

## Is Medicare Causing Problems for your Health Savings Account (HSA)?

Tips for plan sponsors in communicating the impact of Medicare enrollment on HSA eligibility.

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**D**uring a recent PSCA webinar about Health Savings Accounts (HSAs), we received numerous questions from plan sponsors regarding the interaction of HSAs and Medicare. The problem that plan sponsors say they are increasingly dealing with is that their workers don't realize that by enrolling in Medicare they disqualify themselves from participating in the HSA. In this article, we will provide feedback on the most common concerns and questions we have received.

Why is this becoming a growing issue?

- More older workers continue employment,
- Some workers began Social Security benefits after reaching age 62, or upon reaching their Social Security Normal Retirement Age (age 65 or 66), and
- The federal government mandates that Medicare Part A coverage begins (sometimes retroactively) as of the later of the date the individual reaches age 65 or the date the individual commences Social Security benefits.

### How does Medicare enrollment affect the HSA?

Upon reaching age 65, most workers have completed the requirements to receive Medicare Part A without paying a premium. If the worker chooses to enroll, there will be unintended consequences if they participate in an

### Medicare Types

#### • Part A (Hospitalization)

- Generally, Part A covers: Inpatient care in a hospital, skilled nursing facility care, Inpatient care in a skilled nursing facility (not custodial or long-term care), hospice care, and home health care.
- Workers are generally eligible to enroll in this program for free at age 65.

#### • Part B (Physician Services)

- Medically necessary services and preventative services as well as mental health services are covered under Part B.
- Workers must enroll and pay the premium (varies by income) within 3 months of their 65th birthday, unless they are still actively working and offered coverage through their employer.

#### • Part D (Prescription Drugs)

- Part D is optional and supplemental to Part B — it generally covers prescription medications not covered under Part B.
- Individuals enrolled in Part A and/or Part B are eligible to enroll in Part D and pay the additional monthly premium, which varies by state.

HSA — and, the employer won't know as Medicare enrollment is without employer involvement. Here is the problem: HSA contributions can only be made if the medical plan is a qualified high deductible health plan (HDHP). The participant cannot be enrolled in any other plan that does not meet HSA rules. Medicare is not a qualified HDHP plan; therefore, once a worker enrolls in Medicare, the worker becomes ineligible to make an HSA contribution.

There are two other situations that can automatically trigger enrollment in Part A:

1. Where the worker took their social security benefits prior to age 65,

enrollment in Part A occurs without notice.

2. Workers who wait until their Social Security Normal Retirement Age to receive benefits may not realize that doing so will generally trigger Medicare Part A coverage.

### Consequences of Medicare Enrollment

Being *eligible* for Medicare does not affect a worker's ability to contribute to a HSA. Eligibility to contribute to an HSA ends once the worker *enrolls* in Medicare. The worker can be enrolled in Medicare, and can still enroll in a

medical plan (including a HDHP plan) offered at the workplace. However,

1. they may not make an HSA contribution, and
2. they cannot receive an employer contribution to their HSA, but
3. they are still able to use funds that are already in an HSA to pay for eligible uncovered medical expenses that they, or their eligible dependent or spouse, incur.

Eligibility to contribute to an HSA has no impact on the taxation of HSA qualifying expenses. For example, a worker might be enrolled in an HSA-capable health option for 35 years, accumulating significant HSA assets, and, upon reaching age 65, retire and commence Social Security benefits, Medicare Part A, Part B, and Part D coverage. Out-of-pocket medical expenses incurred in retirement will still qualify for tax-free reimbursement if withdrawn from the HSA. Similarly, Medicare Part A, Part B, and Part D premiums will qualify for tax-free reimbursement from the HSA. And, if the employer offers medical coverage (to active workers and/or a Medicare Supplement to retired workers), employee/retiree-paid premiums (contributions) for that coverage are eligible for tax-free reimbursement — so long as they weren't paid with pre-tax dollars contributed through a cafeteria plan).

## Resolving Issues Relative to Medicare Enrollment

Here's a typical scenario: A worker with 30 years of service turns age 66 on March 1, 2019 and he enrolls in Medicare Part A because coworkers incorrectly told him he would have to pay a penalty each month for the rest of his life for late enrollment in Medicare (there is no late enrollment penalty for failing to enroll in Medicare Part A). During open enrollment in November 2019, for the first time, this worker is offered a HSA-capable health option. He selects the HSA plan because it has

### Medicare Coverage and Eligibility to Contribute to an HSA

Single Tier HSA-capable health coverage: Easy. Eligibility for making HSA contributions ends beginning with the month the HSA owner becomes eligible for and enrolls in either Medicare Part A or Part B.

Non-single Tier HSA-capable health coverage: It depends.

- Eligibility for making HSA contributions ends for individuals who are eligible for and enrolled in either Medicare Part A or Part B.
- If an individual is enrolled in Medicare Part A or Part B, but her/his spouse is not enrolled in Medicare Part A or Part B, and if the individual and spouse are enrolled in non-single, HSA-capable health coverage, then the spouse who is not enrolled in Medicare Part A or Part B can contribute the full non-single maximum if otherwise eligible. If age 55 or older, the spouse who is not enrolled in Medicare Part A or Part B can contribute the maximum catch-up contribution as well.
- If an individual is enrolled in Medicare Part A or Part B, and her/his spouse is enrolled in Medicare Part A or Part B, but they have an adult, non-tax-dependent child who is also covered under the non-single HSA-capable health coverage, then the adult, non-tax-dependent child can contribute the full, non-single maximum to her/his own HSA if otherwise eligible. If the adult, non-tax-dependent child is age 55 or older, she/he can contribute the maximum catch-up contribution as well.

a lower employee contribution and a generous employer contribution. When he enrolls, he certifies that he is eligible for HSA contributions — he doesn't read the annual enrollment materials, let alone the fine print. His coworkers told him that Medicare Part A is not "other coverage" since it doesn't cost anything and because he enrolled in HSA-qualifying coverage as his primary medical plan.

After open enrollment ends but before the plan-year begins, he realizes he has made a mistake. Now what?

1. He should contact his Human Resources (HR) department to make them aware of the error. HR should have already established a correction procedure with payroll and the HSA vendor.
2. If HSA pre-tax contributions through the cafeteria plan are stopped before they take effect, no further action is required. *If not,*
3. HSA pre-tax contributions through the cafeteria plan on behalf of an ineligible person and remitted to the HSA vendor are "excess" contributions and must be with-

drawn from the account. To determine the excess contribution:

- 1) Take the total annual contribution limit based on the coverage tier (individual or family)
  - 2) Divide that amount by 12
  - 3) Multiply it by the number of months that the worker was eligible for the year
  - 4) *Example:* If the HSA annual limit was \$3,500 (2019 Single coverage limit) and the worker was eligible for HSA contributions for 4 months, then the limit would be \$1,166.67. If the worker had contributed \$3,500, then remove \$2,333.33 as the excess.
4. The procedure for correction can vary among employers and financial institutions. Contact the HSA vendor for the procedures to follow. The correction method should be approved by the HSA vendor. We also suggest verifying the procedures with a tax professional. Some HSA vendors may be willing to issue the excess to the employer and allow the employer to make the appropriate payroll

corrections. Some employers prefer to have the excess returned to the worker (account owner), so that the worker is responsible for reporting it on their own personal income tax return. Consult your HSA vendor and legal counsel for the appropriate deadlines. Timing matters!

5. Can the employer recoup the funds that they contributed? Yes. But, again, timing matters! There is value in diligent and timely administration of HSA contribution eligibility. This was clarified in IRS Notice 2008-59 Q-23:

**Q-23.** If an employer contributes to the account of an employee who was never an eligible individual, can the employer recoup the amounts?

**A-23.** 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 1.* In February 2008, Employer L contributed \$500 to an account of Employee M, reasonably believing the account to be an HSA. In July 2008, 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 2008.

*Example 2.* The same facts as Example 1, except Employer L first discovers the mistake in July 2009. Employer L issues a corrected 2008 Form W-2 for Employee M, and Employee M files an amended federal income tax return for 2008.

6. What happens if the worker signs up for Medicare (or becomes ineligible) mid-year? The worker will have to remove the excess contributions that were made to his account (see step 3 above). The correction procedure will be the same as previously detailed in steps 3–5 above. It appears that any employer contributions that were remitted to the account after the Medicare eligibility date are not recoverable. IRS Notice 2008-59 addressed this:

**Q-25.** 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 it contributed after the employee ceased to be an eligible individual?

**A-25.** No. Employers generally cannot recoup amounts from an HSA other than as discussed above in Q&A-23 and Q&A-24. See Notice 2004-50, Q&A-82.

Because each situation may have different circumstances, we recommend and advise that you contact your HSA vendor and tax professionals for their guidance on correcting an error in this regard.

### **Is Medicare enrollment at age 65 required?**

As stated earlier, there is no late enrollment penalty associated with Medicare Part A enrollment by itself. However, there are late enrollment penalties for Medicare Part B and Part D if you fail to enroll within 3 months of your 65th birthday which generally apply *unless* you have employer-sponsored coverage because you are still *actively working*.

If you are actively employed and covered by a group health plan providing primary coverage, you will be eligible under Medicare's Special Enrollment Period (SEP) to enroll in Medicare within 8 months of loss of active employment (e.g., retirement) without a penalty. The only time it would make sense to enroll in Medicare Part A, B, or D at age 65 is if you are not working *or* if your medical plan coverage dictates that Medicare will become your primary coverage (which is common if you work for an employer with fewer than 20 employees).

Enrollment in Medicare Part A may be retroactive should you commence Medicare Part A after reaching age 65. If you qualify for Medicare Part A, coverage will take effect (retroactively) up to six months earlier (but not before the month you reached age 65). So, a worker should stop making contributions to an HSA six months before enrolling in Medicare Part A and Part B (or when they apply for Social Security benefits, if you want to collect retirement benefits before you stop working). Otherwise, HSA contributions made during the period when Medicare was retroactive will become part of the HSA excess contribution.

Again and again, timing matters! In our example, our worker enrolled in Medicare Part A on his 66th birthday, March 1, 2019. Changing that example slightly, assume he was enrolled in a HSA-capable health option and made HSA contributions in 2018 and 2019:

- Medicare Part A is retroactive 6 months to October 1, 2018 (potentially having a negative impact on HSA contributions in 2018).
- This worker will need to go back to the prior year and recalculate the 2018 HSA contribution and make the necessary corrections, and may need to file an amended tax return.

### **Why would workers delay commencing Social Security and Medicare benefits?**

Delaying Medicare and Social Security benefits while still employed and with

access to an HSA-capable health option allows continual HSA contributions by the worker and employer. Further:

- By continuing to delay Social Security, the dollar amount of Social Security benefits increases each month at a rate of 8 percent per year, until age 70. This is often the most cost-effective option for those workers who need more guaranteed, inflation-adjusted income.
- By collecting Social Security early (before reaching Social Security Normal Retirement Age), the dollar amount of Social Security benefits is reduced. Further, Social Security benefits paid prior to a worker's Social Security Normal Retirement Age are subject to income limitations. Workers who have earned income in excess of the limits will have to repay a portion of the benefits received.
- Retirement planning education around the income penalties that reduce Social Security and the benefits of delaying commencement of Social Security could help workers obtain the maximum value from Social Security, Medicare, and their Health Savings Account.

### **For workers, is enrolling in Medicare more valuable than the opportunity to contribute to a HSA?**

It depends. If you have reached your Social Security Normal Retirement Age, commencing Social Security benefits and Medicare Part A coverage may have greater value than delaying commencement so as to remain eligible to contribute to a HSA. For example, the Social Security benefits themselves could be saved to defray future medical premiums and out-of-pocket expenses. And, having Medicare Part A coverage as a secondary plan will potentially pay for out-of-pocket costs for hospitalization not covered by the HSA-capable health plan (or whatever coverage option you elect). The employer-sponsored plan will be primary, paying first, and Medicare Part A coverage would pay second.

If you want to maximize the savings you can accumulate in the HSA so that you have more money available to pay future medical costs, then delaying commencement of Social Security and Medicare Part A could be a better choice if you are under age 70 (so that your Social Security dollar amount benefit will continue to increase). In addition, a generous employer HSA contribution may defray the out-of-pocket costs that might have been paid by Medicare as secondary coverage.

### **Avoiding the Issues: Better Communication**

Plan sponsors often encounter situations where workers don't realize that commencing Social Security benefits and/or enrolling in Medicare Part A disqualifies them from contributing to the HSA. The HSA is an individual account, and the individual is responsible for determining if they are eligible. The best option is to incorporate eligibility checks as part of the enrollment process — at hire, at annual enrollment, and upon a change in status — whenever the individual can enroll in an HSA-capable health option.

What's the best option for communicating with older workers and disabled workers regarding the impact of Medicare on their eligibility to contribute to a HSA? Here are some communication suggestions:

1. Ask your HSA provider if they can add a qualifying question to the certification of other coverage to confirm to workers that enrolling in Medicare disqualifies them from contributing to the HSA.
2. Add similar wording to open enrollment materials.
3. Those who use electronic enrollment platforms should add a qualifying question about Medicare coverage.
4. As an alternative to 1–3 above, create your own documents to have workers certify that Medicare coverage disqualifies them from contributing to the HSA, while also

reminding workers that they are solely responsible to monitor their own eligibility to contribute to a HSA, to notify Human Resources with any changes, to correct any errors with the HSA vendor or provider, and to pay any IRS penalties that may result.

5. When conducting enrollment meetings or retirement planning meetings, repeat the message during those sessions — don't forget to take credit for the super tax efficient HSA option you offer.
6. Many companies and plan sponsors overlook providing Medicare education in the workplace. Ask your 401(k) service provider or advisor for help. Alternatively, you may have a financial wellness option or program that might be able to provide education about Medicare and HSAs.

The PSCA HSA committee values your input and is interested in any feedback on the above or any other issues you are encountering with HSAs. Please write to us at [psca@psca.org](mailto:psca@psca.org) with comments or questions..

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