

Employer HDHP and HSA Funding Guide

Purpose: This form reviews a variety of alternatives for funding high deductible health insurance plans (HDHPs) and Health Savings Accounts (HSAs). Please consult with your tax counsel for assistance for your plan. We do not provide tax or legal advice. Caution: For 2011 the employee portion of Social Security taxes is reduced to 4.2% from 6.2%.

Funding of Insurance Premiums

Many employers have elected to share the cost burden of health insurance with their employees. The employer paid portion of insurance premiums is generally deductible by the employer as an employee benefit but, without a cafeteria plan, the employee portion of the insurance cost will have to be paid with after-tax income.

Adding a Section 125 Premium Only Plan (POP). A Premium Only Plan (POP) is a simple, low cost method that allows employees to make insurance payments via pre-tax payroll deferrals.

Employer Benefit: Employers save payroll taxes on the amounts paid by the employees, typically 7.65% of the amounts paid plus state unemployment taxes (where applicable).

Employee Benefit: Employee insurance payments through a POP are tax-free, resulting in a savings of roughly 15% to 32% in income taxes (depending on the employee's tax rate) plus 7.65% for FICA/FUTA (4.65% for 2011).

Funding of Health Savings Accounts

Employers offering High Deductible Health Insurance Plans (HDHPs) also face the choice of whether and how to help their employees with the funding of the employees' Health Savings Account (HSA). The options include:

Option 1 - Employee Funded, After-Tax on Employee's Own

Employers are not required to help with the employees HSAs and may choose not to. In this case, employees may open HSAs on their own and receive the tax deduction on their personal income tax return resulting in savings of about 15-32% depending upon the tax bracket (there is no savings of FICA/FUTA).

Option 2 - Employee Funded, Pre-Tax Through Payroll Deferral

Employers can help employees fund their HSAs by allowing for HSA contributions via payroll deferral. This is inexpensive and can be accomplished by adding Section 125 POP with an HSA module. The administration is limited because the HSA custodian generally does most the work.

Employer Benefit: Employers benefit by not having to pay payroll taxes on the employee's HSA contributions, typically 7.65% of the amounts paid plus state unemployment taxes (where applicable).

Employee Benefit: Employees save 7.65% (4.65% for 2011 due to new law reducing tax) on payroll taxes on HSA contributions made through this method (FICA and FUTA are not withheld). Plus, the HSA contribution is also never counted as income, saving approximately 15-32% on income taxes (depending upon state and federal tax brackets).

Note: HSA contributions made outside of payroll are deductible on personal tax returns.

Option 3 - Employer Contributions to an HSA

Employers may make direct contributions to their employees' HSAs without a Section 125 plan however, the contributions must be "comparable" in order to be tax deductible (see our [Comparability Worksheet](#) for details).

Employer Benefit: Employer HSA contributions are tax deductible by the employer as an employee benefit.

Employee Benefit: Employees receive HSA funds tax-free.

Option 4 - Employer and Employee Pre-tax HSA Contributions through Payroll Deferral

Employers can combine options 2 and 3 (adding a Section 125 POP with an HSA module) allowing themselves and their employees to make tax-free HSA contributions. Employers may contribute some money to the HSAs and the employee can add more through payroll deferral (see our [Contribution Worksheet](#) for contribution limits).

Achieving further tax savings -- add a Limited Purpose Flexible Spending Account (FSA) to an HSA

To maximize tax benefits for health care expenses, employers can add a limited purpose FSA to an HSA. Generally, FSAs are not allowed with HSAs, however, an exception exists for "limited purpose" FSAs (FSAs that are limited to payments for preventive care, vision and dental care). This provides more tax savings and employees use the FSA to pay for the limited purposes expenses and the HSA for other eligible medical expenses.

Note: Special rules apply for sole proprietors, partners and most LLC members and shareholders owning more than 2% of an S-corporation. See our [Small Business Owners Guide](#) for more detail. HSA Authority does not provide tax or legal advice.

Examples

Note: These examples do not reflect the reduced Social Security taxes for the employee paid portion in 2011.

Corporation

ABC Corp employs 10 people at an annual payroll cost of \$500,000. ABC offers an HDHP with an annual premium of \$4,800 per person and offers to pay 50% of the cost of the insurance with employees paying the other 50% of the cost. Subsequent columns assume that the employer has modified the Section 125 plan to allow for employee HSA contributions of \$1,500 and limited purpose FSA contributions of \$1,000.

	<u>Without POP</u>	<u>With POP</u>	<u>With POP & HSA</u>	<u>With POP, HSA & FSA</u>
Payroll	500,000	\$500,000	\$500,000	\$500,000
Pre-Tax Payroll Deductions				
Insurance Premiums	-	(24,000)	(24,000.00)	(24,000.00)
HSA Contributions	-	-	(15,000.00)	(15,000.00)
FSA Contributions	-	-	-	(10,000.00)
Total	-	(24,000)	(39,000.00)	(49,000.00)
Taxable Payroll	500,000	\$476,000	\$461,000	\$451,000
Payroll Taxes	38,250	36,414	35,267	34,502
Payroll Tax Savings		\$1,836	\$2,984	\$3,749

Employee

Bob, an employee of ABC corp, has an annual salary of \$50,000. He is single individual with no exemptions. This example is illustrating his payment for half the insurance premium (\$4,800/2 = \$2,400) and estimating that he would spend \$1,500 on medical related expenses and \$1,000 on preventative care, vision and dental expenses.

	<u>Without POP</u>	<u>With POP</u>	<u>With POP & HSA</u>	<u>With POP, HSA & FSA</u>
Annual Salary	50,000	50,000	50,000	50,000
Pre-tax payroll contributions				
Insurance premiums		2,400	2,400	2,400
HSA Contributions			1,500	1,500
FSA Contributions				1,000
Total pre-tax contributions	0	2,400	3,900	4,900
Taxable Income	50,000	47,600	46,100	45,100
After Tax Costs				
Insurance	(2,400)			
Medical Expenses	(1,500)	(1,500)		
Prevent, Vision, Dental	(1,000)	(1,000)	(1,000)	
Estimated Taxes (30.65% ¹)	(15,325)	(14,589)	(14,130)	(13,823)
Net Pay - After Expenses	29,775	30,511	30,970	31,277
Savings		736	1,195	1,502

¹ Estimated average tax rates of: 20% Federal, 7.65% FICA and 3% State