Ins and Outs of Health Savings Accounts

HSA2/25/F1

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Setting Up a Health Savings Account (HSA)

- A Health Savings Account (HSA) is a tax-exempt trust or custodial account set up with a qualified HSA trustee to pay or reimburse certain medical expenses an individual or his or her spouse or dependents incur
- An individual must be an "eligible individual" to qualify for an HSA
- No permission or authorization from the IRS is necessary to establish an HSA
- An individual sets up an HSA with a qualified trustee or custodian
- A qualified HSA trustee/custodian can be a bank, an insurance company, or anyone already approved by the IRS to be a trustee/custodian of individual retirement accounts (IRAs) or Archer Medical Savings Accounts or anyone else approved by the IRS

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Benefits of an HSA

- An individual can claim a tax deduction for contributions he or she makes to his or her HSA even if the individual does not itemize deductions on Schedule A (Form 1040)
- Contributions to an individual's HSA made by the individual's employer (including contributions made via payroll deduction through a cafeteria plan) may be excluded from the individual's taxable wages
- The contributions remain in the individual's HSA account until the individual uses them
- The interest or other earnings on the assets in the account accrue tax free
- Distributions from the HSA are tax free if the individual pays qualified medical expenses with them
- An HSA is portable and stays with the individual even if the individual changes employers or leaves the workforce

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Qualifying for an HSA Contribution

- To qualify for an HSA contribution, an individual must meet the following requirements:
  - The individual must be covered under a high deductible health plan (HDHP) on the first day of the month
  - The individual must have no other health coverage except what is permitted
  - The individual must not be enrolled in Medicare
  - The individual cannot be claimed as a dependent on someone else's current year income tax return

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Eligible Individuals

- If an individual meets these requirements, he or she is an eligible individual even if his or her spouse has non-HDHP family coverage, provided his or her spouse's health insurance coverage does not cover the individual
- An individual may be an eligible individual even if he or she receives hospital care or medical services from a Veterans Affairs facility for a service-connected disability
- Under the "last-month rule," an individual is considered to be an eligible individual for the entire year if he or she is an eligible individual on the first day of the last month of his or her tax year (December 1 for most taxpayers)

Dependency Is a Disqualifying Event

- If another taxpayer is entitled to claim an individual as a dependent, the individual cannot claim a deduction for an HSA contribution
- This is true even if the other person does not receive an exemption deduction for the individual because the exemption amount is zero for tax years 2018-2025
- Each spouse who is an eligible individual who wants to contribute to an HSA must open a separate HSA in his or her own name; there is no such thing as a joint HSA

High Deductible Health Plans

- An HDHP has:
  - A higher annual deductible requirement than typical health plans, and
  - A maximum limit on the annual out-of-pocket medical expenses that the insured must pay for covered benefits
    - Out-of-pocket expenses include deductibles, copayments, and other amounts, but do not include premiums
  - An HDHP may provide preventive care benefits without a deductible or with a deductible less than the minimum annual deductible
    - NOTE: the Affordable Care Act (ACA) requires all insurance plans (including HDHPs) to cover certain preventive care benefits without a deductible or other cost-sharing requirements (i.e., "free")

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HDHP Minimum and Maximum Deductible Amounts for 2025

	Self-only coverage	Family coverage
▪ Min.	$1,650	$3,300
▪ Max.	$8,300	$16,600

NOTE: Amounts are adjusted annually for inflation

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HDHP Maximum Out-of-pocket Limits (OOPLs) for 2025

- $8,300 for individual/self-only plans
- $16,600 for family plans
- Due to the ACA, embedded individual OOPL cannot be greater than $9,200

NOTE: All amounts are adjusted annually for inflation

Self Coverage and Family Coverage

- Self-only HDHP coverage is HDHP coverage for one individual
- Family HDHP coverage is HDHP coverage for an individual and at least one other individual
  - Example of family HDHP coverage — an eligible individual and his dependent child are covered under an "employee plus one" HDHP offered by the individual's employer

Family Plans That Do Not Meet the High Deductible Rules

- There are some family plans that have deductibles for both the family as a whole and for individual family members
- Under these plans, if an individual meets the individual deductible for one family member, he or she does not have to meet the higher annual deductible amount for the family
- If either the deductible for the family as a whole or the deductible for an individual family member is less than the minimum annual deductible for family coverage (i.e., $3,300 for 2025), the plan does not qualify as an HDHP

Example

- An individual has family health insurance coverage in 2025
- The annual deductible for the family plan is $3,500
- This plan also has an individual deductible of $1,500 for each family member
- The plan does not qualify as an HDHP because the deductible for an individual family member (i.e., $1,500) is less than the required minimum annual deductible ($3,300 for 2025) for family coverage

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Preventive Care Includes, But Is Not Limited to the Following

- Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals
- Routine prenatal and well-childcare
- Child and adult immunizations
- Tobacco cessation programs
- Obesity weight-loss programs
- Screening services

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Screening Services

- Includes screening for diseases and/or health conditions, such as:
  - Cancer
  - Heart and vascular diseases
  - Infectious diseases
  - Mental health conditions
  - Substance abuse
  - Metabolic, nutritional, and endocrine conditions
  - Musculoskeletal disorders
  - Obstetric and gynecological conditions
  - Pediatric conditions
  - Vision and hearing disorders

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Special Rules for Preventive Care

- In general, preventive care does not include care or treatment for individuals with an existing disease, illness, or condition
- In 2019, the IRS recognized specific services for individuals with specific conditions as "preventive care" that HDHPs may cover with limited or no cost-sharing (including deductibles)

Preventive Care for Specified Conditions	For Individuals Diagnosed with
Angiotensin Converting Enzyme (ACE) inhibitors	Congestive heart failure, diabetes, and/or coronary artery disease
Anti-resorptive therapy	Osteoporosis and/or osteopenia
Beta-blockers	Congestive heart failure and/or coronary artery disease
Blood pressure monitor	Hypertension
Inhaled corticosteroids	Asthma
Insulin and other glucose lowering agents	Diabetes
Retinopathy screening	Diabetes
Peak flow meter	Asthma
Glucometer	Diabetes
Hemoglobin A1c testing	Diabetes
International Normalized Ratio (INR) testing	Liver disease and/or bleeding disorders
Low-density Lipoprotein (LDL) testing	Heart disease
Selective Serotonin Reuptake Inhibitors (SSRIs)	Depression
Statins	Heart disease and/or diabetes

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Other Health Coverage

- If an individual has HDHP coverage, the individual cannot have any other health coverage that has a deductible below the minimum HDHP deductible, unless an exception applies
- If an individual has family coverage, the individual can still be an eligible individual even if his or her spouse has non-HDHP coverage, provided the individual is not covered by that plan
- An individual can have additional insurance that provides benefits for the following items without violating the HDHP requirement:
  - A specific disease or illness
  - Pays a fixed amount per day or other period during a hospitalization
  - Liabilities incurred under workers' compensation laws, tort liabilities, or liabilities related to ownership or use of property

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Other Health Coverage

- An individual can also have coverage, whether provided through insurance or otherwise, for the following items:
  - Accidents
  - Disability
  - Dental care
  - Vision care
  - Long-term care

Other Health Coverage – Telehealth

- During the COVID-19 pandemic, an HDHP could cover telehealth and other remote care services without a deductible
  - This expired as of December 31, 2024
  - It is unclear whether and when Congress will extend this coverage in the future
- Other COVID-era “pre-deductible” coverage has also expired
  - Testing for and treatment of COVID-19
  - Vaccinations OK (still considered “preventive care”)

Prescription Drug Plans

- An individual can have a prescription drug plan, either as part of his or her HDHP or a separate plan or rider and qualify as an eligible individual if the plan does not provide medical or pharmacy benefits until the minimum annual deductible of the HDHP has been met
  - Exception: Drugs that are "preventive care"
- If the individual can receive medical or pharmacy benefits other than preventive care before that deductible is met, he or she is not an eligible individual

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Integrating an HSA With a Health FSA or HRA

- Some employers sponsor a Health FSA or HRA program that allows employees to receive a portion of their pay as a pre-tax payroll deduction into a Health FSA or an employer contribution into an HRA
- Participating employees can then spend their election on qualified medical, dental, and vision care and services as well as over-the-counter drugs, medicine, equipment, and supplies
- However, these programs are <u>incompatible</u> with HDHP coverage and cancel HSA eligibility if an individual is enrolled in both an HDHP and a Health FSA or HRA program

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Integrating an HSA With a Health FSA or HRA

- If offered by their employer, employees may enroll other types of Health FSA or HRA without disqualifying them from funding an HSA:
  - A "limited-purpose" Health FSA or HRA reimbursing dental- and vision-related expenses
  - A "post-deductible" FSA or HRA reimbursing medical and health-related expenses on the "back end" of their deductible
    - Example: ABC Company's "post-deductible" HRA will reimburse employees' medical expenses after $3,000 of the HDHP's $5,000 deductible has been met

Health FSA — Grace Period

- Some employers offer a "grace period" with their health FSA that gives employees an additional 2 ½ months after the plan year ends to use up any unspent funds on new expenses incurred during that period
- But grace periods cancel HSA eligibility for 3 months during the grace period, preventing otherwise HSA-eligible individuals from making HSA contributions for those 3 months
- However, if the balance in the health FSA at the end of its prior plan year (i.e., before the grace period begins) is zero, the individual can be HSA-eligible during the grace period

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Health FSA — Rollovers

- The FSA contribution limit for 2025 is $3,300
- Some employers offer a "rollover" feature with their health FSA that automatically carries over any unspent balance at the end of one plan year into the new plan year, up to an annual limit set by the IRS (i.e., $660 for rollovers from 2024 to 2025)
- But this essentially re-enrolls the individual in a health FSA for another entire plan year
- Rollovers cancel HSA eligibility for 12 months unless the funds are rolled over into a limited-purpose FSA or a post-deductible FSA

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Contributions to an HSA

- Any eligible individual can contribute to an HSA
- For an employee's HSA, the employee, the employee's employer, or both may contribute to the employee's HSA in the same year
- Self-employed or unemployed individuals may also contribute to HSAs
- Family members or any other person may also make contributions on behalf of an eligible individual
- Contributions to an HSA must be made in cash
- Contributions of stock or property to an HSA are not allowed

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Limit on HSA Contributions

- The total amount that can be contributed to an individual's HSA for any year depends on:
  - The type of HDHP coverage the insured has (self-only vs. family)
  - His or her age
  - The date the individual becomes an eligible individual, and
  - The date the individual ceases to be an eligible individual

Limit on HSA Contributions

- Annual limit on contributions to an HSA for 2025
  - Self-only: $4,300
  - Family coverage: $8,550

  NOTE: Amounts are adjusted annually for inflation

- Additional $1,000 catch-up contribution for HSA participants who are age 55 and older (not adjusted for inflation)

Catch-up Contributions

- If an individual is an eligible individual who is age 55 or older at the end of his or her tax year, his or her contribution limit to an HSA is increased by $1,000
- It does not matter when the individual's birthday is as long as the individual turns 55 by the end of the year; the IRS considers an individual age 55 all year for tax purposes
  - For example, if an individual has self-only coverage, he or she can contribute up to $5,300 — the contribution limit for self-only coverage ($4,300 for 2025) plus the additional contribution of $1,000
- If an individual is not HSA-eligible for the entire year, he or she must pro-rate his or her "catch-up" contribution along with the regular contribution

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Catch-up Contributions

- If both spouses of a married couple are 55 or older and not enrolled in Medicare, each spouse's contribution limit is increased by the additional $1,000 contribution, bringing the limit for their combined contributions to $10,550 for 2025 ($8,550 + $1,000 + $1,000)
- Each spouse must make their "catch-up" contribution to their own HSA (i.e., they must own separate HSAs)
- The remaining $8,550 may be divided between their two accounts however they wish (see example on next slide)

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Example

- For 2025, Ginger and Luke are married and are both eligible individuals
- They both have family coverage under the same HDHP
- Ginger is 58 years old, and Luke is 53 years old
- Ginger and Luke can split the family contribution limit for 2025 ($8,550) equally, or they can agree on a different division
- If they split it equally for 2025, Ginger can contribute $5,275 to her HSA (one-half the maximum contribution for family coverage + $1,000 "catch-up" contribution), but Luke can only contribute $4,275 to his own HSA (i.e., $9,550 total for 2025)

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Limit on HSA Contributions

- If an individual had family HDHP coverage on the first day of the last month of his or her tax year, his or her contribution limit for 2025 is $8,550 even if the individual changed from self-only coverage during the year
- However, if an individual had self-only HDHP coverage on the first day of the last month of his or her tax year but changed from family coverage earlier in the year, his or her contribution limit for the year is pro-rated based on the number of months he or she had family coverage vs. self-only coverage during the year

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Last Month Rule

- Under the “last month rule,” if an individual is an eligible individual on the first day of the last month of his or her tax year (December 1 for most taxpayers), the individual is considered an eligible individual for the entire year
- The individual is treated as having the same HDHP coverage for the entire year as he or she had on the first day of the last month even if he or she did not otherwise have coverage during the entire year
- This allows the individual to contribute up to the annual limit for that year for the type of coverage he or she has even though they were not eligible for the full year
- However, a “testing period” applies which requires the individual to remain an eligible individual through the entire following calendar year (the “testing period”)
  - For example, the testing period for contributions made for 2025 would run through December 31, 2026

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Testing Period

- If an individual fails to remain an eligible individual during the testing period, for reasons other than death or becoming disabled, the individual must calculate the difference between the total contributions made to his or her HSA and their pro-rated limit based on the number of months he or she was actually eligible
- The individual includes this amount in his or her income in the year in which he or she fails to be an eligible individual
- This amount is also subject to a 10% additional tax
- The income and additional tax are calculated on Form 8889, Part III

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Example

- Chris, age 53, becomes an eligible individual on December 1, 2025
- He has family HDHP coverage on that date
- Using the last-month rule, he contributes $8,550 to his HSA
- Chris loses his HSA eligibility in June 2026
- Because Chris did not remain an eligible individual during the testing period (December 1, 2025, through December 31, 2026), he must include in his 2026 income the contributions made for 2025 that would not have been made except for the last-month rule
- Chris will use the worksheet in the Form 8889 instructions to determine this amount plus the 10% penalty

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Example

- January through November -0-
- December $8,550

- Total for all months $8,550
- Limitation — divide total by 12 $713
- Chris would include $7,837 ($8,550 - $713) in his gross income on his 2026 tax return
- Also, a 10% additional tax ($784) applies to this amount

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Contributions by Domestic Partners

- Contribution limits for unmarried domestic partners depend on their respective coverage under an HDHP (i.e., self-only vs. family) and their ages
- If both partners have self-only coverage, then the self-only contribution limit applies to each person separately, plus a catch-up contribution if either person is age 55 or older
- If either partner has family coverage, then the family contribution limit applies to that person only, plus a catch-up contribution if that person is age 55 or older

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Contributions by Domestic Partners

- If both partners have family coverage, including being covered by the same HDHP, then the family contribution limit applies to both persons individually, plus a catch-up contribution if either partner is age 55 or older
- This "loophole" allows both partners to contribute $8,550 for 2025 to their respective HSAs (i.e., $17,100 total), plus catch-up contributions if applicable
- The "loophole" that applies to domestic partners also applies to one's non-dependent young adult child still on the family's HDHP

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Example

- For 2025, unmarried partners Bill and Stephanie are both covered by the same HDHP (i.e., "family" coverage)
- Both partners are eligible individuals
- Bill is 55 years old and Stephanie is 54
- Bill can contribute up to $9,550 to his HSA for 2025
- Stephanie can contribute up to $8,550 to her HSA for 2025

Enrollment in Medicare

- Beginning with the first month an individual is enrolled in Medicare, his or her HSA contribution limit for that month and future months is $0
- This rule also applies to periods of retroactive Medicare coverage
- If an individual delayed applying for Medicare and later his or her enrollment is backdated, any contributions to his or her HSA made for the period of retroactive coverage are considered excess contributions and must be withdrawn

Example

- An individual turned age 65 in 2025 and enrolled in Medicare effective July 1
- The individual had a HDHP with self-only coverage January 1 – June 30, 2025
- The individual's contribution limit is $2,650 ($5,300 ÷ 12 x 6)

Employer Contributions

- Employers may contribute to the HSAs of eligible employees; contributions are excludable from employees' wages
- Employer contributions may be made in any amount and/or frequency desired, subject to the annual contribution limits
- An individual must reduce the amount he or she (or any other person), can contribute to his or her HSA by the amount of contributions made by his or her employer
  - This includes amounts contributed by an employee to his or her account through payroll deduction

Employer Contributions

- Contributions made by an employer during 2025 must be reported on the employee's W-2 statement for 2025
- An employer can also make contributions to an employee's HSA from January 1 through April 15, 2026 that are allocated to 2025
- The employer must notify the individual and the trustee/custodian of his or her HSA that the contribution is for the prior year
- The contribution will be reported on the individual's Form W-2, Wage and Tax Statement for the year during which the contributions were made (i.e., 2026)

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When To Contribute to an HSA

- Individuals can make contributions to their HSA until the tax filing deadline for the year (April 15 in most years) even if they file their tax return earlier
- If an individual fails to be an eligible individual during one or more months in 2025, he or she can still make contributions for the months they were an eligible individual until the income tax filing deadline for 2025 (i. e., April 15, 2026)

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Reporting Contributions to an HSA

- Generally, the employee can claim contributions he or she makes to his or her HSA and contributions made by any other person, other than the employer, on the employee's behalf, as a deduction from income
- The following HSA contributions are not included in the employee's taxable wages:
  - Contributions made by his or her employer
  - Contributions by an employee to his or her HSA via payroll deduction through a cafeteria plan (treated as employer contributions
- These contributions are reported on the employee's W-2 in box 12 (code "W")

HSA Contributions by Certain Business Owners

- Employees of certain types of businesses are considered "owners" rather than "employees"
  - Members of a Limited Liability Company (LLC)
  - Partners in a partnership
  - Individuals that own 2% or more of an S corporation (ownership attribution rules also include the individual's spouse, children, parents, and grandparents if they are also S corp employees)
- Contributions by a partnership to a bona fide partner's HSA are not considered to be contributions by an employer but instead are treated as a distribution of money by the partnership and are not included in the partner's gross income
- Contributions by a partnership to a partner's HSA for services rendered are treated as guaranteed payments that are deductible by the partnership and includible in the partner's gross income
- In both situations, the partner can deduct the contribution made to the partner's HSA

HSA Contributions by Certain Business Owners

- A 2% S corporation shareholder is someone who owns more than 2% of the company's stock at any time during the year or who owns more than 2% of the company's voting power
- Contributions by an S corporation to a 2% shareholder-employee's HSA for services rendered are deductible by the S corporation and includible in the shareholder-employee's gross income
- The shareholder-employee can deduct the contribution made to the shareholder-employee's HSA
- Owners of a C corporation are generally not subject to these restrictions and can usually receive tax-free deposits from the business and make deposits via payroll deduction

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Excess Contributions

- An individual will have excess contributions if the total contributions to his or her HSA for the year are greater than the prescribed annual limits discussed on earlier slides
- An individual may withdraw the excess contributions and avoid paying income tax and the excise tax on the amount withdrawn if the individual:
  - Withdraws the excess contributions by the due date, including extensions, of his or her tax return for the year the contributions were made, and
  - Withdraws any income earned on the withdrawn contributions and includes the earnings in "other income" on his or her tax return for the year he or she withdraws the contributions and earnings

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Excess Contributions

- Excess contributions are not deductible, and those made by an employer are included in the individual's gross income
- If the excess contribution is not included in box 1 of Form W-2, the individual must report the excess as "Other income" on his or her tax return
- Generally, the individual must pay a 6% excise tax on excess contributions
- See Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, to figure the excise tax
- The excise tax applies to each tax year the excess contribution remains in the account

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Deducting an Excess Contribution to an HSA in a Later Year

- An individual may be able to apply excess contributions for the prior year to his or her contributions for the current year and deduct the excess contributions for the current year
- The excess contribution he or she can deduct for the current year is the lesser of the following two amounts:
  - The individual's maximum HSA contribution limit for the year minus any amounts contributed to his or her HSA for the year, or
  - The total excess contributions in his or her HSA at the beginning of the year
  - Amounts contributed for the year include contributions by the individual, his or her employer, and any other person
  - They also include any qualified HSA funding distribution made to his or her HSA
  - Any excess contribution remaining at the end of a tax year is subject to the excise tax
  - See Form 5329

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Form 8889

- An individual must file Form 8889 with his or her income tax return (Form 1040, 1040-SR, or 1040-NR) if he or she or his or her spouse (if married filing jointly) had any activity (e.g., contributions or distributions) in his or her HSA during the year
- The individual should include all contributions made for 2025, including those made from January 1, 2025, through April 15, 2026, that are designated for 2025
- The individual should receive Form 5498-SA from the account trustee showing the amount contributed to his or her HSA for the year
- Contributions made by an individual's employer and qualified HSA funding distributions are also shown on the form
- An individual's employer's contributions (including the employee's contributions made via payroll deduction) will also be shown on Form W-2, box 12, code W
- The insured individual must file Form 8889 even if only his or her employer or his or her spouse's employer made contributions to the HSA

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Form 8889

- The individual should receive 1099-SA from the account trustee showing the amount distributed from his or her HSA during the year (January 1 – December 31)
- The account owner must report whether the distributions were for eligible expenses (tax-free) or non-eligible expenses (taxable)
- Form 8889 is used to determine any tax deductions or taxes/penalties that will be carried over to the individual's tax return
- If, during the tax year, the insured individual is the beneficiary of two or more HSAs or he or she is a beneficiary of an HSA and he or she has his or her own HSA, the insured individual must complete a separate Form 8889 for each HSA

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IRA to HSA Rollover (Qualified HSA Funding Distribution)

- If an individual is HSA-eligible, he or she can make a one-time transfer of funds (a qualified HSA funding distribution) from his or her traditional IRA or Roth IRA to his or her HSA
- This distribution cannot be made from an active SEP IRA or SIMPLE IRA
  - A SEP IRA or SIMPLE IRA is active if an employer contribution is made for the plan year ending with or within the tax year in which the distribution would be made
- The total qualified HSA funding distribution cannot be more than the individual's HSA contribution limit for the year plus any "catch-up" contribution if the individual is 55 or older
- The distribution must be made directly by the trustee of the IRA or Roth IRA to the trustee of the HSA
- The same person must be the owner of the IRA/Roth IRA and the HSA

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IRA to HSA Rollover (Qualified HSA Funding Distribution)

- The amount transferred is not included in the individual's income and is not deductible, but it reduces the amount that can be contributed to his or her HSA for that year
- The QHSAFD must be made by December 31 because a QHSAFD relates to the taxable year in which the distribution is made. Prior year distributions are not permitted.
- The qualified HSA funding distribution is shown on Form 8889 for the year in which the distribution is made
- An individual can generally make only one qualified HSA funding distribution during his or her lifetime unless the individual changes from self-only to family HDHP coverage during the year

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IRA to HSA Rollover (Qualified HSA Funding Distribution)

- A QHSAFD allows traditional IRA assets that would otherwise be taxed upon distribution (and possibly a 10% penalty) to be transferred to an HSA, and subsequent distributions for "qualified medical expenses" are tax-free
- The one-time distribution does not include transfers from a 401(k) or any non-IRA based employer sponsored retirement plan (i.e., 403(b), 457(b), etc.)
- However, a taxpayer may roll over a 401(k) or other retirement plan from a former employer to an IRA and subsequently transfer some of the assets to his or her HSA

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Example: One Time Distribution From an IRA to an HSA Qualified HSA Funding Distribution (QHSAFD)

- Mary, 37, has single HDHP coverage
- In 2025, $4,300 is the maximum HSA contribution limit for single coverage for individuals under age 55
- Mary may transfer up to $4,300 from her IRA to her HSA in 2025 if she is eligible every month of the year
- If Mary previously made direct HSA contributions (in the year of the transfer) it would reduce her QHSAFD transfer limit
- For example, if Mary previously made $1,000 in direct HSA contributions in 2025, those contributions reduce her QHSAFD transfer dollar-for-dollar to $3,300 ($4,300 minus $1,000)

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Rules for Employers That Make HSAs Available to Their Employees

- If an employer wants its employees to be eligible to have HSAs, the employer should offer an HDHP because employees must be covered by an HDHP
- Employees must be careful not to enroll in any additional coverage other than those exceptions listed earlier under other health coverage
- An employer can make contributions to its eligible employees' HSAs
- The employer deducts the contributions on its business income tax return for the year in which it makes the contributions
- If the contribution is allocated to the prior year, the employer can still deduct it in the year in which it made the contribution

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Non-discrimination Rules for Cafeteria Plans

- Employers that offer a Sec. 125 cafeteria plan may:
  - Allow employees to make contributions to their HSAs via payroll deduction, and/or
  - Offer "matching" contributions to employees' HSAs
- "Non-discrimination" rules apply to all employer contributions (including employee contributions made via payroll deduction, which are considered "employer contributions")
  - Under these rules, employer contributions cannot discriminate in favor of "highly compensated" over "non-highly compensated" employees
- If an employer has a Sec. 125 cafeteria plan in place, the comparability rules (discussed next) do not apply

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Comparability Rules

- If an employer decides to make HSA contributions and there is no Sec. 125 cafeteria plan, the employer must make comparable contributions to the HSA accounts of all similarly situated participating employees
- Contributions are comparable if they are either:
  - The same amount, or
  - The same percentage of the annual deductible under the HDHP covering the employees

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Comparability Rules

- Similarly situated participating employees:
  - Are covered by the employer's HDHP and are eligible to establish an HSA,
  - Have the same category of coverage (either self-only or family coverage), and
  - Have the same category of employment (part-time, full-time, or former employees)
- Employers must notify eligible employees who have neither established an HSA by December 31 nor notified the employer that they have an HSA that they will forfeit the employer's contribution to their HSA if they fail to act by a date certain
- The comparability rules do not apply to contributions made through a Sec. 125 cafeteria plan

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Distributions From an HSA

- Generally, a distribution is money an individual withdraws or receives from his or her HSA
- An individual is not required to make withdrawals from his or her HSA each year
- An individual will generally pay medical expenses during the year without being reimbursed by his or her HDHP until he or she reaches the annual deductible for the plan
- When the individual pays medical expenses during the year that are not reimbursed by an individual's HDHP, he or she may take a distribution from his or her HSA

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Distributions From an HSA

- An individual can receive tax-free distributions from his or her HSA to pay or be reimbursed for qualified medical expenses he or she incurs on or after the date he or she established the HSA
- If an individual receives distributions for other reasons, the amount he or she withdraws will be subject to income tax plus an additional 20% tax
- An individual's total distributions include amounts paid with a debit card and amounts withdrawn from the HSA by other individuals that the individual may have designated
- The trustee will report any distribution to the account owner and the IRS on Form 1099-SA

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Eligible Expenses

- Eligible expenses are those expenses that would generally qualify for the medical and dental expenses deduction under Section 213(d) of the Internal Revenue Code (see also IRS Publication 502)
- Amounts paid for over-the-counter medicines, whether prescribed or not, are also considered an eligible expense for HSAs
- For HSA purposes, expenses incurred before the individual established his or her HSA are not eligible expenses
  - State law determines when an HSA is established
  - An HSA that is funded by amounts rolled over from another HSA or an Archer MSA is considered established on the date the prior account was established

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Eligible Expenses

- Eligible expenses include qualified medical expenses incurred by the following persons:
  - The individual and his or her spouse
  - All dependents claimed on the individual's tax return
- Medical expenses incurred by an unmarried domestic partner are not "eligible expenses" unless the partner can be claimed as a tax dependent (rare)

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Insurance Premiums

- An individual cannot treat insurance premiums as qualified medical expenses unless the premiums are for any of the following:
  - 1. Health care continuation coverage, such as coverage under COBRA
  - 2. Health care coverage while receiving unemployment compensation under federal or state law
  - 3. Traditional Medicare and Medicare Advantage coverage if the individual was 65 years or older (other than premiums for a Medicare supplemental policy, such as Medigap)
  - 4. Long-term care insurance (subject to age-based limits)
- All items (1) through (4) can be for the individual's spouse or a dependent meeting the requirement for that type of coverage
- For item (3), Medicare premiums are not eligible expenses unless the account owner is 65 or older

Retirement Planning Considerations Relating to HSAs

- It is estimated that the average 65-year-old couple in 2025 will need more than $300,000 in today's dollars during their retirement to pay for health care expenses, excluding long-term care
- When long-term care is taken into account, the costs cited increase considerably
- The Department of Health and Human Services indicates that a person turning 65 in 2025 has almost a 70% chance of needing long-term care services in their remaining years
- The Genworth Cost of Care survey reported that in 2022, the national average median cost for a private room in a nursing facility was $8,821 per month and the national average median cost for a home health aide was $4,576 per month
- Some areas of the country have costs well in excess of these amounts

Retirement Planning Considerations Relating to HSAs

- At a minimum, an individual will usually be responsible for Medicare Part B and D premiums, prescriptions, and out-of-pocket costs, like deductibles and coinsurance without any annual limits on cost-sharing
- If a person retires before age 65, when Medicare coverage starts, HSA funds can cover healthcare-related expenses, though generally not insurance premiums
- HSA distributions can be used to pay for some but not all long-term care expenses, including certain home modifications, such as wheelchair ramps
- After someone turns age 65, they can start using their HSA for non-healthcare expenses without paying a 20% penalty
- The HSA owner will owe income tax on whatever amounts are withdrawn from the HSA

Using an HSA To Pay for Long-term Care

- Funds in an HSA can be used tax-free to pay for:
  - Qualified long-term care expenses
  - Premiums for long-term care insurance policies, up to certain limits
- “Qualified long-term care expenses” include:
  - Necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, rehabilitative services, and maintenance and personal care services that are:
    - Required by a chronically ill individual, and
    - Provided pursuant to a plan of care prescribed by a licensed health care practitioner

Using an HSA To Pay for Long-term Care

- Nursing Home Services
  - Medical care in a nursing home, home for the aged, or similar institution
  - Includes the cost of meals and lodging in the home if a principal reason for being there is to get medical care
  - Doesn't include the cost of meals and lodging if the reason for being in the home is personal
    - Can include the part of the cost that is for medical or nursing care

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Using an HSA To Pay for Long-term Care

- Other qualified expenses
  - Wheelchair
    - The cost of acquiring, operating, and maintaining a wheelchair is a qualified expense if used for the relief of a sickness or disability
  - Home modifications
    - You can include in medical expenses amounts you pay for special equipment installed in a home, or for improvements, if their main purpose is medical care for you, your spouse, or your dependent (e.g., wheelchair ramps, bathroom safety, etc.)

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Using an HSA To Pay for Long-term Care

- Nursing Services
  - Includes wages and other amounts paid for nursing services
  - Services can be provided in the patient's home or another care facility
  - The services need not be performed by a nurse as long as the services are the kind that would generally be performed by a nurse, including services connected with caring for the patient's condition, such as:
    - Giving medication
    - Changing dressings
    - Bathing and grooming the patient
  - If the aide also provides personal and household services, amounts paid to the aide must be divided between the time spent performing household and personal services and the time spent for nursing services

Using an HSA To Pay for Long-term Care

- Maintenance and personal care services
  - Care which has as its primary purpose the providing of a chronically ill individual with needed assistance with the individual's disabilities (including protection from threats to health and safety due to severe cognitive impairment)
  - Does not include the cost of household help (e.g., cooking, cleaning, household chores) even if such help is recommended by a doctor
  - You may be able to include certain expenses paid to a person providing nursing-type services
  - Does include the amount you pay for diapers or diaper services, if they are needed to relieve the effects of a particular disease

Using an HSA To Pay for Long-term Care

- Who qualifies as a "chronically ill" individual?
  - An individual is chronically ill if, within the previous 12 months, a licensed health care practitioner has certified that the individual meets either of the following descriptions:
    - The individual is unable to perform at least two activities of daily living (i.e., eating, bathing, dressing, toileting, transferring, continence) without substantial assistance from another individual for at least 90 days, due to a loss of functional capacity
    - The individual requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment

Using an HSA To Pay for Long-term Care

- Qualified long-term care insurance contract
  - Insurance contract that provides only coverage of qualified long-term care services
  - The contract must:
    1. Be guaranteed renewable
    2. Not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed
    3. Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract must be used only to reduce future premiums or increase future benefits
    4. Generally, not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer, or the contract makes per diem or other periodic payments without regard to expenses

Using an HSA To Pay for Long-term Care

- Qualified long-term care insurance contract
  - 2025 limits* on annual premiums that may be reimbursed tax-free from HSAs, per individual (including a spouse or a tax dependent)

Age 40 or under	$480
Age 41 to 50	$900
Age 51 to 60	$1,800
Age 61 to 70	$4,810
Age 71 or over	$6,020

*Amounts are indexed for inflation and will likely change every year

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Death of an HSA Owner
Spouse Is the Designated Beneficiary

- The account owner can and should choose a beneficiary when he or she sets up his or her HSA
- What happens to the balance in the HSA when the owner dies depends on who the owner designates as the beneficiary
- If the owner's spouse is the designated beneficiary of the HSA, the HSA assets can be transferred tax-free to the spouse and will be treated as his or her spouse's HSA after the owner's death

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Death of an HSA Holder
Spouse Is Not the Designated Beneficiary

- If the spouse is not the designated beneficiary of the HSA:
  - The account stops being an HSA when the owner dies, and
  - The fair market value of the HSA becomes taxable to the beneficiary in the year in which the owner dies
- If the owner's estate is the beneficiary, the value is included on the owner's final income tax return
- The amount taxable to a non-spouse beneficiary or the individual's estate may be reduced by any eligible expenses incurred by the decedent that are paid by the beneficiary or executor within 1 year after the date of death

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HSA Update for 2026

- HSA contribution limits for 2026
  - $4,400 for individuals with "self-only" coverage
  - $8,750 for individuals with family" coverage
  - $1,000 for individuals aged 55+
- HSA-qualified plan requirements
  - Minimum deductibles
    - $1,700 for self-only coverage
    - $3,400 for family coverage
  - Out-of-pocket maximums
    - $8,500 for self-only coverage
    - $17,000 for family coverage

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Proposed HSA Changes in House Budget Reconciliation Bill

Expanding Who Can Contribute to HSAs

- Seniors enrolled only in Medicare Part A
- Individuals covered by Bronze and Catastrophic health insurance plans purchased through state insurance exchanges
- Individuals participating in “direct primary care” arrangements
- Workers that use employer-based health clinics
- Individuals with a spouse that participates in a health FSA through their job

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Proposed HSA Changes in House Budget Reconciliation Bill

Expanding HSA Contributions

- HSA contribution limits doubled for individuals/families with incomes below $75K/$150K (phases out at higher incomes)
  - Limits and thresholds indexed to inflation
- Couples age 55+ can make catch-up contributions to the same HSA
- Employees with unspent health FSA or HRA funds could transfer some funds to an HSA in certain circumstances

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Proposed HSA Changes in House Budget Reconciliation Bill

Expanding Tax-free Uses of HSA Funds

- Annual/monthly fees for “direct primary care” arrangements
- Gym memberships or physical activity programs (up to $500/$1,000 per year)
- Qualified expenses incurred up to 60 days before HSA established

Thank You!