PREPARING FOR FUTURE HEALTHCARE COSTS

FREQUENTLY ASKED QUESTIONS ABOUT HEALTH SAVINGS ACCOUNTS

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HEALTH SAVINGS ACCOUNT (HSA) FREQUENTLY ASKED QUESTIONS

Health savings accounts are tax-exempt medical savings accounts available to those enrolled in a high-deductible health plan (HDHP). These individually owned accounts (no joint HSAs) allow for pretax contributions to enjoy tax-free investment growth and be withdrawn tax-free to pay for or reimburse qualified medical expenses.

What are the major tax advantages of an HSA?

- Cash contributions to an HSA are 100% deductible from the federal gross income (within legal limits)
- Interest and investment gains on savings accumulate tax-deferred
- Withdrawals from an HSA for "qualified medical expenses" are free from federal income tax

What are qualified medical expenses?

Qualified medical expenses include: deductibles, dental services, vision care, prescription drugs, co-pays, psychiatric treatments, and other expenses not covered by a health insurance plan. (See IRS Publication 502 for a full list.)

What expenses are not considered qualified medical expenses?

Insurance premiums are not qualified medical expenses unless the premiums are for: long term care insurance, healthcare continuation coverage (COBRA), healthcare coverage while receiving unemployment compensation, and Medicare premiums (other than premiums for a Medicare supplemental policy, such as Medigap).

Withdrawals for nonqualified medical expenses may incur a 20% penalty. Individuals under age 65 who make a nonqualified withdrawal will have the distribution included in income and be subject to the 20% penalty. Those age 65 or older who make a nonqualified withdrawal will have the distribution included in income, but there is no additional 20% penalty.

What is a high-deductible health plan?

Federal tax law defines a high-deductible health plan as any plan with a deductible of at least $1,400 for an individual or $2,800 for a family. For 2021, the HDHP's total yearly out-of-pocket expense (including deductibles, copayments, and coinsurance) can't be more than $7,000 for an individual or $14,000 for a family. (This limit doesn't apply to out-of-network services.)

Can individuals have another insurance plan in addition to an HDHP?

Typically no, and that includes Medicare Part A or Part B. But there are some exceptions as individuals can have standalone dental and vision plans, long term care plans, disability insurance, certain hospital indemnity plans, certain specified disease plans, and worker's comp insurance.

Who qualifies for an HSA?

To qualify for an HSA, individuals need to be enrolled in an HDHP and meet the following requirements as defined by the IRS:

- Must be covered under a qualifying HDHP on the first day of the month
- Can't be claimed as a dependent on someone else's tax return
- Must not have received Veterans Affairs (VA) benefits within the past three months, except for preventive care. This exclusion doesn't apply if there's a disability rating from the VA.
- Cannot have a healthcare flexible spending account (FSA) or health reimbursement account (HRA). Alternative plan designs, such as a limited-purpose FSA or HRA, might be permitted.

When can an HSA be opened?

An HSA can be opened at any time of year, as long as the individual is already enrolled in a qualified HDHP and is otherwise HSA-eligible. If enrolling through an employer, people generally enroll during the employer's open-enrollment period.

Who can contribute and what are the maximums?

Pretax contributions can be funded by an employee, an employer, or both. Family members can also make contributions on behalf of an eligible individual, if the plan allows. For 2021, contribution limits are $3,600 for self-coverage, $7,200 for families, plus a $1,000 catch-up for those 55 or older by the end of the tax year. Contributions can be made to the account up to the tax filing deadline where contributions are reported on IRS Form 8889. Contributions to an HSA cannot be made if enrolled in Medicare. **Medicare.gov** suggests stopping contributions to an HSA at least six months before applying for Medicare to avoid tax penalties.

What if there is an excess contribution?

Excess contributions and any earnings on the excess amount must be withdrawn prior to the tax filing deadline, including extensions. Most distributions for nonmedical expenses incur a 20% penalty, however, there is no 20% penalty on removing excess contributions by the tax filing deadline. The IRS also allows excess contributions to be applied to future periods.

What happens if excess contributions are not withdrawn prior to the tax filing deadline?

There is a 6% excise tax on excess contributions and any earnings from these excess contributions each year the excess remains in the HSA.

Are there any income limits affecting HSA eligibility?

No, there are no income limit restrictions.

Can HSA funds pay for a gym membership?

HSA funds may not be used for gym memberships, diet foods, or cosmetic surgery. General exceptions may allow the funds to be used for cosmetic surgery if the surgery is to correct a genetic anomaly or a disfigurement resulting from an illness.

Can IRA funds transfer into an HSA?

The law allows a one-time transfer of IRA assets to fund an HSA.

The total amount transferred from an IRA and contributed to an HSA may not exceed the amount of one year's contribution limit, and individuals must be otherwise eligible to open an HSA. Transfers are not taxable as IRA distributions, however, amounts transferred into an HSA from an IRA are not tax deductible. See reference Pub 969 for details.

Can HSA funds be used for family members?

HSA funds can pay for the qualified medical expenses of any dependents so long as their expense is not otherwise reimbursed.

What are the contribution limits when enrolling mid-year?

Despite enrolling in an HSA mid-year, participants can still contribute up to the full applicable federal limit, including a full catch-up amount if between ages 55–65, so long as the HDHP coverage started no later than December 1 of that year.

In this scenario, there is a testing period. An HSA must be maintained for a period beginning on December 1 of the year it was started and ending on December 31 of the next year. Otherwise, contribution limits are generally prorated for those months of eligibility.

What about federal tax benefits for same-sex married couples?

For federal tax purposes, marriages of couples of the same sex are treated the same as marriages of couples of the opposite sex. The term "spouse" includes an individual who is legally married to a person of the same sex. However, individuals who have entered into a registered domestic partnership, civil union, or other similar relationship that isn't considered a marriage under state law aren't considered married for federal tax purposes.

What if there are insufficient funds in an HSA at the time medical care was received or at the time eligible medical items were purchased?

Qualified medical expenses can be paid out-of-pocket and then reimbursed from the HSA once additional funds have accumulated in the account. Reimbursements are even allowed for an out-of-pocket expense paid years later, so long as the HSA was open at the time of the expense and there is a receipt establishing the expense as eligible.

Can an HSA be used to pay for expenses incurred before an account is opened?

HSA money can pay for qualified medical expenses incurred only after the account is opened.

Can an HSA be used to pay for a previous year's expenses?

Previous year's eligible medical expenses can be reimbursed after the HSA was established.

Can HSA funds pay for medical services provided in other countries, such as Mexico and Canada?

HSA funds can be used for medical services provided in other countries as long as the amounts reimbursed would also be qualifying medical expenses in the U.S.

What if there is no longer coverage under a high-deductible health plan (HDHP)?

HSA funds are never lost due to changes in employment or health plan. Funds can still be used to pay for qualified medical expenses which are determined by federal law. However, contributions can no longer be made to the account.

What if funds were withdrawn from an HSA for an expense that was thought to be a qualified medical expense, but it turns out the expense was not a qualified medical expense?

Money may be redeposited into the HSA if there is clear and convincing evidence that the withdrawal was a mistake of fact and the trustee is willing to accept the funds back. The account must be repaid before the tax filing deadline of the year following when the mistake was identified.

Can someone contribute to another person's HSA?

Yes, if the plan allows. However, the tax benefit from such a contribution is gained by the person receiving the contribution, not to the person giving the contribution. Additionally, the contribution counts toward the recipient's contribution limit.

What happens during the year, while covered under an HDHP/HSA, if coverage changes from individual coverage to family coverage or vice versa based on a qualified life event?

Continued contributions are still allowed into the HSA. The permitted contribution amount will change from the individual to family contribution or vice versa, prorated appropriately for the year.

Can the unused funds in an HSA be rolled over each year?

HSA funds can accumulate without a maximum cap. However, the annual contribution limit may not exceed the maximum contribution amount set by the IRS. HSAs belong to the participant regardless of employment even if there is a job change, job loss, or retirement.

With a job change, HSA funds can be kept in the existing HSA or rolled to the account provided by the new employer. Transfers from one HSA to another HSA are allowed.

What happens to the HSA at the account owner's death?

If a spouse is the designated beneficiary, then the HSA will be treated as the spouse's HSA after the other spouse's death. If the spouse isn't the designated beneficiary, then the account stops being an HSA, and the fair market value of the HSA becomes taxable to the beneficiary in the year in which the account owner dies. If the estate is the beneficiary, the value is included on the estate's income tax return in the estate's last taxable year.

Who would benefit from an HSA and HDHP?

- If medical expenses are generally limited to preventive care, an HDHP should be considered.
- If in-network medical expenses would trigger the catastrophic limit, an HDHP should be considered.
- If medical expenses do not approach catastrophic limits, a traditional plan should be considered.

Let’s start the conversation together.

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