HEALTH SAVINGS ACCOUNTS

Quick Guide

This quick guide was prepared by Truebridge.

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What Are Health Savings Accounts?

Health Savings Accounts (HSAs) are designed to help individuals save for future medical and retiree health expenses on a tax-advantaged basis.

An HSA permits eligible individuals, who are not enrolled in Medicare, to pay for current medical expenses as well as to save for future “qualified” medical and retiree health expenses that are not covered by insurance on a tax-advantaged basis. See the section *“What Are Qualified Medical Expenses?”* for more information about what kind of expenses can be paid by an HSA. These accounts may be offered through employers. However, HSAs are independent of employment so that any eligible individual can establish an HSA with any eligible financial institution.

Who Can Establish an HSA?

For 2020, the IRS defines a high-deductible health plan (HDHP). In 2019, a HDHP is a plan with a deductible of at least $1,400 for individual coverage and $2,800 for family coverage. In addition, in 2019 the annual out-of-pocket expense (including deductibles copayments, and coinsurance other than premiums) can be no more than $6,900 ($6,650 in for individual coverage and $13,800 for a family. This limit doesn’t apply to out-of-network services.). The annual “catch-up” contribution amount for individuals age 55 or older will remain $1,000.These amounts are indexed annually for inflation. To qualify as an HDHP, no payment can be made from a family coverage plan for an individual (except for preventative care benefits to which a deductible does not need to apply) until the family deductible is met. .

You generally will not be eligible to open an HSA, even if you are covered under an HDHP, if any of the following apply:

- You are already covered under a non-HDHP, including a comprehensive major medical plan, a plan sponsored by your employer or your spouse’s employer, or a prescription drug plan with a low deductible or no deductible. However, depending on the type of non-HDHP coverage you have, you still may be eligible to establish an HSA. For example, if you are covered by a non-HDHP that provides insurance for a specific disease or illness, you may still be eligible for an HSA.
- You can be claimed as a dependant on another person’s income tax return.
- You are entitled to Medicare coverage (i.e., you are age 65 or older), and have enrolled in Medicare.

How Much Can Be Contributed to an HSA?

The 2020 contribution limit is $3,550 ($3,500 in 2019) for individual coverage and $7,000 ($6,900 in 2018) for family coverage regardless of income, even if the plan deductible is less than this amount. To encourage saving for health expenses for retirement, additional "catch-up" contributions may be available to those who are age 55 or older. The contribution limit is $1,000 for 2009 and later years. Both you and your spouse can make separate catch-up contributions to an HSA. However, no regular or catch-up contributions can be made once you reach age 65 and are enrolled in Medicare.

An excise tax applies to contributions that exceed the maximum contribution amount. This excise tax generally is equal to 6%.

Contributions can be made in one lump-sum amount or in monthly payments up until April 15 of the following year (the due date of your individual tax return). The maximum contribution can also be made on the first day of the year. You can make a full deductible contribution to an HSA (up to the annual limit), even if you enroll in a qualifying HSA/HDHP partway through the year. For example, if you become an eligible individual in the last month of the year, you would be treated as having been eligible during every month of the year when figuring the amount that you can contribute to the HSA. Thus, you would be allowed to make contributions for months before you were enrolled in a high deductible health plan.

Contributions can be made by both you and your employer. Employers also may make larger HSA contributions for non–highly compensated employees than for highly compensated employees.

How Do You Establish an HSA?

An HSA is a tax-exempt trust or custodial account that can be established through any qualified trustee or custodian, including a bank or credit union, an insurance company, or a third-party administrator. In some cases, this may be the same institution offering the HDHP. You can open an HSA on your own or, if available, through your employer.

Who Can Make Contributions to an HSA?

You, your eligible family members, or others who wish to do so can make contributions to your HSA. If you are employed, your employer may also make contributions to your HSA. Contributions may be made directly, or through salary reductions, if offered by your employer. However, no contributions can be made to your HSA once you retire.

If your spouse has non-HDHP family coverage, but that plan does not cover you, you may still contribute to an HSA if you are otherwise eligible to do so. However, your spouse will not be eligible to contribute to an HSA.

How Are Contributions Made to an HSA?

Tax-advantaged contributions can be made in three ways:

- You or your family can make tax deductible contributions to your HSA even if you do not itemize deductions on your federal income tax return.
- Your employer can make contributions that are not taxed to either you or your employer.
- Employers may allow employees to contribute untaxed salary through a salary reduction program.

Can You Make Contributions to an HSA if You Are Covered under an FSA or HRA?

You may not be eligible to make contributions to an HSA if you are currently covered under a Flexible Spending Account (FSA) or a Health Reimbursement Arrangement (HRA) that provides duplicate coverage of the HSA. However, if you have an FSA or an HRA, you will be eligible to participate in an HSA if:

- Your FSA or HRA repays or reimburses only vision, dental, or preventive care expenses.
- Your FSA or HRA is a high-deductible arrangement that pays or reimburses health-care expenses only after the minimum annual HDHP deductible has been satisfied.
- You suspend your HRA for a period of time by electing to forgo reimbursement of HRA benefits that you incur during the suspension period (your employer can continue to make contributions during the suspension period).
- Your HRA is a retirement HRA that reimburses medical expenses you incur once you retire (although contributions can be made before you retire).

Can Your Contributions Earn Interest?

Your HSA contributions earn interest. As the account owner, you can direct your contributions to any number of savings or investment options offered by the trustee or custodian of your HSA. Any interest and investment earnings on your contributions grow tax-deferred until money is withdrawn from your HSA. In addition, interest will be tax-free when you withdraw to pay for qualified medical expenses.

How Are Contributions Taxed?

Individual contributions you make to your HSA that do not exceed the maximum contribution limit are tax-deductible. Because you deduct these contributions "above-the-line" when calculating your adjusted gross income, you can deduct HSA contributions even if you do not itemize deductions on your federal income tax return. You can also deduct contributions made by a family member on your behalf.

If your employer makes contributions to your HSA, these are not included in your gross income. Thus, you do not have to pay income tax on the amount contributed by your employer. However, you cannot deduct the HSA contributions made by your employer on your tax return.

Interest and earnings on amounts in HSAs are not taxable.

How Are Distributions Taxed?

You can withdraw money from your HSA for qualified medical expenses for yourself, your spouse, and your dependents. Distributions from an HSA for qualified medical expenses are not taxable. However, distributions from an HSA to pay for nonqualified expenses are considered taxable income and are subject to an additional tax of 20%. The 20% additional tax for nonqualified expenses does not apply if the distribution is made as a result of death or disability or upon reaching age 65, the age of Medicare eligibility.

Even after you are no longer an eligible individual (e.g., you are enrolled in Medicare benefits or you no longer have a HDHP), distributions that you use to pay for qualified medical expenses continue to be tax-free.

If you are married and both you and your spouse have an HSA, you or your spouse may use HSA distributions to pay for the qualified medical expenses of the other spouse, but both HSAs cannot reimburse for the same expenses.

What Are Qualified Medical Expenses?

Qualified medical expenses are health-care expenses, as defined by Internal Revenue Code 213(d), that are paid by you, your spouse, or your dependents for the diagnosis, cure, mitigation, treatment, or prevention of disease. These expenses include laboratory fees, prescription drugs, dental treatment, ambulance service, eyeglasses, and hearing aids, as well as many other health care expenses. Note that over-the-counter (OTC) drugs are no not a qualifying expense. HSA funds may also be used to cover health insurance deductibles and co-payments.

Generally, health insurance premiums, including HDHP premiums, are not qualified expenses, except for the following types of health coverage:

- COBRA health care continuation coverage
- Qualified long-term care insurance
- Health care coverage while receiving unemployment compensation
- Retiree health insurance other than a Medicare supplemental policy (Medigap). This means that if you are age 65 or older, premiums you pay for Medicare Part A, Part B, Part D, or a Medicare HMO, or your share of premiums for employer-sponsored health insurance, including retiree health insurance, can be paid from an HSA.

IMPORTANT NOTE: The HSA trustee or employer is not responsible for ensuring that amounts distributed from an HSA are used for qualified medical expenses.

For a list of qualified medical expenses, see IRS Publication 502.

Are Rollovers Permitted?

Unused balances in an HSA can accumulate and build from year to year. There is no “use it or lose it” provision as is the case with Flexible Savings Plans. These accounts are portable, and may be used by individuals who move from job to job.

Rollover contributions from Archer Medical Savings Accounts and other HSAs are permitted and are not subject to annual contribution limits. See the section *How Much Can Be Contributed to an HSA?* Only one rollover contribution may be made during a one-year period, and the amount must be contributed to the HSA within 60 days in order to be exempt from income tax and the additional 20% tax that applies to nonqualified distributions. However, there is no limit on the number of trustee-to-trustee transfers allowed in a year.

In addition, a one-time direct rollover of a health FSA or an HRA can now be made to an HSA. However, these rollovers are limited to the FSA or HRA account balance as of the rollover date or the account balance as of September 21, 2006, whichever is less. This provision is effective for transfers made on or after December 20, 2006, but before January 1, 2012.

And, effective for tax years beginning after December 31, 2006, eligible individuals can roll over funds directly from an IRA to an HSA once during their lifetimes. The contribution must be made in a direct trustee-to-trustee transfer.

IMPORTANT NOTE: The contribution cannot exceed the HSA contribution limit for that year. However, if a rollover is made during a month in which you have individual coverage as of the first day of the month, an additional rollover may be made during a later month within the year in which you have family coverage. This provision does not apply to Simplified Employee Pensions (SEPs) or to SIMPLE retirement accounts.

What Happens to Funds Remaining in Your HSA?

At the end of the year

One of the advantages of HSAs is that, unlike FSAs, HSAs do not have a "use it or lose it" provision. You do not forfeit unused funds remaining in your account at the end of the year, and the money in the HSA can continue to accumulate tax-free for use in later years.

If you change jobs

An HSA is portable. Because the account is yours, you can keep it. If you qualify, you may continue to make contributions even if you change employers or leave the workforce.

If you divorce

If all or part of your interest is transferred to your spouse as part of a divorce settlement, it will not be considered a taxable transfer, and the transferred money will continue to be treated as an HSA.

If you retire

Although you can no longer make contributions to an HSA once you reach age 65 and are enrolled in Medicare, you can take tax-free distributions from your account to pay for qualified medical expenses. You can withdraw funds from your account for non-medical purposes without owing a penalty, although the amount you withdraw will be subject to income tax.

If you die

Funds remaining in your HSA upon your death become the property of your designated beneficiary.

If the designated beneficiary is your surviving spouse, he or she becomes the account holder and the account remains an HSA. Distributions will continue to be tax-free when used for qualified medical expenses. If the beneficiary is anyone other than your surviving spouse, the account ceases to be an HSA as of the day of your death. Your non-spouse beneficiary must include in his or her gross income the fair market value of your HSA account at your date of death (less any amounts paid from your HSA for your qualified medical expenses, if paid within one year after your death.) ♦