Health Savings Account (HSA) Contribution Rules

Presented by Brown & Brown Northwest

HSA Basics ❯

What is an HSA?

A savings account that is:

- Set up with a trustee or custodian
- Owned by an individual (not the employer)
- Contributed to by the eligible individual or anyone else, including their employer
- Used to pay current and future medical expenses tax-free
- Paired with a High Deductible Health Plan (HDHP)
- Subject to strict tax rules

Advantages

HSAs are a popular benefit option because:

- They are a **powerful tax savings tool.**
- Funds **roll over** from year-to-year.
- Accounts are **individually owned.**
- HDHP/HSAs typically have **lower monthly premiums.**

Tax Savings

HSAs provide a triple tax advantage:

Contributions reduce taxable income.

Interest and earnings accumulate tax-free.

Distributions for medical expenses are tax-free.

HSA Contributions

Contribution Sources

Contributions can be made by the HSA account holder or anyone else—including an employer or family member.

- Employer contributions (including pre-tax salary deferrals) are not taxable.
- If made by the HSA account holder, contributions are "above-the-line" tax deductions.
- If made by other individuals, contributions can be deducted by the HSA account holder in determining taxable income.

Catch-up Contributions

Who Is Eligible?

- People ages 55 and older by the end of the tax year can make an additional $1,000 catch-up contribution.

How Does It Work?

- The maximum annual contribution is $1,000.
- The catch-up contribution limit is not adjusted for inflation and remains the same each year.
- The contribution limit is not reduced for the year if the person turns 55 years old after Jan. 1.

Monthly Contribution Rule

For each month a person is HSA-eligible, they can contribute 1/12 of the applicable maximum contribution limit for the year.

- Contribution limits are updated each year.
- The monthly limit depends on type of HDHP coverage (self-only or family).
- All contributions are aggregated regardless of source.

Full-contribution Rule

What Is It?

- The full-contribution rule is a special rule that allows an individual who is HSA-eligible for only part of a year to make a full year's worth of HSA contributions.
- HSA contribution limits are determined on a monthly basis.

How Does It Work?

- A person is HSA-eligible for the **entire calendar year** if they:
  - Become eligible in any month other than January
  - Are HSA-eligible on Dec. 1 of that year
- That individual should remain eligible during 13-month testing period (with exceptions for death and disability).

Adverse Tax Consequences

If a person makes additional contributions under the full-contribution rule and then is no longer HSA-eligible during the testing period, the additional contributions will be:

- Included in the individual's **gross income**
- Subject to an **additional 10% tax**

Special Rule for Married Individuals

If either spouse has family coverage, both spouses are treated as having only that family coverage.

- If both people are HSA-eligible, the HSA contribution limit is divided between spouses.
- The rule applies even if one spouse has family and other has self-only coverage.
- The rule does not apply to catch-up contributions.

Nonforfeitable Contributions

HSA contributions are nonforfeitable.

- They can’t be subject to **vesting schedule.**
- They are **not returned** if employee ends employment.

HSA Distribution Rules

HSA Distributions

Timing

- Individuals with HSAs can receive distributions **at any time.**
- Reasonable restrictions by trustee or custodian are OK.
- There are no mandatory distributions.
- Balance carries over from year-to-year.
- The individual does not need to be HSA-eligible.

Purpose

- Distribution may be used for **any purpose**, medical or non-medical.

Tax Treatment

- Taxes depend on the timing of distribution and whether the distribution is for a medical expense.

Medical Expenses

HSA distributions are tax-free if they are used to pay for unreimbursed qualified medical expenses incurred after the HSA was established.

- A qualified medical expense is incurred:
  - For medical care, as defined in Code Section 213(d)
  - By the HSA account holder and their spouse or dependents
  - After the HSA was established

Eligible Medical Expenses

- Examples of qualified medical expenses include the following:
  - Most medical care expenses
  - Prescription drugs
  - Over-the-counter drugs
  - Dental or vision care
  - Some insurance premiums, including the following:
    - COBRA
    - Health insurance premiums while receiving unemployment benefits
    - Qualified long-term care premiums
    - Any health insurance premiums paid (other than for a Medicare supplement policy) by individuals ages 65 and over

HSAs and FSAs

Health Savings Accounts (HSAs) and Flexible Spending Accounts (FSAs) do not mix.

If you or your spouse have a full Health Care Flexible Spending Account as of December 1, you cannot participate in the HSA.

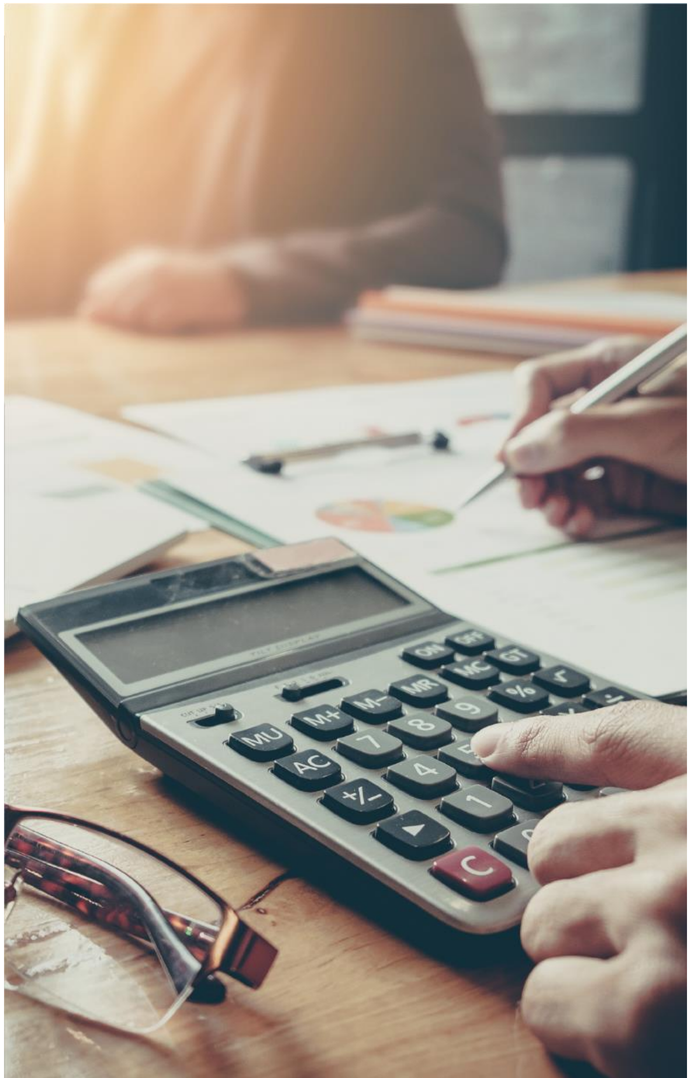
- **Health Care FSA** covers medical, dental and vision expenses.
- **Limited Purpose FSA** covers only dental and vision expenses.

PacificSource Administrators will roll your FSA balance to a Limited Purpose FSA automatically.

Non-medical Expenses

- If an HSA distribution is not used for qualified medical expenses, the amount of the distribution is **included in the account holder’s income.**
- A **20% additional tax** also applies, except when the distribution is made after the individual dies, turns 65 years old or becomes disabled.

Recordkeeping



- Employers are NOT required to determine whether an HSA distribution is used for a qualified medical expense.
- There are no claim adjudication requirements for employers.
- HSA account holders are responsible for keeping track of their distributions and reporting to the IRS (using Form 8889).

Questions?