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Making a One-time Transfer from an IRA to an HSA

Stacy Mendenhall

Health savings accounts (HSAs) are an effective tool for account holders to save for out-of-pocket medical expenses now and during retirement.

Contributions made to HSAs are exempt from federal taxes and most state taxes, and distributions from HSAs for eligible health expenses are tax-free as well. Some account holders may want to deposit more money into their HSA to increase their HSA accounts for health expenses, but they don't have the means to make the contributions. The government allows a one-time transfer from an IRA to an HSA. This transfer can help account holders accumulate more assets in their accounts and ultimately save on taxes.

If an HSA account holder is considering transferring funds from an IRA to an HSA, there are several rules and restrictions that the account holder needs to understand. A qualified HSA funding distribution (QHFD) allows for the transfer of funds from an IRA to an HSA. The rollover is tax-free. Moving funds from an IRA to an HSA may have more tax advantages than saving in an IRA alone.

Transfer Rules

The QHFD is a once-in-a-lifetime direct trustee-to-trustee transfer of an IRA to an HSA. The account holder must own both the HSA and the IRA to make the transfer, except when an inherited IRA is involved. For example, a spouse cannot transfer his or her IRA into the other spouse's HSA. Amounts transferred are not included as taxable income, and the transferred amount cannot be deducted when filing tax returns. The only exception to the one-time transfer rule is if the account holder changes from self-only coverage to family coverage during the same year the transfer takes place.

Eligibilty

The individual must be an HSA-eligible individual to transfer money from an IRA—meaning the individual must be enrolled in a high deductible health plan (HDHP). The account holder must not be ineligible for an HSA for other reasons, e.g., enrolled in any part of Medicare.

Also, the individual must remain eligible for the HSA for at least 12 months after the transfer. If the account holder has an existing HSA but is not enrolled in an HDHP, the QFHD is prohibited because

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HSA contributions are not allowed. Also, if funds are transferred, and then the account holder loses HDHP eligibility before 12 months from the transfer, the QFHD will be taxable and is subject to an additional 10 percent tax. Taxes do not apply in cases of death or disability of an HSA-eligible individual.

Annual Contribution Limit

The IRS imposes a maximum on the total contributions to an HSA, which includes any transfer from an IRA. The 2022 maximum HSA contribution limits are:

Self-only HSA maximum contribution limit	$3,650
Family HSA maximum contribution limit	$7,300
HSA catch-up contribution for individuals age 55 or older	$1,000

A qualified HSA funding distribution relates to the taxable year in which the IRA transfer is made. Account holders can contribute to an HSA for a tax year by depositing an HSA contribution no later than April 15 of the following year. Even so, the IRA transfer counts towards the contribution limit in the year it is transferred, even if transferred between January 1 and April 15.

Examples

Example 1. Individual A is under age 55 and has a family HDHP. A $2,000 contribution is made in 2022. A one-time transfer from an IRA is allowed, but the maximum amount eligible for transfer is $5,300. This is because the annual limit for HSA contributions in 2022 for this individual is $7,300. If Individual A's employer contributes to the HSA, that contribution amount also needs to be subtracted from the total coming over from the IRA. However, if the account holder is aged 55 or older, the HSA contribution limit is $8,300 (due to catch-up allowance). HSA-eligible individuals must subtract any personal HSA contributions and any employer contributions to determine the maximum IRA transfer amount.

Example 2. Individual B is under age 55 and has self-only coverage. The maximum HSA contribution is $3,650. No employee or employer contributions have been made to the HSA in 2022, so a transfer of $3,650 from Individual B's IRA to the HSA takes place on June 1, 2022. On August 1, 2022, Individual B enrolls in family HDHP coverage, so the HSA contribution limit increases to $7,300. In this example, an additional $3650 may be transferred from the IRA to the HSA by December 31, 2022. This case is the only exception to the once-in-a-lifetime transfer rule as noted above.

Traditional IRA versus Roth IRA

The transfer into the HSA can come from a traditional IRA, Roth IRA, inactive SEP, or inactive Simple IRA. If an account holder has multiple types of IRAs, the taxation of IRA accounts can get complicated, so those considering this transfer should speak with a tax advisor to help determine which type of IRA to transfer.

- Traditional IRA—distributions from traditional IRAs are usually subject to taxation. Account holders can save tax dollars when money is transferred from a traditional IRA to an HSA, as distributions from the HSA are not taxed for eligible HSA expenses.
- Roth IRAs—contributions to a Roth IRA are taxable to the account holder but can be withdrawn tax-free at any time. HSA-eligible individuals could withdraw their Roth contributions from their Roth IRA and contribute them to their HSA rather than making a trustee-to-trustee transfer. However, earnings that accumulate from investments in a Roth IRA have not been taxed and may be subject to tax when withdrawn. The beauty of a Roth IRA is that when certain requirements are met, earnings are not taxed,

either. Generally, to avoid taxation on Roth IRA earnings, the account holder must be age 59½ and the Roth IRA must have existed for at least 5 years. There are other exceptions, as well. Some account holders may want to keep their funds in a Roth IRA instead of making a transfer to an HSA because Roth IRA distributions may not be taxed in the future and distributions can be made for any reason, not just to pay medical expenses. That said, any transferred money, including earnings, from a Roth IRA will not be taxable to the account holder when withdrawn from the HSA to pay for eligible medical expenses.

Because only one IRA-to-HSA transfer is allowed, account holders with multiple small-balance IRAs should transfer money from IRA to IRA (if possible) to combine them first, then make one transfer to the HSA.

Conclusion

HSA-eligible individuals seeking to increase the money in their HSA accounts and save taxes on money that ordinarily would be taxed at some time in the future may benefit from this one-time transfer. Account holders considering this option must also anticipate that they will be eligible for an HSA for at least a year after the transfer. As suggested above, anyone considering this option should seek advice from a tax professional before making a transfer. ■

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SOCIETY OF FINANCIAL SERVICE PROFESSIONALS
COMMUNITY CALENDAR

May 17, 2022 • 12:00 noon–1:00 p.m. ET
Charitable Planning Strategies for Regular People
Webinar
Cosponsored by American Cancer Society & FSP

June 9, 2022 • 12:00 noon–1:00 p.m. ET
Topic: TBD
Webinar
Sponsored by Ash Brokerage

June 21, 2022 • 12:00 noon–1:00 p.m. ET
Reviewing the Research on Attitudes and Psychology around Retirement
Webinar
Cosponsored by NAEPC & FSP

July 7, 2022 • 12:00 noon–1:00 p.m. ET
Topic: TBD
Webinar
Sponsored by College Ave

July 13, 2022 • 12:00 noon–1:00 p.m. ET
Topic: TBD
Webinar
Sponsored by Guardian

July 26, 2022 • 4:00 p.m.–5:00 p.m. ET
Charitable Planning with Non-Charitable Trusts
Webinar
Sponsored by American Cancer Society

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DOL Expresses Extreme Skepticism about Allowing 401(k) Plan Participants to Invest in Cryptocurrency

Jean Cogill, Jennifer A. Neilsson, David Tetrick, Jr., and Karen T. Shriver

On March 10, 2022, the U.S. Department of Labor (DOL) issued Compliance Assistance Release No. 2022-01 (the "Release") regarding 401(k) plan participant-directed investments in cryptocurrencies. The Release "cautions plan fiduciaries to exercise extreme care before they consider adding a cryptocurrency option" to the investment menu of a self-directed 401(k) plan, and even calls into question the availability of cryptocurrencies through a plan's brokerage window.

Significant Risks and Challenges to Participants

The Release expressly identifies decisions about whether to "include an option for participants to invest in cryptocurrencies" as subject to ERISA's prudence and loyalty obligations. The DOL expresses "serious concerns" about the prudence of allowing 401(k) plans to offer cryptocurrency based on the "significant risks and challenges" the DOL associates with cryptocurrency and notes that the inclusion of *any* imprudent investment option in a menu can constitute a fiduciary breach, even if participants have other prudent options available to them. The Release highlights five reasons behind the DOL's concerns:

- ***Speculative and Volatile.*** The DOL cites Securities and Exchange Commission (SEC) staff bulletins labeling "investments in cryptocurrency…highly speculative." As a relatively new asset class, cryptocurrency has been "subject to extreme price volatility," the DOL says, with "widely published incidents of theft and fraud." Volatility is a heightened concern for participants approaching retirement and for those participants "with substantial allocations to cryptocurrency."
- ***Participants Cannot be Assumed to Have Necessary Investment Expertise.*** Due to the novelty and complexities of cryptocurrency, typical plan participants may not be able to fully appreciate the risks related to such investments. According to the DOL, plan fiduciaries who "choose to include a cryptocurrency option on a 401(k) plan's menu… effectively tell the plan's participants that knowledgeable investment experts have approved the cryptocurrency option as a prudent option."
- ***Custodial and Recordkeeping Issues.*** Cryptocurrency may be difficult to custody. Many plan custodians/trustees may not be equipped to address issues related to a digital wallet. Losing or forgetting a password may result in permanent loss of the assets in a given wallet. Other methods of holding cryptocurrency could make the asset vulnerable to theft.
- ***Valuation.*** The DOL is concerned that valuation of cryptocurrency is "complex and challenging," especially as compared to traditional equity and debt assets. Further, cryptocurrency market intermediaries may not have adopted consistent accounting treatment or reporting methods.
- ***Evolving Regulatory Environment.*** The DOL instructs plan fiduciaries considering whether to include a cryptocurrency investment option to analyze how to comply with evolving regulatory requirements concerning cryptocurrency, especially in the SEC's realm. The Release also cites as a concern the possibility that law enforcement agencies may shut down or restrict platforms and exchanges, or restrict the use or trade of cryptocurrencies, in connection with investigations of illegal activities.

Promised Investigations

The DOL intends to launch an investigative program aimed at fiduciaries of defined-contribution plans who choose to include cryptocurrency within the investment menu (whether directly or indirectly, through products whose value is tied to cryptocurrency) or permit investment in the asset through a brokerage window. "[P]lan fiduciaries responsible for overseeing such investment options or allowing such investments through brokerage windows should expect to be questioned," the DOL says, "about how they can square their actions with their duties of prudence and loyalty in light of the risks described above."

Action Items

The DOL obviously considers cryptocurrencies an exotic investment by current standards and hopes to discourage new investments in cryptocurrencies with the promise of investigations into the fiduciaries of those plans that already offer cryptocurrency as an option or through a brokerage window. This Release marks a significant departure from the DOL's standard position by indicating that an entire asset class should be viewed skeptically. ERISA, however, does not prohibit 401(k) plans from offering such investments. Including cryptocurrencies as a 401(k) plan investment option may or may not make sense for a particular plan depending on myriad factors.

Nonetheless, the DOL has now provided some guidance that fiduciaries must heed. Plan fiduciaries of 401(k) plans should consider whether any investment options permit participants to invest directly or indirectly in cryptocurrency. In addition to examining whether there is a direct investment option, plan fiduciaries should review brokerage window restrictions and consider whether digital assets should be added to the list of prohibited investments. If the plan and its investment policy statement allow participants to invest in cryptocurrency, even through a brokerage window, we recommend that the plan fiduciary consult with its business and legal advisors to assess and mitigate fiduciary risk. ■

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Successor Beneficiaries—"You Have Got to Be Kidding Me"

Andy Ives

Here we go again. In my March 14 *Slott Report* entry ("Monitoring Concurrent Life Expectancies?—SMH"), I railed against the IRS for a seemingly pointless rule in the new SECURE Act regulations directed at elderly IRA beneficiaries. (Subsequently, I saw other commentary criticizing that same rule as "nasty" and "mean spirited.") In today's article, I am back on my soapbox calling out more baffling guidelines.

I will preface these comments with a direct quote from a financial advisor on Friday, March 18, after I explained the possible options to his successor beneficiary question: *"Give me a break. You have got to be kidding me."*

Nope, not kidding.

A successor beneficiary is the beneficiary of a beneficiary. As a successor, there is definitive guidance when it comes to handling the payouts from an inherited IRA. Successor beneficiaries are strictly bound by the 10-year payout rule. If the previous beneficiary was using the 10-year rule, the successor can only continue that same 10-year window. If, however, the previous beneficiary was stretching required minimum distribution (RMD) payments over his own single life expectancy, upon the death of that first beneficiary, the successor is permitted to start his own 10-year payout period. All good so far.

Now, the concern. For the past 2 plus years, the industry has been operating under the impression that there were no RMDs within the 10-year period. However, the new SECURE Act regulations dictate that there may or may not be annual RMDs within the 10-year period for successor beneficiaries. Whether or not RMDs apply within the 10 years is predicated on how old the *original* IRA owner was in relation to the required beginning date (RBD). If the original IRA owner died on or after the RBD (April 1 of the year after a person turns 70½ or 72), then the successor *will* have to take RMDs within the 10-year period. If the original IRA owner died before the RBD, then no RMDs are required within the 10-year period for the successor. (How to calculate those RMDs is another story.)

And that is why the financial advisor was so incredulous. His client was the first beneficiary who inherited the IRA more than a dozen years earlier. His client had been properly stretching the inherited account RMD payments over her own single life expectancy, but she just passed away. As the first beneficiary, upon her death, her successor now has the 10-year rule. When I asked the advisor if he had any idea who the *original* IRA owner was 12+ years ago or how old that person was at death, he replied with what became the title of this article.

The account had changed custodians a couple of times, information was lost, and the advisor acquired the client and inherited IRA only a few years earlier. He had three options: 1) research the details of the age of the original IRA owner; 2) hope the successor beneficiary knew definitively how old the original IRA owner was at death; or 3) take a conservative approach and require the successor beneficiary to take annual RMDs within the 10-year period.

How many beneficiary IRAs exist that were inherited prior to the SECURE Act in 2020? Hundreds of thousands? A million? Every single one that is left to a successor beneficiary will have to go through this exercise. *"You have got to be kidding me"*—the appropriate response. ■

Andy Ives, CFP, AIF, has over 20 years' experience in the financial services industry where he has engaged in a wide range of duties, including serving as a relationship manager at a mutual fund company and wholesaling 401(k) record-keeping solutions to financial advisors and business owners. He is a past president of the North Florida Chapter of the Society of FSP.

Employers and Providers Fight over COVID-19 Testing Costs

Stephen P. Lucke

While social distancing restrictions associated with COVID-19 are on the wane, lawsuits seeking reimbursement for COVID-19 testing are on the rise. The issue is whether federal legislation passed at the onset of the pandemic allows out-of-network test providers essentially to name their price for the tests they offer—even if that price far exceeds the going rate.

Employers, particularly those that self-fund their health benefits, have an interest in the outcome, since it is they (and often their employees) who will ultimately foot the bill. But these cases also raise larger questions about how disputes over state and federal health benefit mandates should be resolved.

At the heart of the current testing fee controversy is a provision in the Coronavirus Aid, Relief, and Economic Security (CARES) Act requiring that (absent specific arrangements), health plans provide "first dollar" coverage in an "amount that equals the cash price for [testing] services as listed by the provider on a public internet website." Relying on this provision, as well as related regulations that limit medical management techniques in adjudicating claims, some out-of-network testing providers have charged from several hundred dollars to $900 for tests, even though the industry average for similar tests have been in the $130-$150 range.

After encountering pushback from insurers and claims administrators, out-of-network providers have sued to recover reimbursement for thousands of claims, primarily arguing that the CARES Act provides them with a private cause of action for reimbursement at the "cash price" they listed on their websites. Last week, however, after applying the four-factor *Cort v. Ash* test, the court in *Murphy Medical Associates, LLC v. Cigna Health and Life Insurance Company,* No. 3:20-CV-01675-JBA (D. Conn. March 11, 2022) rejected that argument, pointing, among other things, to the absence of congressional intent for a private remedy.

Rather, it treated the provider's reimbursement claims as typical out of network claims for ERISA health benefits—at least with respect to tests administered for participants in employer-sponsored plans. Although the court held that a claim for benefits under ERISA was sufficiently pled, it made clear that, as in other ERISA benefit litigation, the provider must have received from its patients a valid assignment, which yet may be subject to a plan's anti-assignment clause. Evidence of the provider's right to sue for each of the tests it administered will be relevant at trial.

Although benefit claims typically require allegations that the respective health plans actually covered the services provided, the court did not require such allegations, reasoning that the CARES Act effectively modified the terms of the respective plans to cover testing as provided in the statute and associated regulations. The court did not address, however, whether the testing was for diagnostic purposes as opposed to purposes of "surveillance," i.e. testing to satisfy public health or employment requirements, which do not fall within the federal mandate. *See* DOL FAQ's about Family First Coronavirus Response Act and Coronavirus Aid, Relief, and Economic Security Act Implementation Part 44, Q.2.

In other words, as reiterated in later regulatory guidance regarding over-the-counter COVID-19 tests, plans are required to cover some but not all tests. See DOL FAQs about Affordable Care Act Implementation Part 51, Families First Coronavirus Response Act and Coronavirus Aid, Relief, and Economic Security Act Implementation, Q4. Arguably, allegations that tests meet the statutory criteria are necessary to establish coverage. *See Almont Ambulatory Surgery Center, LLC v. UnitedHealth Group,* 99 F. Supp. 3d 1110, 1155-60 (C.D. Cal. 2015). They may also be relevant to failure-to-exhaust-administrative-remedies defenses, as well as subject to proof at trial.

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Notwithstanding the *Murphy Medical* decision, the existence of a CARES Act private cause of action remains a hotly debated issue. In *Diagnostic Affiliates of Northeast Hou, LLC. v. United Healthcare Services,* 2022 WL 214101 (S.D. Tex. Jan. 15, 2022), the court found a private cause of action under the CARES Act, allowing the provider to challenge the plan's denials independent of ERISA's requirements. The court also sustained the provider's alternative ERISA benefit claims without requiring it to allege assignments for the various tests for which it sought reimbursement, in part because it had already found a private right of action. Underscoring the financial interests that employers may have in these cases, the provider in *Diagnostic Affiliates* sued 70 self-funded employers in addition to their claims administrator.

Striking a cautionary note for plans that may suspect fraud or price gouging, the *Murphy Medical* court let stand a "tortious interference" claim arising out of statements the defendants made in notices of denials or explanations of benefits. Unlike other state law claims dismissed as preempted, the court ruled that the provider had alleged conduct independent of the benefits denials. Nevertheless, plans have a variety of options for bringing a provider's wrongful practices to the fore. In addition to challenging the legitimacy of the provider's "cash price" as a defense on the merits, plans may also bring claims and counterclaims for recoupment or declaratory relief, though, as is often the case with ERISA, close attention must be paid to preemption, standing, and other procedural hurdles. *See supra, Almont,* 121 F. Supp. 3d 950.

As noted, in addition to affecting the pocketbooks of plan sponsors, COVID-19 testing cases raise broader implications for resolving the increasing number of claims that involve mandated benefits. To claims seeking such benefits, plans may find that rigorous application of ERISA's rules and protections often provides the best defense. ■

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