



Is a Health Savings Account right for you?

Given the escalating cost of health care, there may be a more cost-effective way to pay for it. For eligible individuals, a Health Savings Account (HSA) offers a tax-favorable way to set aside funds (or have an employer do so) to meet future medical needs. Here are the main tax benefits:

- Contributions made to an HSA are deductible, within limits,
- Earnings on the funds in the HSA aren't taxed,
- Contributions your employer makes aren't taxed to you, and
- Distributions from the HSA to cover qualified medical expenses aren't taxed.

Who's eligible?

To be eligible for an HSA, you must be covered by a "high deductible health plan." For 2021, a high deductible health plan is one with an annual deductible of at least \$1,400 for self-only coverage, or at least \$2,800 for family coverage. For self-only coverage, the 2021 limit on deductible contributions is \$3,600. For family coverage, the 2021 limit on deductible contributions is \$7,200. Additionally, annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits can't exceed \$7,000 for self-only coverage or \$14,000 for family coverage.

An individual (and the individual's covered spouse) who has reached age 55 before the close of the year (and is an eligible HSA contributor) may make additional "catch-up" contributions for 2021 of up to \$1,000.

HSAs may be established by, or on behalf of, any eligible individual.

Deduction limits

You can deduct contributions to an HSA for the year up to the total of your monthly limitations for the months you were eligible. For 2021, the monthly limitation on deductible contributions for a person with self-only coverage is 1/12 of \$3,600. For an individual with family coverage, the monthly limitation on deductible contributions is 1/12 of \$7,200. Thus, deductible contributions aren't limited by the amount of the annual deductible under the high deductible health plan.

Also, taxpayers who are eligible individuals during the last month of the tax year are treated as having been eligible individuals for the entire year for purposes of computing the annual HSA contribution.

However, if an individual is enrolled in Medicare, he or she is no longer eligible under the HSA rules and contributions to an HSA can no longer be made.

On a once-only basis, taxpayers can withdraw funds from an IRA, and transfer them tax-free to an HSA. The amount transferred can be up to the maximum deductible HSA contribution for the type of coverage (individual or family) in effect at the transfer time. The amount transferred is excluded from gross income and isn't subject to the 10% early withdrawal penalty.

Distributions

HSA Distributions to cover an eligible individual's qualified medical expenses, or those of his spouse or dependents, aren't taxed. Qualified medical expenses for these purposes generally mean those that would qualify for the medical expense itemized deduction. If funds are withdrawn from the HSA for other reasons, the withdrawal is taxable. Additionally, an extra 20% tax will apply to the withdrawal, unless it's made after reaching age 65 or in the event of death or disability.

As you can see, HSAs offer a very flexible option for providing health care coverage, but the rules are somewhat complex.