PPACA, HIPAA and Federal Health Benefit Mandates: Practical Q&A

New HSA Erroneous Contribution Guidance: A More Reasonable Approach to the Nonforfeitability Rule for HSA Contributions[1]

One problematic issue for employers and administrators with respect to Health Savings Accounts ("HSAs") is that balances in HSA accounts are nonforfeitable once made. This means that contributions to HSAs generally cannot be returned. This includes all contributions made to an HSA, whether made by the employer, the individual or another person on the individual's behalf. In addition, this rule applies even after an employee leaves employment with an employer; former employees cannot be required to return HSA contributions made during their employment (even if such funding was "frontloaded" in the beginning of the year). This rule raises the issue of what happens when a *mistaken* contribution is made to an HSA.

A September 9, 2015 Information Letter (the "Letter") from the IRS provides that if there is "clear documentary evidence demonstrating that there was an administrative or process error," corrections can be made. Although not binding,[2] this guidance seems to express IRS' view that in certain circumstances, a mistaken HSA contribution can be reversed. This article discusses the three major exceptions to the nonforfeitability rule available to employers as a result of prior guidance and the new Letter, including some nuances of which employers should be aware. Please note that because of the detailed nature of the HSA rules, employers should contact experienced legal counsel before attempting to recoup funds from HSA trustees in the event of a mistaken contribution.

Situation 1: The Individual was Never Eligible for HSA Contributions

The IRS Notice 2008-59 (the "Notice") provides that employers may request that HSA trustees return funds contributed for an individual who was never eligible to make HSA contributions, for that particular calendar year. In this case, the funds would need to be adjusted for any earnings, losses and/or administrative fees affecting the balance of the account. This might sound incongruous with the nonforfeitability rule; however, in the IRS' view, an HSA never existed because the employee was never eligible to establish one, so the nonforfeitability rule would not apply.

If the balance of the account (including earnings) has not been returned by the end of the calendar year, the amounts would be included in the employee's W-2 for the year (i.e., gross income and wages). Note that this only applies in the current taxable year – it does not apply to correct any mistakes made in previous taxable years. If such a mistake is not discovered until the next calendar year, the employer must issue a corrected W-2 to reflect the imputed income for income and employment tax purposes and the employee would need to re-file his or her tax return for the year in question.

Situation 2: The Employer Contributes More than the Annual Maximum Statutory Limit

The second example from the Notice provides that if, because of an error, the amount contributed by an employer exceeds the maximum annual statutory contribution allowed, an employer may request that the HSA trustee return the excess contributions to the employer.

Practice Note: The HSA contribution limits for 2015 are $3,350 (single coverage)/$6,650 (family coverage). For 2016, they are $3,350 (single coverage)/$6,750 (family coverage).

What if the employer had only planned to add $1,000 to an employee's HSA and accidentally adds $5,000? This guidance would not allow the employer to take back any amounts except those over the annual limit – which means that any difference between the intended amount and the annual maximum is essentially forfeited by the employer.

NEW Situation 3: There is Clear Evidence of Administrative or Process Error

While it was not specifically addressed in Notice 2008-59, the IRS Letter provides that the Notice "was not intended to provide an exclusive set of circumstances in which an employer may request the return of contributed amounts." If there is an "administrative or process error" and "clear documentary evidence" demonstrating this is the case, the employer can request funds back from the custodian, in order to put the parties in the same position as they would have been before the mistake. In other words, an erroneous contribution of the wrong amount to an employee's HSA because of a simple data entry mistake can be returned (if the trustee permits). In order to rely on this Letter, employers should maintain documentation related to the mistake.

Below are some examples from the IRS that illustrate what it believes are administrative or process errors. In our annotations below, assume that all employees who contribute to an HSA are eligible to do so under the HSA rules.

An amount withheld and deposited in an employee's HSA for a pay period that is greater than the amount shown on the employee's HSA salary reduction election.

> If Meredith elects to contribute $100 per pay period to her HSA but her December 1st payroll reflects a $150 contribution, her employer may request that the trustee return the $50* (i.e., the difference between the contributed amount and the correct amount).

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An amount that an employee receives as an employer contribution that the employer did not intend to contribute but was transmitted because an incorrect spreadsheet is accessed or because employees with similar names are confused with each other.

John Smith participates in the company's medical plan with single coverage. Joan Smith participates in the company's medical plan with family coverage. The company provides $50 per month to individuals with single coverage and $200 per month to individuals with family coverage. If the payroll department contributes $200 (rather than $50) to John Smith and $50 (not $200) to Joan Smith, because an employee accidentally confused their names when processing that month's payroll, the employer can request that the trustee return the $150 erroneously contributed to John. The employer would then contribute this amount to Joan's account.

An amount that an employee receives as an HSA contribution because it is incorrectly entered by a payroll administrator (whether in-house or third-party) causing the incorrect amount to be withheld and contributed.

Steven is currently contributing $50 per payroll period to his HSA. The payroll administrator, impatient to leave the office for a long weekend, accidentally keys in a $500 contribution to Steven's HSA. Steven's employer may request that the payroll administrator return the $450 (i.e., the difference between the contributed amount and the correct amount).

An amount that an employee receives as a second HSA contribution because duplicate payroll files are transmitted.

Under the terms of its group health plan, Carolyn's employer contributes $50 per pay period to her HSA. If the employer's August 1st payroll reflects a double employer contribution for health plan participants, the employer may request that the trustee refund the $50 for Carolyn (and all of the other employees affected by the duplicate payroll file).

An amount that an employee receives as an HSA contribution because a change in employee payroll elections is not processed timely so that amounts withheld and contributed are greater than (or less than) the employee elected.

Renee decides to contribute $200 per pay period to her HSA in the beginning of the year to cover an expected medical procedure in April. If Renee submits the paperwork to reduce her election to $50 per pay period in May, but this is not processed in a timely manner, her employer can request that the trustee refund the $150 (the difference between the actual contribution and the amount the contribution should have been, under Renee's payroll election) per month that the election change was delayed.

Practice Note: What is "timely" processing? The guidance doesn't specify. Clearly, employers must be able to make reasonable cutoff dates after which salary reduction elections cannot be changed (e.g., June 10th is the last day for changes to the June 15th payroll). A delay of longer than one pay period could arguably be deemed "untimely," but further guidance on this issue would be helpful.

An amount that an employee receives because an HSA contribution amount is calculated in-correctly, such as a case in which an employee elects a total amount for the year that is allocated by the system over an incorrect number of pay periods.

The payroll department of an employer accidentally calculates that the year has 27 payroll periods, when based on their payroll schedule, there actually should be 26 payroll periods that year. Ashley elected to contribute $90 per pay period. Because of the employer's mis-take (i.e., the extra payroll period contribution), $90 extra is contributed to Ashley's HSA that year. The employer may request that the trustee return the $90 (and corresponding amounts for the other employees who were affected by this mistake).

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An amount that an employee receives as an HSA contribution because the decimal position is set incorrectly resulting in a contribution greater than intended.

If Dan has elected to contribute $30 per pay period but the contribution is processed at $300 for a particular pay period, his employer can conclude that this is clearly a mistake in the decimal point that resulted in a contribution greater than Dan intended and request that the trustee return $270 (i.e., the difference between the contributed amount and the correct amount).

What do all of these examples from the Letter have in common? In the IRS' words, they are "administrative or process" errors – essentially, clerical mistakes in the HSA contribution process. In almost all cases, the employer would have clear documentation that the amounts contributed were mistakes; for example, payroll election paperwork that did not match what was actually contributed through payroll. It is important to note that this new guidance does not mean that all contributions can be refunded from a trustee. Thus, this Letter provides some flexibility for situations in which it is clear that HSA contributions were the result of clerical or administrative errors, but employers should keep in mind that exceptions to the general nonforfeitability rule should be carefully considered.

The Affordable Care Act (ACA), the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and other federal health benefit mandates (e.g., the Mental Health Parity Act, the Newborns and Mothers Health Protection Act and the Women's Health and Cancer Rights Act) dramatically impact the administration of self-insured health plans. This monthly column provides practical answers to administration questions and current guidance on ACA, HIPAA and other federal benefit mandates.

Attorneys John R. Hickman, Ashley Gillihan, Carolyn Smith and Dan Taylor provide the answers in this column. Mr. Hickman is partner in charge of the Health Benefits Practice with Alston & Bird, LLP, an Atlanta, New York, Los Angeles, Charlotte and Washington, D.C. law firm. Ashley Gillihan, Carolyn Smith and Dan Taylor are members of the Health Benefits Practice. Answers are provided as general guidance on the subjects covered in the question and are not provided as legal advice to the questioner's situation. Any legal issues should be reviewed by your legal counsel to apply the law to the particular facts of your situation. Readers are encouraged to send questions by email to Mr. Hickman at john.hickman@alston.com.

References

[1]*Stacy Clark, Esq. an associate in Alston & Bird's Atlanta office assisted with the preparation of this article.*

[2]*According to Section 2.04 of IRS Rev. Proc. 2015-1, Information Letters call attention to certain general principles of law and are not binding on the Service.*