Introduction to Health Savings Accounts

In an effort to respond to the rising costs of health care, many employers are offering tax-favored accounts such as health savings accounts (HSAs).

What is a health savings account?

An HSA is a tax-exempt trust or custodial account established for the purpose of paying qualified medical expenses. An HSA accompanies a high deductible health plangraffgraff (HDHP).

HSAs can be a powerful tax savings tool. In general, HSA contributions made by an eligible individual are tax-deductible, and employer HSA contributions made on behalf of an eligible employee are excluded from the employee's gross income. Interest and other earnings on HSA contributions accumulate tax-free. Amounts distributed from an HSA for qualified medical expenses are generally tax-free as well.

Keep in mind that some states define income differently than the IRS. As a result, HSAs that are tax-exempt at the federal level may not be tax-exempt at the state level.

Who can establish an HSA?

An individual may contribute to an HSA in any month in which he or she is covered under an HDHP on the first day of the month. The individual cannot be covered by another health plan that is not an HDHP (with certain exceptions), and he or she cannot be entitled to Medicare benefits or be claimed on another person's tax return. Self-employed individuals are eligible to establish an HSA.

What expenses are eligible for tax-free reimbursement from an HSA?

An HSA may reimburse qualified medical expenses incurred by the account beneficiary and his or her spouse and dependents. In addition to qualified medical expenses, COBRA premiums, health insurance premiums and qualified long-term care (QLTC) premiums may be reimbursed from an HSA. Review a full list of qualified medical expenses.

What expenses are not eligible for tax-free reimbursement from an HSA?

The following expenses may not be reimbursed from an HSA:

- Premiums for Medicare supplemental policies;
- Expenses covered by another insurance plan;
- Expenses incurred prior to the date the HSA was established; or
- Any expenses other than qualified medical expenses and the HSA reimbursable premiums described above.

The amount withdrawn from an HSA for a non-qualifying medical expense is added to the account beneficiary's income and subject to a 20% penalty. If funds are distributed as a result of the account beneficiary's death, disability or after he or she becomes eligible for Medicare, the 20% penalty does not apply.

How much can an individual contribute to an HSA?

For each month an eligible individual is covered under an HDHP, he or she may contribute one-twelfth of $4,150 for self-only coverage or one-twelfth of $8,300 for family coverage for calendar year 2023. Individuals who are age 55 or older by the end of the tax year are permitted to make "catch-up contributions" and can contribute up to an additional $1,000 annually. HSA contributions do not have to be made in equal amounts each month. An eligible individual can contribute in a lump sum or in any amounts or frequency he or she wishes.

Also, the HSA contribution limit is reduced by any contributions made to a medical savings account (MSA) in the same year. Rollover contributions from another HSA or MSA can be accepted. These rollover contributions are not subject to the annual contribution limit.

HSAs may not be right for all employers or individuals. Please contact HORAN for assistance in determining what tax-advantaged account will best meet your goals.