid for long-term care coverage or expenses
- Amounts that are covered under another health plan

Covered under Both a Health FSA and an HRA

Ordering Rules for HRAs and § 125 Health FSAs (IRB 2002-28, Notice 2002-45, Part V): A medical care expense may not be reimbursed from a § 125 health FSA if the expense has been reimbursed or is reimbursable under any other accident or health plan. If coverage is provided under both an HRA and a § 125 health FSA for the same medical care expenses, amounts available under an HRA must be exhausted before reimbursements may be made from the FSA. However, a § 125 health FSA will not violate this rule if coverage is provided under both an HRA and a § 125 health FSA and the FSA reimburses a medical care expense which is not reimbursable by the HRA. In no case may an employee be reimbursed for the same medical care expense by both an HRA and a § 125 health FSA.

Consistent with these rules, before a § 125 health FSA plan year begins, the plan document for the HRA may specify that coverage under the HRA is available only after expenses exceeding the dollar amount of the § 125 FSA have been paid. For example, if an employer sponsors a § 125 health FSA and an HRA, both of which provide coverage for the same medical care expenses, and the HRA plan document includes a provision that the HRA is not available for reimbursements of medical care expenses that are covered by the § 125 health FSA until after expenses exceeding the dollar amount of the § 125 FSA have been paid, then those medical care expenses may be reimbursed first from the § 125 health FSA and then from the HRA when the amount available under the § 125 FSA is exhausted.

Caution: You cannot deduct qualified medical expenses as an itemized deduction on Schedule A (Form 1040) that are equal to the distribution you receive from the FSA.

Qualified Reservist Distribution

A special rule allows amounts in a health FSA to be distributed to reservists ordered or called to active duty. This rule applies to distributions made after June 17, 2008, if the plan has been amended to allow these distributions. Your employer must report the distribution as wages on your Form W-2 for the year in which the distribution is made. The distribution is subject to employment taxes and is included in your gross income.

A qualified reservist distribution is allowed if you were (because you were in the reserves) ordered or called to active duty for a period of more than 179 days or for an indefinite period, and the distribution is made during the period beginning on the date of the order or call and ending on the last date that reimbursements could otherwise be made for the plan year that includes the date of the order or call.

Balance in an FSA

Flexible spending accounts are "use-it-or-lose-it" plans. This means that amounts in the account at the end of the plan year cannot be carried over to the next year. However, the plan can provide for either a grace period or a carryover.

The plan can provide for a grace period of up to 2½ months after the end of the plan year. If there is a grace period, any qualified medical expenses incurred in that period can be paid from any amounts left in the account at the end of the previous year. Your employer is not permitted to refund any part of the balance to you. See *Qualified reservist distribution*, earlier.

For plan years beginning after December 31, 2012, plans may allow up to $500 of unused amounts remaining at the end of the plan year to be paid or reimbursed for qualified medical expenses you incur in the following plan year. The plan may specify a lower dollar amount as the maximum carryover amount. If the plan permits a carryover, any unused amounts in excess of the carryover amount are forfeited. The carryover does not affect the maximum amount of salary reduction contributions that you are permitted to make.

A plan may allow either the grace period or a carryover, but it cannot allow both.

Employer Participation

For the health FSA to maintain tax-qualified status, employers must comply with certain requirements that apply to cafeteria plans. The plans must also comply with rules applicable to other accident and health plans. The following outlines employee requirements and restrictions:

Employee

For cafeteria plans, treat the following individuals as employees:

- A current common-law employee
- A full-time life insurance agent who is a current statutory employee
- A leased employee who has provided services to you on a substantially full-time basis for at least a year if the services are performed under your primary direction or control

Exception for S Corporation Shareholders

Do not treat a 2% shareholder of an S corporation as an employee of the corporation for this purpose. A 2% shareholder for this purpose is someone who directly or indirectly owns (at any time during the year) more than 2% of the corporation's stock or stock with more than 2% of the voting power. Treat a 2% shareholder as you would a partner in a partnership for fringe benefit purposes, but do not treat the benefit as a reduction in distributions to the 2% shareholder.

Plans That Favor Highly Compensated Employees

If your cafeteria plan favors highly compensated employees as to eligibility to participate, contributions, or benefits, you must include in their wages the value of taxable benefits they could have selected. A plan you maintain under a collective bargaining agreement does not favor highly compensated employees.

A highly compensated employee for this purpose is any of the following employees:

1. An officer
2. A shareholder who owns more than 5% of the voting power or value of all classes of the employer's stock
3. An employee who is highly compensated based on the facts and circumstances
4. A spouse or dependent of a person described in (1), (2), or (3)

Plans That Favor Key Employees

If your cafeteria plan favors key employees, you must include in their wages the value of taxable benefits they could have selected. A plan favors key employees if more than 25% of the total of the non-taxable benefits you provide for all employees under the plan go to key employees. However, a plan you maintain under a collective bargaining agreement does not favor key employees.

A key employee during 2014 is generally an employee who is either of the following:

1. An officer having annual pay of more than $170,000
2. An employee who for 2014 is either of the following:
    a. A 5% owner of your business
    b. A 1% owner of your business whose annual pay was more than $150,000

Review Questions

1. What is a salary reduction agreement?
   - A. Amount of employment or federal income taxes deducted from the contributions
   - B. Taxable withdrawals allowed to pay qualified medical expenses
   - C. Contributions made by your employer included in your gross income
   - D. Contribution to your FSA by electing an amount to be voluntarily withheld from your pay by your employer

2. What is an acceptable distribution from a health FSA?
   - A. Reimbursement for qualified medical expenses you incurred during the period of coverage
   - B. Amounts paid for health insurance premiums
   - C. Amounts paid for long-term care coverage or expenses
   - D. Amounts that are covered under another health plan

3. Which of the following is required to make a qualified HSA distribution?
   - A. You must elect not to make a rollover
   - B. Contribution must come directly from a financial institution
   - C. The transfer must not result in a zero balance in the health FSA
   - D. Year-end balance in the health FSA must be frozen

4. Which of the following is <u>not</u> treated as an employee under cafeteria plans?
   - A. Current common-law employee
   - B. Full-time life insurance agent who is a current statutory employee
   - C. Qualified reservist
   - D. Leased employee who has provided services to you on a substantially full-time basis for at least a year

Review Answers

1. A. Incorrect. A salary reduction agreement is not the amount of employment or federal income taxes deducted from an FSA contribution. Rather, no employment or federal income taxes are deducted from the contributions.
   B. Incorrect. A salary reduction agreement is not the taxable withdrawals allowed to pay qualified medical expenses. Instead, withdrawals may be tax free if you pay qualified medical expenses.
   C. Incorrect. A salary reduction agreement is not the contribution made by your employer included in your gross income. Instead, contributions made by your employer can be excluded from your gross income.
   D. **Correct.** A salary reduction agreement is a contribution to your FSA by electing an amount to be voluntarily withheld from your pay by your employer.

2. A. **Correct.** Reimbursement for qualified medical expenses you incurred during the period of coverage is an acceptable distribution from a health FSA.
   B. Incorrect. An amount paid for health insurance premiums is not an acceptable distribution from a health FSA. Instead, you cannot receive distributions from your FSA for health insurance premiums.
   C. Incorrect. Amounts paid for long-term care coverage or expenses are not an acceptable distribution from a health FSA. Rather, this is an example of a prohibited distribution.
   D. Incorrect. Amounts that are covered under another health plan are not an acceptable distribution from a health FSA. Instead, you cannot receive distributions from your FSA for amounts covered under other health plans.

3. A. Incorrect. To make a qualified HSA distribution you must elect to make the rollover.
   B. Incorrect. To make a qualified HSA distribution the contribution must come directly to the HSA trustee by the employer, not a financial institution.
   C. Incorrect. To make a qualified HSA distribution, the transfer must result in a zero balance in the health FSA.
   D. **Correct.** To make a qualified HSA distribution the year-end balance in the health FSA must be frozen.

4. A. Incorrect. A current common-law employee is treated as an employee under cafeteria plans.
   B. Incorrect. Full-time life insurance agent who is a current statutory employee is an employee under cafeteria plans.
   C. **Correct.** A qualified reservist is not treated as an employee under cafeteria plans. Rather, a special rule allows amounts in a health FSA to be distributed to reservists ordered or called to active duty.
   D. Incorrect. Leased employees who has provided services to you on a substantially full-time basis for at least a year is treated as an employee under cafeteria plans.

Chapter 5
Health Reimbursement Arrangements (HRAs)

Learning Objectives

- Pinpoint the limit an employer can contribute to an HRA
- Recognize who reimbursements under an HRA are permitted to be made to
- Identify types of qualified medical expenses under an HRA
- Determine who is classified as a key employee under cafeteria plans

Introduction

A health reimbursement arrangement (HRA) must be funded solely by an employer. The contribution cannot be paid through a voluntary salary reduction agreement on the part of an employee. Employees are reimbursed tax free for qualified medical expenses up to a maximum dollar amount for a coverage period. An HRA may be offered with other health plans, including FSAs.

Note: Unlike HSAs or Archer MSAs which must be reported on Form 1040 or Form 1040NR, there are no reporting requirements for HRAs on your income tax return.

For information on the interaction between an HRA and an HSA, see *Other Employee Health Plans* under *Qualifying for an HSA,* earlier.

HRA Benefits

- Contributions made by your employer can be excluded from your gross income
- Reimbursements may be tax free if you pay qualified medical expenses (see *Qualified Medical Expenses*)
- Any unused amounts in the HRA can be carried forward for reimbursements in later years

Qualifying for an HRA

HRAs are employer-established benefit plans. These may be offered in conjunction with other employer-provided health benefits. Employers have complete flexibility to offer various combinations of benefits in designing their plan. You do not have to be covered under any other health care plan to participate.

Self-employed persons are not eligible for an HRA.

Caution: Certain limitations may apply if you are a highly compensated participant.

Contributions to an HRA

HRAs are funded solely through employer contributions and may not be funded through employee salary deferrals under a cafeteria plan. These contributions are not included in the employee's income. You do not pay federal income taxes or employment taxes on amounts your employer contributes to the HRA.

Amount of Contribution

There is no limit on the amount of money your employer can contribute to the accounts. Additionally, the maximum reimbursement amount credited under the HRA in the future may be increased or decreased by amounts not previously used (see *Balance in an HRA,* later).

Distributions from an HRA

Generally, distributions from an HRA must be paid to reimburse you for qualified medical expenses you have incurred. The expense must have been incurred on or after the date you are enrolled in the HRA.

Debit cards, credit cards, and stored value cards given to you by your employer can be used to reimburse participants in an HRA. If the use of these cards meets certain substantiation methods, you may not have to provide additional information to the HRA. For information on these methods, see Chapter 6, *Revenue Ruling 2003-43*.

If any distribution is, or can be, made for other than the reimbursement of qualified medical expenses, any distribution (including reimbursement of qualified medical expenses) made in the current tax year is included in gross income. For example, if an unused reimbursement is payable to you in cash at the end of the year, or upon termination of your employment, any distribution from the HRA is included in your income. This also applies if any unused amount upon your death is payable in cash to your beneficiary or estate, or if the HRA provides an option for you to transfer any unused reimbursement at the end of the year to a retirement plan.

If the plan permits amounts to be paid as medical benefits to a designated beneficiary (other than the employee's spouse or dependents), any distribution from the HRA is included in income.

Reimbursements under an HRA can be made to the following persons:

1. Current and former employees
2. Spouses and dependents of those employees
3. Any person you could have claimed as a dependent on your return except that:
    a. The person filed a joint return
    b. The person had gross income of $3,900 or more
    c. You, or your spouse if filing jointly, could be claimed as a dependent on someone else's 2013 return
4. Your child under age 27 at the end of your tax year
5. Spouses and dependents of deceased employees

Tip: For this purpose, a child of parents that are divorced, separated, or living apart for the last 6 months of the calendar year is treated as the dependent of both parents whether or not the custodial parent releases the claim to the child's exemption.

Qualified Medical Expenses

Qualified medical expenses are those specified in the plan that would generally qualify for the medical and dental expenses deduction. These are explained in detail in *Chapter 1 – Tax-Favored Health Plans*.
Also, non-prescription medicines (other than insulin) are not considered qualified medical expenses for HAS purposes. A medicine or drug will be a qualified medical expense for HSA purposes only if the medicine or drug:

1. Requires a prescription,
2. Is available without a prescription (an over-the-counter medicine or drug) and you get a prescription for it, or
3. Is insulin.

Qualified medical expenses from your HRA include the following:

- Amounts paid for health insurance premiums
- Amounts paid for long-term care coverage
- Amounts that are not covered under another health plan

Balance in an HRA

Amounts that remain at the end of the year can generally be carried over to the next year. Your employer is not permitted to refund any part of the balance to you. These amounts may never be used for anything but reimbursements for qualified medical expenses.

Employer Participation

For an HRA to maintain tax-qualified status, employers must comply with certain requirements that apply to other accident and health plans. The following outlines employee requirements and restrictions:

Employee

For cafeteria plans, treat the following individuals as employees:

- A current common-law employee
- A full-time life insurance agent who is a current statutory employee
- A leased employee who has provided services to you on a substantially full-time basis for at least a year if the services are performed under your primary direction or control

Exception for S Corporation Shareholders

Do not treat a 2% shareholder of an S corporation as an employee of the corporation for this purpose. A 2% shareholder for this purpose is someone who directly or indirectly owns (at any time during the year) more than 2% of the corporation's stock or stock with more than 2% of the voting power. Treat a 2% shareholder as you would a partner in a partnership for fringe benefit purposes, but do not treat the benefit as a reduction in distributions to the 2% shareholder.

Plans That Favor Highly Compensated Employees

If your cafeteria plan favors highly compensated employees as to eligibility to participate, contributions, or benefits, you must include in their wages the value of taxable benefits they could have selected. A plan you maintain under a collective bargaining agreement does not favor highly compensated employees.

A highly compensated employee for this purpose is any of the following employees:

1. An officer
2. A shareholder who owns more than 5% of the voting power or value of all classes of the employer's stock
3. An employee who is highly compensated based on the facts and circumstances
4. A spouse or dependent of a person described in (1), (2), or (3)

Plans That Favor Key Employees

If your cafeteria plan favors key employees, you must include in their wages the value of taxable benefits they could have selected. A plan favors key employees if more than 25% of the total of the non-taxable benefits you provide for all employees under the plan go to key employees. However, a plan you maintain under a collective bargaining agreement does not favor key employees.

A key employee during 2014 is generally an employee who is either of the following:

1. An officer having annual pay of more than $170,000
2. An employee who for 2014 is either of the following:
    a. A 5% owner of your business
    b. A 1% owner of your business whose annual pay was more than $150,000

Review Questions

1. Which of the following is not a benefit of an HRA?
   A. Contributions made by your employer can be excluded from your gross income
   B. Reimbursements may be tax free if you pay qualified medical expenses
   C. Any unused amounts in the HRA can be carried forward for reimbursements in later years
   D. Stricter reporting requirements ensuring accountability

2. Which of the following is a condition for contributions made to an HRA?
   A. Self-employed persons are eligible for an HRA
   B. Funded solely though employer contributions
   C. Funded solely through employee salary deferrals under a cafeteria plan
   D. Subject to federal income taxes

3. What is an accepted distribution from an HRA?
   A. Qualified medical expenses including amounts that are covered under another health plan
   B. Qualified medical expenses including amounts paid for short-term care coverage
   C. Qualified medical expenses excluding amounts paid for health insurance premiums
   D. Qualified amounts include reimbursements made to spouses and dependents of deceased employees

Review Answers

1. A. Incorrect. A benefit of an HRA is that contributions made by your employer can be excluded from your gross income.
   B. Incorrect. A benefit of an HRA is that reimbursements may be tax free if you pay qualified medical expenses.
   C. Incorrect. A benefit of an HRA is that any unused amounts in the HRA can be carried forward for reimbursements in later years.
   D. **Correct.** Stricter reporting requirements ensuring accountability is not a benefit of an HRA. Instead, unlike HSAs or Archer MSAs which must be reported on Form 1040 or Form 1040NR, there are no reporting requirements for HRAs on your income tax return.

2. A. Incorrect. A condition for contributions made to an HRA is not that self-employed persons are eligible for an HRA. Rather, self-employed persons are not eligible for an HRA.
   B. **Correct.** A condition for contributions made to an HRA is that they are funded solely through employer contributions.
   C. Incorrect. A condition for contributions made to an HRA is not that they are funded solely through employee salary deferrals under a cafeteria plan. Rather, contributions to an HRA may not be made through employee salary deferrals.
   D. Incorrect. A condition for contributions made to an HRA is not that they are subject to federal income taxes. Rather, these contributions are not included in the employee's income and do not require paying federal income taxes or employment taxes on the amount contributed by the employer.

3. A. Incorrect. Qualified medical expenses including amounts that are covered under another health plan is not an accepted distribution from an HRA. Instead, qualified medical expenses from your HRA include amounts that are not covered under another health plan.
   B. Incorrect. Qualified medical expenses including amounts paid for short-term care coverage is not an accepted distribution from an HRA. Instead, qualified medical expenses from your HRA include amounts paid for long-term care coverage.
   C. Incorrect. Qualified medical expenses excluding amounts paid for health insurance premiums are not an accepted distribution from an HRA. Rather, qualified medical expenses from your HRA include amounts paid for health insurance premiums.
   D. **Correct.** Qualified amounts including reimbursements made to spouses and dependents of deceased employees is an accepted distribution from an HRA.

Chapter 6
Revenue Ruling 2003-43

Learning Objectives

- Discern what an individual must do if the dollar amount of a health care provider's transaction equals the dollar amount for that service under a health FSA or HRA

Introduction

This chapter provides further guidance on the use of debit cards, credit cards, and stored value cards (cards) to reimburse participants in self-insured medical reimbursement plans, such as health flexible spending arrangements (health FSAs) and health reimbursement arrangements (HRAs). This chapter also clarifies certain substantiation methods and requirements that apply to all medical reimbursement plans whether or not a card is used.

Revenue Ruling 2003-43 Background

Revenue Ruling 2003-43 addresses the use of cards to reimburse participants in health FSAs and HRAs. The ruling describes three situations in which employers adopt electronic reimbursement systems in connection with health FSAs and HRAs. In each of the three situations, employees who participate in the health FSA or HRA are issued cards.

Each participating employee certifies upon enrollment and for each plan year thereafter that the card will only be used for eligible medical care expenses of the employee, the employee's spouse and dependents. The employee also certifies that any expense paid with the card has not been reimbursed and that the employees will not seek reimbursement under any other plan covering health benefits. The certification is printed on the back of the card and the employee-cardholder understands the certification is reaffirmed each time the card is used. The use of the card is limited to the maximum dollar amount of coverage available in the employee's health FSA or HRA. The card can only be used at merchants and service providers that have merchant category codes related to health care, such as physicians, pharmacies, dentists, vision care offices, hospitals, and other medical care providers.

In Situation 1 of the ruling, the employer establishes procedures for substantiating claimed medical expenses after the card is used (*Exhibit 1*).

Exhibit 1
Procedures for Substantiating Medical Expenses after Card is Used

Procedure 1

If the dollar amount of the transaction at a health care provider equals the dollar amount of the copayment for that service under the accident or health plan (i.e., the major medical plan, health maintenance organization, etc.) covering the specific employee-cardholder, the charge is fully substantiated without the need for submission of a receipt or further review (i.e., copayment match)

Procedure 2

The employer permits automatic reimbursement without further review of recurring expenses that match expenses previously approved as to amount, provider, and time period (i.e., recurring expenses)

Procedure 3

If the merchant, service-provider, or other independent third-party (e.g., Pharmacy Benefit Manager), at the time and point-of-sale, provides information to verify to the employer (including electronically by e-mail, the internet, intranet, or telephone) that the charge is for a medical expense, the charge is fully substantiated without the need for submission of a receipt or further review (i.e., real-time substantiation)

All other charges to the card are treated as conditional pending confirmation of the charge by the submission of additional third-party information, such as a receipt. Claims that are identified as not qualifying for reimbursement because of lack of additional information or otherwise, are subject to certain correction procedures.

Rev. Rul. 2003-43 concludes that the procedures adopted by the employer in Situation 1 meet the requirements of § 105(b) because all claims for medical expenses are substantiated, either automatically or by the submission of additional information. Card systems that do not meet the requirements of § 105(b) result in all payments provided by the cards being included in the participant's income.

Additional Use of Cards to Substantiate Health FSA and HRA Medical Expenses

In addition to the substantiation methods approved in Rev. Rul. 2003-43, as described below, an employer may adopt additional methods for substantiating claimed medical expenses. Employers that adopt these methods must also comply with requirements of including, but not limited to, employee certifications and adoption of meaningful correction procedures for amounts that are not automatically substantiated at the point-of-sale or within a reasonable time after the transaction.

Copayment Amounts

As described in Rev. Rul. 2003-43, the copayment match substantiation method is only permissible at merchants or service-providers that have health care related merchant category codes. Consistent with this approach, this notice expands the copayment match substantiation method to include as automatic substantiations certain matches of multiple copayments. Under this method, if the employer's accident or health plan has copayments in specific dollar amounts, and the dollar amount of the transaction at a health care provider (as identified by its merchant category code) equals an exact multiple of not more than five times the dollar amount of the copayment for the specific service (i.e., pharmacy benefit copayment, copayment for a physician's office visit, etc.) under the accident or health plan (i.e., the major medical plan, health maintenance organization, etc.) covering the specific employee-cardholder, then the charge is fully substantiated without the need for submission of a receipt or further review. In addition, if a health plan has multiple copayments for the same benefit, (e.g., tiered copayments for a pharmacy benefit), exact matches of multiples or combinations of the copayments (but not more than the exact multiple of five times the maximum copayment) will similarly be fully substantiated without the need for submission of a receipt or further review.

If the dollar amount of the transaction at a health care provider exceeds a multiple of five or more times the dollar amount of the copayment for the specific service, the transaction must be treated as conditional pending confirmation of the charge by the submission of additional third-party information. In the case of a plan with multiple copayments for the same benefit, if the dollar amount of the transaction exceeds five or more times the maximum copayment for the benefit, the transaction must also be treated as conditional pending confirmation of the charge by the submission of additional third-party information. Similarly, if the dollar amount of the transaction is not an exact multiple of the copayment (or an exact match of a multiple or combination of different copayments for a benefit in the case of multiple copayments for the same benefit), the transaction must be treated as conditional pending confirmation of the charge, even if the amount is less than five times the copayment. In these cases, the employer must require that additional third-party information, such as merchant or service provider receipts, describing:

1. The service or product
2. The date of the service or sale
3. The amount, be submitted for review and substantiation

The copayment schedule required under the accident or health plan must be independently verified by the employer (i.e., the copayment amount must be substantiated by a third-party; statements or other representations by the employee are not sufficient).

Example
Employer W reimburses health FSA claims through debit cards, as described in Situation 1 of *Revenue Ruling 2003-43 Background*. Employee A and Employee B are participants in the health FSA and are enrolled in W's medical plan. The plan has a $5 copayment for generic prescriptions and a $10 copayment for all other prescriptions.

Employee A uses the card at a pharmacy to purchase five non-generic prescriptions, for a total card transaction of $50. W's system matches the amount of the transaction, $50, with the $10 copayment for non-generic prescriptions under A's coverage and the fact that the transaction is at a pharmacy. Because the amount of the transaction is an exact multiple not in excess of five times the maximum copayment for prescriptions under A's medical coverage and the transaction is at a pharmacy, the transaction is substantiated without further review or documentation.

Employee B uses the card at a pharmacy to purchase three generic prescriptions and three non-generic prescriptions for a total card transaction of $45. Because the transaction is at a pharmacy and the amount of the transaction is an exact match of a combination of the copayments and does not exceed five times the maximum copayment for prescriptions under B's medical coverage, the transaction is substantiated without further review or documentation.

Example
The facts are the same as Example 1 except that A uses the card at a pharmacy to purchase six non-generic prescriptions for a total charge of $60. Because the amount of the transaction exceeds five times the maximum copayment for prescriptions under A's medical coverage, the entire transaction must be further substantiated through the submission of a receipt indicating that A purchased prescription drugs, the date of the purchase, and the amount of the purchase.

Example
The facts are the same as Example 1, except that A uses the card at a pharmacy to purchase two non-generic prescriptions and a nonprescription medication. The amount of the transaction is $27. Because the amount of the transaction is not an exact match of a multiple or combination of the copayments for generic and non-generic prescriptions under A's medical coverage, the transaction must be further substantiated through the submission of a receipt indicating that A incurred a medical expense (the prescription drugs and nonprescription medication), the date of the purchase and the amount of the purchase.

Inventory Information Approval System

An employer may adopt the method described below for approving reimbursements made through a payment card in conjunction with a health FSA or an HRA. Under this method, the payment card processor provides a system for approving and rejecting card transactions using inventory control information (e.g., stock keeping units (SKUs)) with merchants who need not be health care providers as described in Rev. Rul. 2003-43. Card transactions using this method are fully substantiated without the need for submission of a receipt by the employee or further review.

Under this method, when an employee uses the card, the merchant's system collects information about the items purchased using the inventory control information (e.g., SKUs). The system compares the inventory control information for the items purchased against a list of items, the purchase of which qualifies as expenses for medical care under § 213(d) (including nonprescription medications). The § 213(d) medical expenses are totaled and the merchant's or payment card processor's system approves the use of the card only for the amount of the §213(d) medical expenses subject to coverage under the health FSA (taking into consideration the uniform coverage rule) or HRA. If the transaction is only partially approved, the employee is required to tender additional amounts, resulting in a split-tender transaction.

As described in Rev. Rul. 2003-43, if the merchant, service provider, or other independent third-party at the time and point-of-sale provides information to verify to the employer (including electronically by e-mail, the internet, intranet, or telephone) that the charge is for a medical expense, the charge is fully substantiated, without the need for submission of a receipt for further review (i.e., real-time substantiation). Similarly, the inventory information approval system satisfies the substantiation requirements for purposes of reimbursing an employee's § 213(d) medical expenses without further review. However, an employer that adopts this system is nonetheless responsible for complying with all requirements in this notice, including recordkeeping requirements. Under this notice, the information required to be retained may be provided at the time of the transaction, or after the transaction (e.g., upon an examination of the employer by Internal Revenue Service).

An employer using this system may expand card use to merchants or service-providers that do not have health care related merchant category codes, provided that the only non-health care related merchants or service-providers where the card can be used are those that use the system (i.e., participating merchants or participating service-providers). Under the inventory information approval system, attempts to use the card at non-participating merchants or service-providers would be rejected.

For example, if, after matching inventory information, it is determined that all items purchased are § 213(d) medical expenses, the entire transaction is approved, subject to the coverage limitations of the health FSA or HRA. If, after matching inventory information, it is determined that only some of the items purchased are § 213(d) medical expenses, the transaction is approved only as to the § 213(d) medical expenses. In this case, the merchant or service-provider would request additional payments from the employee for the items that do not satisfy the definition of medical care under § 213(d). The merchant or service-provider would also request additional payments from the employee if the employee does not have sufficient health FSA or HRA coverage to purchase the § 213(d) medical items.

Example

Employer Y reimburses health FSA claims through debit cards, as described in Situation 1 of Rev. Rul. 2003-43. Y has adopted the inventory information approval system. Several stores that do not have health care related merchant category codes participate in the system (i.e., participating merchants). These participating merchants sell nonprescription medications. The use of the card has been expanded to include the participating merchants.

Employee C is a participant in the health FSA sponsored by Employer Y and has $100 of health FSA coverage. Y's health FSA covers nonprescription medications. C purchases aspirin, antacid, and cold medication for C and C's spouse and dependents at one of the participating merchants. The total amount for these medical expenses is $20.75. At the same time, C also purchases $50.00 of items that do not qualify as medical expenses under § 213(d), for a total purchase amount of $70.75. The store's system compares the SKUs from all of the items against the SKUs from a list of items that qualify as medical expenses under § 213(d). The charge for the medical expenses totaling $20.75 is authorized and the remaining $50.00 is rejected. Employee C is asked for additional payment to purchase the remaining non-medical items.

Other Substantiation Issues

Direct Third-Party Substantiation

If the employer is provided with information from an independent third-party (such as an explanation of benefits from an insurance company (EOB)) indicating the date of the § 213(d) service and the employee's responsibility for payment for that service (i.e., coinsurance payments and amounts below the plan's deductible), the claim is fully substantiated without the need for submission of a receipt by the employee or further review.

Example

Employee D is a participant in the health FSA sponsored by Employer X and is enrolled in X's medical plan. D visits a physician's office for medical care as defined in § 213(d). The cost of the services provided by the physician is $150.00. Under the medical plan, D is responsible for 20% of the services provided by the physician. X has coordinated with the medical plan and X or its agent is automatically provided with an EOB from the plan indicating that D is responsible for payment of 20% of the $150 (i.e., $30) charged by the physician. Because X has received a statement from an independent third-party that D has incurred a medical expense, the date the expense was incurred, and the amount of the expense, the claim is substantiated without the need for D to submit additional information regarding the expense. D has sufficient FSA coverage for the claim, which was incurred during the coverage period. X's FSA reimburses D the $30 medical expense without requiring D to submit a receipt or a statement from the physician.

Prohibition Against Self-Certification

Section 105 and § 125 require the substantiation of all medical expenses as a precondition of payment or reimbursement (including the automatic substantiation methods described in Rev. Rul. 2003-43). "Self-substantiation" or "self-certification" of an expense by an employee-participant does not constitute the required substantiation.

For example, a health FSA or an HRA does not satisfy the requirements of § 105(b) if it reimburses participants for expenses where the participants only submit information (including via internet, intranet, facsimile or other electronic means) describing medical expenses, the amount of the expenses, and the date of the expenses, but does not provide a statement from an independent third-party (either automatically or subsequent to the transaction) verifying the expenses. Under § 1.105-2 of the regulations, all amounts paid under a plan that permits "self-substantiation" or "self-certification" are included in gross income, including amounts reimbursed for medical expenses whether or not substantiated. Similarly, "self-substantiation" or "self-certification" of an employee's copayment in connection with copayment matching procedures through payment cards or otherwise does not constitute substantiation. If a plan's copayment matching system relies on an employee to provide a copayment amount without independent verification of the amount, claims have not been substantiated, and all amounts paid from the plan are included in gross income, including amounts paid for medical care whether or not substantiated.

Review Questions

1. Which of the following is treated as conditional?
   A. A transaction in which, at the time and point-of-sale, the service-provider provides information to verify to the employer that the charge is for a medical expense
   B. Inventory information approval system
   C. Direct third-party substantiation
   D. A plan with multiple copayments for the same benefit for which the dollar amount of the transaction exceeds five or more times the maximum copayment for the benefit

Review Answers

1. A. Incorrect. A transaction in which, at the time and point-of-sale, the service-provider provides information to verify to the employer that the charge is for a medical expense is not treated as conditional. Rather, this charge is fully substantiated without the need for submission of a receipt or further review.
   B. Incorrect. Inventory information approval system transactions are not treated as conditional. Instead, under this method the payment card processor provides a system for approving and rejecting card transactions using inventory control information.
   C. Incorrect. Direct third-party substantiation is not treated as conditional. Rather, if the employer is provided with information from an independent third-party indicating the date of the service and the employee's responsibility for payment for that service.
   D. **Correct.** A plan with multiple copayments for the same benefit for which the dollar amount of the transaction exceeds five or more times the maximum copayment for the benefit is treated as conditional. This transaction is conditional pending confirmation of the charge by the submission of additional third-party information.

Appendix A: 8889

Form **8889** — **Health Savings Accounts (HSAs)** — OMB No. 1545-0074 — **2013**

Department of the Treasury Internal Revenue Service

▶ Information about Form 8889 and its separate instructions is available at *www.irs.gov/form8889*.

▶ Attach to Form 1040 or Form 1040NR.

Attachment Sequence No. 53

Name(s) shown on Form 1040 or Form 1040NR | Social security number of HSA beneficiary. If both spouses have HSAs, see instructions ▶

Before you begin: Complete Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, if required.

Part I **HSA Contributions and Deduction.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part I for each spouse.

1	Check the box to indicate your coverage under a high-deductible health plan (HDHP) during 2013 (see instructions). . . . ▶ ☐ Self-only ☐ Family		
2	HSA contributions you made for 2013 (or those made on your behalf), including those made from January 1, 2014, through April 15, 2014, that were for 2013. **Do not** include employer contributions, contributions through a cafeteria plan, or rollovers (see instructions)	2	
3	If you were under age 55 at the end of 2013, and on the first day of **every** month during 2013, you were, or were considered, an eligible individual with the **same** coverage, enter $3,250 ($6,450 for family coverage). **All others,** see the instructions for the amount to enter	3	
4	Enter the amount you and your employer contributed to your Archer MSAs for 2013 from Form 8853, lines 1 and 2. If you or your spouse had family coverage under an HDHP at any time during 2013, also include any amount contributed to your spouse's Archer MSAs	4	
5	Subtract line 4 from line 3. If zero or less, enter -0-	5	
6	Enter the amount from line 5. But if you and your spouse each have separate HSAs and had family coverage under an HDHP at any time during 2013, see the instructions for the amount to enter	6	
7	If you were age 55 or older at the end of 2013, married, and you or your spouse had family coverage under an HDHP at any time during 2013, enter your additional contribution amount (see instructions)	7	
8	Add lines 6 and 7	8	
9	Employer contributions made to your HSAs for 2013 . . . . — 9		
10	Qualified HSA funding distributions . . . . — 10		
11	Add lines 9 and 10	11	
12	Subtract line 11 from line 8. If zero or less, enter -0-	12	
13	**HSA deduction.** Enter the **smaller** of line 2 or line 12 here and on Form 1040, line 25, or Form 1040NR, line 25	13	
	Caution: *If line 2 is more than line 13, you may have to pay an additional tax (see instructions).*		

Part II **HSA Distributions.** If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part II for each spouse.

14a	Total distributions you received in 2013 from all HSAs (see instructions)	14a	
b	Distributions included on line 14a that you rolled over to another HSA. Also include any excess contributions (and the earnings on those excess contributions) included on line 14a that were withdrawn by the due date of your return (see instructions)	14b	
c	Subtract line 14b from line 14a	14c	
15	Unreimbursed qualified medical expenses (see instructions)	15	
16	**Taxable HSA distributions.** Subtract line 15 from line 14c. If zero or less, enter -0-. Also, include this amount in the total on Form 1040, line 21, or Form 1040NR, line 21. On the dotted line next to line 21, enter "HSA" and the amount	16	
17a	If any of the distributions included on line 16 meet any of the **Exceptions to the Additional 20% Tax** (see instructions), check here . . . . ▶ ☐		
b	**Additional 20% tax** (see instructions). Enter 20% (.20) of the distributions included on line 16 that are subject to the additional 20% tax. Also include this amount in the total on Form 1040, line 60, or Form 1040NR, line 59. On the dotted line next to Form 1040, line 60, or Form 1040NR, line 59, enter "HSA" and the amount	17b	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 37621P Form **8889** (2013)

Form 8889 (2013) Page 2

Part III **Income and Additional Tax for Failure To Maintain HDHP Coverage.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part III for each spouse.

18	Last-month rule	18	
19	Qualified HSA funding distribution	19	
20	**Total income.** Add lines 18 and 19. Include this amount on Form 1040, line 21, or Form 1040NR, line 21. On the dotted line next to Form 1040, line 21, or Form 1040NR, line 21, enter "HSA" and the amount	20	
21	**Additional tax.** Multiply line 20 by 10% (.10). Include this amount in the total on Form 1040, line 60, or Form 1040NR, line 59. On the dotted line next to Form 1040, line 60, or Form 1040NR, line 59, enter "HDHP" and the amount	21	

Form **8889** (2013)

Appendix B: 8853

Form **8853**

Department of the Treasury
Internal Revenue Service (99)

Archer MSAs and Long-Term Care Insurance Contracts

▶ Information about Form 8853 and its separate instructions is available at *www.irs.gov/form8853.*
▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074
2013
Attachment Sequence No. 39

Name(s) shown on return

Social security number of MSA account holder. If both spouses have MSAs, see instructions ▶

Section A. Archer MSAs. If you have only a Medicare Advantage MSA, skip Section A and complete Section B.

Part I **Archer MSA Contributions and Deductions.** See instructions before completing this part. If you are filing jointly and both you and your spouse have high deductible health plans with self-only coverage, complete a separate Part I for each spouse.

1	Total employer contributions to your Archer MSA(s) for 2013	1	
2	Archer MSA contributions you made for 2013, including those made from January 1, 2014, through April 15, 2014, that were for 2013. Do not include rollovers (see instructions)	2	
3	Limitation from the Line 3 Limitation Chart and Worksheet in the instructions	3	
4	Compensation (see instructions) from the employer maintaining the high deductible health plan. (If self-employed, enter your earned income from the trade or business under which the high deductible health plan was established.)	4	
5	**Archer MSA deduction.** Enter the **smallest** of line 2, 3, or 4 here. Also include this amount on Form 1040, line 36, or Form 1040NR, line 35. On the dotted line next to Form 1040, line 36, or Form 1040NR, line 35, enter "MSA" and the amount	5	

Caution: *If line 2 is more than line 5, you may have to pay an additional tax (see instructions).*

Part II **Archer MSA Distributions**

6a	Total distributions you and your spouse received in 2013 from all Archer MSAs (see instructions) .	6a	
b	Distributions included on line 6a that you rolled over to another Archer MSA or a health savings account. Also include any excess contributions (and the earnings on those excess contributions) included on line 6a that were withdrawn by the due date of your return (see instructions)	6b	
c	Subtract line 6b from line 6a	6c	
7	Unreimbursed qualified medical expenses (see instructions)	7	
8	**Taxable Archer MSA distributions.** Subtract line 7 from line 6c. If zero or less, enter -0-. Also include this amount in the total on Form 1040, line 21, or Form 1040NR, line 21. On the dotted line next to line 21, enter "MSA" and the amount	8	
9a	If any of the distributions included on line 8 meet any of the **Exceptions to the Additional 20% Tax** (see instructions), check here . . . . . ▶ ☐		
b	**Additional 20% tax** (see instructions). Enter 20% (.20) of the distributions included on line 8 that are subject to the additional 20% tax. Also include this amount in the total on Form 1040, line 60, or Form 1040NR, line 59. On the dotted line next to Form 1040, line 60, or Form 1040NR, line 59, enter "MSA" and the amount	9b	

Section B. Medicare Advantage MSA Distributions. If you are filing jointly and both you and your spouse received distributions in 2013 from a Medicare Advantage MSA, complete a separate Section B for each spouse (see instructions).

10	Total distributions you received in 2013 from all Medicare Advantage MSAs (see instructions) . .	10	
11	Unreimbursed qualified medical expenses (see instructions)	11	
12	**Taxable Medicare Advantage MSA distributions.** Subtract line 11 from line 10. If zero or less, enter -0-. Also include this amount in the total on Form 1040, line 21, or Form 1040NR, line 21. On the dotted line next to line 21, enter "Med MSA" and the amount	12	
13a	If any of the distributions included on line 12 meet any of the **Exceptions to the Additional 50% Tax** (see instructions), check here . . . . . ▶ ☐		
b	**Additional 50% tax** (see instructions). Enter 50% (.50) of the distributions included on line 12 that are subject to the additional 50% tax. Also include this amount in the total on Form 1040, line 60, or Form 1040NR, line 59. On the dotted line next to Form 1040, line 60, or Form 1040NR, line 59, enter "Med MSA" and the amount	13b	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 24091H Form **8853** (2013)

Form 8853 (2013) Attachment Sequence No. 39 Page 2

Name of policyholder (as shown on Form 1040) | Social security number of policyholder ▶

Section C. Long-Term Care (LTC) Insurance Contracts. See **Filing Requirements for Section C** in the instructions before completing this section.

If more than one Section C is attached, check here . . . ▶ ☐

14a Name of insured ▶ **b** Social security number of insured ▶

15 In 2013, did anyone other than you receive payments on a per diem or other periodic basis under a qualified LTC insurance contract covering the insured or receive accelerated death benefits under a life insurance policy covering the insured? . . . ☐ **Yes** ☐ **No**

16 Was the insured a terminally ill individual? . . . ☐ **Yes** ☐ **No**

Note: *If "Yes" and the* ***only*** *payments you received in 2013 were accelerated death benefits that were paid to you because the insured was terminally ill, skip lines 17 through 25 and enter -0- on line 26.*

17	Gross LTC payments received on a per diem or other periodic basis. Enter the total of the amounts from box 1 of all Forms 1099-LTC you received with respect to the insured on which the "Per diem" box in box 3 is checked . . .	**17**	
	Caution: ***Do not*** *use lines 18 through 26 to figure the taxable amount of benefits paid under an LTC insurance contract that is not a* ***qualified*** *LTC insurance contract. Instead, if the benefits are not excludable from your income (for example, if the benefits are not paid for personal injuries or sickness through accident or health insurance), report the amount not excludable as income on Form 1040, line 21.*		
18	Enter the part of the amount on line 17 that is from **qualified** LTC insurance contracts . . .	**18**	
19	Accelerated death benefits received on a per diem or other periodic basis. Do not include any amounts you received because the insured was terminally ill (see instructions) . . .	**19**	
20	Add lines 18 and 19 . . .	**20**	
	Note: *If you checked "Yes" on line 15 above, see* ***Multiple Payees*** *in the instructions before completing lines 21 through 25.*		
21	Multiply $320 by the number of days in the LTC period . . . **21**		
22	Costs incurred for qualified LTC services provided for the insured during the LTC period (see instructions) . . . **22**		
23	Enter the **larger** of line 21 or line 22 . . . **23**		
24	Reimbursements for qualified LTC services provided for the insured during the LTC period . . . **24**		
	Caution: *If you received any reimbursements from LTC contracts issued before August 1, 1996, see instructions.*		
25	Per diem limitation. Subtract line 24 from line 23 . . .	**25**	
26	**Taxable payments.** Subtract line 25 from line 20. If zero or less, enter -0-. Also include this amount in the total on Form 1040, line 21. On the dotted line next to line 21, enter "LTC" and the amount . . .	**26**	

Form **8853** (2013)

Appendix C: 5329

Form **5329**

Department of the Treasury
Internal Revenue Service (99)

Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts

▶ Attach to Form 1040 or Form 1040NR.

▶ Information about Form 5329 and its separate instructions is at *www.irs.gov/form5329.*

OMB No. 1545-0074

2013

Attachment Sequence No. **29**

Name of individual subject to additional tax. If married filing jointly, see instructions.	Your social security number

Fill in Your Address Only If You Are Filing This Form by Itself and Not With Your Tax Return

Home address (number and street), or P.O. box if mail is not delivered to your home		Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete the spaces below (see instructions).		If this is an amended return, check here ▶ ☐
Foreign country name	Foreign province/state/county	Foreign postal code

If you **only** owe the additional 10% tax on early distributions, you may be able to report this tax directly on Form 1040, line 58, or Form 1040NR, line 56, without filing Form 5329. See the instructions for Form 1040, line 58, or for Form 1040NR, line 56.

Part I Additional Tax on Early Distributions

Complete this part if you took a taxable distribution before you reached age 59½ from a qualified retirement plan (including an IRA) or modified endowment contract (unless you are reporting this tax directly on Form 1040 or Form 1040NR—see above). You may also have to complete this part to indicate that you qualify for an exception to the additional tax on early distributions or for certain Roth IRA distributions (see instructions).

1	Early distributions included in income. For Roth IRA distributions, see instructions	1	
2	Early distributions included on line 1 that are not subject to the additional tax (see instructions). Enter the appropriate exception number from the instructions: ____	2	
3	Amount subject to additional tax. Subtract line 2 from line 1	3	
4	**Additional tax.** Enter 10% (.10) of line 3. Include this amount on Form 1040, line 58, or Form 1040NR, line 56 **Caution:** *If any part of the amount on line 3 was a distribution from a SIMPLE IRA, you may have to include 25% of that amount on line 4 instead of 10% (see instructions).*	4	

Part II Additional Tax on Certain Distributions From Education Accounts

Complete this part if you included an amount in income, on Form 1040 or Form 1040NR, line 21, from a Coverdell education savings account (ESA) or a qualified tuition program (QTP).

5	Distributions included in income from Coverdell ESAs and QTPs	5	
6	Distributions included on line 5 that are not subject to the additional tax (see instructions)	6	
7	Amount subject to additional tax. Subtract line 6 from line 5	7	
8	**Additional tax.** Enter 10% (.10) of line 7. Include this amount on Form 1040, line 58, or Form 1040NR, line 56	8	

Part III Additional Tax on Excess Contributions to Traditional IRAs

Complete this part if you contributed more to your traditional IRAs for 2013 than is allowable or you had an amount on line 17 of your 2012 Form 5329.

9	Enter your excess contributions from line 16 of your 2012 Form 5329 (see instructions). If zero, go to line 15	9	
10	If your traditional IRA contributions for 2013 are less than your maximum allowable contribution, see instructions. Otherwise, enter -0-	10	
11	2013 traditional IRA distributions included in income (see instructions)	11	
12	2013 distributions of prior year excess contributions (see instructions)	12	
13	Add lines 10, 11, and 12	13	
14	Prior year excess contributions. Subtract line 13 from line 9. If zero or less, enter -0-	14	
15	Excess contributions for 2013 (see instructions)	15	
16	Total excess contributions. Add lines 14 and 15	16	
17	**Additional tax.** Enter 6% (.06) of the **smaller** of line 16 **or** the value of your traditional IRAs on December 31, 2013 (including 2013 contributions made in 2014). Include this amount on Form 1040, line 58, or Form 1040NR, line 56	17	

Part IV Additional Tax on Excess Contributions to Roth IRAs

Complete this part if you contributed more to your Roth IRAs for 2013 than is allowable or you had an amount on line 25 of your 2012 Form 5329.

18	Enter your excess contributions from line 24 of your 2012 Form 5329 (see instructions). If zero, go to line 23	18	
19	If your Roth IRA contributions for 2013 are less than your maximum allowable contribution, see instructions. Otherwise, enter -0-	19	
20	2013 distributions from your Roth IRAs (see instructions)	20	
21	Add lines 19 and 20	21	
22	Prior year excess contributions. Subtract line 21 from line 18. If zero or less, enter -0-	22	
23	Excess contributions for 2013 (see instructions)	23	
24	Total excess contributions. Add lines 22 and 23	24	
25	**Additional tax.** Enter 6% (.06) of the **smaller** of line 24 **or** the value of your Roth IRAs on December 31, 2013 (including 2013 contributions made in 2014). Include this amount on Form 1040, line 58, or Form 1040NR, line 56	25	

For Privacy Act and Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 13329Q Form **5329** (2013)

Form 5329 (2013) Page **2**

Part V **Additional Tax on Excess Contributions to Coverdell ESAs**

Complete this part if the contributions to your Coverdell ESAs for 2013 were more than is allowable or you had an amount on line 33 of your 2012 Form 5329.

26	Enter the excess contributions from line 32 of your 2012 Form 5329 (see instructions). If zero, go to line 31			26	
27	If the contributions to your Coverdell ESAs for 2013 were less than the maximum allowable contribution, see instructions. Otherwise, enter -0-	27			
28	2013 distributions from your Coverdell ESAs (see instructions)	28			
29	Add lines 27 and 28			29	
30	Prior year excess contributions. Subtract line 29 from line 26. If zero or less, enter -0-			30	
31	Excess contributions for 2013 (see instructions)			31	
32	Total excess contributions. Add lines 30 and 31			32	
33	**Additional tax.** Enter 6% (.06) of the **smaller** of line 32 **or** the value of your Coverdell ESAs on December 31, 2013 (including 2013 contributions made in 2014). Include this amount on Form 1040, line 58, or Form 1040NR, line 56			33	

Part VI **Additional Tax on Excess Contributions to Archer MSAs**

Complete this part if you or your employer contributed more to your Archer MSAs for 2013 than is allowable or you had an amount on line 41 of your 2012 Form 5329.

34	Enter the excess contributions from line 40 of your 2012 Form 5329 (see instructions). If zero, go to line 39			34	
35	If the contributions to your Archer MSAs for 2013 are less than the maximum allowable contribution, see instructions. Otherwise, enter -0-	35			
36	2013 distributions from your Archer MSAs from Form 8853, line 8	36			
37	Add lines 35 and 36			37	
38	Prior year excess contributions. Subtract line 37 from line 34. If zero or less, enter -0-			38	
39	Excess contributions for 2013 (see instructions)			39	
40	Total excess contributions. Add lines 38 and 39			40	
41	**Additional tax.** Enter 6% (.06) of the **smaller** of line 40 **or** the value of your Archer MSAs on December 31, 2013 (including 2013 contributions made in 2014). Include this amount on Form 1040, line 58, or Form 1040NR, line 56			41	

Part VII **Additional Tax on Excess Contributions to Health Savings Accounts (HSAs)**

Complete this part if you, someone on your behalf, or your employer contributed more to your HSAs for 2013 than is allowable or you had an amount on line 49 of your 2012 Form 5329.

42	Enter the excess contributions from line 48 of your 2012 Form 5329. If zero, go to line 47			42	
43	If the contributions to your HSAs for 2013 are less than the maximum allowable contribution, see instructions. Otherwise, enter -0-	43			
44	2013 distributions from your HSAs from Form 8889, line 16	44			
45	Add lines 43 and 44			45	
46	Prior year excess contributions. Subtract line 45 from line 42. If zero or less, enter -0-			46	
47	Excess contributions for 2013 (see instructions)			47	
48	Total excess contributions. Add lines 46 and 47			48	
49	**Additional tax.** Enter 6% (.06) of the **smaller** of line 48 **or** the value of your HSAs on December 31, 2013 (including 2013 contributions made in 2014). Include this amount on Form 1040, line 58, or Form 1040NR, line 56			49	

Part VIII **Additional Tax on Excess Accumulation in Qualified Retirement Plans (Including IRAs)**

Complete this part if you did not receive the minimum required distribution from your qualified retirement plan.

50	Minimum required distribution for 2013 (see instructions)	50	
51	Amount actually distributed to you in 2013	51	
52	Subtract line 51 from line 50. If zero or less, enter -0-	52	
53	**Additional tax.** Enter 50% (.50) of line 52. Include this amount on Form 1040, line 58, or Form 1040NR, line 56	53	

Sign Here Only If You Are Filing This Form by Itself and Not With Your Tax Return

Under penalties of perjury, I declare that I have examined this form, including accompanying attachments, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Your signature ▶ Date

Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
	Firm's name ▶			Firm's EIN ▶	
	Firm's address ▶			Phone no.	

Form **5329** (2013)

Appendix D: 5498-SA

☐ CORRECTED (if checked)

TRUSTEE'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone number

1 Employee or self-employed person's Archer MSA contributions made in 2013 and 2014 for 2013
$

2 Total contributions made in 2013
$

OMB No. 1545-1518

2013

Form 5498-SA

HSA, Archer MSA, or Medicare Advantage MSA Information

TRUSTEE'S federal identification number	PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2014 for 2013 $

PARTICIPANT'S name

4 Rollover contributions
$

5 Fair market value of HSA, Archer MSA, or MA MSA
$

Street address (including apt. no.)

City or town, province or state, country, and ZIP or foreign postal code

6 HSA ☐
Archer MSA ☐
MA MSA ☐

Account number (see instructions)

Copy B

For Participant

The information in boxes 1 through 6 is being furnished to the Internal Revenue Service.

Form 5498-SA (keep for your records) www.irs.gov/form5498sa Department of the Treasury - Internal Revenue Service

Appendix E: 1099-SA

☐ CORRECTED (if checked)

TRUSTEE'S/PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone number			OMB No. 1545-1517 2013 Form 1099-SA	Distributions From an HSA, Archer MSA, or Medicare Advantage MSA
PAYER'S federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess cont. $	Copy B For Recipient
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	
Street address (including apt. no.) City or town, province or state, country, and ZIP or foreign postal code		5 HSA ☐ Archer MSA ☐ MA MSA ☐		This information is being furnished to the Internal Revenue Service.
Account number (see instructions)				

Form 1099-SA (keep for your records) www.irs.gov/form1099sa Department of the Treasury - Internal Revenue Service

Glossary

A

Archer Medical Savings Account (MSA): A tax-exempt trust or custodial account that is set up with a U.S. financial institution (such as a bank or an insurance company) in which money can be saved exclusively for future medical expenses.

F

Form 1099-SA: A form sent from a trustee that repots any distributions to an HSA, Archer MSA, or Medicare Advantage MSA.

Form 5498-SA: A form sent from a trustee that reports the contributions to an HSA, Archer MSA, or Medicare Advantage MSA.

Form 5329: A form that is sued to report additional taxes on: IRAs, other qualified retirement plans, modified endowment contracts, Coverdell ESAs, QTPs, Archer MSAs, or HSAs.

Form 8853: A form that is used to: report Archer MSA contributions (including employer contributions), figure the Archer MSA deduction, report distributions from Archer MSAs or Medicare Advantage MSAs, report taxable payments from long-term care (LTC) insurance contracts, or report taxable accelerated death benefits from a life insurance policy.

Form 8889: A form that is used to do the following: report HSA contributions (including those made on an individual's own behalf and employer contributions), figure the HSA deduction, report distributions from HSAs, and figure amounts an individual must include in income and the additional tax that may be owed if failing to remain an eligible individual.

H

Health Flexible Spending Arrangement (FSA): An arrangement set up by an employer for an employee that allows for pre-tax contributions to be made to the account that is used to reimburse for qualified medical expenses.

Health Reimbursement Arrangement (HRA): An arrangement that is employer-funded that reimburses employees for qualified medical expenses.

Health Savings Account (HSA): A tax-exempt trust or custodial account that you set up with a qualified HSA trustee to pay or reimburse certain medical expenses you incur.

High Deductible Health Plan (HDHP): A type of health insurance plan that has a higher annual deductible and lower premium than typical health insurance plans.

Highly compensated employee: An employee that is either:

1. An officer
2. A shareholder who owns more than 5% of the voting power or value of all classes of the employer's stock
3. An employee who is highly compensated based on the facts and circumstances
4. A spouse or dependent of a person described in (1), (2), or (3)

K

Key employee: An employee that is either:

1. An officer having annual pay of more than $170,000
2. An employee who for 2014 is either of the following:
   a. A 5% owner of your business
   b. A 1% owner of your business whose annual pay was more than $150,000

L

Last-month rule: Rule that states if an individual is eligible on the first day of the last month of the tax year, he/she is considered an eligible individual for the entire year.

Limited-purpose health FSA: An arrangement that can pay or reimburse items that are considered as "other health coverage" (except long-term care) in an HSA.

Limited-purpose HRA: An arrangement that can pay or reimburse items that are considered as "other health coverage" (except long-term care) under an HSA.

M

Medicare Advantage Medical Savings Account (MSA): An Archer MSA designated by Medicare to be used solely to pay for qualified medical expenses of the account holder who is eligible for Medicare.

P

Post-deductible health FSA: An arrangement that does not pay or reimburse any medical expenses incurred before the minimum annual deductible amount is met.

Post-deductible health HRA: An arrangement that does not pay or reimburse any medical expenses incurred before the minimum annual deductible amount is met.

Q

Qualified HSA distribution: A distribution from a health FSA or an HRA that is transferred to an individual's HSA.

Qualified long-term care insurance contract: An insurance contract that provides only coverage of qualified long-term care services. This type of contract must:

1. Be guaranteed renewable
2. Not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed
3. Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract must be used only to reduce future premiums or increase future benefits
4. Generally not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer, or the contract makes *per diem* or other periodic payments without regard to expenses

Qualified medical expense: A medical expenses (costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and the costs for treatments affecting any part or function of the body)that can be included in figuring medical expenses for distributions.

Qualified reservist distribution: A special rule that allows amounts in a health FSA to be distributed to reservists ordered or called to active duty.

R

Revenue Ruling 2003-43: Ruling that addresses the use of debit cards, credit cards, and stored value cards to reimburse participants in self-insured medical reimbursement plans, such as health FSAs and HRAs.

Roth IRA: An individual retirement account that is similar to a traditional IRA, but contributions are not tax deductible and qualified distributions are tax free.

S

Savings Incentive Match Plan for Employees (SIMPLE) IRA: A retirement plan that either a small employer or an individual that is self-employed can establish. The employer is allowed a tax deduction for contributions made, which are either matching or non-elective contributions.

Simplified Employee Pension (SEP) IRA: A retirement plan that either an employer or an individual that is self-employed can establish. The tax deduction for contributions made to the SEP plan is allowed as a tax deduction. The contributions made to employees are on a discretionary basis in this type of plan.

Small employer: An employer who had an average of 50 or fewer employees during either of the last two calendar years.

Suspended HRA: An arrangement where an HRA is suspended and does not pay or reimburse, at any time, the medical expenses incurred during the suspension period except preventive care and items listed as "other health coverage" under an HSA. At the end of the suspension period, an individual can no longer make contributions to the HSA.

T

Testing period: A period an individual must remain eligible, which begins on the last month the tax year and ends on the last day of the 12^{th} month following that month.

Traditional IRA: An individual retirement account where pretax income (up to annual limit) is applied toward investments that can grow tax-deferred.

U

Unqualified medical expense: A medical expense that cannot be included when figuring medical expenses for distributions.

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