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EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

IRS ANNOUNCES RELIEF FROM REDUCED FAMILY HSA CONTRIBUTION LIMIT

On April 26, 2018, the IRS published relief from the reduced health savings account ("HSA") maximum contribution limit that it had announced in March. This is welcome news for employers.

On March 5, 2018, the IRS had announced that for 2018, the maximum contribution an individual may make to an HSA based on enrollment in family coverage would be $6,850, a $50 reduction from the previously announced limit of $6,900. The reason for the mid-year reduction in the limit was a change in the way inflation adjustments are made under certain Internal Revenue Code provisions. The change in method was required by the new tax law.

In response to an outcry of concern by employers and HSA providers regarding the difficulties created by the mid-year limit reduction, the new IRS guidance (Rev. Proc. 2018-27) says that taxpayers may treat the original $6,900 maximum as the applicable maximum for 2018. This is good news for employers and individuals who took no action in connection with the March 5th announcement reducing the limit. Employers who implemented changes to limit 2018 contributions to $6,850[1] can now undo those changes and revert back to the original $6,900 limit[2].

Individuals who took a distribution from their HSA of an excess contribution based on the $6,850 limit (i.e., individuals who had contributed the $6,900 maximum before the March 5th reduction announcement) may repay the distribution to their HSA and treat the distribution as the result of a "mistake of fact." Under long-standing HSA guidance, the portion of a mistaken distribution (including earnings) that an individual repays to the HSA by April 15th of the following year (i.e., April 15, 2019 in this case) isn't included in the individual's gross income, is not subject to the 20% additional tax on distributions not used for qualified medical expenses, and is not subject to the excise tax on excess contributions. The new IRS guidance notes that HSA trustees and custodians are not required to allow individuals to repay mistaken contributions.

Individuals who took such a "mistaken distribution" but who do not repay the distribution to their HSA may suffer adverse tax consequences, depending on the source of the contributions to their HSA and whether the distribution was used for qualified medical expenses. Employers are not required to report any of the $6,900 in employer and/or employee pre-tax contributions as taxable. Individuals will need to determine the appropriate tax treatment on their individual tax returns.

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[1] $7,850 for individuals who will be 55 or older by year-end and eligible to make a $1,000 "catch-up" contribution.
[2] $7,900 for individuals who will be 55 or older by year-end and eligible to make a $1,000 "catch-up" contribution.

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