

# HSAs: How do they work?

This summary provides a brief overview of Health Savings Accounts. It is not inclusive of each HSA provision. Should there be a discrepancy between the information contained in this document and the HSA Rules and Regulations stipulated by the IRS, the IRS Rules and Regulations will govern.

## Health Savings Accounts (HSAs)

A Health Savings Account (HSA) is a consumer-oriented, tax-advantaged savings account that is always combined with a high deductible health plan (HDHP). It is an interest-accruing account, similar to an Individual Retirement Account (IRA), which provides financial control over how you spend your health care dollars and can be used to pay for your out-of-pocket medical expenses. HSA earnings grow tax-deferred and qualified withdrawals are tax-free without "use it or lose it" provisions found with a Flexible Spending Account (FSA). Money not used in your Health Savings Account can be rolled over to the following year. HSA funds can be used for all qualified medical expenses, including medical services, as well as eyeglasses, dental procedures, prescription drug coverage and over-the-counter medications. (Effective January 1, 2020, you no longer need to have a prescription from your provider for OTC medications).

HSAs enable you to pay for current health expenses and save for future qualified medical and retiree health expenses on a tax-free basis. You must be covered by a High Deductible Health Plan (HDHP) to be qualified to open a HSA. An HDHP generally costs less than what traditional health care coverage costs, so the money that you save on insurance premiums can be put into the Health Savings Account. You own and control the money in your HSA. Decisions on how to spend the money are made by you without relying on a third party or a health insurer. You will also decide what types of investments to make with the money in the account in order to make it grow.

## Health Savings Account Eligibility

Eligible individuals include those who are:

- Covered by a HSA-qualified High Deductible Health Plan (HDHP)
- Not covered by other health insurance that is not an HDHP (including a spouse's plan in which he/she has selected family coverage and/or a General Purpose Healthcare FSA – set up by you or your spouse)\*
- Not enrolled in Medicaid
- Not enrolled in Medicare
- Not eligible to be claimed on another's tax return
- There are exceptions: Insurance coverage for accidents, dental care, disability, long-term care, and vision care do not disqualify you from opening an HSA; nor do Limited-Purpose FSA's. If you have Worker's Compensation benefits, specified disease, or fixed indemnity coverage, you can also open an HSA.

## High Deductible Health Plans (HDHP)

You must have an HDHP if you want to open an HSA. A HDHP is health insurance plan that generally does not pay for the first several thousand dollars of health care expenses. Your HSA helps pay for the qualified expenses that your plan does not cover. In order to qualify to open an HSA, your HDHP minimum deductible must be at least \$1,400 (self-only coverage) or \$2,800 (family coverage) for 2022. The annual out-of-pocket (including deductibles and copays) cannot exceed \$7,050 (self-only coverage) or \$14,100 (family coverage) for 2022. All HDHP's provide coverage for preventive care without requiring deductibles and apply higher out-of-pocket limits, copays, & coinsurance for non-network services.

## HSAs and HDHP Coverage

Once funds are deposited into the HSA, the account can be used to pay for qualified medical expenses tax-free, even if you no longer have HDHP coverage. The funds in your account roll over automatically each year and remain indefinitely until used. There is no time limit on using the funds.

## HSA Account Management

There are many institutions which provide HSAs. In the event an account is funded entirely by an employer, the banking institution and contributions may be pre-selected. If the HSA is fully funded by an employee, there may be an advantage to using a specific bank if an employer provides direct deposit of pre-tax HSA contributions to that bank. If an employee chooses to set-up and maintains his or her own HSA, it is important to consider the fees, interest rates, investment options and other features associated with HSAs when selecting a financial institution. The contribution generally would not be payroll deducted and will need to be made with after-tax dollars. After-tax contributions can be deducted from an employee's income on annual tax returns.

## Utilizing HSA Accounts

You can use the money in your HSA account to pay for any "qualified medical expense" permitted under federal tax law. This includes most medical care and medications as well as dental and vision care. HSAs can be used to pay for medical expenses for yourself as well as your spouse, and/or your dependent children. Any amounts used for purposes other than to pay for "qualified medical expenses" are taxable as income and are also subject to a 20% tax penalty.

Employees have the option of using their HSA debit card or HSA checks (if applicable). Personal funds may also be used to pay for qualified expenses and employees can then reimburse themselves from their HSA.

## Contribution Limits

The 2022 HSA maximum contribution is \$3,650 for self-only coverage and \$7,300 for family coverage. These amounts are set by law and will be increased for inflation in future years. You can contribute in a lump sum or in any amounts or frequency you wish. However, your account trustee/custodian (bank, credit union, insurer, etc.) can impose minimum deposit and balance requirements.

## Employer Contributions

Contributions to HSAs can be made by you, your employer, or both. If your employer contributes some of the money, you can make up the difference. The maximum contribution includes money contributed by you and/or your employer. The combined contributions from you and your employer cannot exceed the annual maximum as set by the IRS.

## Catch-Up Contributions

Individuals 55 and older who are covered by an HDHP can make additional "catch-up" contributions each year until they enroll in Medicare. The additional "catch-up" contributions to HSA allowed are as follows:

- o 2022 - \$1,000

*Note: If an employee and spouse are both age 55 or older, each individual must have a HSA established for both parties to take advantage of the catch-up contribution.*

## HDHP Coverage Loss

Funds deposited into your HSA remain in your account and automatically roll over from one year to the next. You may continue to use the HSA funds for qualified medical expenses, even if you are no longer covered by a HDHP. You may no longer contribute to a HSA for months that you are not covered by a HDHP. If you made a contribution to your HSA for the year based on a full year's coverage by the HDHP, you will need to withdraw some of the contribution to avoid the tax on excess HSA contributions. If you regain HDHP coverage at a later date, you can begin making contributions to your HSA again.

## HSA Advantages

There are many advantages of opening a Health Savings Account. In addition to the savings of lower health insurance premiums, 100% of HSA contributions are pre-taxed. The interest earned by the money in a HSA is also tax-free. You pay no taxes or penalties when you use your HSA for qualified medical expenses. Some other advantages include:

- **Tax Savings:** You can elect to have your HSA pre-tax contributions payroll deducted or contributions can be deducted from your gross income on your federal tax return.
- **Earnings:** You will earn interest from the funds in your HSA as it grows with tax-deferred interest.
- **Portability:** You own your account, so in the event you change jobs, your HSA funds are not affected.
- **Affordable Health Coverage:** HSA's can cover the cost of medical expenses such as coinsurance, deductibles, and medications.
- **Long-Term Savings:** HSA tax-deferred funds can be rolled over each year, allowing your account to grow. HSA's have been referred to as the "Medical IRA."
- **Retirement Bonus:** After age 65, you may make withdrawals from your HSA for any reason without a 20% penalty. Withdrawals for reasons other than qualified medical expenses will be subject to ordinary income tax.
- **Safety Net:** There is no "use it or lose it" provision, so you can build up the savings in your HSA to use for major health events.
- **Additional Coverage:** You can use HSA funds for expenses not covered by health plans, including dental, optical, and much more.
- **Investment Potential:** Many financial institutions allow you to invest your HSA funds into stocks, mutual funds and other investment vehicles, allowing your money to grow more quickly.

## HSA Mid-Year Eligibility

Your eligibility to contribute to an HSA is determined by the effective date of your HDHP coverage. You can join an HSA-compatible plan mid-year and make the full IRS-allowed contribution for that year, but you will be required to stay in the plan through December of the following year in order to avoid any tax penalties. If you are covered on December 1, 2017 you are treated as an eligible individual for the entire year. However, if you cease to be an eligible individual during 2018, the contributions you made for the months in which you were not enrolled in a qualified HDHP plan are included in income and subject to a 20% additional tax.

## Health Savings Accounts at Age 65

You can continue to use your account tax-free for out-of-pocket health expenses. When you enroll in Medicare, you will no longer be eligible to contribute money to your account but you can use your account to pay Medicare premiums, deductibles, copays, and coinsurance under any part of Medicare. If you have retiree health benefits through your former employer, you can also use your account to pay for your share of retiree medical insurance premiums. One expense you cannot use your account for is to purchase a Medicare supplemental insurance or "Medigap" policy. Once you turn age 65, you can use your account to pay for things other than medical expenses without penalty but will be subject to income tax. Individuals under age 65 who use their accounts for non-medical expenses must pay income tax and a 20% penalty on the amount withdrawn.

## HSA Funds In the Event of a Death

If you are married, your spouse becomes the owner of the HSA when you die. If you are unmarried, the HSA becomes part of your taxable estate.