

# Health Savings Accounts (HSAs)

Health Savings Accounts (HSAs) are a special form of savings that provide a unique way to offset the rising costs of health care. These accounts not only offer tax advantages for contributions and withdrawals, but have a variety of investment options, are portable in the event the owner changes employers and can be passed to a surviving spouse upon the owner's death.

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## BENEFITS OF A HEALTH SAVINGS ACCOUNT

In order to incent individuals to build savings to cover their future health care expenses, HSAs offer three different levels of tax benefit:

- Contributions to an HSA made by the account owner (or anyone other than the owner's employer) are fully tax-deductible. Contributions made to an employer-sponsored HSA, either by the employer directly or via payroll deductions, are considered employer contributions and are excluded from gross income reported on the employee's W-2.
- Any investment earnings inside the HSA are tax-deferred.
- Distributions from the HSA are tax-free if they are used to pay qualified medical expenses.

In addition to the tax benefits of HSAs, they also offer more flexibility than other forms of saving for medical expenses. For example, funds may remain in an HSA until needed, and there is no set timeframe during which the money must be spent. Also, HSAs are portable, meaning they can be kept even if the employee changes employers or leaves the workforce.

## QUALIFYING FOR AN HSA

To be eligible to contribute to an HSA, an individual must meet the following requirements:

- Must be covered under a health insurance plan considered a "high deductible health plan" (HDHP)
- Must not have any other health coverage besides the HDHP
- Cannot be enrolled in Medicare
- Cannot be claimed as a dependent on someone else's tax return

A high deductible health plan is a plan that has a higher annual deductible than typical health plans, and also caps the out-of-pocket amount spent on medical expenses (deductible plus coinsurance) in any given year. The thresholds are adjusted annually, and are based on whether the insurance covers one person or the family. The 2023 levels are shown below:

## Health Savings Accounts (HSAs), *continued*

High Deductible Health Plan	Self-Only Coverage *	Family Coverage *
Minimum Annual Deductible	\$1,500	\$3,000
Maximum Out-of-Pocket Expense	\$7,500	\$15,000

### CONTRIBUTIONS TO A HEALTH SAVINGS ACCOUNT

The maximum contribution to an HSA is based on the type of coverage purchased. For 2023, the HSA contribution limits are as follows:

	Self-Only Coverage	Family Coverage
Maximum Contribution	\$3,850	\$7,750
Catch up Contribution (age 55 or older at year end)	\$1,000	\$1,000

Any eligible individual can contribute to an HSA. For an employee's HSA, the employee, the employer, or both may contribute to the account in the same year. Family members or any other person may also make contributions on behalf of an eligible individual.

HSAs are always titled in one individual's name – there is no such thing as a joint HSA – although each spouse may establish their own HSA if they meet the eligibility requirements. If either spouse has family coverage under the HDHP, their combined contributions can't exceed the maximum for family coverage. The total HSA contribution can be allocated between their two accounts in any amount as long as it doesn't exceed the maximum amount. If each spouse is age 55 or older, they can also each make a catch-up contribution for the year, although each amount must be contributed to their own account. Each spouse's HSA can be used to pay expenses incurred by the owner, their spouse or any dependents (see the section titled Qualified Medical Expenses for more information).

Eligibility for contributions is determined on a monthly basis. If an eligible person becomes ineligible during the year, their maximum contribution for the year will be prorated. Ineligibility includes enrolling in Medicare during the year, and the proration applies to both employee and employer contributions. Conversely, an eligible individual on the first day of the last month of the tax year (typically December 1) is considered an eligible individual for the entire year and may make the full HSA contribution. This is known as the "last-month rule". However, they must remain an eligible individual for the next 12 months. If they violate this rule, any contributions for the prior year that would have been disallowed are reported as income in the subsequent year and are also subject to an additional 10% tax.

#### **HSA Planning Tip if one spouse is enrolled in Medicare**

**Q:** What is my contribution limit if I have family HDHP coverage for the entire year and the plan also covers my spouse who is covered by the plan and also has coverage through Medicare?

**A:** You may contribute the §223(b)(2)(B) statutory maximum for family coverage, which is \$7,750 for 2023 (plus a catch-up of \$1,000 if age 55 or older). Your spouse having other coverage does not affect the individual's contribution limit, except that if the spouse is not an otherwise eligible individual, no part of the HSA contribution can be allocated to the spouse. The contribution must be deposited into an HSA in your name, not in the name of the spouse who is covered by Medicare.

Contributions for the current tax year may be made until that year's tax filing deadline, not including extensions (generally April 15 of the year after the year to which the contribution applies).

Contributions in excess of the maximum are not deductible, and instead must be included in gross income, and are also subject to a 6% excise tax. Excess contributions withdrawn by the tax return due date, including extensions, are not subject to the extra tax. Any earnings attributed to the excess contribution must also be withdrawn and reported as income in the year of the distribution.

### **QUALIFIED FUNDING DISTRIBUTION**

Contributions to an HSA must be made in cash – contributions of stock or property are not allowed. However, contributions can be made by transferring funds from a Traditional or Roth IRA to the HSA. This type of contribution is called a qualified funding distribution, and must be made directly from the trustee of the IRA to the trustee of the HSA. This distribution cannot be made from an ongoing SEP or SIMPLE IRA. Additionally, the HSA owner must be covered by a HDHP in the year they make the qualified funding distribution.

The maximum qualified funding distribution is the HSA contribution limit for the year the distribution is made, less any employee or employer contributions already made to the HSA for that year. The distribution from the IRA is not included in income, but the contribution to the HSA is also not deductible. A qualified funding distribution reduces the amount that can be contributed directly to an HSA by the owner. Once the distribution is made, the account owner must remain eligible to contribute to an HSA for another 12 months after the month of the distribution. Failure to meet the requirement will cause the IRA distribution to be reported as income and subject to a 10% additional tax.

Only one qualified funding distribution may be made during the HSA owner's lifetime. However, if a qualified funding distribution is made when the HSA owner has self-only coverage, a second qualified funding distribution can be made in that same tax year if the owner changes to family coverage.

### **DISTRIBUTIONS FROM A HEALTH SAVINGS ACCOUNT**

Distributions from an HSA are tax-free if they are used to pay for qualified medical expenses (see the following section for more information), or to reimburse the owner for medical expenses they paid directly. Distributions for any other reason are considered nonqualified and will be subject to income tax and a 20% additional tax. Nonqualified distributions after age 65, or upon the death or disability of the HSA owner, are taxable but are exempt from the 20% penalty. Tax-free distributions for qualified medical expenses are allowed even if the HSA owner is no longer eligible to make contributions to the account.

Qualified distributions from the HSA do not have to be made in the year the qualified medical expense was actually incurred. Qualified distributions may be made in a later year for expenses incurred in a previous year, as long as the HSA was open when the expense was incurred, no other reimbursement was made, and no tax benefit derived from those prior medical expenses. The reimbursement must occur during the owner's lifetime, however. As a result, HSA owners may want to pay for medical expenses with non-HSA funds, while allowing the HSA to continue growing tax-deferred. Those expenses can then be reimbursed at a later date, perhaps as a way to provide tax-free cash flow during retirement.

### **QUALIFIED MEDICAL EXPENSES**

In order to be a qualified HSA distribution, the distribution must be due to a qualified medical expense for the owner, their spouse, or a dependent. Qualified medical expenses are medical and dental expenses that would generally qualify for the medical and dental expenses itemized deduction. An extensive list of medical expenses can be found in [IRS Publication 502](#).

Amounts paid after 2019 for non-prescription (over-the-counter) medications as well as menstrual care products are considered qualified medical expenses.

Only the following forms of insurance premiums are considered qualified medical expenses:

- Long term care insurance (up to IRS-imposed limits)
- Health care continuation coverage, such as COBRA
- Health care coverage while receiving unemployment compensation
- Medicare premiums, except for Medicare Supplement/Medigap plans

Qualified expenses also include continuing coverage premiums or health care premiums while unemployed for the owner's spouse or dependent. However, Medicare premiums for a spouse or dependent are not a qualified expense if the account owner is under the age of 65.

### DEATH OF HSA HOLDER

When establishing an HSA, the account owner must also designate a beneficiary on the account. Upon the death of the HSA owner, the tax treatment of the account is based on the owner's relationship to that beneficiary.

- Designated beneficiary is the spouse. If the account owner's spouse is the designated beneficiary, the HSA will be treated as the spouse's own HSA after the owner's death.
- Designated beneficiary is a non-spouse. If the beneficiary is anyone other than the account owner's spouse, the HSA terminates and the fair market value of the account becomes taxable to the beneficiary. If the owner's estate is named the beneficiary, the value is taxable to the decedent and reported on their final income tax return.

### TAX REPORTING FOR HSAs

Contributions to an HSA are reported on IRS Form 8889. Any deductible portion of the contribution is claimed as an adjustment to income on Form 1040. Salary deferrals to an HSA by an employee are treated as employer contributions and are excluded from income reported on the employee's Form W-2. As a result, no additional deduction is claimed for those contributions, although they are still reported on Form 8889. The HSA trustee will issue Form 5498-SA to the account owner for any year in which it receives a contribution. Excess contributions subject to the additional 10% tax are reported on Form 5329.

Withdrawals from an HSA are reported to the account owner by the HSA trustee on Form 1099-SA. The owner then reports these withdrawals to the IRS on Form 8889. If any of the withdrawal is considered nonqualified, the additional 20% tax is also computed on this form.