What is a Health Savings Account (HSA)?

An HSA works like a savings account into which you can deposit money on a tax-deductible basis for medical expenses. HSAs enable you to pay for current health expenses and save for future qualified medical and retiree health expenses on a tax-free basis. Technically, an HSA is a tax-exempt trust or custodial account. HSAs must be set up through a qualified HSA trustee such as a bank or insurance company.

To be able to take advantage of an HSA, you must be covered by a High Deductible Health Plan (HDHP). An HDHP generally costs less than traditional health care coverage, therefore the money that's saved on insurance can be put into the HSA.

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 also decide what types of investments to make with the money in the account in order to make it grow. Earnings on your HSA grow tax-free.

What Is a High Deductible Health Plan (HDHP)?

An HDHP is a health insurance plan that must meet certain deductible and out of pocket requirements. Because the deductible and out of pocket limits are much higher than conventional insurance, the premium costs are generally lower. Once the deductible and co-insurance required amounts have been paid by the covered person, the HDHP policy pays the rest of covered charges. Your HSA is available to help you pay for the deductible, co-insurance, and other expenses not covered by the HDHP.

In order to qualify to open an HSA for 2013 and 2014, your HDHP minimum deductible must be at least $1,250 for self-only coverage, or $2,500 for family coverage. However, HDHPs may provide preventive care benefits without a deductible or with a deductible below the minimum annual deductible.

For 2013, the annual out-of-pocket cost, including deductibles and co-pays, cannot exceed $6,250 for self-only coverage or $12,500 for family coverage (for 2014, self-only coverage cannot exceed $6,350 or $12,700 for family coverage). An HDHP can apply higher out-of-pocket limits, co-pays, and coinsurance for non-network services.

How Much Can I Contribute to an HSA?

Contributions to your HSA are deducted from adjusted gross income on the front of your tax return. You do not have to itemize deductions to claim this benefit.

Contributions are limited to the maximum highest deductible for the year. The maximum highest deductible is indexed for inflation. For 2013, the maximum highest deductible is $3,250 for self-only coverage, or $6,450 for family coverage (for 2014, $3,300 for self-only coverage or $6,550 for family coverage).

If you are age 55 or older, an additional catch-up contribution, in addition to the annual limits, is allowed. For 2013 and 2014, the additional contribution amount is $1,000. You can continue making contributions to your HSA until you enroll in Medicare.

Contributions for Self-employed Taxpayers

Self-employed persons may not take the amount of their HSA contribution as a deduction when computing self-employment tax. However, self-employed individuals may contribute to an HSA with after-tax dollars and take the HSA contribution deduction from adjusted gross income on Form 1040.

Can My Employer Contribute to My HSA?

Contributions to HSAs can be made by you, your employer, or both. All contributions are added together to determine whether you have contributed the maximum allowed. If your employer contributes some of the money, you can make up the difference. Employer contributions to your HSA are not taxable to you, therefore, you are not allowed a deduction for employer contributions.

Using Distributions From Your HSA

You may withdraw funds to pay qualified medical expenses for you, your spouse, and/or dependents. Distributions from your HSA can be used to pay any qualified medical expense, even if the expense is not covered by an HDHP. For example, most health insurance does not cover the cost of over-the-counter medicines, but HSAs can be used for this purpose. If the money from the HSA is used for qualified medical expenses, the distribution is not taxed.

If you withdraw the money and use the funds for something other than qualified medical expenses, the withdrawal will be included in income. If you are not disabled or over age 64, the distribution is also subject to a 20% tax penalty.

Can Distributions be Used to Pay for Health Insurance Premiums?

You can only use your HSA to pay for your health insurance premiums if you are collecting federal or state unemployment benefits, or you have COBRA continuation coverage through a former employer.

You can use the funds in your HSA to pay for long-term care insurance. The long-term care premium amount that is considered a qualified medical expense is limited and depends on your age.

You can also use HSA funds to pay for Medicare and other health care coverage if you are 65 or older (other than premiums for a Medicare supplemental policy, such as a Medigap policy).

What Happens to My HSA if I No Longer Have an HDHP?

An HSA is not a “use-it or lose-it” type of account. The money you deposit into your HSA remains in your account and is available for future years. You may continue to take distributions from your HSA for qualified medical expenses. However, you will no longer be eligible to contribute to an HSA if you are not covered by an HDHP.

If you have coverage by an HDHP for less than a year, the annual maximum contribution is reduced. 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.

What Happens When I Reach Age 65?

Distributions may continue to be made for qualified medical expenses, tax free. Non-qualified distributions will be taxable, but not subject to the 20% penalty. Once you enroll in Medicare, you can use your account to pay Medicare premiums, deductibles, co-pays, and coinsurance under any part of Medicare, but you are no longer eligible to make contributions to your HSA. 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. However, you cannot use your account to purchase Medicare supplemental insurance, such as a Medigap policy.

What Happens to My HSA After Death?

You should name a beneficiary when you establish your HSA. If your spouse is the beneficiary, your HSA becomes your spouse’s HSA at the time of your death. If you name someone other than your spouse as the beneficiary, the account ceases to be an HSA and the fair market value of the account is included in the beneficiary’s taxable income in the year of your death. If your estate is the beneficiary of your HSA, the value of the account is included on your final tax return.

This brochure contains general tax information for taxpayers. As each tax situation may be different, do not rely upon this information as your sole source of authority. Please seek professional advice for all tax situations.

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