



**April 12, 2006**  
**Pennsylvania Personal Income Tax**  
**No. PIT-06-005**  
**Health Savings Accounts; Withholding**

ISSUES

1. If Employer makes contributions to a health savings account for an employee, is Taxpayer required to report the compensation as income and withhold Pennsylvania Personal Income Tax?
2. If Employer's federally qualified cafeteria plan includes a health savings account as one of its qualified benefits, is Employer required to report the contributions that an employee elects to be contributed to the account as compensation and withhold tax on the contributions?
3. Is Employer required to withhold Pennsylvania Personal Income Tax from the contributions that an employee makes to a health savings account?

CONCLUSIONS

1. No. Payments made by Employer for a nondiscriminatory health plan are excluded from compensation and therefore not subject to withholding tax.
2. No. Payments that an employee directs to be made under the cafeteria plan to a health savings account maintained as a qualified benefit of an employer's cafeteria plan are excluded from compensation and therefore not subject to withholding tax.
3. Yes. The Health Savings Account Act provides no exemption for employee contributions made to a health savings account.

FACTS

The Health Savings Account Act<sup>[1]</sup> (the HSA Act) was signed by the Governor on July 14, 2005, and applies to tax years beginning after December 31, 2004. In contrast to the Medical Care Savings Account Act,<sup>[2]</sup> which contains a tax exemption for contributions made to a medical care savings account, the final version of House Bill 107 did not contain the paragraph, which provided a tax exemption for employer and employee contributions.<sup>[3]</sup>

DISCUSSION

Although the HSA Act<sup>[4]</sup> contains no tax exemption for contributions made to a health savings account (an HSA), the Tax Reform Code of 1971 (the Code) excludes employer payments that are made to provide hospitalization, sickness, disability or death benefits, supplemental unemployment benefits or strike benefits for employees.<sup>[5]</sup> Regulation Section 101.6 provides specifically that compensation does not include payments made by an employer for a nondiscriminatory health, accident or death plan.<sup>[6]</sup> Therefore, since distributions from an HSA are exempt from tax only when the employee uses them for

qualified medical expenses, contributions that are made by an employer to an employee's HSA are excluded from compensation and are not subject to withholding.

The Code also excludes payments made for hospitalization, sickness, disability or death benefits when the benefits are obtained through a cafeteria plan qualifying under Section 125 of the Internal Revenue Code.<sup>[7]</sup> Thus, Regulation 101.6 explains that an employee's elective contributions which are used to obtain health, accident or death benefits through the employer's cafeteria plan are excluded from an employee's compensation.<sup>[8]</sup> Consequently, since an employer is permitted to include an HSA in its cafeteria plan and HSA distributions are only exempt when used for qualified medical expenses,<sup>[9]</sup> contributions to an HSA are excluded from compensation and are not subject to withholding when they are made through the employer's cafeteria plan. All other contributions made by the employee to an HSA are included in compensation and are subject to withholding tax.

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<sup>[1]</sup> 72 P.S. §§ 3402b.1 – 3402b.6. Act 48 of 2005. (HB 107; PN 2567).

<sup>[2]</sup> 72 P.S. §§ 3402a.1 – 3402a.4.

<sup>[3]</sup> The following language was deleted from the final version of the House Bill: Any contribution to a health savings account by an account beneficiary or the employer of that account beneficiary that conforms to section 223(a) and (b) of the Internal Revenue Code of 1986 (Public Law 99-514, 26 U.S.C. § 223(a) and (b)).

<sup>[4]</sup> 72 P.S. §§ 3402b.1 – 3402b.6.

<sup>[5]</sup> 72 P.S. § 7301(d).

<sup>[6]</sup> 61 Pa. Code § 101.6(c)(6).

<sup>[7]</sup> 72 P.S. § 7301(d).

<sup>[8]</sup> 61 Pa. Code § 101.6(c)(6).

<sup>[9]</sup> I.R.C. §§ 125(f); 106(d).