Rules about HSA contributions and withdrawals

Contributions to HSA can be made by the employer or the individual, or both. The 2020 maximum amount that can be contributed to an HSA from all sources is $3,550 for individuals and $7,100 for families, plus an additional $1,000 “catch up” contribution after age 55. All Contributions must stop once an individual is enrolled in any type of Medicare.

Employee Contributions

- May be made through payroll deduction if your employer offers it. Payroll deductions for contributions are “pre-tax” and not subject to income taxes.
- Can be made post-tax directly to your HSA custodian. The full amount is deductible on your annual tax return.
- Election can be changed on a month-by-month basis.
- Can be made by others on your behalf and deducted on your tax return.
- Can be made via a one-time transfer your HSA, subject to contribution limits.

Employer Contributions

- Some employers make a contribution to the employees’ HSA. This is at the employer’s discretion and may be based on certain requirements such as completing a health assessment.
- Can be contributed in a lump sum, monthly, or on some other frequency.
- Are always excluded from employees’ federal income (deducted pretax). Certain states tax HSA contributions.
- Any employer contributions count toward the employee’s maximum annual contribution limit.

If you become eligible for the HSA mid-year

If you become eligible in a month other than January and are eligible on Dec. 1 of the year, you can make a full year’s contribution (plus catch-up, if applicable) to an HSA. If you contribute the annual maximum but are eligible only part of the year, you will be subject to taxes and penalties if you don’t remain eligible for the next 12 months following the last month of the year.

If you accidentally contribute over the HSA limit

Contributions to the HSA larger than the maximum limits must be withdrawn by the individual or be subject to a tax penalty. Any earnings that were made on the excess funds will need to be removed also. You will have to pay income tax on the withdrawn amount, but no penalty. Consult your tax advisor for guidance.

Withdrawals are tax-free, for eligible expenses

Withdrawals are tax-free as long as they are taken for “eligible healthcare expenses” incurred after the HSA was established. You can use your HSA funds to pay for or reimburse yourself for your own qualified medical expenses or those of your spouse and any dependents you claim on your tax return (even if not covered by the HDHP).

When is an HSA withdrawal not tax-free?

If the withdrawal is not made for "eligible healthcare expenses" the amount of funds used is included in your taxable income and subject to a 20% tax penalty. The exception to this is if the funds are withdrawn after the account owner dies, becomes disabled or reaches age 65.

Eligible medical expenses do not include insurance premiums unless the premiums are for:

- Long-term care insurance
- Healthcare continuation coverage (such as COBRA)
- Healthcare coverage while receiving unemployment compensation
- Medicare and other healthcare coverage if you are age 65 or older (other than premiums for a Medicare supplemental policy, such as Medigap)

What else do you need to know?

- Keep your receipts! You may need to prove to the IRS that withdrawals from your HSA were for eligible medical expenses. It is important to keep records sufficient to prove the expenses incurred were not paid for or reimbursed by another source or taken as an itemized deduction.
- You can reimburse yourself from your HSA for prior expenses as long as they were incurred on or after the date your established your HSA. For example, if you don't have enough money in your HSA to pay for an expense up front, you can pay out-of-pocket and then reimburse yourself later once you have accumulated enough tax-advantaged dollars in your account.
- Mistakes happen! Incorrect distributions/withdrawals can be returned to the HSA, with evidence that it was a mistake.

If a beneficiary inherits your HSA

If your spouse is the beneficiary of your HSA, ownership will transfer to them upon your death and the account will continue as an HSA. If your beneficiary is not your spouse, your HSA ceases to be an HSA and the beneficiary is required to include the amount of your existing HSA assets in their gross income. The taxable amount will be reduced by any qualified medical expenses incurred by you before death and paid by the beneficiary, as well as any applicable estate tax.