The Complete HSA Guidebook

How to make Health Savings Accounts work for you

2027 Edition

Updated to reflect recent health policy and tax changes

Stephen D. Neeleman, M.D.

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Foreword

We began writing the first edition of The Complete HSA Guidebook a few months after new legislation allowed the creation of the first Health Savings Accounts (HSAs) on January 1, 2004. In the 20+ years since then, people have developed an understanding of, and appreciation for, this important health benefit. Millions of people use HSAs, not only to pay for immediate healthcare needs with tax-free dollars, but also to save for healthcare expenses in retirement. According to Devenir Research's 2025 Year-End HSA Market Statistics & Trends, Americans hold nearly 41.7 million HSAs, containing over $174 billion in funds.[1]

We founded HealthEquity in 2002. As this edition goes to print, HealthEquity members have saved more than $36 billion dollars in 10 million HSAs.[2] Our team of 3,100 HSA enthusiasts remains committed to helping more and more Americans understand and use HSAs to prepare for future healthcare and retirement needs. The more we study the effects of HSAs, the more we believe they can help "save and improve lives by empowering healthcare consumers," which has become our mission.

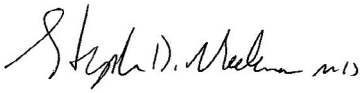
We intend to make HSAs as common as retirement accounts—because of their tax savings and their potential to lower overall healthcare expenditures for both consumers and businesses.

HealthEquity focuses on helping employers and their employees manage out-of-pocket healthcare costs, which continue to increase every year. We believe that leveraging HSAs is the best way to make excellent healthcare coverage available to businesses and consumers, to save taxes, and to reduce healthcare premium costs. We will continue to work with businesses and legislative leaders to increase access to HSAs so that every American can effectively manage their out-of-pocket health costs.

As our company grows, I remain amazed at the passion and commitment that our teammates exhibit as they build relationships with, and provide remarkable service for, our members, clients, and partners. As a result of their skill and expertise, we have grown to be the largest HSA custodian, by number of accounts, in the United States.[2] On behalf of our entire team, I hope this

publication helps you understand HSAs and encourages you to consider opening one—or to better manage the one you already have.

Sincerely,



Stephen D. Neeleman, M.D.
HealthEquity Founder and Vice Chairman
Salt Lake City, Utah
November 2026

HealthEquity, Inc. is a publicly traded (NASDAQ: HQY) non-bank custodian of Health Savings Accounts (HSAs).

This publication provides a general explanation of HSAs—not legal, financial, or tax advice. As always, consult your own legal, tax, and financial advisors for the best advice tailored to your specific needs.

HSAs are never taxed at a federal income tax level (when used appropriately for qualified medical expenses) and are seldom taxed at the state level. Please consult a tax advisor to learn your state's specific rules.

HealthEquity bases its opinions and its decisions on sound research and data and recognizes that readers' experiences with HSAs may vary.

Examples, results, and calculations included in this publication serve illustrative purposes only. In this edition, we cite the Internal Revenue Code (IRC) and have made every effort to ensure accuracy. Even so, we cannot guarantee the accuracy or currency of all citations. Report errors or direct questions and comments to HSAGuidebook@healthequity.com.

1. 2025-Year-End-Devenir-HSA-Research-Report-Executive-Summary.pdf
2. HealthEquity 2026 annual report HQY-2026-01-31 10K

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Introduction

Overview

Imagine a savings account that allows you to make tax-advantaged contributions. As the account increases in value, your earnings remain untaxed—even if you invest the funds. In addition, you pay no tax on money you use for qualified medical expenses.

Only a Health Savings Account (HSA) provides this “triple-tax” benefit. At no point, from earning to spending (for qualified medical expenses), do the funds in your HSA incur either federal or most state income tax.[1] Other retirement saving plans, such as traditional IRAs, Roth IRAs, and 401(k)s, generally apply taxes either to contributions or withdrawals.

Health Savings Account benefits

Individuals
Because HSAs provide so many tax advantages, you should learn how to become eligible to open one—to help reduce your tax burden, protect yourself against rising medical costs, save for unexpected healthcare expenses, and increase your retirement savings.

You own your HSA. This means HSA funds automatically roll over every year and the account becomes part of your estate upon death. Or the account can transfer to your spouse as an HSA.

HSAs provide flexibility (you can use the funds before and after you retire) as well as more tax advantages than retirement accounts. If you contribute to an IRA or 401(k), you don’t pay tax on your contributions, but you do pay taxes on the funds you withdraw during retirement (your original contributions plus account earnings). For a Roth IRA or Roth 401(k), you pay tax on the money

you contribute, but you don't pay tax on distributions (including account growth).

If you have a health Flexible Spending Account (FSA), you contribute and spend pre-tax dollars, but may lose funds you have not spent at the end of the plan year, unless your employer offers a limited carryover or grace period feature.

Only HSAs provide the flexibility of a retirement savings plan but with a triple-tax benefit: you make pre-tax contributions, your account grows and earns interest free of federal income tax (and free of income tax in most state taxes), and your distributions (when used for qualified medical expenses) also remain tax-free. In addition, you can invest your HSA funds which, while riskier, increases the potential for tax-free growth.

Because of these significant tax savings, the Internal Revenue Service (IRS) limits who can contribute to an HSA. Only individuals covered by an HSA-qualified health plan (sometimes called high-deductible or consumer choice health plan, or a bronze or catastrophic level plan through an Affordable Care Act exchange) may open or contribute to an HSA. An HSA-qualified health plan must meet government-mandated limits on minimum deductibles and maximum out-of- pocket expenses. These requirements, along with contribution limits, change slightly from year to year.

A few other restrictions exist:[2]

- You may not have other health coverage (except certain permitted coverage)
- You may not be enrolled in Medicare
- No one can claim you as a dependent for tax purposes

In addition to the significant tax benefits HSAs provide, they can encourage more choice and flexibility than traditional healthcare and help individuals manage chronic illness by encouraging the development of more knowledgeable and engaged healthcare consumers. To the extent that individuals better manage their health, they are rewarded by tax-free growth of unused contributions in their HSA.

Employers
HSA-qualified health plans provide a means of controlling ever-rising healthcare costs without impairing employees' access to high-quality healthcare. Besides saving money on overall premium costs, employers also reduce their tax burden because they do not pay taxes on the money they or their employees contribute to their employees' HSAs.

Healthcare
HSA-qualified plans provide financial incentives to individuals both to manage medical expenses and to take a more active role in healthcare decisions—especially decisions concerning medications, tests, and procedures. The fact that HSA owners can keep the money they save (for example, when choosing in- or out-of-network providers or facilities) encourages participants to become careful healthcare consumers who demand and receive better value for their healthcare dollars—increasing overall benefits to consumers, competitive pricing, and responsible consumption.

Organization

This publication has three sections to help you easily find the information you need.

Section 1 explains foundational terms and concepts. It also describes HSAs in depth and then steps back to provide context about how HSAs compare to, and interact with, other consumer-driven healthcare products.

Section 2 provides an owner's manual for HSAs—everything you need to know to wisely use this important savings vehicle to meet your present and future financial and healthcare needs—presented in an easy-to-read, sequential format.

Topics include:

- Opening an HSA
- Contributing to an HSA
- Spending HSA funds
- Saving and investing HSA funds

Section 3 helps you set up a recordkeeping system, explains the paperwork you will receive, and provides information for employers who want to make HSAs available to their employees.

By strategically contributing to your HSA and other retirement accounts, you can reduce your tax burden and increase financial stability in your retirement years. According to the latest retiree healthcare cost estimate by Employee Benefit Research Institute (EBRI), a married couple with average prescription drug expenses enrolled in Medigap will need approximately $366,000,[3] on average, to pay for their medical needs in retirement.

Employees of all ages should consider making HSAs a part of their overall retirement and healthcare strategy. It's never too early or too late to save for healthcare expenses now and into retirement. Young people just starting their careers have the potential to save hundreds of thousands of dollars to help meet financial objectives. On the other hand, those close to retirement who may have recently discovered the usefulness of an HSA still have time to take advantage of the many benefits HSAs offer.

Choosing an HSA-qualified health plan may require you to make some changes in the way you think about and use healthcare, but you do not have to compromise the quality of the healthcare you receive.

For us to provide the best possible resource for exploring this important savings option, please help us to help you. If you find a typographical or content error, please let us know by sending an email to HSAGuidebook@healthequity.com.

Summary

HSAs provide a triple-tax benefit: tax-advantaged contributions, tax-free account growth, and tax-free distributions (if used for qualified medical expenses). Other health savings and retirement savings vehicles offer only one or two of the three tax advantages. Health Savings Accounts are also your money—they are personally owned, portable, and investable.

- Restrictions on who can contribute to an HSA include:
  - No impermissible healthcare coverage
  - No Medicare
  - Not included as a dependent on someone else's tax return
- An HSA-qualified health plan solves several important health-coverage-related problems, besides making pre-tax funds available to pay consumers' qualified out-of-pocket medical expenses:
  - Provides more choice and flexibility than traditional healthcare
  - Helps manage expenses associated with chronic illness
  - Develops more knowledgeable and engaged healthcare consumers. As individuals take more control of their health and reduce healthcare spending, HSA balances grow, creating rewards for better health
  - Benefits employers by helping reduce their tax burden
- HSAs benefit healthcare in general by increasing consumer awareness—especially by encouraging comparison shopping and research.

Resources

1. Note that California and New Jersey tax HSA contributions. (https://www.ncsl.org/research/health/hsas-health- savings-accounts.aspx)
2. IRS Publication 969
3. EBRI Issue Brief March 2025 (Projected Savings Medicare Beneficiaries Need for Health Expenses Continued to Rise in 2024)

Chapter 1

Definitions and explanations

Chapter overview

This chapter defines and explains foundational concepts used throughout the rest of the publication. Consider marking this chapter so you can refer to it as you read. In addition, take a moment to glance at the glossary in APPENDIX A to see explanations for other health insurance and tax-related terms. Finally, make a note of the chart at the end of this chapter, which compares government-mandated contribution limits for various types of accounts—for last year, this year, and next year, where available. Later digital versions will be released online updating these limits as they become available.

The terms and concepts in this chapter will help you understand the unique benefits of Health Savings Accounts (HSAs) and enable you to compare the features of various types of health plans.

As mentioned previously, to open and contribute to an HSA, you must meet the following Internal Revenue Service (IRS) requirements:

- You must have coverage under an HSA-qualified health plan on the first day of the month in which you open (or make an initial or ongoing contribution to)[1]
- You have no other health coverage (except certain permitted coverage)[2]
- You are not enrolled in Medicare
- No one claims you as a dependent for tax purposes[3]

These requirements apply only to your eligibility to open and contribute to an HSA. They do not apply to your eligibility to maintain the account, earn tax-free interest and investment dividends, or distribute money from the account for qualified medical expenses. You can keep, grow, and spend all the money in the account, even if you leave your employer, lose your qualifying coverage, or obtain other impermissible coverage.[4]

Health coverage terms

Deductible

HealthCare.gov defines a deductible as the amount of covered expenses that you must pay before your health plan starts to pay. Some services, such as preventive care, may not be subject to your deductible. (For more information, see the “First-dollar coverage” section later in this chapter). This deductible typically resets or starts over every plan year.

The plan year may align with the calendar year (January 1 to December 31) or refer to some other 12-month period that your employer or insurer chooses. Some plans allow deductibles to accumulate for more than 12 months. (See the “Carry-over deductible” section later in this chapter).

HSA-qualified health plans must adhere to statutory limits for both minimum deductible and maximum out-of-pocket expenses. These limits may change year to year, based on changes in the Consumer Price Index (CPI). The Internal Revenue Service (IRS) typically announces changes in May or June before the change takes effect the following tax year[5] The exception to the statutory limits are with bronze and catastrophic plans that are offered on government health exchanges as described below.

HSA-Qualified Health Plan Guidelines | 2027

Minimum annual deductible		Out-of-pocket maximum	
Single	Family	Single	Family
≥$1,750	≥$3,500	≤$8,700	≤$17,400

Embedded deductible

Some HSA-qualified health plans provide an embedded deductible. In such plans, when an embedded individual deductible equals or exceeds the statutory minimum family deductible, the plan qualifies for an HSA.[6] In other words, even though you have family coverage, if you meet the individual embedded deductible for one family member under such a plan, you have met your entire deductible for the family.

If either the deductible for the entire family or the deductible for an individual family member fails to meet the minimum annual deductible for family coverage allowed by the IRS (shown in the previous table), then the plan does not qualify for contributions to an HSA.

EXAMPLES: Embedded deductible
Elliott has family health insurance coverage for 2027, with an annual deductible of $3,400 and an individual deductible (or embedded deductible) of $1,500 for each family member.

The plan does not qualify as an HSA-qualified health plan because the deductible for an individual family member falls below the minimum annual deductible of $3,500 for family coverage in 2027.[7]

Sheela's family health insurance coverage for 2027 has an annual deductible of $6,000 and an individual deductible (or embedded deductible) of $3,500 for each family member.

Sheela's plan qualifies as an HSA-qualified health plan, because the deductible for an individual family member equals the minimum annual deductible of $3,500 for family coverage in 2027.[8]

Carry-over deductible
Some health plans allow expenses that applied to a previous deductible to apply (carry over) to the new policy when the plan year resets. Usually, the carry-over deductible applies to expenses incurred at the end of the plan year during a certain period (usually three months before the plan year ends).[9]

Carry-over deductibles provide an added benefit when expenses occur late in the year, though in some circumstances, they may cause your health plan to lose its HSA-qualified status.

The required minimum deductibles for HSA-qualified coverage are annual requirements (that is, based on a 12-month period). IRS Notice 2004-50 confirms, however, that a deductible carryover provision (for example, a provision allowing expenses incurred during the last three months of the prior plan year to count toward the current year's deductible) will not prevent a plan

from being an HSA- qualified health plan, so long as the required minimum annual deductible used to determine whether the plan is HSA-qualified is proportionately increased to account for the fact that expenses incurred over more than 12 months may be used to satisfy the plan's deductible.

To calculate the adjustment, multiply the applicable required minimum annual deductible for self-only or family HSA-qualified health coverage by the number of months allowed in which to satisfy the deductible, then divide the resulting amount by 12. For the plan containing the deductible carryover provision to be an HDHP, the annual deductible under the plan must be equal to, or greater than, the adjusted required minimum annual deductible. The adjusted HSA-qualified health plan required minimum deductible cannot exceed the applicable (self-only or family) maximum out-of-pocket expense limit.[10]

Because the deductible includes more than 12 months, recalculate the IRS minimum deductible limit to extrapolate what deductible limits would allow your plan to remain HSA-qualified.

Annual Deductible x (# months in plan ÷ 12)

EXAMPLE: Carry-over deductible
Matt has a plan that allows him to include expenses from 15 months (a three-month carry-over) to satisfy the deductible. Instead of the minimum annual deductible listed in the previous table, Matt's health plan must satisfy the following calculated amounts to qualify Matt to make HSA contributions.

- Individual policy minimum deductible for 2027:
  $1,750 x (15/12) = $2187.50
- Family policy minimum deductible for 2027:
  $3,500 x (15/12) = $4,375

Copayments vs. coinsurance

"Copayment" refers to the fixed-dollar payment a patient makes for each doctor visit, treatment, test, prescription, etc. For example, you might pay $25 for an office visit or $50 for an x-ray.

“Coinsurance” is the percentage of a medical expense which the patient pays. For example, after meeting the deductible, you might pay 20% of your in-network medical expenses until you reach your out-of-pocket maximum for the year.

Out-of-pocket maximum

The out-of-pocket maximum is the upper limit of your financial exposure for care during any given plan year. The ACA limits the out-of-pocket maximum for in-network care, but any care provided out-of-network may be subject to a higher or even an unlimited out-of-pocket maximum.

With HSA-qualified health plans, the amounts you pay for in-network deductibles, copayments, or coinsurance (but not insurance premiums) contribute toward your out-of-pocket maximum.[11] Whether out-of-network charges also contribute toward the out-of-pocket maximum can vary by plan.

Once you reach your plan’s limit for the year, your health coverage pays all additional in-network, qualified expenses, regardless of the plan’s usual copayment or coinsurance arrangements.

Remember, the maximum out-of-pocket expense limit often applies only to in-network care. Health plans may require higher out-of-pocket limits for out-of-network care. For more information, see the “Networks and discounts” section later in this chapter. If a plan has separate out-of-pocket maximums

for each family member, the sum of these limits must be equal to or less than $17,500 in 2027.

EXAMPLE: Out-of-pocket maximum
Tricia has a deductible of $1,700 and an out-of-pocket maximum of $3,000.

Tricia pays all covered medical expenses until she meets her $1,700 deductible, after which her plan agrees to split the bill 80/20. The plan pays 80% of covered medical expenses after the deductible, and Tricia pays 20% in coinsurance.

If Tricia has additional qualified expenses after she reaches her deductible, she pays 20% of those bills until she spends another $1,300 out of her own pocket. Again, these limits might not include out-of-network or non-covered expenses.

When her total spending for qualified expenses reaches $3,000 (her out-of-pocket maximum), her health plan pays 100% of the rest of her covered medical expenses for that plan year.

EXAMPLE: Multiple out-of-pocket maximum limits[12]
Dean, Laurie, and their two children have a family plan. Their plan defines each family member's in-network, out-of-pocket maximum as $3,000 (thus, $12,000 for the entire family), after which the plan pays 100%.

Because the IRS defines the HSA-qualified health plan out-of-pocket maximum per family as $17,500 in 2027, their plan qualifies them to make contributions to an HSA.

4 x $3,000 = $12,000

$12,000 < $17,500

However, if they had four children, their plan would not qualify because the maximum out-of-pocket limit exceeds the legal maximum.

6 x $3,000 = $18,000

$18,000 > $17,500

Preventive care

First-dollar coverage
Your insurance company may cover some of your medical costs, especially for preventive care and some chronic condition treatments that the IRS considers "preventive care," without cost-sharing or at no cost to you and before you meet your deductible.

The Patient Protection and Affordable Care Act (PPACA) requires all new group health plans and plans in the individual market to provide coverage for

preventive services, including immunizations, preventive care for infants, children, and adolescents, and preventive care and screenings for women without cost sharing.

The definition of preventive care that applies to HSA-qualified health plans generally excludes any service or benefit intended to treat an existing illness, injury, or condition. However, on July 17, 2019, the IRS and Health and Human Services expanded the list of preventive services that health plans may include without cost sharing—without jeopardizing HSA qualification.[13]

This expanded list includes specific treatments for some chronic conditions, such as congestive heart failure, asthma, diabetes, and depression.[14]

Because employers and health plans have some discretion about which preventive services their coverage pays for, check to see which of the following your plan includes:[15]

- Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals
- Telehealth and remote care services
- Routine prenatal and well-child care
- Child and adult immunizations
- Tobacco cessation programs
- Obesity weight-loss programs
- Medications intended to prevent disease (such as certain blood pressure and cholesterol medications)
- Screening services for the following:
    - Cancer
    - Heart and vascular diseases
    - Infectious diseases
    - Mental health conditions
    - Substance abuse
    - Metabolic, nutritional, and endocrine conditions

- Musculoskeletal disorders
- Obstetric and gynecological conditions
- Pediatric conditions
- Vision and hearing disorders

Network considerations

If your health plan has negotiated rates with a specific network of providers for the preventive care they cover, only preventive services offered by in-network providers must be covered without cost sharing and before you satisfy your deductible. If you receive preventive care from an out-of-network provider, you may have to pay for the services and those expenses may not count toward your deductible or out-of-pocket maximum. However, you can use funds from your HSA to pay for such services.

Networks and discounts

In general, an HSA-qualified health plan provides more flexibility and benefit if you open an HSA. Because you own the money in your HSA, you can use it to obtain treatment from virtually any licensed healthcare provider, whether or not they belong to your health plan's network.

In-network services

Because a plan negotiates lower prices for services received "in-network," your

HSA money can go further if you use facilities and providers within your HSA-qualified health plan's network.

Seeking care at in-network facilities and from in-network providers has two advantages:

- You generally pay less money if you use services covered under your plan and consult only providers who participate in your plan's network
- You can typically count most or all of your healthcare expenditures toward your plan's deductible and out-of-pocket limits

Repricing
If your health plan distinguishes between in- and out-of-network providers, it will modify ("reprice") your healthcare costs when you use in-network providers—to reflect discounts your health plan may have negotiated with the provider. HSA-qualified health plans need not create "networks" (with whom they have negotiated discounts), but they often do. This provides significant cost savings to members of the health plan. In some circumstances, you may also see repricing for out-of-network providers.

EXAMPLE: Paying a network provider
Hope's doctor charges $150 for a visit for an acute sore throat.

As a provider in her health plan's network, her doctor has agreed to accept $75 from her plan for this type of visit.

Hope does not pay her provider the $150 charge at the time of the visit. Instead, because she chose an in-network provider, she waits for the health plan to reprice the claim, applying the discount that her provider agreed to accept. She may also receive a bill directly from her doctor for the adjusted amount.

If she has not yet met her deductible at the time of the visit, she pays the $75 from her HSA (or from another account). Her plan credits this amount toward her annual deductible and out-of-pocket limit.

Usual, customary, and reasonable amounts

Plans typically pay only what they consider usual, customary, and reasonable (UCR)—the estimated "going rate" paid in your geographical area for a given medical service or procedure. Any expenses above that amount not paid by

an HSA-qualified health plan typically do not apply toward your deductible or your maximum out-of-pocket expenses.[16]

EXAMPLE: Fee charged by an out-of-network provider
Your plan determines that a certain type of surgery should reasonably cost $2,000—a price it has negotiated with its in-network providers. You go to an out-of-network provider who charges $2,500. Your insurance will pay only $2,000 of this bill, and the additional $500 you pay may not apply to your health plan's deductible and out-of-pocket limit.
Inquire as to whether your HSA-qualified health plan has separate limits for in-and out-of-network care and whether its network includes the providers you want to use. You can get this information from your employer's benefits administrator, your

health plan, your HR team, or the Summary of Benefits and Coverage (SBC) given to you during enrollment.

Refusal of charges
If your provider has not contracted with your plan, then the plan has no obligation to cover the provider's full charges, so you may need to pay the difference, which may not apply to your health plan's deductible and out-of-pocket limit.

EXAMPLE: UCRs and deductibles
Naomi's doctor charges $150 for an x-ray. Her insurance company decides that the UCR charge is $130 and then pays half of this reduced amount ($65), based on a 50% coinsurance provision for x-rays in Naomi's plan.

Naomi pays the remaining half ($65), and likely the $20 difference between the UCR and the billed charge if the doctor does not have a negotiated discount agreement.

If the doctor requires that she pay the extra $20, the visit costs Naomi $85. The doctor still receives her usual fee of $150: $85 from Naomi and $65 from her insurance company. However, because her health plan sets a UCR cap, the additional $20 that Naomi paid does not count toward her deductible and out-of-pocket limit for the year—though the $20 could come from her HSA.

Referrals and authorization

Even if you use network providers, you may still need to obtain a referral from your primary care provider to see a specialist or receive authorization for a medical procedure from your health plan.

Gatekeepers
Depending on your plan's rules, you may also need to use a gatekeeper or primary care physician to obtain referrals or receive authorizations for certain medical services or procedures from your health plan. Certain primary care providers, such as general practitioners (GPs), family practitioners, pediatricians, and internists generally act as gatekeepers, overseeing and coordinating all aspects of a patient's care. When a plan requires a gatekeeper, you will designate a group or doctor as your primary care physician and must contact the plan if you wish to designate a different gatekeeper.

Referrals
Many managed care plans require a referral from your primary care provider for you to see a specialist. Even if your provider allows you to make an appointment with a specialist directly, your insurance might not cover the visit if you did not first receive a referral, so familiarize yourself with your health plan's guidelines to avoid unexpected expenses.

Authorization
In addition to a referral, you may also need authorization (your health plan's permission) to proceed with a medical or surgical procedure. Without authorization, the plan may refuse to pay for the procedure, even for procedures that otherwise qualify.

If you fail to obtain a referral or authorization when required, your plan may charge you a higher copayment, coinsurance rate, or even a flat-dollar penalty. The excess copayments, coinsurance, and penalties may not count toward your HSA-qualified health plan's out-of-pocket limit for the year; however, you may pay these expenses out of your HSA. Failure to understand and follow your plan's rules can cost you money.

Contribution and other limits

The following table summarizes IRS-imposed limits for various accounts.

Account	Details	2025	2026	2027
Health FSA	Individual, Family	$3,300	$3,400	**$3,500**
LPFSA	Individual, Family	$3,300	$3,400	**$3,500**
DCFSA	Individual or Married, file separately	$2,500	$3,750	**$3,750**
	Family or Single parent	$5,000	$7,500	**$7,500**
FSA	Carryover	$660	$680	**$700**
HSA[17]	Individual	$4,300	$4,400	**$4,500**
	Family	$8,550	$8,750	**$9,000**

	>55 catch-up	$1,000	$1,000	**$1,000**
QSEHRA	Individual	$6,350	$6,450	**$6,700**
	Family	$12,800	$13,100	**$13,550**
EBHRA	Max amt newly available	$2,150	$2,200	**$2,250**

In addition to the account parameters listed in the previous table, other caps and limits include:

HSA-qualified health plan	Min deductible: Individual	$1,650	$1,700	**$1,750**
	Min deductible Family	$3,300	$3,400	**$3,500**
	Max OOP: Individual	$8,300	$8,500	**$8,700**
	Max OOP: Family	$16,600	$17,000	**$17,400**
PPACA[20]	Max OOP: Individual	$9,200	$10,600	**$12,000**
	Max OOP: Family	$18,400	$21,200	**$24,000**
Transportation	Monthly allowance	$325	$340	**$350**
Parking	Monthly allowance	$325	$340	**$350**

Long-term care deduction limits
A portion of long-term-care premiums are qualified medical expenses for tax and reimbursement purposes. The tax-deductible portion increases with age*:

<40	$500
41-50	$930
51-60	$1,860
61-70	$4,960
71+	$6,200

**Referencing 2026 figures*

Summary

- HSA-qualified health plans must meet standards set by the government for plan terms, minimum deductibles, and maximum out-of-pocket expense caps (except for bronze and catastrophic plans that are offered on government health exchanges.).
- Terms
  - Deductible: The amount of covered expenses that you must pay in a given plan year before your health plan starts paying covered medical claims
  - Out-of-pocket maximum: The cap on what you will pay for in-network and out-of-network care in any given year
  - Copayment: A set dollar amount charged for services such as office visits and tests
  - Co-insurance: The percentage of the overall bill that you must pay after you meet your deductible
- You generally save money by receiving treatment from in-network providers and in-network facilities, which have negotiated discounts with your insurance company.

Resources

1. IRC §223(c)(1)(A)(i)
2. IRC §223(c)(1)(A)(ii)
3. IRC §223(b)(6)
4. IRS Notice 2004-2 Q&A 20
5. Rev. Proc. 2020-32
6. IRS Notice 2004-50 Q&A 20
7. IRS Notice 2004-2 Q&A 3
8. IRS Notice 2004-2 Q&A 3
9. IRS Notice 2004-50 Q&A 24
10. https://www.irs.gov/pub/irs-drop/rp-25-19.pdf

11. IRS Notice 2004-50 Q&A 21
12. IRS Notice 2004-50 Q&A 20, Example 1
13. IR-2019-129
14. IRS Notice 2019-4
15. IRS Notices 2004-23 and 2019-45
16. IRS Notice 2004-50 Q&A 16
17. IRS Rev. Proc 2022-24
18. As income rises, the amount an accountholder can contribute to a Roth IRA decreases.
19. As income rises, the amount an accountholder can deduct from their taxes decreases.
20. https://www.healthcare.gov/glossary/out-of-pocket-maximum-limit/

Chapter 2

Health Savings Accounts

Chapter overview

The government defines a Health Savings Account (HSA) as a "tax-exempt trust or custodial account you set up with a qualified HSA trustee [for example, a bank, insurance company, or Treasury-approved non-bank custodian or trustee] to pay or reimburse certain medical expenses you incur."[1]

Many HSA administrators provide online banking services similar to those offered for a personal bank account. In many cases, the federal government insures your account balance; read the literature from your custodian or trustee to make certain. HSA holders may wish to increase their earning potential by investing in qualified investment accounts such as stocks, mutual funds, and other investments (which the government may not guarantee or insure).[2]

If you qualify,[3] you and your employer can make tax-advantaged contributions to your HSA and you can use the funds, tax-free, as long as you use them for qualified medical expenses.

If you contribute more than you spend from your HSA, those funds accumulate and could potentially increase in value over the years—especially if you choose to invest money from your HSA, which carries a higher potential for growth. You can prepare for future healthcare and retirement needs by thoughtfully using an HSA alongside an HSA-qualified health plan, 401(k), and other retirement accounts.

For information about who can open or contribute to an HSA, see the "Contribute to an HSA" section of CHAPTER 4 or refer to CHAPTER 5. For information about saving and investing HSA funds, see CHAPTER 7

What is an HSA?

A Health Savings Account, or HSA, is just that—an account that you can contribute money to and use to pay for qualified out-of-pocket healthcare expenses. Because you can rarely accurately predict annual healthcare expenses, opening and contributing to an HSA helps you to manage these costs over time.

In addition, you can use the difference between what you contribute to your HSA and what you spend each year from your HSA to save for future healthcare expenses. You also save money by not paying taxes (with a few state exceptions) on your HSA contributions. Because you own your HSA, you keep the savings when you spend less than you contribute in any given year.

In other words, account owners can use HSA funds for qualified medical expenses and keep whatever they do not spend.

You and your employer can make tax-deductible contributions to your HSA if you have HSA-qualified coverage and no impermissible healthcare coverage. Review the previous chapter for HSA-qualified health plan requirements.

You can use HSA funds, to cover the following qualified expenses:

- Your health plan's deductible
- Copayments and coinsurance you need to pay before you meet your health plan's out-of-pocket maximum
- Qualified prescription, medical, vision, or dental expenses
- Other qualified medical expenses that your health plans might exclude

Tax advantages

An HSA provides potential triple-tax advantages because you pay no taxes on your contributions, earnings, or distributions—if you follow the rules.

- The triple-tax advantage includes: You pay no federal tax on contributions to your HSA—whether the contributions come from you, your employer, or from family and friends.[4] As an added benefit, unlike a 401(k), you don't pay Social Security or Medicare taxes (e.g., FICA withholdings) on the

money you and your employer contribute to your HSA through payroll.[5] You also pay no state tax on contributions to your HSA, with just a few exceptions. Contact your tax advisor for specific states that may not exempt HSA contributions from taxation.

- Your account and investment earnings are tax-free, if you use the money for qualified medical expenses.[6]
- You pay no taxes on funds distributed from your HSA, provided you use the money for qualified medical expenses.[7]

Contributing funds to your HSA on a pre-tax basis not only reduces your income tax liability, but may also reduce other employment-related taxes, including the following:

- Federal Insurance Contributions Act (FICA). Your employer withholds FICA taxes from each paycheck you receive. In 2026, FICA taxes include a 6.2% Social Security tax, a 1.45% Medicare tax, and a 1.45% Medicare surtax for those earning more than $200,000. Your employer also pays a 6.2% Social Security tax and a 1.45% Medicare tax based on your earnings, but these taxes do not come out of your paycheck.

  By contributing to your HSA using pre-tax payroll deductions (rather than making deposits outside of payroll or accepting contributions from others), you not only reduce your taxable income, but you also reduce the amount you and your employer pay in FICA tax.
- Federal Unemployment Tax Act (FUTA). Your employer pays FUTA taxes on the first $7,000 you earn but does not withhold this amount from your wages. When you or your employer contribute to your HSA, it lowers the total earnings used to calculate the FUTA tax. (See CHAPTER 1).
- State Unemployment Tax ACT (SUTA). SUTA is the state version of FUTA. Each state sets its own unemployment tax rate and wage base. When you or your employer contribute to your HSA pre-tax, it lowers the earnings used to calculate the employer-paid SUTA tax in most states.

Ownership

You own all of the money in your HSA (including contributions from your employer) even if you leave your job, lose your qualifying health plan, or retire. In other words, you cannot lose or forfeit your HSA funds, as you might with other “use- or-lose” accounts such as certain Flexible Spending Accounts

(FSAs) or Health Reimbursement Arrangements (HRAs) that may be forfeited upon your termination of employment or at the end of a plan year.[8]

When the HSA law passed that offered these unique tax advantages, the government chose to limit the amount of money you can contribute each year to your HSA. If you contribute more than the federally mandated limits shown in the following table, you will pay income tax on the overage, as well as a penalty. For more information about HSA contributions, see CHAPTER 5.

HSA Contribution Limit | 2027

Individual	Family	Catch-up (over 55)
$4,500	$9,000	$1,000

As your balance rolls over from year to year, it increases in value—earning interest and potentially growing within invested holdings, similar to an IRA or a 401(k). At a certain threshold, most HSA administrators allow you to invest the funds the same way you invest dollars from other retirement accounts. Check with your custodian about investment vehicles and minimum requirements. For more information about saving and investing HSA funds, see CHAPTER 7.

Choice and flexibility

Having an HSA alongside your HSA-qualified health plan gives you greater choice and flexibility when managing your healthcare options. You alone decide how to use the money in your HSA, including whether to save it or spend it now for healthcare expenses.

Pay for qualified medical expenses
You may use your HSA to reimburse qualified out-of-pocket medical expenses not covered by your health plan and those expenses that you could otherwise deduct on your federal tax returns. In general, you can use HSA funds to pay for more expenses than your health plan typically covers, because your HSA can also be used to pay for other health-related items such as over-the-counter medications. Make sure you don't use your HSA for expenses you choose to deduct on your federal tax return or for which you are reimbursed from your health plan or another source.

IRS *Publications 969* and *502*, when used together, provide guidance about qualified expenses.[9]

Cover work/life transitions
You can use an HSA to pay for qualified medical expenses or health plan premiums while you are receiving unemployment compensation, for COBRA (Consolidated Omnibus Budget Reconciliation Act) premiums (for continued healthcare coverage through your former employer),[10] or certain premiums for long-term care.

Pay for post-retirement healthcare expenses
HSAs help you save for health expenses you will incur in retirement, tax-free. You can use your HSA to pay for qualified out-of-pocket expenses including deductibles, copays and coinsurance, and Medicare premiums (except Medigap or Medicare supplements) including the following:[11]

- Part A (hospital and inpatient services)
- Part B (physician and outpatient services)
- Part C (Medicare Advantage plans)
- Part D (prescription drugs)

Manage the variability of expenses
HSAs provide a way to manage the variability of healthcare expenses. For example, one year you may have just a few healthcare expenses, while the next year you may meet your deductible mid-year and still have more expenses. Because an HSA allows flexibility when you reimburse yourself, you can choose to save your money for times when you have more expenses. You can only use HSA funds for qualified expenses incurred after you establish your HSA.[12]

Benefit from a healthy lifestyle
Since 2011, HSA-qualified health plans must cover preventive care services without cost-sharing,[13] as designated by your health plan. If you take advantage of preventive care services and adopt healthy lifestyle habits, you may reduce your medical expenses, potentially increasing your ability to pay for healthcare costs in retirement.

How do HSAs compare to IRAs or 401(k) plans?

HSAs have features in common with retirement accounts such as tax-advantaged individual retirement accounts (IRAs) and 401(k) plans. Like IRAs and 401(k) plans, HSAs allow year-to-year rollover, portability, choice of account investments, and survivor benefits.

These investment opportunities as well as others (such as Roth IRAs, 529 education accounts, and Coverdell accounts) have helped people save for retirement and other expenses using tax-advantaged accounts.

Similarities between an HSA and a 401(k) or IRA

- You and your employer can both make pre-tax contributions to your account (though employers can make 401(k) contributions above and beyond individual contribution limits, whereas an employer's HSA contribution plus the member's cannot exceed the published contribution limit)
- Your unused contributions carry over from year to year and stay in your account until you use them
- Your funds grow tax-free for as long as you own the account
- Your account becomes part of your estate when you die, so you can pass the money on to your survivors. Your spouse can also inherit your account as his or her own HSA, tax-free[14]

HSA advantages

- Unlike the 401(k), neither you nor your employer pay FICA taxes (Social Security and Medicare) on HSA contributions made through payroll[15]
- You can contribute money from both earned and unearned income up to the IRS annual limit, if you have HSA-qualified health coverage and do not have any impermissible coverage. Family members and other individuals can contribute to your account as well, but only you and your employer receive the tax benefits.[16] Note that your tax benefits are limited to the

amount of your taxable income, and you cannot carry your deduction forward to another year[17]

- You can use your pre-tax HSA funds to pay qualified medical expenses incurred by your spouse and your IRS-qualified dependents. Purchases are subject to sales tax
- If you are no longer employed, you can still make tax-advantaged contributions to your HSA if you are still covered by an HSA-qualified plan and are not enrolled in Medicare or have any other disqualifying coverage
- If you use the funds for qualified medical expenses, you can make tax-free distributions at any time throughout your life without tax or penalty[18]
- After age 65, you can use HSA distributions on anything you wish, without paying a 20% penalty. However, you will have to pay income tax on distributions not used for qualified medical expenses

Is an HSA right for you?

An HSA allows you peace of mind in having resources set aside for qualified medical expenses—both expected and unexpected. It also encourages you to make thoughtful decisions about how to spend healthcare dollars and helps you to budget effectively. To make the best use of your account, regularly assess your financial situation and consider the type of healthcare you have used in the past and expect to use in the future.

Consider if you qualify to establish and contribute to an HSA, have benefits paid from an HSA, or (if you can't contribute on a pre-tax basis through your employer) if you can claim a deduction when you file your taxes.

Before choosing an HSA-qualified health plan, consider several variables, including the health needs of you and your family and how often you expect to change jobs or health plans. For specific side-by-side cost comparison scenarios, see the "Examples" section of "Saving and investing HSA funds."

Tax-free retirement spending

Even with the passage of the Patient Protection and Affordable Care Act (PPACA) and changes in Medicare, healthcare costs have continued to rise.

Industry analysts warn that many retirees will fall short of the amounts needed to cover the gaps in medical coverage as they age.

The Employee Benefit Research Institute (EBRI) estimates that an average 65-year-old couple enrolled in Medigap needs $366,000 in savings to cover medical costs in retirement (including Medicare premiums, deductibles, and out-of-pocket spending for outpatient prescription drugs). A couple with higher prescription drug expenses will need about $428,000.[19]

Without an HSA, many retirees pay for their share of medical expenses by taking distributions from their 401(k)s and other retirement savings plans. Unfortunately, these distributions are taxable.[20]

By using accumulated balances in an HSA, a retiree can save significant amounts of money on taxes by paying for qualified medical expenses with pre-tax dollars. This can make retirement savings in other accounts, such as an IRA, Roth IRA, or 401(k)/403(b), go further.

Chronic conditions

When you have a choice of health plans, whether from a selection of plans offered by your employer or as an individual purchaser, consider how you have used healthcare in the past.

A chronic condition—one that lasts a long time or recurs frequently and can be treated but not cured—often incurs higher-than-average healthcare expenses. An HSA may benefit you or a family member who suffers from a chronic disease such as diabetes, heart dysfunction, or asthma, because some HSA-qualified health plan policies treat specific medications for chronic conditions as “preventive care,” covering these medications before you meet your deductible.

Not all chronic conditions require expensive treatment; some may require monitoring, adherence to treatment regimens, or perhaps the use of medical devices not typically provided by health plans but considered qualified medical expenses for purposes of an HSA. You can often pay for these items from your HSA.

Before committing to an HSA-qualified health plan, compare the flexibility and tax advantages of HSA distributions with the coverage offered by lower-deductible (and typically higher-premium) traditional health plans to help you choose the best option for your specific circumstances.

As premiums, copays, and coinsurance costs all continue to increase, HSA-qualified plans have the potential to provide long-term savings.

Unanticipated expenses

Even if you and your family enjoy good health, healthcare coverage protects you when you face an unexpected or expensive medical emergency or major illness.

Many people do not reach their deductibles because they do not spend much on healthcare in a typical year. An HSA-qualified health plan helps these people by allowing them to save tax-free in an account for use in years when they have more healthcare expenses.

Determine if you can set aside money in an HSA on a regular basis to cover your usual healthcare needs, such as medications, office visits, and treatment for minor illnesses or injuries.

Job changes

Consider your job, industry, and occupation, as well as your career stage and plans. People tend to change jobs more often in some fields than in others and younger people tend to move around more than those who have more seniority and have invested more time in their careers.

You can continue coverage under an HSA-qualified health plan when you have a COBRA-qualifying event, just like any other plan, and you can use your HSA to pay COBRA premiums and healthcare expenses during a period when you lack other coverage.[21] In this way, an HSA can provide an important safety net in a difficult economy.

In addition, when you assess benefits offered by your new employer, be sure to look at any HSA-qualified plans so you can continue contributing to your HSA.

Legal considerations

Since HSAs were created in 2004, various laws have shaped and defined the accounts.

On December 8, 2003, President George W. Bush signed Section 1201 of the Medicare Prescription Drug Improvement and Modernization Act of 2003, which became Public Law No. 108-173. This provision adds Section 223 to the Internal Revenue Code (IRC) to permit eligible individuals to establish HSAs beginning in tax year 2004.

On March 23, 2010, President Obama signed the PPACA, which applies to a broad range of healthcare issues. Some of these new requirements affect HSAs.

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which allows reimbursement from an HSA for over-the-counter medications and menstrual products and created a temporary safe harbor until December 31, 2021, for pre-deductible coverage of telehealth visits.

On March 15, 2022, President Biden signed into law the Consolidated Appropriations Act of 2022 (the “Act”), which restored pre-deductible coverage of telehealth visits beginning April 1, 2022 through December 31, 2022.

On December 29, 2022, President Biden signed into law the Consolidated Appropriations Act of 2023, which further extended pre-deductible coverage of telehealth visits through December 31, 2024.

On July 4, 2025, President Trump signed into law the One Big Beautiful Bill Act (“OBBBA”). This bill brought back and made permanent the safe harbor for pre-deductible telehealth visits (retroactive to Jan. 2025), established that direct primary care arrangements are not disqualifying coverage for HSA-eligibility and permitted direct primary care fees to be paid with HSA funds, and established that bronze and catastrophic plans offered on ACA exchanges are HSA-eligible coverage.

The following section describes the legal framework that governs HSAs.

Trusts and HSAs

The law treats HSAs as trusts, because individual account holders own them,

funds accumulate year to year, and specific rules govern them. Both state and federal laws affect HSAs.

Trusts require a fiduciary relationship: a bank, corporation, or other entity acting as a trustee holds legal title and has a legal obligation to keep and use the trust for the benefit of the equitable owner.

Trustees have legal responsibility to hold property in the best interest of or for the benefit of another entity or person, by managing and investing funds. A custodian, on the other hand, maintains an account, but has no investment or management responsibilities. Only banks, insurance companies, and non-bank entities that meet specific IRS requirements qualify as HSA trustees.[22]

The trustee must deal with the trust property honestly, put the beneficiary's interest above its own, and closely follow the terms of the trust. Though it may have discretion over investments and day-to-day management, the trust agreement still governs these functions. The trustee holds and administers an HSA to pay for qualified medical expenses.

Opening a trust

Many state trust laws say that the act of depositing funds into the account establishes or opens the HSA. This date may affect how much you can contribute the first year, and which expenses you can pay from the account.

Some states may have different rules regarding the establishment of trusts. For example, Utah amended its trust law in 2009 to allow the establishment of the HSA to coincide with the date the account holder enrolls in an HSA-qualified healthplan,[23] if that date occurs before the filing deadline (without extensions) for the account owner's federal tax return.

These dates determine when you can begin incurring expenses that can be reimbursed from your HSA.

HSA-qualified health plans: federal vs. state law

State laws may affect the tax status of HSAs. In some instances, a plan might conform to federal law but not meet state requirements. When state insurance laws conflict with the federal laws governing HSA-qualified plans, contributing to an HSA might be prohibited, or perhaps allowed only in special circumstances.

Many states have adopted insurance laws that may conflict with federal law—especially about requiring that health plans provide certain healthcare benefits (especially preventive care) without first having to meet the deductible. Because this requirement might jeopardize the tax status of an HSA (by paying benefits before meeting the minimum annual deductible), many state laws that govern HSA-qualified health plans provide a safe harbor, so HSA-qualified health plans are exempt from the requirements and can waive the deductible for preventive care benefits.[24] See CHAPTER 1, "Health coverage terms" for a list of preventive care services that HSA-qualified health plans might include.

Although federal income tax does not apply to HSA contributions, growth, or distributions (for qualified medical expenses), HSA contributions may not qualify for tax breaks according to state or local income tax laws, the state component of the tax that finances unemployment benefits, or estate law. Check with your tax advisor to determine your specific tax obligations.

Healthcare reform

When President Obama signed the PPACA into law in 2010, many HSA advocates expressed concern that the new law might undermine the success of HSAs.

Instead, regulations have addressed many of the ambiguous parts of the law in a way that does not appear to restrict HSAs—and might even create a more favorable environment for them. The CARES Act provided even more benefit to HSA owners.

We describe several of these PPACA and CARES Act provisions below, including waiving pre-existing condition exclusions, removing lifetime and annual coverage maximums, providing coverage for preventive care without cost

sharing, and eliminating the prescription requirement for over-the-counter (OTC) medication.

Health insurance exchanges

Individuals can purchase health insurance through their employer, directly from an insurance company, or through a health insurance exchange. Exchanges (such as the Health Insurance Marketplace at HealthCare.gov) allow consumers to comparison shop for standardized health packages.

Most states use the federal health insurance exchange, but 20 states and the District of Columbia created their own exchanges: California, Colorado, Connecticut, Georgia, Idaho, Illinois, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Jersey, New Mexico, New York, Pennsylvania, Rhode Island, Vermont, Virginia and Washington.[25]

Whether purchased from a federal or state exchange, HSA-qualified health plans tend to cost less than other plans. Healthcare reform has further assisted people at many income levels to obtain affordable coverage by providing tax credits and facilitating enrollment. Note, however, that if employers offer “affordable minimum essential coverage” to employees, individuals are ineligible for subsidies.

Penalties

On December 19, 2017, Congress passed the Tax Cut and Jobs Act of 2017,[26] which eliminated the Affordable Care Act’s penalty for not having health insurance, starting with the 2019 plan year (for which you filed taxes in 2020).

The law does not eliminate the requirement that individuals have healthcare coverage—only the financial penalty for not doing so.

Essential health benefits

As of 2014, ACA-compliant health plans (purchased by individuals from insurance companies or exchanges or offered by small employers) must cover the following items and services, referred to as “essential health benefits” or EHBs:[26]

- Ambulatory patient services

- Emergency services
- Hospitalization
- Maternity and newborn care
- Mental health and substance abuse services
- Prescription drugs
- Rehabilitative and habilitative services and devices
- Laboratory services
- Preventive and wellness services and chronic disease management
- Pediatric services, including oral and vision care

EHBs must meet certain specifications:

- A cost-sharing limit for in-network, out-of-pocket maximum of $112,000/$24,000 for single/family in 2027

- Meet 60% actuarial value (AV) requirements, meaning that the plan must pay at least 60% of the cost of care potentially covered by a plan that has no out-of- pocket cost-sharing requirement. Federal regulations confirm that employers' contributions to HSAs count toward the 60% requirement.[27]

In addition to the PPACA cost-sharing limits, HSA-qualified health plans must follow additional IRS rules, which apply different minimum deductible and maximum out-of-pocket limits, as listed in the "Deductibles" section of CHAPTER 1, "Health coverage terms."

Preexisting conditions

Health plans may no longer deny coverage for treatment of pre-existing health conditions; neither can they charge higher premiums because of health status, gender, or other variables. Premiums may only vary with age (no more than 3:1—for example, a 65-year-old may pay three times what a 21-year-old pays), geography, family size, and tobacco use.

Annual and lifetime limits

The prohibition of annual and lifetime limits (the total benefits an insurance company will pay in a year or in a lifetime) began with some plans in 2010. By

2014, all major medical health plans (except gap or mini-med plans) eliminated annual limits, which eliminated the need to purchase supplemental coverage.

Clinical trials

As of 2014, the PPACA prohibits plans from dropping coverage if an individual participates in a clinical trial. In addition, they also cannot deny coverage for routine care they would otherwise cover if the individual did not participate in a clinical trial. This applies to any clinical trial that treats cancer or other life-threatening diseases.

Summary

- An HSA allows you to contribute tax-advantaged dollars to pay for healthcare costs now and in the future, provided you have HSA-qualified health coverage and no impermissible coverage. Because you own the account, funds can continue to grow year over year. HSAs compare favorably with other tax-advantaged and retirement savings accounts because of their triple-tax advantage: You can make tax-advantaged contributions, grow tax-free earnings, and enjoy tax-free distribution (for qualified medical expenses)
- You can either spend all the money in your account on qualified medical expenses or save some or all of it—for instance, if you have fewer expenses than contributions, if you can afford to pay for healthcare out of pocket, or if you can cover your medical expenses using another account
- HSAs are trusts and require a trustee or custodian
- HSAs have contribution limits, which adjust each year based on the Consumer Price Index (CPI). Anyone can contribute to your HSA, with two caveats: the combined contributions from all sources must not exceed the annual limit, and only contributions from the account holder and the employer receive tax benefits

Resources

1. IRS Publication 969
2. Investments made available to HSA holders are subject to risk, including the possible loss of the principal invested, and are not FDIC or NCUA insured, or guaranteed.
3. You must have an HSA-qualified health plan, no other health coverage (with some exceptions), including Medicare. In addition, no one may claim you as a dependent for tax purposes.
4. IRS Notice 2004-2 Q&A 20
5. IRC §223(f)(1)
6. IRC §223(d)(1)(E)
7. IRC §223(d)(2)(A); IRC §213(d); IRS Notice 2004-2 Q&A 26; IRS Publication 502

8. IRC §223(d)(2)(C)(ii); IRS Notice 2004-2 Q&A 27
9. IRC §223(d)(2)(C)(iv); IRS Notice 2004-2 Q&A 27
10. IRS Notice 2004-50 Q&A 3
11. Federal Register :: Coverage of Certain Preventive Services Under the Affordable Care Act
12. IRC §223(f)(B)(A)
13. IRS Notice 2004-2 Q&A 19
14. IRS Notice 2004-2 Q&A 18
15. IRS Notice 2004-2 Q&A 17
16. IRC §223(f)(1); IRS Notice 2004-2 Q&A 25 & 26
17. EBRI Issue Brief 2025
18. IRC §402(a)
19. IRC §223(d)(2)(C); IRS Notice 2004-2 Q&A 27
20. IRC §223(d)(1)(B)
21. UT Code §75-7-401(2)
22. IRC §223(c)(2)(C)
23. https://www.healthcare.gov/marketplace-in-your-state/
24. §11081 of Tax Cut and Jobs Act of 2017
25. §1302(d)(2)(B) of the Affordable Care Act, 45 CFR 156.140(c)

Chapter 3

Consumer-driven healthcare

Chapter overview

The previous chapter describes Health Savings Accounts (HSAs) and HSA-qualified health plan requirements. This chapter describes HSA-qualified health plans within the context of consumer-driven healthcare (CDHC) and discusses the relationship of HSAs to other consumer-directed benefits (CDBs).

The terms “consumer-driven” or “consumer-directed” health plan (sometimes referred to as CDHP) are interchangeable and refer to a comprehensive health plan that allows more involvement by the consumer. It usually combines a lower-premium health plan with a tax-preferred healthcare account of some kind—an HSA, Health Reimbursement Arrangement (HRA), or Flexible Spending Account (FSA). Members typically have a higher deductible in exchange for lower premiums and pay routine healthcare expenses directly from their HSA, FSA, or HRA. All Patient Protection and Affordable Care Act (PPACA)-compliant health plans will have an out-of-pocket maximum that protects covered individuals from extraordinary medical expenses. They are consumer-directed (or consumer-driven) because they encourage the consumer’s involvement in the purchase of healthcare and in taking care of themselves, to make the most cost-effective use of their healthcare.

With this type of plan, you can pay your medical expenses using one of several methods:

- First, you pay for qualified medical expenses (other than preventive care) until you reach your deductible, reimbursing yourself from your HSA, FSA, or HRA. Your employer may have (or will have, in the case of an HRA) made contributions to the account to help you with these expenses
- Once you meet your deductible, you share in the costs with your health plan until you have met your out-of-pocket limit, reimbursing yourself from

your HSA, FSA, or HRA. Again, your employer may have (or will have, in the case of an HRA) made contributions to the account to help you with these expenses

- Once you reach your out-of-pocket maximum, your health plan pays all further in-network costs for the plan year

For decades, employers have offered various types of consumer-directed benefit accounts, such as HRAs, HSAs, FSAs, and Archer Medical Spending Accounts (MSAs). Consumers use these accounts to pay for medical copayments, dental and vision expenses, and other qualified medical expenses with tax-advantaged (or pre-tax) dollars.

Each type of account offers advantages. In some situations, supplementing an HSA with an HSA-qualified FSA or HRA provides useful options for making the HSA- qualified health plan option even more attractive to both employees and employers. Employees who contribute to an HSA may only use certain types of FSAs or HRAs—those that are HSA-qualified. They can use these specially designed FSAs and HRAs to make their HSA balances go further.

Consumer-directed health plans can control costs and, at the same time, may improve overall health and wellbeing because of the focus on cost transparency and consumer responsibility. According to a study,[1] patients with consumer-directed health plans ask about cost and choose a less expensive treatment option more often than patients enrolled in traditional plans.

As mentioned before, HSA ownership requires health coverage that meets certain statutory requirements. These HSA-qualified health plans are a specific type of consumer-driven health plan. To learn what differentiates various types of consumer-directed health benefits and how they work with one another, please continue reading!

HSA-qualified health plans

Only health plans that adhere to certain deductible and out-of-pocket guidelines qualify the member to contribute to an HSA. The One Big Beautiful Bill Act (OBBBA) also established that bronze and catastrophic-level plans through the Affordable Care Act are HSA-compatible.

Like most plans, an HSA-qualified health plan generally covers 100% of qualified medical expenses once the member has reached their annual out- of-pocket maximum, which protects the member from large and unexpected healthcare expenses.

Like all health plans, exactly what your plan covers depends on your employer and the choices you make from among the plans available to you. Even though some variation exists, all HSA-qualified health plans must pay for certain preventive care services, according to Patient Protection and Affordable Care Act (PPACA) regulations.

Because HSA-qualified health plans vary, do not assume that your current plan covers the same items your last one did. Acquaint yourself with your new plan's provisions, which you can find in the detailed Summary Plan Description (SPD) and the briefer Summary of Benefits and Coverage (SBC) you receive during enrollment. You may also need to request a copy of the plan's drug formulary to check that your health plan covers the medications your family takes.

2027 Limits

Minimum annual deductible		Out-of-pocket maximum	
Single	Family	Single	Family
$1,750	$3,500	$8,700	$17,400

Types of coverage

1. Self-only HSA-qualified health coverage
2. Self-only coverage covers only the individual member enrolled in the plan.

3. Family HSA-qualified health coverage
4. Family HSA-qualified health coverage covers an eligible individual plus at least one other individual—even if the additional person does not qualify to open an HSA. For example, the other person may also have a self-only plan that would disqualify them from contributing to an HSA. However, the eligible individual can contribute to their HSA at the Family coverage limits.

EXAMPLE: Family coverage
Nicholas and Opal, a married couple, have one daughter. Nicholas selects HSA-qualified coverage from his employer that covers his entire family. Opal has self-only coverage from her employer, but not an HSA-qualified health plan. Nicholas can make a full family contribution to an HSA, provided he has no other disqualifying coverage.[2]

Employee-plus-one HSA-qualified health coverage
If an eligible individual and his or her dependent child are covered under an employee-plus-one HSA-qualified health plan, the IRS considers them to have family coverage, which means they can make a full family contribution to an HSA.[3]

EXAMPLE: Employee-plus-one coverage
Before the birth of Nicholas' and Opal's daughter, he had employee-plus-one coverage, because of the convenient in-network facilities and providers. Opal also maintained self-only coverage because of the in-network specialists she preferred to see. Nicholas can make a full family contribution to his HSA, provided he has no other disqualifying coverage, though Opal cannot open or contribute to an HSA, even if she has an HSA-qualified plan, because she has other coverage (from Nicholas). However, Nicholas can use his HSA to reimburse Opal's out-of-pocket expenses.

Benefits and restrictions

The IRS has rules about what kinds of insurance you can have along with an HSA-qualified health plan. Having another policy with benefits that overlap some of the medical coverage in your HSA-qualified health plan can make you ineligible to contribute to an HSA. The following section describes some benefits that might affect HSA eligibility.

Prescription drug benefits
Some plans offer prescription drug benefits through separate plans (also called pharmacy riders) that cover prescription drugs even before meeting the deductible. Such prescription drug benefits are not considered permitted coverage under HSA law, unless these riders cover only preventive care medications.[4]

An individual covered by an ineligible prescription drug plan or rider may not open or contribute to an HSA because the prescription plan provides coverage for medications before the deductible is met.

Discount cards and drug coupons
HSA owners may use discount cards or drug coupons that provide price reductions on services or health products (such as prescription drugs) so long as they must pay the healthcare costs (considering the discount or coupon value) until they satisfy their deductible.[5]

Note that some states are considering or have passed legislation that would apply the discount or coupon value toward both the deductible and out-of-pocket limits—which makes individuals ineligible to contribute to an HSA. There is also ongoing rulemaking at the federal level, in response to litigation on this issue. Further guidance from the Department of Health and Human Services and the Internal Revenue Service is expected, and this book will be updated to reflect any policy developments on the treatment of drug coupons and similar programs.

Advocacy efforts are underway to provide safe harbors for HSA-qualified plans, protecting individuals' eligibility to contribute to HSAs. It's important you understand how your plan works and if, indeed, it is HSA-qualified.

Hospitalization indemnity plans
An indemnity plan pays benefits in the form of cash payments rather than as reimbursement for actual services, typically as a fixed amount for each day of your hospital stay. These can protect your HSA dollars and help you pay qualified hospital expenses before you build up your account balance.

Hospitalization indemnity plans require hospital admission for benefits to begin. They do not cover actual hospital services, such as medical tests you might

have in a hospital or hospital-related facility, but only offer cash benefits for each day of hospitalization. Hospitalization indemnity plans do not impact HSA eligibility.

Specified disease or Illness plans
These plans also pay benefits in the form of cash payments rather than as reimbursement for actual services, typically as a fixed amount for a specific diagnosis or illness. These can protect your HSA dollars and help you pay healthcare expenses before you build up your account balance.

These require a diagnosis for benefits to begin. They do not cover actual services, such as medical tests you might have, but only offer cash benefits for the specific diagnosis. Specified disease or illness plans do not impact HSA eligibility.

Care from IHS or VA
Receiving care from Indian Health Service (IHS) or the Department of Veterans Affairs (VA)—except for dental, vision, or preventive care—makes individuals ineligible to make HSA contributions for a period of time.[6] You may not make HSA contributions in each month that you received medical benefits from VA or from an IHS facility at any time during the previous three months. However, if your spouse meets the eligibility requirements, your spouse may contribute the full family maximum and pay for the family's expenses from their HSA.

The IRS waives the three-month rule when veterans receive treatment for service-connected disabilities.[7]

Direct Primary Care Arrangements
The OBBBA established that Direct Primary Care (DPC) Arrangements are not impermissible coverage for the purposes of HSA-eligibility, with certain limitations, beginning in January 2026. The DPC must not have a monthly fee over $150/month for an individual, $300/month for a family (these amounts will be indexed moving forward). Furthermore, the primary medical care services don't include procedures that require the use of general anesthesia, prescription drugs (other than vaccines), and laboratory services not typically administered in an ambulatory primary care setting. Arrangements may be paid for by health plans, employers, or by consumers, including from their HSAs.

Other permitted coverage[8]
The tax code and the IRS have specific rules for insurance plans that coexist with HSAs and plans that might otherwise disqualify you from contributing to an HSA. For a quick summary, see the following lists:

Permitted coverage

- Direct Primary Care Arrangements that meet the OBBBA requirements.
- Automobile, dental, vision, and long-term care insurance
- Wellness programs offered by employers that do not pay significant medical benefits
- HSA-qualified FSAs and HRAs, including:
  - Limited purpose FSAs and HRAs (limited to dental, vision, or preventive care)
  - Post-deductible FSAs and HRAs (which pay for qualified medical expenses after the consumer meets the minimum statutory HSA-qualified plan deductible)[9]
- Employer-sponsored HRAs which only pay medical expenses after you retire
- Workers' compensation insurance
- Tort liability coverage
- Prescription or other discount programs or coupons if members must pay the healthcare costs (including the discount or coupon value) until they satisfy their full medical deductible
- Other health plans, even those not specifically labeled as an HSA-qualified health plan, such as the following:
  - An HSA-qualified PPO or HMO, if the deductible meets or exceeds the HSA-qualified health plan required minimums and other statutory requirements
  - Family HSA-qualified health coverage with an embedded individual deductible, if the embedded deductible equals or exceeds the minimum required family HSA-qualified health plan deductible[10]

Disallowed coverage

- General FSAs or HRAs that pay for any kind of qualified medical expense before the insured meets the HSA-qualified statutory health plan deductible. (Note that the IRS allows HSA-qualified--also called limited-purpose and post- deductible-- FSAs and HRAs)
- A spouse's FSA or HRA, if it can pay for qualified medical expenses before meeting the HSA-qualified health plan deductible[11]
- Employer payments or reimbursements for medical expenses below the minimum HSA-qualified health plan deductible
- Medicare[12]
- Health benefits or prescription drugs received from the VA or one of its facilities in the last three months. (Note that beginning on January 1, 2016, hospital care or medical services received under any law administered by the Secretary of Veterans Affairs for a service-connected disability is considered allowable coverage)[13] [14]
- TRICARE[15]

Comparison of HSAs, FSAs, and HRAs

The following table compares three common types of medical payment accounts. Refer to the table as you read more detailed descriptions of each account in following sections.

	HSA	FSA	HRA
	Health Savings Account	Health Flexible Spending Account	Health Reimbursement Arrangement
Purpose	Long-term savings/ investment	Short-term spending account	Employer-funded reimbursement
Variations	May or may not be offered through a cafeteria plan	General purpose, HSA-qualified FSAs, including limited purpose, post-deductible FSAs	EBHRA | ICHRA | QSEHRA | Retiree HRA, HSA-qualified including Limited Purpose HRA | Post-Deductible HRA
Health plan types	HSA-qualified health plan required	Various	Various or, in some cases, none
Account ownership	Member-owned, portable, transferable, inheritable	Employer-owned (no portability)	Employer-owned (no portability)
Restrictions	Must have an HSA-qualified health plan. Cannot have Medicare or other impermissible coverage. Must not be claimed as a tax dependent.	Compatible with traditional health plans.	Compatible with most health plans
Contributors	Anyone (member, employer, family member)	Member, employer	Employer only (except COBRA)
2027 contribution limits	$4,500/$9,000 (individual/family) $1,000 catch-up for over 55	$3,400 for either individual or family	Varies
Employer contributions	Count towards contribution limit	Do not count towards contribution limit	REQUIRED; no employee contributions allowed
Tax deductions	Contributions, earnings, and distributions, for qualified medical expenses*	Contributions and distributions, for eligible medical expenses	Contributions and distributions, for eligible medical expenses
Use-or-lose?	No	Yes, unless the plan allows a grace period or carryover of unused funds	Depends on plan design
Covered individuals	Holder, spouse, other tax dependents	Employers, spouse, other tax dependents, children who have not attained age 26	Can depend on plan design but typically employee, spouse, other tax dependents, children who have not attained age 26

MSAs and Archer MSAs
A precursor to HSAs, Medical Spending Accounts (MSAs) and Archer MSAs launched in 1997. The program continued until 2007; accounts opened before then still exist, but no new accounts may be opened.

Promoters believed that Archer MSAs would help limit excessive use of healthcare services by making employees aware of the actual costs of medical care. Archer MSAs provided a more affordable alternative to high-priced, low-deductible health plans for small employers and self-employed individuals. Owners could roll over unused savings in an MSA from year to year.

The fact that only self-employed individuals and employees of small businesses could enroll limited the program's impact. When HSAs were introduced in 2003 and the MSA pilot program was terminated, HSAs largely replaced MSAs.

FSAs[16]
An FSA allows employees to set aside pre-tax earnings to pay for benefits or expenses (such as copays, deductibles, dental, and vision expenses) that insurance and other benefit plans do not cover. Only HSA-qualified FSAs, commonly called limited purpose or post-deductible FSAs, are compatible with HSAs.

FSAs usually offer IRS-allowed flexibility in the use-or-lose rule. Specifically, they either allow a portion of your account to carry forward to next year (up to 20% of the maximum contribution limit) or they allow a brief grace period of up to two and a half months after the plan year ends during which you can use the previous plan year's funds to reimburse current eligible expenses. An FSA can offer a carryover or a grace period, but not both.[17] For more information, see the "Grace period" section later in this chapter.

FSAs must adhere to the uniform coverage rule[18], which requires that "the maximum amount of reimbursement from a Health FSA must be available at all times during the period of coverage (properly reduced as of any particular time for prior reimbursements for the same coverage period)."[19] In certain limited situations, you may prefer an FSA to an HSA, if you have healthcare expenses in the first part of the plan year that you cannot afford to pay out-of-pocket.

Several versions of FSAs exist; check with your employer to find out which option(s) they offer.

Let's look at a couple of examples.

EXAMPLES: HSAs with and without matching funds
Essie and her husband both have access to an FSA. Essie had a heart transplant several years ago and always meets her deductible early in the year. In 2025, she met her HSA-qualified health plan's out-of-pocket maximum of $5,500 in February. She and her husband both contributed $3,300 to their FSAs in 2025, for a total of $6,600. Essie's employer did not make HSA contributions. Because Essie and her husband did not have liquid funds available for their health expenses early in the year, they decided that having each of them contribute the maximum to their FSAs would benefit them more financially than contributing to their HSA. Essie was able to receive reimbursement for out-of-pocket expenses of $5,500 as she submitted claims for them, even though she and her husband had not yet contributed the full amount.

The situation changes the following year in 2026 when Essie's employer puts in a match of $2 for every dollar contributed to an HSA and includes a feature that allows Essie to advance her employer contributions, so she can use the money before she contributes it. Essie and her husband decide to open an HSA and contribute the family maximum of $8,750. In 2026 Essie contributes $2,918 and her employer matches it with an additional $5,832 for a total of $8,750. This allows Essie and her husband to receive reimbursement for their out-of-pocket expenses (up to the maximum out-of-pocket for their plan of $5,500),but still have a balance of $3,250 in their HSA for qualified out-of-pocket medical expenses.

HRAs
Some employers prefer to offer HRAs, which allows them to reimburse employees for eligible medical expenses (including copayments, deductibles, vision and dental expenses, prescriptions, and personal health coverage premiums).

Employers do not pay taxes on the contributions they make to their employees' HRAs, nor do employees pay taxes on the reimbursements they receive.

Several varieties of HRAs exist to meet different needs:

- Group Coverage HRA (provides financial assistance to employees towards eligible out-of-pocket expenses)
- Dental/Vision HRA, Limited Purpose HRA, or Post-deductible HRA
- Qualified Small Employer HRA (QSEHRA)
- Individual Coverage HRA (ICHRA)
- Excepted Benefit HRA (EBHRA)
- Retiree HRA

All HRAs adhere to a similar process:

1. Employer designs plan, then defines which employees may participate and sets reimbursement limits
2. Employee incurs healthcare costs
3. Employee submits claims for reimbursement
4. Employer reviews claim and reimburses employee, up to a pre-determined limit

HRAs can either stand alone or exist alongside other health benefits, depending on the type of HRA. Employers have complete flexibility to customize their HRA plan design. Unused funds may roll over to a subsequent HRA plan year, depending on the plan design. In addition, employees may use HRA funds after termination or in retirement, depending on the plan design.

Specialized accounts

Having a general FSA or HRA can make you ineligible to contribute to an HSA. However, to provide FSA or HRA benefits for employees also covered by an HSA-qualified health plan, employers can make HSA-qualified versions of these plans available.[20,]

For a side-by-side comparison of various types of HRAs, refer to the following table. For more details, see the descriptions that follow the table.

	HRA	HSA-Qualified HRA	QSEHRA
	Health Reimbursement Arrangement	Post-Deductible or Limited Purpose HRA	Qualified Small Employer HRA
General purpose	An HRA to help with out-of- pocket costs	An HRA for HSA owners	HRAs for small businesses
Eligible expenses	Out-of-pocket medical expenses	Either limited to dental and vision expenses, or to out-of-pocket medical expenses incurred after your deductible	Out-of-pocket medical expenses
Pays coverage premiums	No	No	Individual and group (group premiums reimbursed after tax)
Compatible with FSA	Yes	Yes	No
Compatible with HSA	No	Yes	Sometimes
Premium Tax Credit (PTC)	Affordable Minimum Value coverage disqualifies	No impact	Affordable Minimum Value coverage disqualifies
HSA eligibility	Other group health coverage required	No impact	QSEHRA not available

	ICHRA	EBHRA	Retiree HRA
	Individual Coverage HRA	Excepted Benefit HRA	Retiree-Only HRA
General purpose	Like QSEHRA, with higher limits	May limit benefits (perhaps no vision or dental coverage)	Only for use after retirement
Eligible expenses	Out-of-pocket medical expenses, some premiums	Based on design, but potentially all eligible out-of-pocket medical expenses	Based on design, but potentially all eligible medical expenses
Pays coverage premiums	Individual only	COBRA EBHRA STLDI[21]	No
Compatible with FSA	Yes	Yes	Yes
Compatible with HSA	Sometimes	Sometimes	Sometimes
Premium Tax Credit (PTC)	Affordable MV coverage disqualifies	No impact	Affordable MV coverage disqualifies
HSA eligibility	ICHRA unavailable unless with a restricted FSA	Non-excepted, group health plan required	No impact
New availability maximum	N/A	$2,200 in 2026	N/A

HSA-qualified FSA/HRA

An HSA-qualified FSA or HRA can either provide narrower coverage (for example, limited to dental and vision expenses) or pay all eligible §213(d) expenses only after you meet the HSA-qualified health plan minimum deductible for the year.

Limited purpose HRA/FSA

FSAs and HRAs that limit expenses to dental and vision, typically referred to as limited purpose FSAs (LPFSAs) or limited purpose HRAs (LPHRAs), work in parallel with HSAs in that you can draw money from both accounts at the same time to pay for separate expenses. LPFSAs provide the advantage of making all the money in the account available to you at the start of the plan year, even if expenses in the future.

In summary, LPFSA features include the following:

- Covers vision and dental expenses only
- Does not affect HSA eligibility (unlike a health FSA)
- Is funded with pre-tax dollars

It makes sense to contribute to an LPFSA if you choose to contribute the entire allowable yearly maximum to your HSA. Unfortunately, unless your employer allows you to roll over unused amounts from your FSA or provides a grace period you must forfeit all unspent FSA funds at the end of the year. Fortunately, this is extremely rare for an LPFSA because dental and vision expenses are easier to predict.

EXAMPLE: Maximizing tax-advantages through an LPFSA
Spencer has an HSA with an LPFSA that covers vision and dental expenses only. When his wife, Rachel, takes their young son to the dentist, the dentist says they will need a dental appliance to correct a jaw problem. Rachel asks the dentist for a cost estimate for the appliance, as well as for other dental work Spencer will need during the coming year.

Rachel also wants to replace her prescription sunglasses. She contacts several optical shops to compare costs and gets estimates for exams, frames, and lenses.

In 2026, Spencer and Rachel want to maximize their HSA contribution so they can start investing the funds. Spencer sets up his payroll deductions to contribute the full maximum for a family: $8,750. Then, he elects to contribute $2,300 to his limited purpose FSA (based on the estimates for dental work and glasses). Spencer and Rachel reduce their taxable income by a total of $11,050.

With the FSA to pay the dental and vision expenses, Spencer and Rachel can invest more of their entire HSA contribution for the year in a mutual fund.

Post-deductible FSA/HRA[22]

Alternatively, an HSA-qualified FSA or an HRA might reimburse dental and vision expenses and, once the statutory minimum annual deductible for an

HSA-qualified health plan is satisfied, reimburse other eligible healthcare expenses. This is sometimes called a post-deductible FSA or HRA.

In this case, the FSA or HRA works in cooperation with the HSA. While these arrangements pay for dental and vision expenses from the first day of the plan year, they cannot pay or reimburse any other eligible medical expenses until you meet the minimum HSA-qualified health plan deductible of $1,750 for single coverage or $3,500 for family coverage in 2027. After that, you can use the account to cover copayments, coinsurance, deductibles, and any other healthcare expenses. Some post-deductible FSAs or HRAs require you to meet your specific HSA-qualified HDHP's deductible rather than the minimums stated above. Be sure to check with your employer so you understand the specific rules of your plan.

If your employer provides an HSA-qualified health plan with a post-deductible FSA or HRA, you cannot submit your receipts for reimbursement until you meet your minimum deductible and have provided proof of the date that you satisfied the deductible.

EXAMPLE: Gap between deductible and out-of-pocket maximum
Toshiko's employer offers an HSA-qualified health plan with a $3,000 deductible and a $4,000 out-of-pocket maximum.

To help close the gap between the plan's deductible and the out-of-pocket maximum, her employer also offers a $500 post-deductible HRA.

Toshiko has a lot of medical expenses during the year, and she spends her entire 2027 HSA contribution of $4,500. After meeting her deductible and paying her coinsurance, she submits a reimbursement request to her employer and receives $500 from the HRA.

Qualified small employer HRA

Developed in 2017, a QSEHRA (pronounced cue-sarah) allows small employers (with fewer than 50 employees) to reimburse employees tax-free for individual health insurance premiums as well as for eligible medical expenses, rather than simply provide group insurance.[23] Each employee may choose their own individual health plan. Employees who already have coverage, perhaps through their spouse, can use the allowance to pay for other medical expenses.

QSEHRAs provide a couple of advantages over traditional group plans by creating a reimbursement model (sometimes called "defined contribution") that gives employers more control over costs and gives employees more options to choose from. The current model of group insurance (sometimes called "defined benefit") requires that employers choose one or more specific plans for the group that may not meet individual employee needs and limits employees to the option(s) provided by the employer.

Individual coverage HRA

Developed in 2020, an ICHRA (pronounced ick-ruh) expands on the QSEHRA by providing higher limits and greater design flexibility. Like a QSEHRA, it allows employers to reimburse employees tax-free for individual health insurance.

Like QSEHRAs, ICHRAs also provide a couple of advantages over traditional group plans, moving the responsibility of managing a health plan from the employer to the employee. Instead of getting involved in choices about design features or which provider networks employees prefer, employers merely decide which employees qualify and then set monthly allowances. Employees

then choose their own insurance, offsetting premium costs with ICHRA funds from the employer.

Excepted benefit HRA

Since 2019, employers have used EBHRA (pronounced ebb-ruh) accounts to provide funds to employees for eligible §213(d) healthcare expenses, including vision, dental, COBRA, or short-term limited-duration insurance premiums. General health insurance premiums do not qualify for reimbursement under an EBHRA. Contribution limits are $2,250 for 2027. If the plan limits covered expenses to dental and vision only, the EBHRA may also be considered HSA-qualified.

You do not need to opt into your employer's group health insurance coverage for EBHRA eligibility.

Retiree HRA

A retiree HRA pays or reimburses only those medical expenses incurred after retirement (and no expenses incurred before retirement). In this case, the individual may contribute to an HSA before retirement, but not after the HRA begins to pay or reimburse eligible medical expenses during retirement. Therefore, after retirement, an individual can no longer contribute to an HSA.

Suspended HRA

To contribute to an HSA, you could suspend your HRA before the beginning of the HRA coverage period, should the employer allow this option. The HRA does not pay or reimburse the medical expenses incurred during the suspension period, except for dental, vision, and preventive care. When the suspension period ends, you no longer qualify to make contributions to an HSA.

Other benefits

An Employee Assistance Program (EAP) covers all or part of the cost for employees to receive counseling, referrals, and advice in dealing with stressful issues in their lives.[24]

An employee covered by an EAP, wellness program, or a disease management plan can still contribute to an HSA—but only if these plans do not provide substantial medical benefits.

Carryover, grace period, run-out period

FSA carryover

The IRS sets the carryover limit for health FSAs to 20% of the annual salary reduction contribution limit. The limit increased to $680 in 2026 (20% of the $3,400 limit on salary reduction contributions).

How the employer designs the carryover provision will impact HSA eligibility. For example, some carryover provisions are limited to those who enroll for an FSA the subsequent year. Other employers design their carryover feature so that employees who elect an HSA-qualified plan and HSA have funds automatically roll into an HSA-qualified FSA. If the employer has not considered the ramifications of the carryover provision to HSA eligibility, the unused funds in an FSA may roll over to the following plan year into a plan that will disqualify you from making HSA contributions for the year.

General-purpose FSA grace period

Some general-purpose health FSAs have a grace period allowing you up to two and a half months after the plan year ends to use balances accumulated in your account during the plan year (a total of 14½ months). Most grace periods let you continue to incur expenses and get reimbursed, while a run-out period only allows reimbursement for expenses incurred during the plan year. Your plan may or may not provide this benefit.

You may make HSA contributions during an FSA grace period that spills into the next plan year only if you have no money in a general-purpose Health FSA at the end of the prior plan year.

If you still have funds in the general-purpose FSA during the grace period, you cannot begin contributing to your HSA for the current plan year until the first day of the month following the end of the grace period.

EXAMPLE: General-purpose health FSA with a grace period balance
Vernon ends his traditional plan, general health FSA coverage on December 31, 2025, and opens an HSA-qualified health plan on January 1, 2026.

Because he still has money in the FSA at the beginning of the new plan year, he cannot begin contributing to his new HSA until after the FSA's grace period ends on March 15, 2026. Because HSA eligibility always begins on the first day of the month, he must wait until April 1, 2026, to make his first HSA contribution.

EXAMPLE: General-purpose FSA with a zero balance
Anita had a traditional health plan and a general health FSA in 2025. She starts her HSA-qualified health plan and HSA on January 1, 2026. Although her FSA technically disqualifies her during the grace period (until March 15, 2026), she spent her FSA down to zero by December 31, 2025, so she can begin contributing to her HSA on January 1, 2026.

Post-deductible FSA grace period

You could lose your eligibility to contribute to an HSA if you have funds in a post-deductible FSA during the FSA grace period.

EXAMPLE: Post-deductible FSA with balance carried into a grace period
Hanna ends her traditional plan with post-deductible Health FSA coverage on December 31, 2025, and opens an HSA-qualified health plan on January 1, 2026.

Because she still has money in the FSA at the beginning of the new plan year, she cannot begin contributing to her new HSA until after the FSA's grace period ends on March 15, 2026. Because HSA eligibility always begins on the first day of the month, she must wait until April 1, 2026, to make her first HSA contribution.

EXAMPLE: Post-deductible health FSA with a zero balance
Sam had a traditional health plan and a post-deductible health FSA in 2025. He starts his HSA-qualified health plan and HSA on January 1, 2026. He is still technically covered by his FSA during the grace period until March 15, 2026.

However, because he spent his FSA down to zero by December 31, 2025, he can begin contributing to his HSA on January 1, 2026.

LPFSA grace period

You do not lose your eligibility to contribute to an HSA if you have funds in an LPFSA during the FSA grace period.

EXAMPLE: LPFSA with a balance carried into the grace period
Lorenzo had an LPFSA that only covered vision and dental during 2025. On January 1, 2026, he begins his new HSA-qualified coverage.

Although he still has funds in the FSA during the FSA's grace period in the new plan year, he may contribute to his HSA starting on January 1, 2026, because limited purpose FSAs do not affect HSA eligibility.

Summary

- Consumer-driven healthcare includes HSAs, Archer MSAs, FSAs, and HRAs
- Health FSAs disqualify the member from opening or contributing to an HSA unless they are specifically designed to work with an HSA by being limited to only vision/dental expenses or to vision/dental expenses with other §213(d) expenses reimbursed only after satisfying the deductible
  - FSA carryovers and grace periods can affect HSA eligibility
- HRAs come in several varieties, many of which might affect your ability to contribute to an HSA
  - GCHRA: group coverage heath reimbursement arrangement
  - QSEHRA: qualified small employer heath reimbursement arrangement
  - ICHRA: individual coverage heath reimbursement arrangement
  - EBHRA: excepted benefit heath reimbursement arrangement
  - HSA-qualified FSAs, including:
    - LPFSA: limited purpose heath flexible spending arrangement
    - Post-deductible FSA
- HSA-qualified HRAs, including:
  - LPHRA: limited purpose heath reimbursement arrangement
  - Post-deductible HRA
- Retiree HRA
- An FSA may provide either a grace period or carryover, but not both. Each of these options might affect your ability to contribute to an HSA

Resources

1. Consumer directed health plans: a review of the evidence
2. IRC §223(b)(5), IRS Notice 2008-59 Q&A 16
3. IRS Notice 2004-50 Q&A 12
4. IRS Notice 2004-50 Q&A 26

5. IRS Notice 2004-50 Q&A 9
6. IRS Notice 2012-14 (OJS) and 2004-50 Q&A 5 (VA)
7. IRC §223(c)(1), §4007(b) of the Surface Transportation Act of 2015 (HR 3236), IRS Notice 2015-87 Q&A 20
8. IRC §223(c)(1)(B), IRC §223(c)(3), IRS Notice 2004-50 Q&A 7–10
9. Rev. Rul. 2004-45
10. IRS Notice 2004-50 Q&A 20
11. Rev. Rul. 2004-45
12. IRC §223(b)(7)
13. IRC §223(c)(1)(C)
14. HR 3236, IRS Notice 2004-50 Q&A 5
15. IRS Notice 2004-50 Q&A 6
16. Within this publication, FSA refers to the Health FSA and not the Dependent Care FSA, unless otherwise noted.
17. https://www.irs.gov/pub/irs-drop/n-13-71.pdf
18. Proposed Regulation §1.125-5(d)
19. Prop. Treas. Reg. §1.125-5(d)(1) and IRS Chief Counsel Advice 201107026 (Jan. 6, 2010)
20. Rev. Rul. 2004-45
21. Short-term, limited-duration insurance
22. Rev.Rull.2004-45
23. IRS Notice 2015-17
24. IRS Notice 2004-50 Q&A 10

Chapter 4

Opening an HSA

Chapter overview

To open a Health Savings Account (HSA), you must be covered under an HSA-qualified health plan by the first day of the month in which you want to begin contributing to the HSA. Then, as soon as your account is considered open, you can begin incurring and paying for qualified medical expenses and spending from the account.

State law regulates when you can begin receiving distributions from your HSA for qualified medical expenses.

Choose a custodian

You cannot simply set aside HSA contributions in a shoebox, safe-deposit box, or ordinary bank account—you can only use an account specifically designated as an HSA.

Role of custodian

The HSA trustee or custodian holds your balances, receives and records contributions, and processes distributions. The custodian also prepares the appropriate tax reporting forms for you at the end of the year.

In general, an insurance company or a bank can act as an HSA trustee or custodian, or any entity approved by the Internal Revenue Service (IRS) as a trustee or custodian for individual retirement accounts (IRAs). Other entities may request approval to become an HSA trustee or custodian under IRS regulations.

Not all companies provide the same level of service or support. Do your homework about the quality of product, services offered, and fees associated with the account before you sign up with an HSA custodian.

For more details about trusts, trustees, and custodians, see the “Trusts and HSAs” section of CHAPTER 2, “Health Savings Accounts.”

Questions to ask

You may set up an HSA on your own, or your employer may facilitate contributions to an HSA with a particular HSA custodian.

The same company does not need to manage both your HSA-qualified health plan and HSA; you may prefer the service, terms, and investment opportunities of an HSA custodian independent from your insurance company.

Establish clear expectations for the basic administration of your HSA. Take time to review fees, investment earnings potential, and account management.

Consider finding the answers to the following questions before selecting a custodian.

Account contributions and management

- How much can I contribute and how often?
- How often can I contribute?
- What methods can I use to make contributions?
- How often will I receive a statement? Will I receive it electronically or in the mail?
- When and how often can I increase or decrease my contributions?
- Is there a debit card associated with this account?
- When will I receive my debit card and other welcome materials?
- What should I do if I need to use the account before I receive my debit card?

- How should I save and organize my receipts for tax filing and potential disputes?
- Can I invest funds? Are there any restrictions on my investments?

Fees

The Department of Labor (DOL) requires that custodians provide timely and comprehensive information about any applicable fees. Before selecting a custodian, ask the following questions:

- How does the custodian set fees?
- What does the trustee or custodian charge to manage accounts, keep records, and send forms and statements?
- What does the trustee or custodian base fees on—on the amount in my account or on my monthly contribution? Or do I pay a fixed fee, independent of my HSA balance?
- Does the custodian waive fees if my balance reaches a certain level?
- What fees do they assess?

Fees might include those for account maintenance, replacement of lost or stolen checks, stop-payment (in the event of a dispute with a healthcare provider or an erroneous charge), rollover, and account closure.

- Who pays the fees?
- If I open an account through my employer, does my employer pay the fees, or do I?
- Can I pay fees directly or must I pay them from my account?
- Do fees count against the amount I can spend?

Account earnings

HSA custodians can offer federally insured accounts (through the Federal Deposit Insurance Corporation [FDIC] or National Credit Union Administration [NCUA]) which earn a modest interest rate while guaranteeing the principal. Most HSA custodians also offer a platform of self-directed mutual funds—usually publicly traded stocks and bonds, subject to market risk and fluctuation in value over time. No one guarantees the principal balance in mutual funds, nor does the FDIC or NCUA insure them. Investors should carefully consider

information contained in the fund prospectus, including investment objectives, risks, charges, and expenses.

- What rate of return will I receive?

  For instance, what is the interest rate and how is interest compounded?
- Is it federally insured?
- What about making investments?
- Do I need to have a certain balance before I can make investments?
- Is there a charge to make investments?
- Is there a minimum investment amount?

Account management by trustee or custodian

- Does the trustee or custodian impose limits on the size or number of distributions that I can take during a given period?

- Does the trustee or custodian accept rollovers or trustee-to-trustee transfers from other eligible accounts?

The law allows trustees and custodians to accept rollovers and transfers but does not require them to.

- How easily can I move money from an investment account back to the HSA if needed for a large medical expense?
- Is there a waiting period?
- Are there extra fees?
- Does the trustee or custodian provide a broad range of investments and investment choices that suit my needs?

Additional services
Sometimes healthcare costs seem confusing or opaque. As an HSA owner, learn how to determine true costs so you can spend your money wisely and maximize your investment.

Some HSA providers offer services to assist you in making wise decisions. Choose an HSA provider that adds value by helping you research healthcare costs so you can save money and spend your healthcare dollars wisely. Consider the following:

- Will I have access to quality cost comparison tools from my employer, health plan, or HSA custodian?
- Does the trustee or custodian provide phone and/or online help to assist me in reviewing and minimizing my healthcare spending?
- Will I receive phone support? During what hours? What if I have an emergency in the middle of the night?
- Does the trustee or custodian offer mobile access? If so, what types of services do they provide through the mobile app?
- Does my custodian provide simple-to-use investment options and advice to help me potentially grow my HSA balance?
- Does my custodian charge me to invest my HSA dollars?

Other considerations

Various HSA custodians offer different investment options and benefits and charge various fees. When selecting an HSA custodian, consider the following:

Investment advice
Automated advice (sometimes called “robo-advice”) can help manage investments using computer algorithms or other formulas. The algorithms, controlled by software, do not require a human financial adviser to manage the client’s account. If your HSA custodian does provide automated advice, ask how much this service costs.

- Does the HSA provider offer advice on your investments, including automated advice?

Fees
Provider fees vary, so clarify the fee structure before choosing an HSA custodian. Lower fees mean you will keep more of your earnings; higher fees could dramatically reduce your earnings over time. Take into consideration the underlying fees that funds typically carry when calculating the overall cost of investing with a given provider.

- How much does the HSA custodian charge in investment-related fees?

EXAMPLE: Save vs. invest
Raphael has an HSA-qualified family health plan and, after medical expenses, makes a net contribution of $3,000 each year to his HSA. If Raphael saves the same amount every year for 30 years but doesn’t invest those dollars, he will accumulate $90,000 over a 30-year period, assuming he does not receive significant interest on his cash balance. However, if Raphael invests the net contribution of $3,000 each year (after meeting the minimum investment threshold) in a diversified investment portfolio, continually invests the balance and achieves a 7% annualized rate of return, his savings could grow to over $300,000—this is more than $200,000 than the actual amount he invested. Note that individual results may vary.

Open an HSA

You can open your HSA at any time throughout the year if you have an HSA-qualified health plan, but most people initiate their HSA or establish contribution amounts during their employer's open enrollment period. Once you qualify to open an HSA, you can keep it, but to continue making contributions to your HSA, you need to have continued enrollment in an HSA-qualified health plan (and no other disqualifying coverage).

Enrollment

If you are employed and get your health coverage through your employer, in most cases, you will enroll through your employee benefits or HR website. If you open an HSA independent of your employer, then the HSA provider you select may have an online enrollment process. If you open an HSA at a bank, you can enroll in person or on the bank's website. If you use an insurance broker, they will have forms or websites to help you enroll in an HSA.

Custodial agreements

Your HSA custodian will require that you sign a trust agreement (IRS Form 5305-B) or a custodial agreement (IRS Form 5305-C), or otherwise enroll as part of your employer-based health insurance program. If you enroll in an HSA online, you may not need to sign a physical form.

Customer Identification Program (CIP)

As part of the USA PATRIOT Act, an individual opening any sort of financial account (in this instance, an HSA) undergoes a verification process, which includes name, date of birth, Social Security Number (SSN), and address.[1]

Beneficiaries

When you open an HSA, designate a beneficiary. If you designate your spouse, ownership of the HSA transfers upon your death as a tax-advantaged HSA. For other named beneficiaries, the fair market value of the HSA becomes part of your estate and becomes taxable income for the beneficiary when distributed.

Payment methods

Generally, your healthcare provider will contact your health plan and submit the claim information to have your health plan pay any eligible medical expenses. You then decide whether to use your HSA for the portion that you must pay. Your HSA custodian and your health plan can assist you if you have questions.

Doctors and other healthcare providers may ask you to pay at the time of your visit or, if you use a network provider, they may send the bill to your insurance company for repricing and then send you the adjusted bill.

Many HSA custodians provide a debit card with which to pay qualified medical expenses from your HSA.

Contribute to an HSA

The IRS has specific guidelines to determine who can open and contribute to an HSA. Once you open an HSA, it remains yours, even if you no longer have an HSA-qualified health plan. You only need eligibility to make additional contributions to your account.

Definition of an eligible individual

Under the law, an eligible individual:

- Must be covered under an HSA-qualified health plan on the first day of any month for which eligibility is claimed[2]
- May not be covered under any health plan that would disqualify you from having an HSA, except for certain permitted coverage and certain health-related payment plans discussed in CHAPTER 1, “Health coverage terms”
- Must not be enrolled in Medicare (the healthcare component of the Social Security program)[3]
- May not be claimed as a dependent on another individual’s tax return[4]

Healthcare reform and adult children

Under the Patient Protection and Affordable Care Act (PPACA), adult children

up to the age of 26 can be covered by their parents' HSA-qualified health plan, but their medical expenses may not be paid from their parents' HSA (see the "Who does your HSA cover" section later in this chapter).

You may choose to cover your adult child until they turn 26, even if he or she:

- Gets married
- Has a baby or adopts a child
- Attends school (or not)
- Does not live with you
- Qualifies for health coverage through their job

If your adult child supports himself or herself, or does not qualify as a tax dependent, you cannot pay for that child's healthcare expenses with your HSA. However, single adult children who do not qualify as tax dependents and who have coverage under a parent's family HSA-qualified health plan can open their own HSAs and contribute up to the annual family maximum: $9,000 for 2027.[5]

Anyone can contribute to the adult child's HSA, even their parents, provided the balance does not exceed the legal annual contribution limit. Your adult child can use his or her own HSA to pay for qualified medical expenses incurred by their spouse and tax dependents.

In other words, parents of adult children may contribute the family maximum to their own HSA. Also, they (or their children) can contribute the family maximum to their adult children's HSAs as well. You do not have to split the maximum family contribution limit with the children, as you would with a spouse.

If you contribute to your adult child's HSA, you do not get to deduct the contribution, but your child receives the contribution tax-free.[6]

Employed individuals

Employers typically pay a portion of their employees' health plan premium and an employer who offers an HSA-qualified health plan may also contribute

toward an HSA because premiums typically cost less than those of other health plans. Even if the employer contributes, the participant owns all the HSA funds.

Employers may have additional requirements for employees who want to participate in any offered health plan, including a certain length of employment or a minimum number of hours, so clarify your employer's eligibility requirements to reduce misunderstandings and confusion.

Self-employed individuals

Even subchapter S owners or self-employed individuals can open an HSA and make contributions if they meet the IRS eligibility requirements.

As a self-employed individual or 2-percent shareholder-employee in an S corporation, you are not considered an employee and cannot contribute to an HSA through the cafeteria plan under IRC §125—but you can make HSA contributions and deduct them on your taxes.[7]

Retired and disabled individuals

If an otherwise eligible person has not yet enrolled in Medicare even though that individual has reached age 65, he or she can contribute to an HSA until

the month they enroll in Medicare.[8] The individual may also make catch-up contributions prior to their enrollment in Medicare.[9]

Regardless of your age, you can set up and contribute to an HSA if you have an HSA-qualified health plan but are not enrolled in Medicare.

If you have an HSA-qualified health plan as well as access to a retiree HRA that provides reimbursement only after you retire, you may still set up an HSA if you do not have Medicare coverage and are not receiving benefits from the retiree HRA.[10]

If you have an HSA-qualified health plan and an HSA and you qualify for short-term or long-term disability benefits under an employer-sponsored plan, you

should remain eligible if the basic healthcare coverage arrangement remains intact during the disability period.

If you receive Social Security disability benefits, you may lose eligibility to contribute to your HSA when your Medicare coverage begins.

Pay for others' expenses

Under the law, you can use HSA funds to pay qualified medical expenses for

yourself, your spouse, and any dependents claimed on your taxes, as well as a few other individuals, described below.

You and your spouse

You can pay your spouse's qualified medical expenses from your HSA whether or not your spouse has an HSA-qualified health plan.

Even if both spouses have an HSA, one spouse can pay for qualified medical expenses for the other.

You can also use HSA funds to pay the qualified medical expenses of same-sex spouses, but not domestic partners unless they qualify as dependents for tax purposes.[11]

EXAMPLE: Paying expenses for spouse not covered by an HSA
Paul has a traditional plan that does not meet the criteria for an HSA-qualified health plan (because his plan has only a $500 deductible) and does not cover Sean, his husband.

Sean elects an HSA-qualified health plan and HSA for himself. Even though Sean's HSA-qualified health plan does not cover Paul, Sean can use his HSA to pay Paul's copayments.[12]

Your dependents

Who counts as a dependent for family coverage?

According to IRS rules, a person claimed as a dependent for income tax purposes must bear a relationship to the taxpayer in one of the following ways:[13]

- Child (including a legally adopted or foster child), grandchild, or great-grandchild
- Stepchild or your stepchild's descendant
- Sibling, half-sibling, step-sibling, or a descendant of these
- Parent, grandparent, or other direct blood ancestor
- Stepfather or stepmother
- Brother or sister of your father or mother
- Descendant of your brother or sister
- Father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law

Tax dependents must also meet other stipulations, not included here, that may not apply to those considered dependents for your health plan's purposes.

Whose medical expenses can you pay from your HSA?

According to IRS Publication 969,[14] you can pay your qualified medical expenses, your spouse's, and those of anyone you claim as a dependent on your tax return (a qualifying child or relative), as well as the expenses for those that you could have claimed as a dependent except:[15]

- You, or your spouse, if filing jointly could be claimed as a dependent on someone else's tax return
- A relative has a gross income higher than the IRS-determined limit ($5,300 in 2026)
- A child or relative files a joint return (for example, a married child under 19, or 24 if a full-time student)

In addition, your dependents can pay for their dependents' qualified medical expenses from their HSA(s), even if your dependents (such as adult children) cannot claim them (their own children) as tax dependents because you claim your adult child as a dependent for tax purposes.

Again, please note that the examples in this book merely illustrate, rather than offer tax or legal advice. Always discuss your specific situation with tax or legal professionals.

EXAMPLE: Married child covered by parents' HSA
Your 19-year-old daughter, Sarah, and her husband, Richard, live with you. You provide more than half of her support. Even though they file jointly and earn more than $5,300, you may be able to pay her qualified medical expenses out of your HSA.

In general, you may be able to cover more people with your health plan than you can cover with your HSA. For example, you can include your adult children in your family coverage until they're 26 but can only pay their expenses from your HSA if they qualify as a dependent for tax purposes (under 19, or under 24 and a full-time student).

Likewise, your HSA may be able to pay the qualified medical expenses of a broader variety of people than you can claim as tax dependents. For example, you can pay the expenses of a married adult child who files a joint return if they are younger than 19 (or if they are a full-time student younger than 24).

In a nutshell, your HSA funds generally cover the expenses incurred by your spouse and tax dependents, with a couple of possible additions.

Summary

- You need to be covered by an HSA-qualified health plan and no other impermissible coverage to open an HSA. To qualify, the plan must adhere to government-mandated minimum annual deductibles and out-of-pocket maximums. These two limits usually change every year
- You can choose one of several types of custodians for your HSA. The custodian will oversee contributions and distributions and provide statements and tax paperwork
- To open an HSA, you must be covered by an HSA-qualified health plan and have no other impermissible coverage by the first day of the month in which you want to open your account. You can contribute up to specified limits based on your HSA-qualified coverage level, which usually changes every year
- Name an HSA beneficiary to avoid confusion and unnecessary taxes for your heirs when you die
- You may use your HSA to pay qualified medical expenses for any dependents you claim on your taxes, even though your health coverage (HSA-qualified health plan) may cover dependents who you cannot claim for tax purposes, including children between the ages of 19 and 26 as well as dependents whom you do not financially support
- Even though you cannot use your HSA to pay the expenses of adult children who do not qualify as your tax dependents, they may open an HSA for themselves if covered by an HSA-qualified health plan (their own or yours)

Resources

1. HR 3162, Public Law 107-56
2. IRC §223(a), IRS Notice 2004-2 Q&A 2 through Q&A 7
3. IRC §223(b)(7), IRS Notice 2004-50 Q&A 2 through Q&A 4
4. IRC §223(b)(6)
5. IRC §223(b)(6), IRS Notice 2004-2 Q&A 18
6. IRS Notice 2004-2 Q&A 18
7. IRC §125(d)(1)(A), IRC §1372, IRC §318

8. IRC §223(b)(7), IRS Notice 2004-50 Q&A 2
9. IRS Notice 2004-50 Q&A 3
10. Rev. Rul. 2004-45 Situation 5
11. IRS Notice 2014-1
12. IRS Notice 2004-50 Q&A 36
13. IRC §152, IRS Notice 2008-5
14. IRS Publication 969
15. IRC §223(d)(2)(A); IRS Notice 2008-59 Q&A 33; IRC §152, PHS §2714

Chapter 5

Contributing to an HSA

Chapter overview

Your contributions to your Health Savings Account (HSA) are not subject to federal income tax as well as state income tax (in most states). In addition, the government provides generous contribution rules for HSAs:

- Anyone (employer, family member, or any other person) may contribute to an HSA on behalf of an eligible HSA holder
- The maximum allowable contribution is indexed to inflation, typically resulting in annual increases
- Even if you open an HSA mid-year, you can still contribute the entire annual maximum amount, provided you remain eligible throughout the next year
- Rollovers and transfers do not contribute to your annual contribution limit, with some restrictions

Tax breaks and ownership

You never pay federal income tax on the money in your HSA—not when you contribute, realize growth, or even spend the money, provided you use the account for qualified medical expenses. Even if you contribute using taxable income (for example, if you have an HSA not associated with your employer's health plan), you can deduct your contributions as an above-the-line deduction when you file your federal income tax return, reducing your taxable income whether or not you itemize deductions.[1]

Although nearly anyone can contribute to your HSA, only you and your employer can claim a tax deduction on contributions. Others who contribute to your account may not take a tax deduction, but their contributions to your HSA do not increase your gross income. Likewise, if you contribute to an adult child's HSA, you cannot take a tax deduction, but the contribution does not count as taxable income for the child.

Employer contributions also do not affect your potential eligibility for the earned income credit (EIC).[2]

Because self-employed individuals and 2% owners of S corporations are not considered employees, they cannot receive "employer" contributions to their HSA from their business. However, they can make personal contributions and claim the above-the-line deduction when filing a federal income tax return, reducing taxable income whether or not deductions are itemized.[3]

HSA ownership

Because you own all the money in your HSA, if the company you work for files for bankruptcy or becomes involved in a lawsuit, your employer's creditors cannot touch these funds. In addition, the law protects your account's beneficiaries. (Note that in the event of personal bankruptcy or divorce, creditors may be able to access the funds in your HSA).

Unused money in your HSA rolls over year to year. In addition, you can take the account with you if you leave your employer, your employer changes health plans, or if you change health plans.

Finally, an employer cannot recoup any money they previously contributed to your HSA (except under certain narrow circumstances, such as a contribution made incorrectly or to the wrong person).[4, 5]

EXAMPLE: Employee quits before end of the first year
Reuben's employer contributed $2,000 to his HSA on January 1 expecting that he would work through December 31. Reuben terminated his employment on May 3, but his employer may not recoup any portion of its contribution to Reuben's HSA.

EXAMPLE: Contribution applied to the incorrect employee
John Smith's employer contributed $2,000 to his HSA on January 1. However, the contribution was intended for John Smyth. John's employer may fix the mistaken contribution, recouping it from Smith's account and making the contribution to Smyth's HSA instead.

Contribution limits

The IRS determines the maximum amount you can contribute to your HSA every year. These limits apply to the total amount added to the HSA during the year, from all sources. HSA holders and employers may contribute less than the limit, if desired.

EXAMPLE: Employer contributes to employee's HSA
Jerome's employer contributes $85 per month to his HSA, for a total of $1,020 per year. Because Jerome's HDHP family plan 2027 HSA contribution limit is $9,000, he can contribute (or receive contributions from others) up to $7,980—though he can choose to contribute less than that, or even nothing at all.

Age-related considerations

55 and older[6]
Individuals 55 and older can make catch-up contributions to their HSAs. HSA owners who turn 55 before the end of the tax year can make an additional $1,000 contribution that year (and every year thereafter) to increase their account balance before retirement. Note that the catch-up contributions are in addition to their annual contribution limit for a family HSA plan.

If each spouse is 55 or older, then both spouses can make a catch-up contribution, but must each have their own HSA for catch-up contribution deposits. A married couple with two individual HSAs may each make catch-up contributions of $1,000, totaling $2,000, if each person makes the catch-up contribution to their own account.[7]

EXAMPLE: Married couple makes catch-up contributions
Roger (56) and Noelle (55) each have HSAs and neither has Medicare coverage, so they can contribute a combined additional $2,000 ($1,000 each) to their individual HSAs for any year they are 55 by the end of the tax year.

Medicare enrollment
All contributions must cease once you enroll in Medicare. Though you can't contribute to your HSA, you can continue to invest the money in your account and take distributions for qualified medical expenses.

If you delay your enrollment in Medicare, you can continue to make contributions (including catch-up contributions) past the age of 65, provided you still have an HSA-qualified health plan and no other disqualifying coverage.[8]

Mid-year HSA enrollment

New account holders who enroll and are covered by an HSA-qualified health plan and open an HSA midyear may either contribute a prorated amount (for the actual number of months they qualify) or take advantage of the IRS full-contribution rule and contribute the entire yearly maximum for their age and level of coverage, provided they are continuously eligible to contribute to an HSA for the following tax year. Some life changes, described in the "Family changes" section later in the chapter, also affect contribution decisions.

Applying the full contribution rule
The full-contribution rule (or last-month rule) allows individuals who have HSA-qualified health coverage on the first day of the last month of their tax year (December 1 for most taxpayers) to contribute up to their full yearly maximum.

For example, if an individual first becomes eligible for an HSA on December 1, 2026 and has family HSA-qualified health coverage, for purposes of HSA contribution limits he or she is considered to have had family HSA-qualified health coverage for all 12 months of 2026.

The full contribution rule also applies to catch-up contributions for individuals aged 55 and older.

The full-contribution rule applies regardless of whether the individual was eligible for the entire year, had HSA-qualified health coverage for the entire year, or had disqualifying coverage for part of the year.

However, to use the full-contribution rule, you must maintain an HSA- qualified health plan during the entire testing period (usually the entire next plan year) and have no impermissible coverage. If you fail to do so, you will have to pay taxes and penalties for making an excess contribution. For more details, see the next section.

EXAMPLES: Using the full-contribution rule
Roberto's individual HSA-qualified health coverage starts on November 10, 2027. Because he has HSA-qualified health coverage by December 1, he can contribute $4,500 to his HSA, as if he had qualifying coverage for the entire year.

Karl's coverage by an HSA-qualified health plan begins on November 30, 2026, but he waits until February 1, 2027, to open his HSA. The IRS allows account holders to make 2026 contributions until April 15, 2027, so Karl makes a lump sum contribution of $4,400 for 2026. He also starts contributing for 2027 by setting up regular payroll deductions.

Nancy joins her HSA-qualified health plan on December 2, 2026. She cannot make a full-year contribution for 2026, like Roberto and Karl, because she must have an HSA-qualified health plan on the first day of the month in which she contributes to her HSA. She cannot make any contributions for the 2026 tax year and must wait until January 1, 2027, to begin making contributions.

Prorating the contribution
If you do not know if you will continue your coverage in an HSA-qualified health plan during the entire next tax year, then contribute a prorated amount for only the months in the current tax year you have HSA-qualified coverage. To do this, divide the yearly allowable maximum contribution by 12, then multiply the result by the number of months you are covered by the HSA-qualified plan during this tax year.

EXAMPLE: Contributing a prorated amount
Carlos starts a new job in September and begins coverage as an individual in his company's HSA-qualified health plan on October 1, 2026, but his assignment does not become permanent until the end of his company's standard six-month probationary period.

Carlos wants to contribute as much as possible to his HSA, but has only three months left in the year, with no guarantee of employment and coverage by an HSA-qualified health plan in the coming year.

Carlos decides to prorate his contribution during his health plan enrollment in the current year.

He divides his yearly maximum contribution by 12.

$4,400 ÷ 12 months = $366.66/month

He multiplies the prorated amount by the number of eligible months to determine the amount he can safely contribute without penalty in the event he does not have the opportunity to enroll in an HSA-qualified health plan next year.

$366.66 x 3 months = $1,100.00

Testing period

Under the full-contribution rule, the testing period begins with the last month of your tax year and ends on the last day of the twelfth month following that month (for example, December 1, 2026, through December 31, 2027).

If you contributed to your HSA under the full-contribution rule, then you must remain HSA-eligible for the entire testing period. If you lose eligibility during the

testing period (except by death or disability), you must pay taxes on the excess contribution, as well as a 10% penalty.

To determine the excess amount, use the following formula:

1. Determine the per-month prorated amount by dividing the yearly maximum contribution by 12.
2. Multiply the monthly amount by the number of eligible months in the year the full-contribution rule applied.
3. Subtract this number from the amount of the contribution made to determine how much the government will reclassify as income.

EXAMPLE: Eligible for only part of the testing period*
Chris, age 53, becomes eligible for an HSA on December 1, 2026, with family HSA-qualified health coverage. Under the full-contribution rule, he contributes $8,750 to his HSA for 2026.

Chris loses his eligibility in June 2027 when he drops his HSA-qualified health coverage. Because Chris does not remain an eligible individual during the testing period (December 1, 2026, to December 31, 2027), he must include the contributions made in 2026 under the full-contribution rule with his 2027 income, the year he became ineligible (not 2026, the year in which he made the excess contribution).

Chris uses the worksheet for line 3 of IRS Form 8889 instructions to determine this amount.

January	0
February	0
March	0
April	0
May	0
June	0
July	0
August	0

September	0
October	0
November	0
December	$8,750
Total for all months	**$8,750**
Total for one month	**$729.17**

Chris includes $8,020.83 ($8,750 minus the $729.17 that was allowed for the one month he was eligible in 2026) in his gross income on his 2027 tax return. Also, an additional 10% tax ($802.08) applies to the $8,020.83 he over-contributed in 2026.

EXAMPLE: Eligible for only part of the testing period
Sixty-year-old Lian started a new job and enrolled in her HSA-qualified health plan and HSA on June 1, 2025.

Because she plans to retire in five years, she wants to contribute as much as she can to her retirement accounts. She decides to take advantage of the full-contribution rule and contributes the maximum annual amount in her HSA ($4,300 + catch-up contribution of $1,000 = $5,300). Because her new job began on June 1, Lian had qualified health coverage for seven months in 2025.

Lian needs to remain in an HSA-qualified health plan until December 31, 2026, to avoid taxes and penalties on the extra amount she contributes in 2025. Unfortunately, Lian’s employer lays her off in March 2026.

Because Lian does not stay in her employer’s HSA-qualified health plan for the entire testing period (December 1, 2025, through December 31, 2026), she must pay income tax and a 10% excise tax on the amount she over-contributed in 2025. To calculate the amount that she must reclassify as taxable income, she divides the amount she contributed in 2025 by 12 to find the prorated monthly amount.

$5,300/12 = $441.67

Then, she multiplies the monthly prorated amount by five to calculate the amount she overcontributed (for the five months she was not enrolled in an

HSA-qualified health plan in 2025):

5 x $441.67 = $2,208.35

She prepares to add $2,208.35 to her adjusted gross income on her 2025 tax return and pay an additional 10% tax ($220.83) but finds out she doesn't need to. By continuing her HSA-qualified health coverage under COBRA until December 31, 2026, she satisfies the testing period. In addition, the law allows Lian to use her HSA funds to pay the COBRA premiums.[9]

By purchasing COBRA coverage, she not only avoids additional tax and the penalty, but she also continues her health insurance coverage throughout the rest of 2026, even though she did not have a job.

Her decision turned out well: she maximized her HSA balance and probably paid lower COBRA premiums, because HSA-qualified health plan premiums generally cost less than those for traditional low-deductible health plans.

*Note examples are for illustrative purposes only. Individual results and costs may vary.

Eligibility and timing of contributions

Eligibility determined monthly
The IRS determines eligibility to contribute to an HSA on a monthly basis

- Participants must have HSA-qualified health coverage by the first day of the month to make contributions to their HSA during that month[10]
- Unless contributing under the full-contribution rule (see the previous section), you can only make HSA contributions for the months you receive coverage through an HSA-qualified health plan

Contributions tied to the tax year
You will report HSA contributions on your individual tax return, so contribution

limits align with the tax year, not with when coverage begins or when the insurance plan year begins. For example, you cannot make 2026 tax year contributions before the start of that tax year, nor after the legal tax year deadline, without extensions.[11]

Most individuals pay their taxes based on the calendar year; therefore, they can make contributions between January 1 of a given year and (generally) April 15 of the following year.

Even though your health coverage plan year may last for only 12 months, the schedule for HSA contributions (and distributions) aligns with the tax year.

Within each tax year, you have flexibility in deciding when to make contributions. You can spread them throughout the year or make them all at once. Both you and your employer can make contributions of any size at any time during the tax year, so long as the combined contributions do not exceed the legal limit.

EXAMPLE: Front-loading the HSA early in the year
Miles and Donetta learn that their first baby, due early in the year, may have a gastrointestinal defect that will require a multi-week stay in the neonatal intensive care unit (NICU).

Their hospital requires that they pay the entire out-of-pocket maximum immediately upon their child's birth. If they do not have enough money in their HSA at that time, they will have to make those payments with post-tax (non-HSA) dollars.

Donetta works until a month before the baby's due date.

She and Miles decided to contribute her entire paycheck to their HSA, up to the 2027 limit of $9,000.

After the baby's birth, they pay their deductible and coinsurance from their HSA until meeting their out-of-pocket maximum, at which time their HSA-qualified health plan pays 100% of their remaining expenses.

Miles compares their expenses with what they would have paid without the HSA. Considering premiums, coinsurance, deductibles, tax savings, and the interest they would have paid if they financed their portion of the bill with the hospital, they spent significantly less than they would have under their previous traditional, low-deductible PPO plan.

Multiple HSAs

If you have more than one HSA (for example, if you open a new account with a new employer, rather than rolling over your existing HSA), your total yearly contributions to your HSAs combined cannot exceed the IRS-mandated limits.

Family changes

Adding a spouse or child

If you get married, have a baby, or adopt a child, your healthcare coverage needs may change. Under the Health Insurance Portability and Accountability Act (HIPAA), you have the right to ask your plan to cover new family members without waiting for the plan's open enrollment period. (See Appendix A for more information on HIPAA).

Enrolling a new spouse or baby in your plan
Enroll new family members in your plan as soon as possible. If you switch from an individual plan to family coverage, your allowable HSA contribution increases on the first day of the first full month after you obtain HSA-qualified family coverage. You may either make a prorated increase in your contributions for the year or contribute the family maximum for the year in one lump sum, if you believe you will stay in a family plan through the testing period.

Stepchildren
You can typically cover a stepchild in your employer's plan, even if you have not formally adopted him or her. The child must live with you in a parent-child relationship, and you must support him or her financially. Some plans require that you or your current spouse claim the child as a dependent for tax purposes to enroll the child in your plan.

As with adding a newborn, adding a stepchild to your HSA-qualified plan may allow you to increase your HSA contribution. When determining the best way to cover a stepchild, consider the options under your plan as well as those available to your spouse or partner.

Spouse loses coverage
Other life events may require changing from self-only to family coverage.

If you have self-only coverage and your spouse loses coverage, you can change to HSA-qualified family coverage without waiting for your open enrollment period, if your employer allows. As with a new child, your allowable

HSA contribution also changes on the first day of the month during which your spouse becomes covered by your HSA-qualified health plan.

EXAMPLE: Spouse's family coverage disqualifies the HSA

Alfonso and Muriel each have self-only coverage through their employers. Alfonso has an HSA-qualified health plan, while Muriel has a traditional plan that does not qualify as an HSA-qualified health plan.

Muriel acquires custody of her daughter, Felicia, who comes to live with them. Muriel wants to cover Felicia under her plan. However, her plan only offers self-only or family coverage. If Muriel elects family coverage, Alfonso loses his HSA eligibility, because he would have coverage under her plan—even if he doesn't use it.

If Alfonso's plan offers self-plus-child coverage, it may save the family money if he covers Felicia under his plan.

Spouse has HSA-qualified health plan and an HSA
If you and your spouse have self-only HSA-qualified health coverage under separate plans, you can each open an HSA and contribute the yearly maximum for an individual.

If either spouse has HSA-qualified family health coverage (and the other spouse does not have disqualifying coverage), the IRS considers you both to

have family HSA-qualified health coverage for the purposes of annual contribution limits.

If each spouse has an HSA and family coverage under separate plans, you and your spouse can split the annual contribution limit for families between you—equally or however you choose, provided your total contributions do not exceed the annual maximum. The IRS limits HSA contributions for families to $9,000 in 2027.[12]

Each spouse 55 and older (and not enrolled in Medicare) can contribute an additional $1,000 catch-up contribution, whether enrolled in family or individual

HSA-qualified health plans, provided they each have an HSA. Some HSA custodians will open another HSA for no additional cost.

Adult children

Adult children aging out

Once your child turns 26 and transitions from your plan to his or her own plan, you and your child can both contribute to your child's HSA if the child retains HSA-qualified health coverage. While they received coverage under your HSA-qualified health plan, they could contribute up to the family maximum. When they receive their own coverage, their contribution limit depends on whether they have self-only or family coverage. (For more information about adult children, see the "Contribute to an HSA" section in CHAPTER 4, "Opening an HSA.")

You make contributions to your children's HSAs with post-tax dollars, but your contributions do not increase your child's taxable income because they can claim the HSA contributions you make as an above-the-line income tax deduction.

EXAMPLE: Adult child ages off parents' HSA-qualified coverage

Lana received coverage under her parents' HSA-qualified health plan, but ages out. Her parents have not claimed her as a tax dependent for several years, but she has her own HSA to which she and her parents both contributed to reach the family limit of $8,750 for 2026. She begins coverage under her own,

self-only HSA-qualified health plan beginning in January of 2027. She (and her parents, if they wish) can contribute toward Lana's HSA, up to the self-only annual limit of $4,500.

Legal separation and divorce

Spouses do not jointly own an HSA; each must qualify separately to contribute to an HSA. In the event of a divorce or legal separation, the court may award all or part of an HSA owned by one spouse to the other as part of the settlement.

Changing from family to self-only HSA-qualified health coverage
If you made the maximum family contribution to your HSA and keep your family coverage after divorce or legal separation, you will not risk making excess contributions.

However, if you or your spouse have an HSA-qualified health plan with family coverage and you change to self-only coverage after your divorce, you may have to pay income tax and penalties on your excess contributions. In addition, you may have to adjust your contributions to ensure that you do not over-contribute in the future. Talk to your tax preparer about how to deal with additional taxes and penalties related to potential excess contributions.

If you made a maximum yearly contribution for a family under the full-contribution rule, divorced mid-year, and changed your coverage to self-only under your health plan's HSA-qualified health plan, you will fail the testing period for eligibility under family coverage. Either return the excess contribution before the tax filing deadline or include the amount in your gross income and pay a 6% penalty on the excess.

For more information about the testing period, see the "Testing period" section earlier in this chapter.

Avoiding excise tax
You may withdraw some (or all) of the excess contributions and not pay the applicable excise tax if you withdraw both the excess contribution and the interest earned before the tax deadline. You must still pay income tax on the excess amount and earnings.

Include the excess contributions and interest earned as “other income” on your tax return for the tax year you withdraw the contributions and earnings. Note that states might levy separate excise taxes.

For more information about returning excess contributions, see the “Penalties” section at the end of this chapter.

EXAMPLE: Changing to single coverage during testing period
Janet enrolls with family coverage in her HSA-qualified health plan on October 1, 2025. Her husband, Jacob, a freelance cabinet maker, does not have his own insurance, so Janet puts him on her plan. They have no children.

Although she enrolls in her HSA-qualified health plan late in the plan year, she can lawfully contribute on December 1, 2025, so she makes the maximum family contribution of $8,550 under the full-contribution rule.

Janet and Jacob divorce in September 2026. In the divorce settlement, Janet keeps her HSA and changes her HSA-qualified health plan to self-only coverage. Although she fulfilled the testing period by remaining in an HSA-qualified health plan, she does not fulfill the testing period for family coverage. After the divorce, Janet qualifies only for the maximum contribution for a single person under the full-contribution rule.

To determine her excess contribution for 2025, she subtracts the maximum contribution for single-only coverage ($4,300) from the $8,550 family contribution: $8,550 – $4,300 = $4,250

When she calculates her 2025 taxes, Janet adds the excess $4,250 to her adjusted gross income and pays an additional 10% tax on that amount ($425.00) because she failed the testing period for family coverage and the additional amount is not considered an excess contribution.

In January 2026, Janet makes a lump sum contribution of $8,750 thinking she will have family coverage all year. Because she is still eligible for family coverage on September 1, 2026, she can make nine months of family contributions.

She divides $8,750 and $4,400 by 12 to get the prorated monthly contribution for family and single-only coverage.

Family prorated monthly contribution: $8,750/12 = $729.17

Single-only prorated monthly contribution: $4,400/12 = $366.66

She multiplies the family monthly contribution by nine to calculate the amount of the family-level contributions she can make during 2026. Then she does the same for the single-level contributions for the three months after her divorce.

She adds the two amounts to get her maximum allowable contribution for the 2026:

$729.17 x 9 = $6,562.53

$366.66 x 3 = $1,099.98

$6,562.53 + $1,099.98 = $7,662.51

Then she subtracts the amount from the $8,750 she contributed to determine her excess contribution for 2026:

$8,750 – $7,662.51 = $1,087.49

Janet adds the $1,087.49 to her adjusted gross income on her 2026 return and pays the 6% excise tax for the excess contribution.

COBRA coverage for the divorced spouse[13]
If you or your spouse have a family plan, providing coverage for both of you, and you get divorced, the spouse not employed by the plan's sponsor may be able to continue coverage under COBRA through the other spouse's plan. For more information about COBRA, see the U.S. Department of Labor site, https://www.dol. gov/agencies/ebsa/laws-and-regulations/laws/cobra?#employees.

Divorce is a qualifying COBRA event. Eligible individuals might have to pay up to 102% of the employer's cost of coverage for COBRA and are entitled to coverage for a limited period (from 18 to 36 months, depending on the qualifying event).

Transfers between tax-advantaged accounts

Trustee-to-trustee transfers

Trustee-to-trustee transfers move funds directly from one trustee or custodian to another.

Transfers from other HSAs or from Archer MSAs into an HSA are permitted if the same person owns both accounts.[14] You may not transfer money from another individual's HSA—even one that belongs to a spouse or other family member.

HSA transfers (which may contain balances accumulated in previous tax years) do not affect the current year's contribution limits. This type of transfer has similar rules as moving funds from one IRA to another. You can make unlimited trustee-to-trustee transfers within any 12-month period.

Rollover transfers

Rollovers move funds from one HSA or Archer MSA to another—but the funds are sent to the account holder rather than to the trustee or custodian. The individual has 60 days to post the funds to another HSA without incurring taxes or penalties.

Account holders may execute only one rollover within a 12-month period. Like trustee-to-trustee transfers, the rollover does not apply toward annual contribution limits.[15]

EXAMPLE: Transferring an HSA to another bank or trustee
Omar has an HSA with $5,000 at Bank A and he wants to transfer the entire balance to an HSA at Bank B.

He can roll over his HSA by withdrawing the balance from Bank A and re-depositing it into Bank B, but only if the two transactions occur within 60 days of each other.

He also can request a trustee-to-trustee transfer, in which Bank A sends the money directly to Bank B.

Omar may choose either of these options and still make contributions for that tax year, without having to consider the rolled over amount in his yearly limit calculations.

However, if Omar withdraws the money and does not re-deposit it or spend it on qualified medical expenses within 60 days, a 20% penalty will apply, and he will have to pay income tax on the amount withdrawn.[16]

IRA transfers[17]

To help fund the HSA, an account holder can make a once-per-lifetime trustee-to-trustee transfer from a traditional or Roth IRA (but not a Simple or SEP IRA) to the HSA. This transfer contributes to the annual contribution limit, and thus cannot exceed the maximum annual contribution for the year.

The individual must remain an eligible individual for the entire 12-month testing period following the month the transfer occurs. If he or she does not remain eligible, the transferred amount counts as income, for tax purposes, and incurs an additional 10% penalty as well.

Contributions by others

Spouses

HSAs exist only as individual accounts—never as joint accounts. Even when a husband and wife both work for the same employer and have the same health coverage, their HSAs and contributions remain separate.

The following rules for married people apply only if both spouses qualify for HSAs. Contribution limits for spouses depend on the type of coverage each spouse chooses.

- If either spouse has family HSA-qualified health coverage (that is, if one spouse covers dependents with their HSA-qualified healthcare plan) and

the other spouse covers only themselves, then, for the purposes of contribution limits, the IRS treats both spouses as if they have one HSA-qualified family health plan[18]

- If each spouse has family coverage under a separate plan, then the two of them combined can only contribute up to $9,000 in 2027. Spouses usually split the contributions equally between them but can choose any division they wish[19]
- If both spouses are 55 or older, each spouse may make the $1,000 catch-up contribution. If both spouses meet the age requirement, the total contributions under family coverage cannot exceed $11,000 in 2027. Each spouse must make the catch-up contribution to his or her own HSA

EXAMPLE: Both spouses have family coverage
Dominick, age 58, and Anika, age 53, are married and each have family coverage under separate HSA-qualified health plans.

Because both plans provide family coverage, Dominick and Anika can together contribute the $9,000 family maximum for 2027. They decided to split the contribution equally, so Dominick contributes $5,500 to his HSA (half of $9,000, plus a $1,000 catch-up contribution). Anika can contribute only $4,500 to her HSA (half of the $9,000 annual maximum for a family). Because she is only 53, she cannot make a catch-up contribution.

Dominick and Anika can agree to contribute different amounts, but their total annual 2027 contributions cannot exceed $10,000 ($9,000 + $1,000) and Anika's total contribution cannot exceed $9,000.

EXAMPLE: Only one spouse has qualifying coverage
Darrel and Sabrina are married. Darrel's employer offers an HSA-qualified health plan. Sabrina's employer offers a traditional PPO plan that does not meet eligibility requirements for an HSA-qualified health plan.

Sabrina chooses family coverage, covering Darrel under her non-qualifying plan. Darrel may not contribute to an HSA because Sabrina's traditional plan covers him whether or not he uses the coverage.

However, if Sabrina elected coverage under her plan solely for herself, or for herself and their children, Darrel could participate in his employer's HSA-qualified health plan and contribute to his own HSA

EXAMPLE: Both spouses have self-only coverage
Bernard, age 35, and Joon, age 33, are married. Each has self-only HSA-qualified health coverage, and each has an HSA.

Bernard can contribute $4,500 to his HSA in 2027, and Joon can contribute $4,500 to hers.

The same limits apply—whether Bernard and Joon work for different employers, one is self-employed and one is an employee, or both are self-employed.

EXAMPLE: One spouse eligible to contribute to HSA
Enrique, age 65, and Felicia, age 56, are married. When Enrique turned 65, he enrolled in Medicare. Enrique and Felicia have separate HSAs, each with self-only coverage.

Enrique can no longer contribute to his HSA, but he can continue to use the funds in either his account or Felicia's to pay qualified medical expenses for either himself or Felicia—though they cannot use Felicia's HSA to pay Enrique's Medicare premiums because she has not yet reached age 65.

Felicia has an HSA-qualified health plan, so she can contribute up to $4,500 to her HSA in 2027, plus a catch-up contribution of $1,000 each year, because she is over 55.

EXAMPLE: Simultaneous family and single coverage
Kirk and Isabel are married. Because he has young children from a previous marriage, Kirk has family coverage under an HSA-qualified health plan with a $5,000 deductible.

Through her employer, Isabel has self-only coverage under an HSA-qualified health plan with a $2,000 deductible.

Because one spouse has family coverage under an HSA-qualified health plan that could potentially cover the other spouse, the IRS treats them as if they both have family coverage. They can contribute up to $9,000, the family limit for 2027, between the two of them, even though logic might suggest that Kirk could make the maximum family contribution and Isabel could also contribute,

up to the maximum self-only limit. They can both contribute to HSAs as long as together, they do not exceed the family maximum contribution limit.

Business entities

In general, self-employed HSA owners and individuals associated with the entities listed below cannot make pre-tax contributions to their own HSAs, and only sometimes qualify for business tax deductions. Because details vary for each entity and for each individual, consult your tax advisor to determine the rules for your specific situation.

Individuals or sole proprietors
Tax law treats sole proprietors the same as individuals who make their own HSA contributions, in that they can deduct their own HSA contributions and health insurance payments from their personal income tax returns.

They do not, however, receive the business-related tax deduction that employers who contribute to their employees' HSAs usually receive. Therefore, sole proprietors cannot enter contributions to their own HSAs as business expenses on Schedule C, because the contribution does not relate to the self-employed individual's trade or business.

In addition, the amount of the contribution does not factor in when determining net earnings from self-employment on Schedule SE.[20]

However, the amounts contributed by the business on behalf of its employees do qualify as deductions for Schedule C.

Partnerships and multiple-member LLCs
When a partnership contributes to a partner's HSA in exchange for services rendered, the law considers the contribution "distribution of money to the partner," rather than an employer contribution to an employee's HSA.

As guaranteed payments, they increase the partner's gross income, but the partner may enter the amount as an above-the-line deductions on a federal income tax return.

The partnership may also deduct these constributions.[21]

S corporations
The IRS treats contributions by an S corporation to the HSA of a 2-percent shareholder-employee in exchange for services rendered as guaranteed

payments. Because of this, the S corporation may deduct the contributions but must also include them in the individual's gross income.

The shareholder-employee may deduct contributions made to their own HSAs on their personal income tax returns.

Because the law treats 2-percent shareholder-employees as self-employed individuals, the rules concerning guaranteed payments for partners apply. (See the previous section).

Single-member LLCs are treated the same as sole proprietorships.

Penalties

Excess contributions

Excess contributions include any amounts contributed to your HSA that exceed the IRS-determined maximums for that year. You must pay income tax for this amount as well as a 6% excise tax penalty. Even if an employer contribution

caused the excess contribution, the employee bears the responsibility for the income and federal excise taxes.

To avoid paying the penalty, do the following:

- Withdraw the excess contributions by the due date of your tax return for the tax year during which you made the contributions (for example, by April 15, 2027, for contributions made in 2026)

- Withdraw not only the contributions, but also any income earned on those contributions. Include the earnings in “other income” on your tax return[22]

Note that even if you avoid the excise tax, you may still pay income tax on the excess contribution.

Testing period failures

If you used the full-contribution rule to make an entire year’s contribution to your HSA but did not fulfill the testing period, you may pay a 10% penalty, plus income tax on the overage. If, before the tax filing deadline for the previous year, you learn that you will not meet the testing period requirements, you can withdraw the excess contribution plus earnings, as described in the previous section.

Calculating penalties

If you lose your eligibility after the previous year’s tax filing deadline, follow the steps in the “Testing period” section earlier in this chapter to calculate the amount of your over-contribution. To determine your tax liability, download IRS Form 5329 from www.irs.gov and fill out the worksheet.

Summary

You can make tax-deductible contributions to your HSA, whether you contribute pre-tax wages or after-tax money for which you later take an above-the-line deduction on your federal income tax form. Either way, the contributions you make do not count as taxable income.

- Anyone—you, your employer, your family, etc.—may contribute to your HSA. Keep in mind that all donations count towards the annual contribution limit. (This limit usually changes every year, with the family maximum about twice the individual maximum)
- If you exceed the annual contribution limit (even if your employer made the contribution that put you over the limit), you will—in most cases—pay a 6% excise tax as well as paying income tax on the overage
- Enhance your savings by carefully planning contributions and monitoring your progress toward meeting your deductible
- The full-contribution rule allows you to contribute the entire allowable amount to your HSA if you open it before the first day of the last month of the tax year— usually December 1. If you make the maximum contribution under the full-contribution rule, you must remain eligible until the last day of the next tax year (known as the testing period). If you lose eligibility during the testing period, you will pay income tax as well as a 10% excise tax on the overage
- Qualifying life events—marriage, divorce, a new baby, stepchildren, adoption, changing or losing a job, disability, death—all present new coverage needs. Make necessary enrollment changes as soon after the event as possible—usually within 30 days of the life event
- Having an HRA or FSA makes you ineligible to contribute to your HSA unless you have one specifically designed to work with an HSA.

  HSA-qualified versions exist that do not disqualify you from opening or contributing to an HSA

Resources:

1. IRS Notice 2004-2 Q&A 17
2. IRS Notice 2004-50 Q&A 85
3. IRS Notice 2004-2 Q&A 17

4. IRS Notice 2008-59 and IRS Informational Letter 2018-0033 (September 9, 2015
5. IRC §223(d)(1)(E), IRS Notice 2004-50 Q&A 81
6. IRC §223(b)(3)
7. IRS Notice 2004-2 Q&A 14
8. IRS Notice 2004-50 Q&A 2
9. IRC §223(d)(2)(C)(i), IRS Notice 2004-2 Q&A 27
10. IRC §223(c)(1)(A)
11. IRS Notice 2004-2 Q&A 21
12. IRC §223(b)(5)(B)
13. IRS Notice 2002-4 Q&A 23
14. IRC §223(f)(5), IRS Notice 2004-50 Q&A 55
15. IRC §223(f)(4)
16. IRC §223(b)(4)(C); IRC §408(d)(9); IRS Notice 2008-51
17. IRC §223(b)(5)(A)
18. IRC §223(b)(5)(A)
19. IRC §223(b)(5)(B)(ii); IRS Notice 2004-50 Q&A 32
20. IRS Notice 2004-50 Q&A 84
21. Rev. Rul. 91.26, IRC §§162 and 707
22. IRC §223(f)(3), IRS Notice 2004-2 Q&A 22

Chapter 6

Spending HSA funds

Chapter overview

Under the law, Health Savings Account (HSA) distributions are tax-free if used for qualified medical expenses incurred by the following people:

- You and your spouse (but not your domestic partner unless they are a dependent for tax purposes)
- Any dependents you claim on your tax return
- Any person you might have claimed as a dependent on your taxes if the person had not filed a joint return or had a gross income of $5,300 (2026) or more

Even if you claim adult children (or others) as dependents on your taxes, they may pay qualified medical expenses from their own HSAs for their own dependents.[1]

Over the many years you own an HSA, you might experience life events that affect your HSA eligibility, the amount you can contribute to your HSA, what kinds of distributions you can make from your HSA, and if you can have other kinds of health coverage besides the HSA-qualified health plan.

This chapter describes some of the decisions you might need to make when you face a significant medical event or major life change such as job loss, marriage or divorce, childbirth or adoption, or disability.

Healthcare expenses

You may use your HSA for a wide variety of qualified medical expenses, including those you can deduct from your individual tax return. You cannot use your HSA for any expenses you deduct on your tax return. If you use money from your HSA for non-qualified expenses, you will add that amount to your gross income plus pay a 20% penalty.[2]

However, if you (or one of your tax dependents) is over 65, you may use HSA funds for non-qualified expenses without paying a penalty. Income taxes will still apply.[3]

Timing of expenses

Only expenses incurred after you establish your HSA qualify. You may not have funds dispersed for expenses incurred before you establish your HSA,[4] See CHAPTER 4, “Opening an HSA” for more details about the date of establishment.

Qualified medical expenses

- The costs of diagnosis, cure, mitigation, treatment or prevention of disease, and the costs for treatments affecting any part or function of the body[5]
- Payments for legal healthcare services rendered by physicians, surgeons, dentists, and other healthcare practitioners, including the costs of equipment, supplies, and diagnostic devices needed for these healthcare services
- Goods and services necessary to alleviate or prevent a physical or mental defect or illness—not including items or activities needed to improve general health, such as vitamins (unless prescribed to treat a diagnosed condition) or a vacation (even if prescribed). In 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act expanded the list of those qualified medical expenses that an HSA can reimburse to include over-the-counter medications and menstrual care products
- Premiums for qualified long-term care insurance, COBRA premiums, and insurance premiums paid during periods of unemployment
- Direct Primary Care fees, for 2027, up to a $150 monthly limit for

- individuals and $300 for families. These limits will be indexed moving forward.
- Some other long-term care expenses, beyond premiums

Services not covered under your health plan

You can also use your HSA balance to pay for healthcare not covered under your health plan, within the limits of qualified medical expenses. This includes many dental and vision expenses, as well as less common expenses, such as removing lead-based paint from your residence. Although you can pay these expenses from your HSA, they do not count toward your deductible because health plans do not usually cover those types of expenses.

Limited access

The trustee or custodian of your HSA has the legal right to limit or deny distributions under certain circumstances. For example, the trustee may prohibit distributions for amounts of less than $50 or might only allow a certain number of distributions per year. If you need easy access to your account, clarify this issue when shopping for an HSA custodian.

Insurance or health coverage premiums

Generally, you cannot use your HSA to pay medical insurance or health coverage premiums, but exceptions exist.[6]

Medicare premiums

Once you are 65 and eligible for Medicare, you can use your HSA to pay Medicare premiums (A, B, C, and D), out-of-pocket expenses that Medicare does not pay, and Medicare HMO premiums.

You cannot pay Medicare supplement insurance (Medigap) premiums with your HSA. Medigap insurance, sold by private companies, covers remaining

healthcare costs, such as copayments, coinsurance, and deductibles that you may have while covered by Medicare.

Premiums for employer-based coverage after 65

If you work beyond age 65, you can pay your share of premiums for employer-based coverage out of your HSA, but not if those are already paid through pre-tax salary reductions.

Those over 65 who do not work can use an HSA to pay the share of premiums required for your employer-sponsored retiree healthcare coverage if it is not considered a Medicare supplement policy.

Premiums for the unemployed

You can also pay for healthcare coverage from your HSA while receiving unemployment compensation under federal or state law, including COBRA premiums.

Long-term care insurance

You may use your HSA to pay premiums for qualified long-term care insurance that meets criteria determined by federal law.[7]

Using healthcare wisely

Understanding your HSA-qualified health plan helps you focus on making the best choices for your long-term medical and financial wellbeing.

Conducting research

Consider spending time researching your condition, the treatment possibilities, and the risks and benefits of certain treatments. Research might include seeking a second opinion or speaking with friends and relatives who may have had a similar condition. Many HSA administrators and health plans offer powerful online tools that provide explanations and descriptions of possible treatment options.

Getting a second opinion

If a healthcare provider tells you that you need surgery, consider getting a second or third opinion, because professionals often have different opinions and perspectives about the best course of treatment for a given condition.

Even if you have not met your HSA-qualified health plan's annual deductible, understand your plan's requirements concerning surgery. Many plans require you get prior authorization for non-emergency surgery; some may require a second opinion before providing authorization. You can use your HSA to pay for any out-of-pocket expenses incurred to obtain a second opinion from any expert you choose—whether in or out of network.

Just like most plans, following the rules of your HSA-qualified health plan can cut waste, save money, and provide you with better information about your treatment options. It also allows you to use your HSA funds wisely, and when you need them most.

Choosing your doctor and hospital

Like other health plans, an HSA-qualified health plan gives you the freedom to use either in-network or out-of-network providers. If you face a major medical event, such as surgery, explore the options in your network fully before checking out-of-network resources.

Whether your plan has separate out-of-pocket limits for in-network and out-of-network care will help you decide if you want to use a doctor or hospital in or out of your plan's network. If your plan has separate limits, you might pay thousands of dollars more for care that is comparable to what is provided in your network. Additionally, in-network providers will typically accept deeper discounts for their services than out-of-network providers, which can also save you money.

If you have not yet accrued much money in your HSA, you may initially have to pay with after-tax dollars. Many hospitals and physicians will finance your debt and you can use future HSA contributions to make these payments, or to reimburse yourself if you pay the expenses with other funds. Balance this

course of action against any interest charges that the hospital or physician may charge, because you cannot pay interest charges from your HSA.

If you plan to have surgery, remember that the procedure will involve many other providers, besides your principal surgeon. For example, try to choose an anesthesiologist in your plan's network to take full advantage of your benefits.

Ask your doctor which specialists will participate in your surgery and where your doctor has operating privileges. Then, call the hospital and the other specialists to find out if they belong to your network. Your health plan can often provide this information by telephone or online. Out-of-network providers may offer a prompt- payment discount or might honor your in-network pricing if you ask in advance.

The time you take to research these questions can save you money.

Obtaining authorizations and referrals

Make sure you know your plan's requirements concerning authorizations and referrals. Your plan may impose financial penalties if you do not get required referrals and authorizations, even for in-network providers. Penalties will not count toward meeting your out-of-pocket limit for the year. Choosing not to follow the plan's rules can cost you money.

EXAMPLE: Negotiating discounts with an out-of-network provider
Serena's primary care physician suggested elective gallbladder removal and referred her to a surgeon who does not practice within her health plan's network. Serena feels comfortable with this surgeon and wants to use her despite her out-of-network status.

The surgeon's office explains that because Serena has an HSA and can pay promptly, they will offer a discount, charging her only $50 more than an in-network provider.

Serena then finds out that her out-of-network surgeon can perform surgery in both the in-network surgery center and an out-of-network hospital in her town.

Serena's surgeon agrees to schedule Serena's surgery at the in-network surgery center, because this will save her significant out-of-pocket expenses.

Because she makes careful, well-informed decisions, Serena pays a little extra to have the surgery performed by the doctor she chooses and saves thousands of dollars by pre-selecting the in-network surgery center.

Experiencing a medical emergency

Know your plan's rules about whom to call or visit in an emergency.

Generally, you or your representative (such as a family member) must communicate with your plan within 24 to 48 hours of the onset of an emergency. However, if you are initially taken to an out-of-network facility, you may not have to change hospitals until your condition stabilizes.

As in the case of surgery, emergency treatment can cost much more than expected, so try to use in-network providers once the immediate danger has passed.

In non-emergency situations, call your health plan's urgent care line or nursing hotline before seeking care (you can generally find the number on the back of your health plan card).

In the case of an urgent condition (one that needs treatment within 24 hours to prevent it from becoming a serious or life-threatening condition) call first so urgent care personnel can direct you to an in-network urgent care center or hospital near you—especially when you're traveling. Remember, many plans are national in scope and have in-network providers all over the country.

Recent legislation, the No Surprises Act, effective January 1, 2022, is designed to protect patients from surprise bills for emergency services at out-of-network facilities or with out-of-network providers, holding patients liable only for in-network cost-sharing amounts. So, in a true medical emergency, patients can seek care first and worry about the costs later.

Losing eligibility

Even if you lose eligibility to contribute to your HSA, you can continue to spend the funds for qualified medical expenses.

Job changes

Job loss
If you lose your job, change jobs, have your working hours reduced, or your employer changes the plan it offers, you may lose HSA-qualified health coverage, which would make you ineligible to contribute to an HSA.

Even if you lose eligibility to contribute to your HSA, you can still use the money in the account to pay for qualified medical expenses. You continue to own the account, even though you can no longer contribute to it. If you purchase an HSA-qualified health plan in the future, you may resume contributions.

COBRA provides an important safety net when you lose your employer-sponsored medical coverage. Although the premiums can appear expensive, COBRA coverage protects you in a couple of ways:[8]

- Continues to cover qualified medical expenses
- Allows your qualified out-of-pocket medical expenses to count toward your deductible

Several types of job changes can trigger COBRA eligibility, including quitting your job, getting laid off, retiring, or getting fired (other than for gross misconduct, which COBRA does not specifically define and might depend on specific facts and circumstances as well as your employer's determination). Generally, most reasons for involuntary termination, such as excessive absences or generally poor performance, do not amount to gross misconduct.

Having your work hours reduced may also trigger COBRA eligibility (unless your company provides health coverage for part-time employees). A strike by unionized employees can qualify as a reduction in hours.

If you choose COBRA coverage, you can use your HSA to pay COBRA premiums and can continue to contribute to your HSA.

It's important that you also look at your options under the PPACA and associated healthcare marketplaces. You may be eligible for subsidies, which could drastically reduce the amount you pay for coverage. Your COBRA notice should provide you with resources to explore those options.

New job
Many employers impose a waiting period before newly hired employees can enroll in health coverage. If you have a new job that imposes a waiting period and have either an HSA-qualified health plan or COBRA continuation coverage from your last job, you can continue to make HSA contributions during this waiting period.

If your new employer offers an HSA-qualified health plan, consider transferring your old HSA over to the new one. You can make an unlimited number of direct trustee-to-trustee transfers.

Company changes

Employer bankruptcy
If your company closes or files for bankruptcy, it may no longer have a health plan and might not make COBRA coverage available.

If, however, a successor employer offers another plan, you may have COBRA rights or eligibility for a new health plan through that employer. If you decide on COBRA coverage, you may use your HSA to pay those premiums. Or, if you become covered under an HSA-qualified plan, you can also continue making contributions to your HSA.

If the bankrupt company does not make COBRA coverage available, you can use your HSA to pay for qualified medical expenses and other coverage, including premiums for insurance you buy while receiving unemployment compensation.

Branch closure
If your employer is subject to COBRA and your plant or branch office closes but the rest of the company or a parent company remains in business, your employer must offer you COBRA coverage if you lose your job and health coverage because of the closure. You can use your HSA to pay those premiums.

Company acquisition
If another company acquires yours and you lose your job, the buyer might have to provide COBRA coverage. If you opt for COBRA coverage, you can use your HSA to pay your premiums.

Change of insurance plan
Termination of a health plan does not trigger COBRA eligibility. If your employer stops offering an HSA-qualified health plan, you may no longer contribute to your HSA, but you *can* continue to use your HSA for qualified medical expenses. You can also opt for another HSA-qualified plan, but if you choose a health plan that does not qualify for HSA ownership, you cannot contribute to your HSA.

Other changes

Retirement before Medicare eligibility
If you retire before age 65, you can use your HSA for a wide range of qualified medical expenses. You can use it to pay COBRA premiums, premiums for long-term care insurance, or premiums for coverage you may buy on your own (if you receive unemployment compensation). You may also use your HSA balance to directly pay for qualified medical expenses.

If you retire from your job, accept a pension from your employer, and go to work for another employer, you cannot use your HSA to make any premium payments that your new employer may require unless you are at least age 65. Once you are 65, you may use your HSA for any health insurance premiums if it’s not a Medicare Supplement or Medigap coverage.

Medicare recipients should realize that premiums for Medigap insurance or Medicare Supplement coverage—private insurance that covers out-of-pocket costs not covered by Medicare—are not qualified expenses, so they cannot be

paid for with your HSA. Medigap policies, purchased from private insurers, differ from retiree health insurance, which employers provide. If you have retiree health insurance, you usually do not need Medigap coverage.[9]

Medicare enrollment
Once you enroll in Medicare, you may not make HSA contributions. Remember, enrolling in SSI (the income portion of Social Security) or beginning to take Social Security benefits automatically enrolls you in Medicare Part A and disqualifies you from making HSA contributions.

Like early retirees, you can use an HSA to pay COBRA premiums, premiums for long-term care insurance, or non-COBRA premiums for coverage you buy on your own (if you receive unemployment compensation). You can also use your HSA balance to pay qualified medical expenses directly.

If you remain employed after age 65, you can use your HSA to pay your share, if any, of employer-sponsored healthcare coverage if pre-tax salary reductions do not cover the amount.

If your employer offers healthcare coverage to retirees or their survivors and requires a premium contribution from participating retirees or survivors, HSAs can be used to pay for that coverage as well.

You can also use your HSA to pay Medicare premiums once you reach age 65.

Personal bankruptcy
Because HSAs fall under laws governing savings accounts, most are not protected from creditors in the event of personal bankruptcy. This means that if creditors use the money in the HSA towards outstanding debts, the account holder will have to pay income tax and the 20% penalty on the amount used for nonqualified distributions.

However, under the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), an individual debtor may deduct any reasonably necessary health insurance, disability insurance, and HSA expenses for the debtor, the spouse of the debtor, or the dependents of the debtor when determining his or her statement of monthly income.

HSA as collateral[10]
Account beneficiaries (owners) and HSA trustees and custodians cannot conduct a prohibited transaction with the HSA—namely the sale, exchange, or lease of property; borrowing or lending money; furnishing goods, services, or facilities; or the transferring to or use by or for the benefit of the beneficiary of any assets contained in the account.

In addition, IRS rules do not allow you to pledge any part of your HSA as security for a personal loan—whether for you or for someone else. If you do pledge some (or all) of your account as collateral, the Internal Revenue Service (IRS) treats the distribution as gross income, used for non-medical expenses, and therefore subject to income tax and a 20% excise tax penalty.[11]

Disability
Since you do not need to work to make HSA contributions, you can still make contributions if you continue coverage under your employer's plan (or another HSA-qualified health plan) after becoming disabled.

If you have HSA-qualified health coverage and qualify for short-term or long-term disability benefits under your employer-sponsored plan, nothing should change if your employer's healthcare coverage remains the same during the disability period.

However, because your HSA requires an HSA-qualified health plan, you become ineligible to contribute to an HSA if you lose your employer-sponsored HSA-qualified coverage because you can no longer work—unless you qualify for COBRA or obtain HSA-qualifying health plan coverage as an individual. (Note that when losing your job-based coverage, you may be eligible for PPACA's premium tax credits, and you can purchase coverage as an individual). You can use your HSA balance to make COBRA payments if you become eligible for COBRA coverage.

Note: If you must take a distribution from your HSA for non-medical expenses because of a disability, you will pay income tax on the distribution, but not the excise tax.[12]

Social Security Disability Insurance
If you qualify for Social Security Disability Insurance (SSDI) benefits,

everything changes. Note that you qualify for SSDI benefits separately from benefits under an employer-sponsored disability plan.

The Social Security Administration says that you have a qualifying disability if:

- You cannot do work and engage in substantial gainful activity (SGA) because of a medical condition, for at least the five months before filing
- You cannot do the work you did previously or adjust to other work because of your medical condition
- Your condition has lasted (or is expected to last) for at least one year or is expected to result in death[13]

If you receive SSDI benefits, you become eligible for Medicare coverage two years later. Once you have Medicare coverage, you may no longer make HSA contributions because Medicare coverage disqualifies you.

You can continue to use your HSA both during the application process and after you receive benefits. Prior to receiving SSDI benefits, you can use your HSA to pay COBRA premiums, if eligible, and can continue to make contributions if you have HSA-qualified health coverage, and no disqualifying coverage.[14] You can also use your HSA for other qualified medical expenses.

Death
When the account owner dies, any amount remaining in the HSA passes to the entity or individual named as the HSA's beneficiary. If the owner names their spouse as beneficiary, the HSA becomes the HSA of the surviving spouse.[15]

Because an HSA is an individual account, the spouse inheriting the HSA becomes the owner. The spouse can then use the HSA as any other HSA owner would.

The surviving spouse must pay income tax on amounts not used for qualified medical expenses.

If the HSA passes to a person or persons other than a surviving spouse, then the HSA funds no longer qualify for tax benefits. The heir or heirs must include

the fair market value of the HSA (as of the date of the account owner's death) as gross income.[16] Beneficiaries may reduce the calculated fair market value by any payments made from the HSA on behalf of the decedent within one year of death.[17]

Choose a beneficiary when you set up your HSA, because what happens to your HSA when you die depends on who you designate as the beneficiary. If you name your estate the beneficiary, your final income tax return will include the value of your HSA.

Summary

- Research all options for using your HSA. Familiarize yourself with qualified medical expenses, investment options, and other rules and regulations to ensure you spend and save your money wisely
- For the most accurate information about qualified medical expenses, see Title 26 Internal Revenue Code §213(d), which describes tax-deductible healthcare expenses (all of which are qualified) and §223(2)(A), which provides additional clarifications. The IRS provides two helpful publications that are updated every year. The first, Publication 502, lists qualified medical expenses that you can deduct on your taxes. This publication and Publication 969 provide helpful guidance in understanding how to use your HSA (and other tax-advantaged healthcare accounts) effectively and compliantly
- In general, you cannot use your HSA to pay insurance premiums, but you can pay Medicare premiums (except Medicare Supplement or Medigap premiums) from your HSA. Some other exceptions exist including long term care insurance premiums
- Research your options before having surgery to minimize billing surprises
- HSAs can help you with employment changes and transitions in and out of the workforce
- Coverage under Medicare puts an end to making contributions to your HSA. However, you can still use the funds you have built up in your HSA for qualified expenses, including some insurance premiums

Resources:

1. IRC §223(d)(2)(A), IRS Notice 2008-59 Q&A33, IRS Pub. 969
2. IRC §223(f)(4)(A)
3. IRC §223(f)(4)(B) and (C)
4. IRS Notice 2004-50 Q&A 39
5. IRC §213(d)
6. IRC §223(d)(2)(C); IRS Notice 2004-2 Q&A 27; IRS Notice 2005-59 Q&A 29
7. IRS Publication 969

8. IRC §223(d)(2)(c)(1); IRS Notice 2004-2 Q&A 27, IRS Notice 2008-59 Q&A 32
9. IRS Notice 2004-2 Q&A 27
10. IRC §223(e)(2), IRC §4975, IRS Notice 2004-50 Q&A 67
11. IRC §223(f)(4)(A))
12. IRC §223(f)(4)(B)
13. According to IRS Publication 524, “Substantial gainful activity is the performance of significant duties over a reasonable period of time while working for pay or profit, or in work generally done for pay or profit. Full-time work (or part-time work done at your employer’s convenience) in a competitive work situation for at least the minimum wage conclusively shows that you’re able to engage in substantial gainful activity”
14. IRC §223(d)(2)(c)(1)
15. IRC §223(f)(8)(A); IRS Notice 2004-2 Q&A 31
16. IRC §223(f)(8)(B)(i)
17. IRC §223(f)(8)(B)(ii)

Chapter 7

Saving and investing HSA funds

Chapter overview

As you learn more about how your HSA-qualified health plan works and how to manage your Health Savings Account (HSA), you can stretch the dollars in your account to cover more healthcare needs or, better yet, to save more money, year over year, for future use. By strategically contributing to your HSA and your other retirement accounts, you can reduce your tax burden and increase financial stability in your retirement years, especially for healthcare expenses you may have in retirement.

Saving HSA funds

Channeling premium savings to your HSA

A higher deductible generally means lower monthly premiums. In some cases, all available plans have higher deductibles but differ in terms of coverage before the deductible is satisfied, the network that's available, and other parameters. Be sure that you carefully consider the up-front exposure you have as well as the outer limits (out-of-pocket maximum) of financial liability you have under each option to be sure that you are making an informed decision.

While it may seem intimidating to take on an HSA-qualified health plan, it may save you money over time. If you contribute what you save by paying lower premiums into your HSA, the balance in your account can offset your higher deductible. When you contribute more than you require for healthcare expenses in any given year, your account grows. Any employer contributions add to the HSA balance. Unlike some other healthcare benefits accounts, your HSA balance can continue to grow year over year.

As an example, car insurance with a $50 deductible typically has higher premiums than a policy with a $500 deductible. Much like making decisions regarding your car insurance costs, you make decisions regarding your health coverage. Decide whether you want to pay lower upfront premium costs and save for unexpected expenses, or if you prefer the predictability of higher premium costs but less exposure when you have unexpected expenses. Doing the math usually leads to choosing a lower premium and the ability to set aside money for those potential unexpected costs.

Considering coinsurance and copayments

Your share of costs, through coinsurance and copayment levels, affect your premium price—the greater your share of costs, the lower the premium price.

For example, you will most likely pay a higher premium for a health plan that covers 100% of costs (a plan that pays 100% after the deductible) than for an 80/20 coinsurance plan (the plan pays 80% and you pay 20% until you meet your out-of- pocket maximum).

Managing coinsurance and copayments also affect your need for an HSA and/or other tax-advantaged accounts, such as a flexible spending account (FSA) or health reimbursement arrangement (HRA) and how much you may need to pay out of pocket after you meet your deductible.

Keep in mind that most coinsurance levels can also vary for in- and out-of-network care.

Using an HSA with an HRA or FSA

Contributing to an HSA requires you to have coverage under an HSA-qualified health plan and have no other disqualifying coverage. For example, some employers offer a Health Reimbursement Arrangement (HRA) or health Flexible Spending Account (FSA) that provides coverage before satisfying a deductible, which would disqualify you from opening or contributing to an HSA.

On the other hand, some employers offer HSA-qualified HRAs or FSAs (in the form of either a limited purpose HRA or FSA or a post-deductible HRA or FSA) to cover the gap between the deductible and out-of-pocket maximum for HSA owners. See Chapter 3, “Consumer-driven healthcare,” for more details. Know the requirements of your benefits, keep accurate records of your expenses, and watch the calendar—many people forget to submit reimbursement requests to their employers before the end-of-year submission deadlines for FSAs and HRAs.

If you have an HSA-qualified FSA in conjunction with your HSA, talk to your dentist and vision service providers during open enrollment to get an estimate of the dental and vision care you will need, then make an election for an LPFSA contribution to cover that amount. Make sure you do not over-contribute to the LPFSA because you can lose any unspent money at the end of the year, unless your employer’s plan allows a grace period or carryover provision, discussed in more detail in Chapter 3, “Consumer-driven healthcare.” Using an HSA-qualified FSA or HRA for your dental and vision expenses instead of your HSA lets you stretch your HSA balance further.

An HSA-qualified FSA makes the most sense for people who contribute the annual maximum to their HSA. Try to maximize your HSA contributions when considering an HSA-qualified FSA. While you can use HSA dollars for dental

and vision, you can maximize your savings by contributing to both accounts and first spending the funds from your HSA-qualified FSA.

Again, if you have a general Health FSA, you may not contribute to an HSA, but you may use the HSA-qualified version of an FSA or HRA, or both and still contribute to an HSA.

Contribution Limits for HSAs and FSAs | 2027

	Individual	Family	Catch-up contribution for >55-year-olds	Use-or-lose
HSA	$4,500	$9,000	$1,000	No
HSA-qualified FSA	$3,500	$3,500	N/A	Sometimes. Depends on employer design
HSA-qualified HRA	Employer-funded	Employer-funded	N/A	Depends on employer design

Determining how much to contribute

Try to contribute as much money to your HSA as the law and your family budget allow, because HSAs have better tax benefits than any other savings plan, including traditional Individual Retirement Accounts (IRAs), 401(k)s, and Roth IRAs.

Among other insurance plans and retirement accounts, only an HSA lets you make tax-deductible contributions, enjoy tax-free growth through interest or investments, and spend the money on qualified medical expenses without paying federal income tax, and in most cases, state income tax as well.

Unlike other tax advantaged health accounts such as FSAs or HRAs, the money in your HSA belongs to you forever. You may also use your HSA to pay non-health-related costs when you reach 65, paying only income tax (and no penalties on the funds you withdraw).

If you have a tight budget and can't fully fund your HSA, remember that Internal Revenue Service (IRS) rules allow you to make contributions beyond the end of the year (until the tax filing deadline) and still receive tax benefits.

Funding strategies for HSAs and 401(k)s

Many employers offer both HSAs for healthcare security now and into retirement and 401(k)s for retirement security. Employees can contribute to both accounts and should consider the unique triple-tax advantage of the HSA when they decide how to allocate contributions between the benefits.

Try and maximize your savings potential by funding your accounts in such a way that you receive the full benefits of both.

- Remember that an HSA provides tax-free reimbursement for any money that you spend on qualified medical expenses now or in the future. In addition, you can use an HSA after the age of 65 for non-healthcare spending without penalty—though you will pay income tax, as with traditional IRAs and other retirement accounts such as 401(k)s/403(b)s.
- Determine if your employer contributes to either your HSA or other retirement accounts, the level of their contribution, and if you need to contribute to receive employer contributions. If possible, plan to contribute what you need to, to obtain the full employer contribution. Do not turn down free money.
- Think about the total amount of money that you have in your budget to contribute collectively to *all* your retirement accounts.

With these factors in mind, consider first contributing enough money to your HSA and other retirement accounts to receive any contributions and matching funds that your employer offers. Then consider contributing to your HSA up to the allowable annual maximum contribution limit, including catch-up contributions if you qualify. Also, consider adding funds to your 401(k), up to the annual maximum—keeping in mind that HSAs offer more tax advantage than 401(k) and Roth accounts.

To enhance your savings even more, consider paying your medical expenses out of pocket, if you can afford to.

As always, discuss your funding strategy with your accountant or other tax professional.

Using payroll deductions

If you foresee a large medical expense during the year, try to prepare for it by increasing your payroll deduction or fully funding your HSA at the beginning of the year, particularly if you expect to retain HSA-qualified health coverage for the entire year. Alternatively, review your HSA terms to see if there is an acceleration feature allowing you to access funds earlier in the year than contributed.

EXAMPLE: Funding an HSA early in the year
The Kim family is expecting their second child in July. The plan year for their HSA-qualified health plan began six months earlier, on January 1, 2026.

They have family coverage with a $5,000 deductible and no embedded deductible. Their plan has maternity coverage and no coinsurance once they meet their deductible.

Expecting out-of-pocket expenses in July associated with the birth of their child, they increase their HSA contributions to $800 per month, so that by July 1, they will have contributed $4,800 in their HSA for the year.

For the 2026 tax year, Mr. and Mrs. Kim can contribute up to $8,750 to their account, meaning they can still contribute $3,950 over the next six months if they remain eligible to contribute to the HSA for the entire year.

By the time of the projected due date, they will have nearly enough money in their HSA to satisfy their entire $5,000 deductible. Their HSA-qualified health plan will fully pay all in-network costs that exceed $5,000.

Shopping carefully

You have many opportunities to compare costs and shop for bargains on prescriptions and medical supplies, both through your health plan and by doing a little research on the internet. Don’t forget to check websites that rate

hospitals and compare treatment costs. Your HSA administrator may provide links for cost comparison tools and websites on your HSA member portal. There are also a growing number of price transparency tools that are available if you spend the time to research them. Your HSA custodian or health plan may also have resources to assist you in comparing prices.

Examples

*Note the examples used are for illustrative purposes only.

As you become familiar with the covered benefits, deductibles, contributions, and out-of-pocket expenses associated with your HSA-qualified health plan, you can use your HSA more effectively.

The following examples show how HSAs can help decrease health coverage premiums and build good healthcare consumer skills. These studies illustrate how to get the most out of your HSA by:

- Understanding and selecting the best HSA-qualified health plan design for your situation
- Determining the right amount of money to contribute to your HSA

So that you can easily make side-by-side comparisons, the employee contributes no money to their HSA in each of the examples below.*

EXAMPLE: Comparison shopping

Holly, a 35-year-old married mother of four, lives with insulin-dependent diabetes. Holly's husband recently left a job that offered health benefits through a lower-deductible, traditional plan. His new employer offers an HSA-qualified health plan.

With her previous health plan, she had a reasonable copay for insulin, so she didn't consider checking for a better deal elsewhere. As she started using her new plan, she realized that she received comparable care to what she had before and could put money in her own pocket when she shopped around.

By asking questions about lab work, blood tests, and examinations, she learned how to save money by switching to generic drugs and buying a less expensive blood glucose monitor and test strips. In fact, she started buying a hemoglobin A1c (HbA1c) test from the pharmacy, which cost about half of what she paid when the lab tested her blood. She also learned to watch for coupons and rebates.

EXAMPLE: HSA-qualified health plan vs. PPO with chronic disease

Clark and Alexis, a middle-aged married couple, begin to need care for chronic conditions. During his employer's open enrollment period for 2027 benefits, Clark uses his and Alexis' medical history from 2026 to compare benefit options.

In 2026, Clark and Alexis took advantage of free preventive care screenings through their health plan. They also took medications for some mild chronic illnesses and had one urgent care visit during the year.

	Clark	Alexis
Age	58	57
Health	One chronic condition with two prescriptions	Pre-diabetic controlled by diet
Healthcare utilization	Regular doctor and preventive visits One urgent care visit for cut hand	Regular doctor and preventive visits

To compare plans, Clark totals the premiums, medical expenses, and employer contributions to the HSA.

Even though he does not typically meet his HSA-qualified health plan deductible and had to pay for healthcare expenses out of his HSA (and out of his own pocket after depleting the HSA), he still pays $1,583 less under the HSA-qualified health plan.

Money in				
Employer HSA contributions		$0	$82.25 x 12 months	$987
Money out				
Employee contribution to healthcare premiums[1]	$645 x 12 months	$7,740	$381 x 12 months	$4,572
Total provider visits	Copays	$115	Paid from HSA	$895

Total prescriptions	Copays	$140	Paid from HSA	$722
Money out subtotal		$6,272		$6,189
Less employer HSA contribution		$0		-$1,500
Total money out		$6,272		$4,689
Difference in out-of-pocket expenditures			Savings	$1,583
HSA balance remaining		$0		$0

EXAMPLE: HSA-qualified health plan vs. PPO with good health
Li knows the importance of health insurance and good habits. She watches what she eats and gets enough exercise and sleep. She has a relatively low income and watches her budget carefully.

	Li
Age	35
Health	Excellent
Medications	One generic antibiotic
	Two doctor visits: annual checkup, strep throat

Like Clark, Li compares her two plan options using her expenses from 2025. Because she worries about the higher deductible in the HSA-qualified health plan, she finds the $0 deductible in the PPO very attractive. Even though she enjoys good health, she does not think she can afford unanticipated medical expenses because she largely lives paycheck to paycheck.

She also notices that the out-of-pocket maximum for the HSA-qualified health plan is $3,200, compared to $2,000 from the PPO plan.

Her employer contributes $750 to her HSA at the beginning of the plan year, but she does not see much of an impact from that at first. Her co-worker encourages her to do the math.

Premiums and contributions

	PPO plan		HSA-qualified health plan	
Deductible		$0		$1,500
Out-of-pocket maximum		$2,000		$3,200
Annual premium contributions	$85 x 12 months	$2,004	$97 x 12 months	$1,164
Employer HSA contributions		N/A	$62.50 x 12 months	$750

Both of Li's insurance plan choices would cover her annual checkup as a preventive benefit.

Provider visits

	PPO plan		HSA-qualified health plan.	
Annual preventive exam	100% covered	$0	100% covered	$0
$100 doctor visit	$25 copay	$25	Pays from HSA	$100
Total office visit costs		$25		$100

Li purchased only one prescription in 2025: an antibiotic (generic instead of name brand) to treat strep throat.

Prescriptions

	PPO plan		HSA-qualified health plan	
Antibiotic ($152.16 or $31 for generic)	$10 copay	$10		$31
Total prescriptions		$10		$31

Everything comes into perspective with a contribution to her HSA, she saves money with an HSA-qualified health plan.

Though worried about the higher deductible and out-of-pocket maximum, she finishes the year with a positive balance in her HSA (more than $600). Even with a $0 deductible, she would have paid at least $700 more with the PPO

plan compared to the HSA-qualified plan when she factors in monthly premiums and copay costs.

	PPO plan		HSA-qualified health plan	
Money in				
Employer HSA contributions		$0	$62.50 x 12 months	$750
Money out				
Annual premium contributions	$167 x 12 months	$2,004	$97 x 12 months	$1,164
Total office visit costs	Copays	$25	Paid from HSA	$100
Total prescriptions	Copays	$10	Paid from HSA	$31
Total money out		$2,039		$1,295
Money out: PPO vs. HSA-qualified health plan			Savings	$744
HSA balance remaining		$0		$619

EXAMPLE: PPO vs. HSA-qualified health plan with accidental injury
Derek and Lauren have two children. Derek works for an electrical contractor and Lauren works at a local university. Lauren has better benefits, so she opts for family coverage from her employer.

They have two very active boys. One was injured in a bicycle accident in 2026. They have no reason to believe that the boys will become any less adventurous in 2027.

	Derek	Lauren	Children
Age	38	36	6 and 10
Health	Excellent	Excellent	One child required surgery
Medications	None	None	None
Healthcare utilization	Regular doctor and preventive visits	Regular doctor and preventive visits	Regular doctor and preventive visits, one ER visit, surgery, and 3-day stay for injury

Lauren uses the family's 2026 medical expenses as a guide to compare her two 2027 plan options: a PPO plan with a relatively low deductible and out-of-

pocket maximum and an HSA-qualified plan with a much higher deductible and out-of-pocket limit, but no employee-paid premium. Her company will also contribute to an HSA, if she opens one.

Premiums and contributions

	PPO plan		HSA-qualified health plan	
Deductible		$2,000		$4,000
Maximum out-of-pocket limit		$2,500		$5,000
Coinsurance		20%		20%
Annual premium contributions	$400 x 12 months	$4,800	$0 x 12 months	$0
Employer HSA contributions		$0	$150 x 12 months	$1,800
Employee HSA contributions		N/A	$0	$0

The hospital expenses for the surgery far exceed the out-of-pocket maximum for both plans, so she only uses the out-of-pocket amounts to compare the actual costs of each plan.

Provider visits

	PPO plan		HSA-qualified health plan	
Two annual preventive exams	Preventive 100% covered	$0	Preventive 100% covered	$0
Emergency room, surgery, labs, prescriptions for bicycle accident	All expenses above out-of-pocket max. paid 100% by health plan	$19,735	All expenses above out- of-pocket max. paid 100% by health plan	$19,735
Out-of-pocket maximum	Entire amount paid out-of-pocket	$4,000	$1,800 from HSA, $4,000out of pocket	$5,800

When Lauren compares money in versus money out, she sees that the HSA-qualified health plan option provides greater protection against out-of-pocket expenses.

	PPO plan		HSA-qualified health plan	
Money in				
Employer HSA contributions		$0	$150 x 12 months	$1,800
Money out				
Annual premiums	$400 x 12 months	$4,800	$0 x 12 months	$0
Provider costs		$4,000		$5,800
Money out subtotal		$7,300		$5,800
Less the HSA employer contribution		$0		$1,800
Total money out		$7,300		$4,00000
Money out: PPO vs. HSA-qualified health plan			Savings	$4,000
HSA balance remaining		$0		$0

With this plan design, Lauren saves $4,000 by choosing the HSA-qualified health plan, even with a large, unforeseen expense. She can save even more if she uses her savings to make additional pre-tax contributions to her HSA.

Minimize spending, maximize savings

You can increase the balance in your HSA by both reducing expenditures and increasing account earnings.

Retail pricing
Most providers may have negotiated contracts with several health plans, so may not be able to tell you what your actual cost will be for the service. It's wise to contact your health plan about costs or how to obtain the best pricing when you visit your doctor.

Early HSA contributions
The law governing HSAs provides you and your employer with flexibility in funding your HSA. You or your employer can make contributions to the HSA on

any schedule that you find convenient, as long as the total contributions made to your account each year do not exceed the annual maximum contribution limits.

If you have a bill that exceeds your balance, you can pay the bill using other resources, then file for reimbursement from your HSA once your balance has grown sufficiently. Your HSA trustee will provide you with what you need to request reimbursements.

Return duplicate reimbursements to your HSA
If you pay directly from your HSA and then receive reimbursement from the health plan for the same expense (or a refund from the provider because of discounted rates), return the reimbursed amount to the HSA administrator promptly. If you do not return the duplicate reimbursement, you will have to pay income taxes and a penalty to the IRS. This also applies to any refunds you receive from health providers for over-payment.

You can repay mistaken distributions from an HSA before the tax filing deadline without penalty, provided your HSA's trustee permits it, and you can provide "convincing evidence" that the distribution occurred because of a mistake.[2]

Investing HSA funds[3]

If you make your maximum annual contributions, manage your funds carefully, and look for ways to get the best value (for example, by comparing prescription prices at different pharmacies and using in-network providers), the money in your HSA can grow over the years.

Investing the money in your HSA can increase the earning potential of your account, but it also increases your risk. When your account balance reaches the minimum required by your HSA administrator (usually $1,000 or $2,000), you can invest any money over that threshold.

Investment options usually include mutual funds, stocks, and other investments. Most HSA administrators provide a website for you to set up investments and make trades.

You will not pay the federal tax on the increase in value in these investments, provided you spend the money on qualified medical expenses.

Investment choices
You can invest your HSA funds in the same sorts of investments approved for IRAs: annuities, certificates of deposit (CDs), stocks, mutual funds, and bonds. You cannot invest in life insurance contracts or collectibles (art, antiques, etc.), nor can you co-mingle HSA assets with other property, except in a common trust or investment fund.[4]

Earnings on money invested from your HSA accrue tax-free at a federal level, but keep in mind that all investments carry risk, including the possible loss of the principal invested, and are not protected by FDIC or NCUA insurance. As such, some account holders may choose not to invest their funds. Those who do should review the applicable fund's prospectus. Investment options and thresholds vary amongst HSA custodians and sometimes change year to year. Consult your advisor or the IRS with any questions regarding investing or filing your tax return.

Paying qualified medical expenses using invested HSA funds
If you have a large qualified medical expense, you can move money out of your investments back into your HSA with no tax penalties and without affecting your yearly contribution maximum, because the IRS views this transfer as a dispersal, not a contribution.

If you choose an HSA administrator with no trading fees, you can make trades and maintain your investment account with no extra fees.

Summary

Employ various strategies to reduce your overall out-of-pocket medical and retirement costs.

- Before selecting from among your available health plans, analyze your options by reviewing last year's healthcare costs against the options you have available. Consider insurance premiums, employer contributions, tax liability, copay and coinsurance, deductibles, and out-of-pocket maximums
- To maximize your tax benefit and help your savings grow as quickly as possible, consider contributing enough to receive all matching funds that your employer provides. Keep in mind that HSAs provide even more tax advantages than 401(k)s

Resources:

1. Kaiser Family Foundation 2021 Employer Health Benefits Survey; National Survey of Employer-Sponsored Health Plans
2. IRS Notice 2004-50 Q&A 37
3. IRS Notice 2004-50 Q&A 65
4. See IRC §408(m)

Chapter 8

Paperwork, recordkeeping, taxes

Chapter overview

You own the funds in your Health Savings Account (HSA), so treat your HSA (and HSA-related records) as you would your other financial accounts, including retirement accounts, investment and savings accounts, and credit cards. Check your statement each month and make sure you understand the charges to your account; if you don't, seek immediate explanation.

Set up an intuitive, easy-to-use filing system and keep accurate, well-organized records—not only to request reimbursement or calculate tax deductions, but also to prove the deductions claimed on your tax return if audited by the Internal Revenue Service (IRS).

Disputes or questions about billing and payments can arise even a year or two after a procedure or office visit. It's important to keep records in a way that allows you to easily reconstruct exactly how you spent your money.

Processing paperwork

You may find keeping track of HSA expenses, contributions, and earnings similar to sorting expenses you deduct on your income tax but using different categories.

Submitting expenses

Submitting expenses to your HSA-qualified health plan
If your provider participates in your plan's network, they should submit your claim to your insurance plan. If not, you may have to file the claim yourself, for accurate tracking of your deductible and out-of-pocket limit. The plan should supply you with a form for filing claims, but many providers include enough information on the statement you receive before you leave the office that you can use the statement itself to file your claim. Remember: always keep copies of your statements in case of a dispute.

Requesting distributions from the HSA
Some HSA administrators provide a debit card or checkbook to pay qualified expenses directly from your HSA. You can also pay these qualified medical expenses from your personal account or credit card and then submit requests for reimbursement from your HSA. Some HSA administrators make provisions for account holders to transfer funds electronically from their HSA to their personal account.

Regardless of how you get reimbursed, you can receive reimbursement only for expenses you incurred after your HSA was established.[1] See CHAPTER 2 "Health Savings Accounts" for more details.

Unlike your health plan, flexible spending account (FSA), and health reimbursement arrangement (HRA), your trustee or custodian does not determine if the distributions qualify as reimbursable medical expenses, so you must maintain proper records to prove your claims—especially if you need to pay with personal funds and seek reimbursement.

Submitting expenses to another plan, such as an FSA or HRA
If you had an FSA in the past and your employer converts to an HSA-qualified health plan with an HSA-qualified flexible spending account (FSA) or health

reimbursement arrangement (HRA), you will find the submission process very similar. You submitted expenses to your FSA or HRA administrator by explaining benefits form (see description below) or itemized receipt; your HSA-qualified FSA or HRA will work the same way.

Reviewing insurance-related paperwork

Invoices and point-of-sale receipts
As of January 1, 2020, over the counter (OTC) medications no longer require a doctor's prescription to be an HSA-qualified medical expense. You can also purchase other items with your HSA, such as diabetic supplies, canes, reading glasses, and bandages.

All receipts and invoices should have as much detail about the goods or services provided as possible, including date, item, service description, vendor, etc.

Explanation of benefits (EOB)
Your health plan periodically provides an EOB, a summary of charges and payment responsibilities. It shows how much the provider originally charged, how much your health plan paid the provider, and the contracted discounts to which your providers have agreed.

The EOB also shows your financial responsibility, summarizes the cost of the services provided during the doctor's visit, updates you on your progress toward meeting the plan deductible, and explains your right to dispute any statements made in the EOB.

HSA statements
Your HSA administrator will provide a periodic statement containing the following details concerning your account:

- Your contributions
- Contributions your employer made on your behalf
- Payments made to providers from your HSA
- Investment and interest earnings accrued
- Fees

Organize and save these statements the same way you do for other financial accounts, possibly even in the same place.

If you treat your HSA as a long-term savings vehicle, you can accumulate funds over a considerable period and may receive reimbursement from your account many years after you incur a qualified medical expense. Because you might need to produce records about account transactions long after they occurred, keep all receipts and statements for at least three years after you receive reimbursement. Tax audits usually occur within three years, though they can sometimes take as long as six years to occur.[2]\

Sample of explanation of benefits
(Note: examples used are for illustrative purposes only)

THIS IS NOT A BILL
(Please keep this form for your records)

Explanation of Benefits (EOB)

Carolyn Harper
82 Smith Street
Webster, IL 62372

Date: **March 12, 2027**
Benefit plan number: **XYZ00000000A**
Page number: **1 of 1**

Participant: **Caroline Harper**
Patient: **Caroline Harper**
Relationship: **Subscriber**

Member services
Local: **000.000.0000**
National: **800.000.0000**

Payment Summary					
Patient/claim no.	Paid to	Total charges	Covered amount	Previously processed	Patient responsibility
Caroline H 1234567890		$135.00	$60.00	$0.00	$75.00

Subscriber's responsibility: $75.00
Does not reflect any payments you may have made to the provider.

2027 year-to-date cost sharing status

Applied to $3,000 per member deductible:
Caroline H. **$75.00**
$75.00 has accumulated toward deductible maximum.

Sample of periodic HSA statement

(Note: examples used are for illustrative purposes only)

If you have any questions,
please call **800.000.0000**

Caroline Harper
82 Smith Street
Webster, IL 62372

Account statement
Account number: **123456**
Period: 06/01/2027 to 06/30/2027
Statement print date:07/01/2027

Date	Description of transaction	Deposit (withdrawal)	Acct balance
	Beginning balance		$ 8,803.98
06/02/2027	Employer contribution (Tax year: 2027)	$83.33	$8,887.31
06/02/2027	Employer contribution (Tax year: 2027)	$89.58	$8,976.89
06/03/2027	Payment for claim 219325-0142	($15.00)	$8,961.89
06/15/2027	Employee contribution (Tax year: 2027)	$89.58	$9,051.47
06/15/2027	Employer contribution (Tax year: 2027)	$249.99	$9,301.46
06/21/2027	Payment for claim 219325-0143	($102.74)	$9,198.72
06/30/2027	Payment for claim 219325-0146	($244.69)	$8,954.03
06/30/2027	Investment: Fund A	($1,043.10)	$7,910.93
06/30/2027	Investment: Fund B	($695.40)	$7,215.53
06/30/2027	Investment: Fund C	($1,043.13)	$6,172.40
06/30/2027	Investment: Fund D	($695.40)	$5,477.00
06/30/2027	Investment: Fund E	($695.40)	$4,781.60
06/30/2027	Investment: Fund F	($695.40)	$4,086.20
06/30/2027	Investment: Fund G	($695.40)	$3,390.80
06/30/2027	Investment: Fund H	($695.40)	$2,695.40
06/30/2027	Investment: Fund I	($695.40)	$2,000.00
06/30/2027	Interest for Jun-19 (Annual percentage yield earned for period is 1.25% on average collected balance of $8,864.03)	$9.18	$2,009.18
Ending balance			$ 2,009.18

Investment portfolio

Fund	Category	Shares	Closing price	Closing value
Fund A	Small Cap Fund	73.14	$18.71	$1,368.45
Fund B	Small Cap Stock Index	82.71	$16.34	$1,351.48
Fund C	Blue Chip Value	223.25	$9.10	$2,031.58
Fund D	Emerging Markets	34.82	$41.06	$1,429.71
Fund E	International Market Masters	93.76	$15.12	$1,417.65
Fund F	Appreciation Fund	43.90	$31.39	$1,378.02
Fund G	Capital Appreciation	66.34	$20.72	$1,374.56
Fund H	Equity Income Fund	69.49	$19.52	$1,356.44
Fund I	Large Cap Index	108.47	$18.89	$2,049.00
			Ending balance	$13,756.89

Tracking deductibles

The EOB you receive from your health plan will show your progress toward meeting the plan limits for the year. Make sure you know how to interpret the deductible information in the EOB and always try to work from the most recent statement so you can make the right decisions about your care and how to pay for it. If you do not have an HSA administrator that integrates with your insurance company and gives you a history of all the expenses paid by your HSA, it takes more effort to track your payments.

Always reconcile the paperwork you receive from your health plan with statements from your HSA. If you have had a problem with your health plan or HSA, you may have to follow up with both your health plan and HSA administrators to correct the error in both accounts.

In-network vs. out-of-network care

Most plans that include provider networks apply different out-of-pocket limits, deductibles, or both, to in-network and out-of-network care. In most health plans, this doesn't matter to you unless you or your family have a particularly costly year or see a lot of out-of-network providers.

Because the deductible under an HSA-qualified plan may be higher than you are used to, pay close attention to the progress toward your in-network and out-of- network deductibles and out-of-pocket limits so you can adjust your provider choices accordingly.

EXAMPLE: Selecting a network provider

Raj has a self-only plan with a $1,700 out-of-pocket limit for in-network care and a $2,600 limit for out-of-network care.

In-network care is covered at 100%, out-of-network care at 80%. His plan's deductible is $1,700.

Raj has spent $1,600 so far this year for in-network care and $250 for out-of-network care. He may have foot surgery that will cost $2,000.

He can choose an in-network provider or one out of his network. If he chooses an in-network provider, he will pay $100, no matter what price the provider has negotiated with his plan. If he chooses an out-of-network provider, he will pay $400 ($2,000 x 20% non-network coinsurance).

Recordkeeping

Tracking HSA usage

In all health plans, your plan only pays for what it covers. Typically, plan documents or a summary plan description (SPD) received from your employer or the health plan lists covered services.

By using an HSA, though, you can pay for a wide range of expenses, limited only by HSA legislation and IRS rules for qualified medical expenses.

You need to understand what expenses qualify and save appropriate documentation and receipts in case you need to substantiate your distribution. If you do not, you may face a 20% penalty plus taxes for ineligible distributions, just as you do if you spend the money on items other than qualified medical expenses.

Keeping accurate records

You can use any home financial software or spreadsheet program to help you budget and track medical expenses. However, if you need to substantiate or contest a claim, you will need copies of the original documents—either paper copies or electronic files. Some HSA administrators provide mobile apps to conveniently photograph and store these documents. Keep your HSA records for as long as the account remains open, even if you have moved your account to a different provider or have lost your eligibility to contribute.

Your HSA may pay for expenses not covered by your HSA-qualified health plan. For example, you can use your HSA for chiropractic services that your health plan may not cover.

Organizing HSA and health plan records

You may choose to save and file hard copies of your statements and receipts. If so, consider using a simple multi-pocket folder or a three-ring binder with separators. Remember that you will need original documents, electronic

copies, or photocopies of receipts in the event of an Internal Revenue Service (IRS) audit.

Alternatively, you may prefer to manage your insurance-related paperwork electronically by scanning your documents and storing them on your computer or in the cloud. Financial reports provided by your HSA administrator or by household budget programs can help you track your expenses.

After you have picked your organization system, set up the following sections:

- Bills and proofs of payment from in-network providers

  In addition to the bills you receive, include canceled checks or credit card receipts for any bills you did not pay directly from your HSA

- Bills and proofs of payment from out-of-network providers

  Again, include canceled checks or credit card receipts for any bills you did not pay directly from your HSA and copies of all bills

- EOBs from network providers

  Arrange in reverse chronological order (most recent on top), so you can easily track your progress toward meeting your health plan's limits that may apply to your network care

- EOBs from out-of-network providers

  Arrange in reverse chronological order to easily track your progress toward meeting any separate health plan limits that may apply to out-of-network care. You may not need separate files for in-network and out-of-network care if your health plan does not apply separate limits

- Bills and proofs of payment for healthcare not covered by your health plan Retain receipts and importantly, the bills that give details about the products and services obtained for costs incurred that your health plan does not cover (and therefore do not count toward your deductible), because you can use your HSA for expenses not covered by your health plan. For example, the cost of braille reading materials for a blind person or the cost for transportation to and from providers or to see a specialist in another city are potentially covered by your HSA

- Statements from HSA trustee or custodian

For ease of reference, you may want to arrange this part of your file in reverse chronological order to see the most current statement first

Ensure that your system allows you to differentiate between submitted, paid, and outstanding expenses.

Label your file with the current year and set up a new file every year. This will make it easier to track bills and reimbursements as time passes.

Storing records electronically

If you choose to store your records electronically, we suggest you have both on-site and off-site backups (in case of disaster, both your computer and on-site backup can suffer damage). If you plan to store your back up in the cloud, choose carefully because some commercial services do not encrypt data, making it potentially visible to hackers, government agencies, and other entities. Some HSA administrators provide long-term access to your claims and HSA transactions for future reference and reimbursement needs.

Disputing charges

If you get a bill that does not make sense, call your provider's office, the customer service number provided for your health plan, or both. If you receive an incorrect statement, resolve the issue as soon as you can.

Everybody makes mistakes; a busy medical practice deals with many different plans that change requirements frequently, as well as patients whose plans change from time to time. Take the initiative to keep track and follow up.

Disagreeing with your health plan
All health plans can experience claims-processing errors from time to time. Errors might include processing an in-network provider's invoice as out-of-network or recording a participant's birth date incorrectly, resulting in a denial of benefits.

Because errors like these might affect your progress toward receiving coverage or meeting the year's deductible, immediately follow up on errors.

Disagreeing with your HSA statement
You've probably had an unauthorized charge appear on a credit card at some

point—sometimes because of identity theft and sometimes because of a simple processing error. If your HSA custodian issues you a debit card, review charges on your HSA just as you do the charges on your other debit and credit card statements.

Understand your rights to have a disputed charge investigated, removed, or both. If your HSA issues checks, understand your rights to stop payment on a check and learn what to do if you lose your checkbook. The laws governing checkbooks and debit cards differ. Therefore, your rights to dispute a claim will vary depending on how the account was used.

Meeting IRS requirements

Because your HSA provides tax advantages, the IRS determines how you can spend your money. You can wait as long as you wish after incurring a qualified medical expense to submit it to your HSA. However, no matter how old the expense is, you must have what you need to fully document it to the IRS in the year you claim it or receive the distribution, if necessary.

Meeting HSA-qualified health plan deadlines

Your employer may change from an HSA-qualified health plan offered by one company to one offered by another or may eliminate your HSA-qualified health plan entirely and move to another plan design.

If you change health plans, ensure that the correct plan pays the accrued expenses. You may need to coordinate your HSA with the new HSA-qualified health plan. If your employer changes plans or your spouse's coverage changes and you become ineligible to contribute to an HSA, you cannot contribute to your HSA as of the first day of the first month after the month your HSA-qualified health coverage ends. For example, if your HSA-qualified health coverage ends on June 15, you may not contribute to your HSA as of July 1. However, you can continue to use the funds in your HSA for qualified medical expenses.

Saving receipts and statements

You must retain proof that your HSA distributions paid for qualified products

and services. The HSA custodian or trustee, your health plan, and your employer provide various aspects of your account reporting, but not this.

The IRS can generally audit most individual taxpayers for three years after the extended due date of the return.[1] For example, your income tax return for 2026 is due April 15, 2027, but you file for the automatic extension to October 15, the IRS can audit you until October 15, 2030.

In some situations, the IRS may conduct audits up to six years later—for example, if you understate income more than 25% of the total you have reported. In the case of tax fraud or tax evasion, the window extends even further.[2]

Keep records documenting your HSA distributions for at least the period of time your income tax return is subject to audit, and preferably for as long as you maintain the account.

Even if your HSA provider gives you a debit card, credit card, or a checkbook, you may end up requesting reimbursement yourself because you forgot to use the HSA, or because you may not have had enough money in your account at the time of the expense.

If you wait to organize your receipts, you may miss out on important benefits from your account and you may end up using post-tax dollars when you had HSA funds available. However, some use this strategy to preserve their account. Many HSA owners choose to pay for qualified medical expenses with after-tax dollars, saving documentation for later tax-free reimbursement.

Be sure you obtain the documentation needed in the event your plan changes and you no longer have access to the health plan's website.

EXAMPLE: Postponing reimbursement
Lakeem has had an HSA-qualified health plan for years and built the balance in his HSA up to more than $150,000. Lakeem plans to retire soon, but will wait to take Social Security until after 70 to maximize his monthly benefit.

Lakeem diligently pays any out-of-pocket expenses with after-tax funds and saves the documentation, keeping a running total qualified expenses.

Just before Lakeem retires at age 69, he requests a distribution of $75,000 (which happens to equal his annual take-home pay) to reimburse expenses he previously paid with after-tax dollars.

This distribution will fully fund his first year of retirement, allowing him to postpone his Social Security benefits until they reach their maximum benefit level.

Paying taxes

Deductions

Your employer will report employer HSA contributions on your Form W-2. Your HSA trustee or custodian will report distributions to you and the IRS on Form 1099-SA and contributions on Form 5498-SA.

The employer, employee, or individual (for HSAs not associated with employer-sponsored benefits), depending on who makes the contribution, may claim federal income tax deductions for HSA contributions—and for most states.

Deductions for contributions from others
Although parties other than the account holder or their employer can make contributions to the account holder's HSA, those third parties cannot deduct the contribution from their taxes.

However, the account holder who received the contribution can deduct the contribution from his or her gross income.

EXAMPLE: Contributing to an adult child's HSA
Mindy and Maria's 25-year-old son Carlos attends college—too old to qualify as a tax dependent, but young enough to retain coverage by his parents' HSA-qualified health plan.

Mindy helps Carlos open his own HSA and makes a $1,000 contribution to it. Mindy and Maria cannot deduct the $1,000 on their own tax return, but Carlos will not include it in his gross income.

Deductions for an employee or individual purchaser
Calculate the tax-deductible contribution amount on a month-to-month basis, based on the total amount of the deduction and the number of months of participation.

You can enter your contribution as an above-the-line deduction to calculate adjusted gross income. Individuals covered under a cafeteria plan will make contributions on a pre-tax basis which will be reflected on the W-2 from their employer.

EXAMPLE: Making an HSA contribution an above-the-line deduction

Hank, a single taxpayer, makes $36,000 a year and contributes $1,000 to his HSA.

On his tax return, he can only deduct medical expenses that exceed 7.5% of his adjusted gross income if he itemizes his deductions on Schedule A. Hank has not had any medical expenses for the year. He can, however, take an above-the-line deduction by subtracting the $1,000 HSA contribution when calculating his adjusted gross income through completion of IRS Form 8889.

Double-dipping
You cannot deduct an HSA contribution as an itemized medical expense. Similarly, you cannot request payment for the same expense from two different health plans or both take a distribution from your HSA for a medical expense AND deduct it on your taxes.
However, as an eligible individual, you can deduct a contribution to your HSA (other than those made on a pre-tax basis through salary reduction) on your tax return, even if another person makes it on your behalf.[3]

Contributions

Employer-provided coverage
The IRS treats employer contributions to an employee's HSA as employer-

provided coverage under an accident or health plan (and therefore excludable from the employee's gross income, if made on behalf of an eligible individual. [4])

Employer contributions are not subject to income tax withholding from wages or to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), or the Railroad Retirement Tax Act.

State taxes may apply to some employer contributions.

Self-employed individuals and owners of S corporations
Self-employed individuals and 2-percent shareholder-employees of S corporations are not considered employees. As such, they cannot receive employer contributions.

However, they can make their own contributions and claim the above-the-line deduction on their personal income tax return.

Treat contributions to the HSA from a bona fide partner as a distributive share of partnership income—payments derived from the partnership's trade or business and reported as such on IRS Schedule−K1 (Form 1065). Include the contributions in the partner's net earnings, from which the partner may deduct the contributions as an adjustment to gross income, just as any HSA owner may legally do.

The IRS considers contributions to the HSA of a greater than 2-percent shareholder-employee (for services rendered) as earnings. As such, the greater than 2-percent shareholder-employee must include the amount in his or her net earnings and can then deduct the contribution as an adjustment to gross income.

General tax forms

Wage and tax statement (W-2)
Employers must generally file a W-2 Form for any employee to whom they pay wages in a given tax year. Employees must provide either a physical or digital copy of this form with federal, state, and local income tax returns. Your employer must report employer contributions (which include pre-tax cafeteria

plan contributions to your HSA) in Box 12 on your W-2 Form (coded “W,” according to the instructions).

US individual income tax return (Form 1040)
If your HSA contributions exceed the legal limit ($4,500/$9,000 for individuals or families in 2027), the excess increases your adjusted gross income (AGI). The HSA holder must report the excess contribution and compute the excise tax on Form 5329. Be sure and enter any post-tax HSA contributions on Form 1040 to calculate your AGI. Also include distributions made for anything other than qualified medical expenses using Form 8889.

Specific medical and Health Savings Account forms

The amounts reported on Forms 5498-SA and 1099-SA must agree with what you report on Form 1040.

Contributions to Medical Savings Accounts (Form 5498-SA)
Your HSA trustee or custodian will report HSA contributions to both you and the IRS on Form 5498-SA. This form also covers other Medical Savings Accounts: HSAs, Archer MSAs, and Medicare Advantage MSAs (MA MSAs).

Distributions from Medical Savings Accounts (Form 1099-SA)
Your HSA trustee or custodian will report HSA distributions to both you and the IRS on Form 1099-SA. For this reason, keep accurate records so you can prove the legality of your HSA distributions. Form 1099-SA also covers other Medical Savings Accounts: HSAs, Archer MSAs, and Medicare Advantage MSAs (MA MSAs).

HSAs (Form 8889)
You must file Form 8889 with Form 1040 or Form 1040NR if you (or your spouse, if married and filing a joint return) had any activity in your HSA during the year (contributions or distributions). You must file the form even if the only contributions to your HSA came from your employer or your spouse’s employer.

Complete a separate Form 8889 for each HSA if, during the tax year, you are the beneficiary of two or more HSAs, or you are a beneficiary of an HSA and you have your own HSA. Enter “statement” at the top of each Form 8889 and

complete the form as instructed. Next, complete a controlling Form 8889 combining the amounts shown on each of the statement Forms 8889. Attach the statements to your tax return after the controlling Form 8889. If you and your spouse both have HSAs, complete separate forms for each account; the IRS does not publish a joint Form 8889.[5]

Taxable contributions and distributions (Form 5329)
The calculations on Form 5329 will help you determine if you made contributions to or distributions from your HSA beyond the IRS-established limits. Also, if you experienced a significant life event, such as a divorce, this form could help you determine if your change in coverage caused additional tax liability.

If you have taxable HSA-related income, you will not only pay income taxes, but penalties as well: 6% for excess contributions and 20% for non-qualified distributions in 2025. If your calculations show that you owe tax or penalties on non-qualified distributions or excess contributions, you must file this form with your income tax return.

Note: HealthEquity does not provide legal, tax, financial, or medical advice.

Summary

- You have several ways to pay for healthcare expenses:
  - Your in-network provider submits a claim to your health plan for goods or services rendered
  - You file the claim yourself
  - You use a debit card to spend from your HSA, or you request reimbursement from your HSA
  - You submit expenses to your HSA-qualified FSA or HRA instead of your HSA for reimbursement. Spending from a use-or-lose account enhances the tax advantage of your HSA
- Set up a well-organized filing system for invoices, point-of-sale receipts, explanations of benefits (EOB), and HSA statements. Store either physical documents or electronic copies, but ensure you have a safe backup
- You can pay for a wider range of expenses with your HSA than your health plan covers. Familiarize yourself with the rules (which change from time to time) to maximize your benefit
- In addition to ensuring the accuracy of your records, use your records to track your progress toward your deductible to make wise decisions about the timing of larger non-emergency expenditures
- Good recordkeeping protects you from surprises—like the unexpected arrival of a delayed bill

Resources:

1. IRC §6501(a)
2. IRC §6501(a)(ex)(1)(A)(6 year rule), 6501(c)(fraud rule)
3. IRS Notice 2004-2 Q&A 18
4. IRS Notice 2004-2 Q&A 19
5. Instructions for Form 8889

Chapter 9

Implementation, regulation, legislation

Chapter overview

Because HSA-qualified health plans are generally lower in cost than other plans, employers generally pay less in premiums. Employers offering HSA-qualified plans also tend to see lower insurance rate increases each year.

The number of Health Savings Accounts (HSAs) and the total funds contributed to HSAs grows each year, suggesting that more employers offer HSA-qualified plans to save money and help them comply with Patient Protection and Affordable Care Act (PPACA) health reform requirements. According to Devenir Research, as of the end of December 2025, HSA assets crossed the $174 billion milestone, in 41.7 million accounts.[1]

By using a thoughtful implementation strategy, employers can gain momentum and achieve significant savings.

While employers save money, they also take on some administrative responsibility—first to set up the plan, and then to maintain its tax-exempt status.

Benefits of offering HSA-qualified health plans

Combatting rising costs

According to data published by Peterson-KFF in 2025, health spending has risen from $74.1 billion in 1970 to $5.8 trillion in 2024—more than a 70-fold increase and well beyond cost-of-living increases.[2]

Why the huge increase?

- New technologies and treatments increase life expectancy
- More patients have chronic illnesses
- Patients do not shop for lower-cost options (such as generic drugs)
- Patients over-utilize healthcare facilities (for example, using emergency rooms for non-emergency situations)
- Companies pass administrative costs on to consumers
- State and federal governments require extended coverage

Employers have control over only some of these variables. Specifically, they can influence healthcare usage patterns, help prevent chronic diseases through wellness programs, and perhaps lower the average cost of claims. Increased HSA adoption can potentially slow the trend of rising insurance rates by rewarding positive employee behavior.

Increasing awareness

Our healthcare system often separates the acts of receiving medical services and paying for them. A third party—the insurance company, employer, or plan administrator—usually processes and pays the bill, so consumers have little awareness of the actual price of medical services and products. Because the consumer only sees the amount of the copayment, not the full price for office visits, lab tests, etc., they may assume that the copayment covers the entire cost.

Similarly, employees often see only their share and not the full premium cost and may not realize the value of the health plan offered by their employer. Too often, the first time an employee understands the cost of health coverage is when they leave their employer and receive a COBRA continuation notice with the costs to continue coverage listed.

As services become more expensive, consumers pay for the increased costs indirectly, through higher premiums. Again, the indirect connection between rising costs and rising premiums obscures the actual cost of goods and services. Only by understanding the actual price can consumers effectively comparison shop.

Increasing consumer choice

An HSA-qualified health plan can encourage consumer choice by increasing incentives for consumers to compare costs and demand better value. Because HSA owners save on taxes and keep some of the savings achieved by careful consumerism, they have even more incentive to take an active role in controlling healthcare costs. This can theoretically lower the average cost of claims through better utilization of healthcare services, which would in turn lower premium costs.

Employers may use the savings achieved through HSA strategies to fund additional benefits for their employees, like wellness programs.

Implementation strategies

As more employees choose an HSA-qualified health plan, employers see benefits—often to the point that they have more bargaining power to ask for lower rates from their insurance carriers. Additionally, employers pay less payroll tax when they contribute to employees' HSAs and encourage employee contributions.

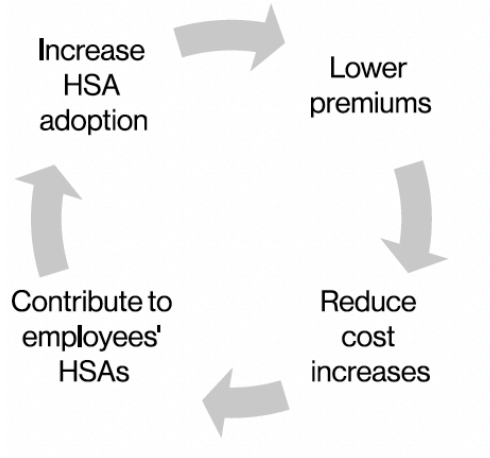
Migrating gradually vs. full replacement

Some employers choose to offer their employees only one option for healthcare: an HSA-qualified health plan. This full-replacement strategy significantly increases HSA ownership and the resulting savings.

Other employers, concerned about possible employee backlash or weakened ability to attract top employee talent, choose a gradual approach by offering multiple benefit plan choices that include one or more HSA-qualified health plan options. These employers often set a goal to fully replace more traditional plans with HSA-qualified health plans within three to five years.

Employers have four primary motivators for adopting the more aggressive, full-replacement approach:

- Premium increases. Because of increasing premiums, employers may need to reduce benefits to control costs. They can no longer afford traditional low-premium, low-out-of-pocket plans
- Increase adoption rates. Cost projection tools make a case for rapid adoption



- Increase ancillary benefits. When all employees have HSAs, more of them use low-cost services such as wellness programs, wellness incentives, telemedicine, and cost-transparency tools
- Lower costs. Higher HSA adoption can reduce employer costs for healthcare

Projecting savings

Let's look at a hypothetical company considering a consumer-driven healthcare strategy, with the goal of maximizing HSA ownership. The company especially wants to help their employees prepare for healthcare costs in retirement. They believe this strategy will provide savings for the company and for their employees. To project savings for budget purposes, the company must consider the cost of coverage, utilization, tax savings, and adoption rate.

Cost of coverage
HSA-qualified health coverage remains the most economical; in 2025 KFF reported the family coverage for an HSA-qualified High-Deductible Health Plan was $26,993 with employers paying an average of $20,143 and employees paying $6,850.[3]

Utilization
Utilization and consumer behavior can also influence savings because members in an HSA-qualified health plan tend to research and compare medical products and services, seeking medical care less often and spending less per visit for comparable care. This behavior can ultimately reduce overall healthcare spending.

Tax savings
HSA contributions reduce tax liabilities and can also contribute significantly to employers' savings.

- Employers save money on payroll taxes when they contribute to their employees' HSAs and encourage their employees to contribute as well
- Employees save on income and FICA taxes when they contribute to their own HSAs

Adoption rate
Company savings also depend on how quickly employees adopt the HSA-qualified health plan option. Quicker adoption enhances cost stability and increases overall savings, both by reducing spend and by minimizing annual cost increases.

To increase the rate of HSA adoption at your organization, consider the following issues:

- If you offer more health coverage choices and adopt a more gradual implementation strategy, more employees will choose traditional plans unless you incentivize the HSA-qualified plan
- Employees with higher healthcare expenses often enroll in the richest possible plan, without realizing that all plans cap out-of-pocket limits, protecting them from high out-of-pocket expenses. Many times, employees pay higher premiums (and the company pays higher premium costs) for the same protection under a more expensive plan. Help your employees do the math and consider all the factors

Employees really have two choices:

- Pay higher premiums
- Pay lower premiums now and save the difference for future out-of-pocket expenses—all while enjoying tax benefits and accruing interest

The faster companies achieve full adoption, the sooner the HSA strategy achieves the momentum necessary to build savings for the employer and healthy HSA balances for employees.

Reducing perceived risk

HealthEquity, the nation's oldest and largest non-bank custodian of HSA funds, has conducted research among its client base and concluded that three main factors influence an employee's decision on whether to enroll in an HSA-qualified health plan:

- Insufficient funds. Consumers express concern that they will incur major healthcare expenses before their HSA balance can cover their deductible
- Age. Consumers believe that only younger, relatively healthy people should consider HSA-qualified health plans
- Perceived relative financial value. Consumers do not believe they can build and keep a large enough balance to realize significant financial benefits with an HSA-qualified health plan.

Overall, employees express concern about high out-of-pocket expenses. That concern, along with perceived safety of a traditional low-deductible health plan, may discourage adoption, slow momentum, and reduce overall savings.

Increasing HSA adoption

Previous chapters have discussed how HSA-qualified health plans benefit both employees and employers; they also described some misconceptions and barriers to adoption.

Using a full-replacement approach that offers only one plan option, an HSA-qualified health plan, encourages adoption. Couple this strategy with robust communication and financial incentives to enhance trust with your employees and increase the benefit to both your organization and your employees.

This section describes best practices in increasing HSA adoption. The chart at the end of the section summarizes how various practices affect adoption rates.

Reduce the number of plan options
HealthEquity clients who offer three or more plan options generally reported that their employees consistently remain with the same plans. HSA adoption among those groups remains at 5% or less. On the other hand, employers that choose the full-replacement plan option, offering only HSA-qualified health plans, report higher rates of adoption. As an added benefit, this strategy seems to increase communication amongst employees, commenting on their healthcare options and educating one another, creating better educated healthcare consumers.

Increase employee premium differentials
When the premium of the HSA-qualified health plan option costs the employee at least 40% less than other plan options, HSA adoption increases significantly.

Reduce deductible levels
Keeping the deductible as low as possible reduces the perception of risk associated with HSA-qualified health plans. HealthEquity has observed that most clients who achieve high adoption (greater than 30%) set the deductible of the HSA-qualified health plans to less than $2,000/$4,000 for individual/family coverage.

Reduce out-of-pocket maximums
Employers should also offer the lowest possible out-of-pocket maximum. Employees perceive less risk when employers set the out-of-pocket maximum level for the HSA-qualified health plan option equal to other plans offered. Reducing employee risk and increasing employer contributions improves adoption rates, even when a company offers two or more plans to employees during open enrollment.

Increase HSA employer contributions
Offering a meaningful employer contribution to employees' HSAs encourages employees to choose an HSA-qualified plan. Enhancing the wealth-building aspect of an HSA-qualified health plan reduces the perception of risk.

Make an HSA-qualified health plan the default option
Make it easy for employees to choose the HSA-qualified health plan by creating easy-to-use enrollment tools. If open enrollment provides more than one option, make the HSA-qualified health plan the default choice.

Consider multiple HSA-qualified health plans
Consider more than one HSA-qualified health plan with different deductibles and out-of-pocket limits. For example, maybe one HSA-qualified plan has deductibles of $3,000 self-only/$6,000 family and out-of-pocket limits of $4,000/$8,000, while another has deductibles of $2,000 self-only/$4,000 family with out-of- pocket limits of $3,500/$7,000.

Involve executive management
HealthEquity has noted that all its successful client groups actively involve company executives in their communication campaigns. Robust campaigns should begin early (several months before open enrollment) and include executives by providing messages from them about their own enrollment in HSA-qualified health plans. Executives have unique power to enhance trust and build enthusiasm for HSA programs.

In addition, enlist a broad spectrum of employees to discuss their own experience with an HSA-qualified plan and the benefits of the HSA. Other employees often are the best resource for other employees who may want real-life endorsement before they enroll.

Educate and communicate
A smooth transition to HSA-qualified health plans requires an organized effort to educate employees, increasing their awareness of and comfort with HSAs.

Those who do not understand how the tax savings and premium decreases compare financially to a higher deductible may consider an HSA-qualified health plan a reduction in benefits. To communicate the true value, employers must help employees understand how the new plan works, help them with the financial decision involved in participating, and teach them how to contribute and how to make payments.

Additionally, employees need to know how much to contribute to an HSA, how to keep records, who to ask when they have questions, how to check HSA balances, how to use a network, and how to find good healthcare information.

The HSA administrator and health plan may have tools to help employers educate their employees.

Employers who provide employees with information and tools to help them make better healthcare decisions, especially decisions on how to use the healthcare system effectively, will benefit their employees. Employers can also realize significant cost savings, as evidenced by a recent study that was conducted for HealthEquity. Research conducted by FinMed Partners, based on interviews with HealthEquity installed-base clients, found that employers that deployed a best practice-enabled HSA saved $1,630 per employee per year in healthcare costs[4]. Some HSA custodians, like HealthEquity, can also help employers and their employees develop solutions that provide credit for employees to pay their healthcare bills prior to them building up their account balances. This is a great tool to help more adoption in HSAs.

Employers and their HSA providers should conduct employee education and communication activities throughout the plan year—not just prior to open enrollment.

The following table shows how various strategies described previously influence HSA-qualified health plan adoption rates.

	Low adoption rate	Medium	High
Number of healthcare plan options available	≥3	2	1 (only HSA-qualified health plan)
Employee premium differential vs. traditional plan Deductible level	≤15%	16%–39%	≥40%
Deductible level	>$2K/$4K single/ family	Up to $2K /$4K	Federally mandated minimum
Out-of-pocket max, compared to traditional plans	>51% higher	0–50% higher	Equal to
HSA employer contribution (as percentage of deductible)	≤25%	26%–59%	≥60%
Active vs. passive enrollment	Passive Non-HSA-qualified health plan default	N/A	Active, HSA-qualified health plan offered as default option
Executive involvement	None	Endorse HSA-qualified health plans	Executives choose HSA-qualified health plans
Communication strategy	Limited or none	Moderate 0–2 months	Active ≥6 months

HSA rules and regulations

For employees to retain tax benefits and for employers to avoid penalties, companies must adhere to several Internal Revenue Service (IRS) guidelines regarding HSAs. Specifically, employer contributions to employees' HSAs must pass a nondiscrimination test. In some instances, contributions must also adhere to a comparability test.

Nondiscrimination

Nondiscrimination rules forbid companies from providing greater benefits to highly compensated employee (HCEs) and key employees (those with major ownership or decision-making authority) than they do to lower-paid employees.

These nondiscrimination rules apply to most benefits offered by employers, such as health benefits, 401(k)s and FSAs.[5]

Nondiscrimination testing includes three key concepts:

- Eligibility. The plan must cover a high enough percentage of non-HCEs
- Contributions. HCEs cannot receive disproportionately more contributions than non-HCEs
- Benefits. HCEs cannot have access to more plan features than non-HCEs

Comparability

Employers can most effectively make contributions to employee-owned HSAs through a Section 125 cafeteria plan (which are not subject to comparability testing). However, if employers choose to make direct contributions to employees' HSA (instead of through a cafeteria plan), contributions must adhere to comparability rules.

Comparability rules require that employers contribute the same dollar amount (or the same percentage of the annual deductible amount) to all HSA owners who have the same employment status (such as full-or part-time) and the same category of coverage (such as self-only or family[6]). Failure to follow comparability requirements could result in a 35% excise tax on employer contributions.

This means that all individuals within each of the four categories listed below must receive comparable contributions from their employer:

- Part-time employee with self-only coverage
- Part-time employee with family coverage
- Full-time employee with self-only coverage
- Full-time employee with family coverage

Note that the actual categories may differ (for example, categories might include self-plus-one coverage), but the principle of providing comparable contributions within each category always applies.

One company might pass the comparability test if each eligible full-time self-only employee receives $500 toward their HSA and each full-time family-covered employee receives $750. Another company makes comparable contributions if all part-time employees receive funds equal to 75% of their deductible.

Remember that if a married couple works for the same employer, their HSAs and the contributions made to their accounts must remain separate. To do otherwise risks violating comparability rules because if one spouse receives the contribution for themselves as well as for their spouse, they would receive twice the contribution of some other employees.[7]

Non-HCE exception
One exception to the comparability rule exists: employers may contribute more to the HSAs of non-highly compensated employees (non-HCEs). The IRS uses the same definition for HCEs here as they do for other retirement accounts. Non-HCEs make less than $160,000 in 2026.[8]

Exception for cafeteria plan HSAs
Because cafeteria plan HSAs do not need to adhere to comparability rules, employers may match employee contributions or require an employee to contribute to their HSA before also contributing.

If employer contributions fail the comparability test, they must pay a 35% excise tax on employer contributions.[9]

Notice to employees

The notice requirement only applies to cafeteria-plan HSAs.

Through a cafeteria plan, employers may require employees to contribute to their HSA before the employer contributes.[10] For example, through a cafeteria plan, an employer may offer to contribute $500 to employees' accounts on the condition that they also contribute to the account.

Under the notice requirement, employers must notify employees that each eligible employee who establishes an HSA by the last day of February and

notifies their employer will receive a comparable contribution to the HSA for the prior year.

Employers will meet the notice requirement if, by January 15 (the month before the end-of-February deadline), they provide written notice to all affected employees.[11]

Employers will meet the contribution requirement (described in the previous section) for these employees if, by April 15 or an IRS-specified deadline, they contribute comparable amounts plus reasonable interest to the employees' HSAs for the prior year.[12]

The table below summarizes these guidelines.

	HSA as part of a cafeteria plan	HSA outside of a cafeteria plan
Employee contributions	Pre-tax contributions (saves money on payroll taxes). May be required to contribute to receive employer funds.	Post-tax contributions are deducted (above-the-line) from income on federal tax return. May receive employer funds without contributing.
Employer contributions	Pre-tax contributions through employer-sponsored plan	Contributions allowed as tax-free employer-provided benefit
Rules	Nondiscrimination rule applies[13]	Both nondiscrimination and comparability rules apply[14]
Matching contributions	Permitted. Notice to employees required	Not permitted, hence no "notice to employee" requirement

Required reporting

HSA owners must receive periodic statements that include HSA balances, interest earned, investment returns, fees administrative expenses (for example, maintenance fees and check replacement), and expenses paid out of the HSA.

Oversight

Two government agencies oversee most of the federal regulation of private employer benefit plans: the US Department of Labor and the IRS.

The Employee Retirement Income Security Act (ERISA), enforced by both the IRS and the DOL, established legal guidelines for the administration and investment practices of private employer benefit plans.

ERISA generally preempts state laws that apply to private-sector employee benefit plans. In that case, state laws do not apply to employee benefit plans, even if state law sets higher standards of benefits than what the plan offers.[15]

The Department of Labor (DOL) enforces participants' benefit rights under ERISA, and the IRS ensures that employers meet the tax code that applies to sponsoring benefit plans and deducting associated costs.

The DOL protects healthcare benefits, but they do not consider HSAs an employee benefit plan (for which ERISA regulations apply). Instead, as a personal healthcare savings vehicle, state laws (rather than group insurance regulations) apply to HSAs.[16]

This safe harbor exemption from ERISA for HSAs exists even if the employer makes contributions to the HSA, unless the HSA fails to meet any of the following requirements:

- The employer must allow eligible employees to move their funds to another HSA, while adhering to restrictions laid out in the Internal Revenue Code (IRC)
- The employer may not impose conditions on utilization of HSA funds beyond the IRS's restrictions
- The employer cannot make or influence investment decisions with respect to funds contributed to the HSA. The employer cannot represent the HSA as an employee welfare benefit plan established or maintained by the employer
- The employer may not receive any payment or compensation in connection with the HSA

Failure to meet one of these requirements can trigger ERISA oversight; otherwise, state law applies.

Implications
Because ERISA rules do not generally apply to HSAs, the accounts lack protection in the event of personal bankruptcy. Most retirement savings plans are shielded from creditors. For example, when an account holder accumulates funds in an employer-sponsored pension plan or 401(k), creditors may not seize the funds if the account holder declares personal bankruptcy.

Also, states' unclaimed properties law (also known as escheat laws) apply to non- ERISA HSAs. If your account lies dormant for a certain amount of time, the trustee or custodian must forward the amount to the State's treasury, which will hold it until the account owner claims it back. To prevent this, you need to keep your account active by checking the balance periodically. Check with your custodian for state- specific regulations.

Summary

- Employers receive tax benefits when their employees have HSA-qualified health plans and HSAs and tend to pay less in overall healthcare costs
- Increased adoption provides more savings opportunities for employees and employers. Increase efficiency by only offering HSA-qualified health plans. Enhance the effectiveness of the strategy by reducing deductible levels and out-of-pocket maximums, increasing communication, and obtaining executive management buy-in
- HSAs (and other retirement savings plans) must pass nondiscrimination testing: highly compensated employees and key employees may not benefit disproportionately
- In addition to the non-discrimination rule, non-cafeteria plan HSAs must also comply with the comparability rule, which requires equivalent employer contributions for all similar employees. The comparability rule does not apply to cafeteria plan HSAs, which allows them to provide employer matching contributions or to require employees to contribute to an HSA before their employer does
- Two agencies oversee employee health benefits: the Employee Retirement Income Security Act (ERISA) establishes individuals' benefit rights, while the DOL enforces the rights and the IRS ensures that employers meet the relevant tax code
- Because the DOL does not consider HSAs an employee benefit plan (but rather a personal healthcare savings vehicle), state law applies to HSAs

Resources:

1. 2025-Year-End-Devenir-HSA-Research-Report-Executive-Summary.pdf
2. National Health Spending Explorer - Peterson-KFF Health System Tracker
3. 2025 Employer Health Benefits Survey - Summary of Findings
4. FinMed Partners research, October 2025.
5. Treas. Reg. §54.4980G-5 Q&A 1, IRC §125(b), (c) and (g)

6. IRC §4980G, Treas. Reg. §54.4980G-5 Q&A 1 and 2Treas. Reg. §54.4980G-3 Q&A 8
7. https://www.irs.gov/pub/irs-drop/n-25-67.pdf
8. IRC §4980G, Treas. Reg. §54.4980G-1, Q&A 4
9. Treas. Reg. §54.4980G-4 Q&A-8; Treas. Reg. §54.4980G-5
10. Treas. Reg. §54.4980G-4 Q&A 14
11. Treas. Reg. §54.4980G-4 Q&A 2(f)
12. Eligibility, contributions, and benefits must not favor highly compensated individuals
13. Similar employees receive equivalent employer contributions
14. ERISA §514, with the exception of Hawaii's healthcare laws enacted before 1974
15. DOL Field Assistance Bulletin 2004-1; 2006-2

Appendix A

Glossary

Health insurance and tax-related terms

401(k) plan
A defined contribution retirement plan that allows participants to have a portion of their compensation (otherwise payable in cash) contributed pre-tax to a retirement account on their behalf. The plan gets its name from the section of the Internal Revenue Code that establishes the rules for the plan.

Above-the-line deduction
A deduction taken from gross income to calculate adjusted gross income (AGI)–a term derived from the solid bold line on Form 1040 and 1040A above the adjusted gross income. Examples of above-the-line deductions include IRA contributions, HSA contributions, half of the self-employment tax, the self-employed health insurance deduction, and alimony. An above-the-line deduction reduces the AGI, even if the taxpayer chooses the standard deduction.

Annual limit
A dollar limit on the claims an insurer will pay over the course of a plan year. The Patient Protection and Affordable Care Act (PPACA) prohibits annual limits for essential benefits for plan years beginning after September 23, 2010.

Authorization
A health insurance plan's permission to proceed with a medical or surgical procedure.

Balance billing
A bill that the participant receives for the portion of an out-of-network provider's

bill that the insurance plan doesn't cover. When a participant receives services from a healthcare provider that doesn't participate in the insurer's network, the healthcare provider has no obligation to accept the insurer's payment as payment in full, and they can bill the participant for the unpaid amount.

Cafeteria plan
An employee benefit plan that allows employees to choose pre-tax benefits from among several different options, including FSAs, health coverage, dental coverage, vision coverage, other insurance, and paid time off.

Calendar year
January 1 to December 31 of the same year. The calendar year may differ from the plan year, which may include any 12-month period established by an employer or insurer.

Carryover or Rollover (for FSA)
A provision the employer can provide that allows unused funds (up to 20% of the statutory employee contribution limit or $680 for 2026 funds carried into 2027). The employee forfeits any unused funds in excess of the carryover limit back to the employer. A plan can have a carryover/rollover or a grace period or neither, but it cannot have both a grace period and carryover feature.

Certificate of coverage
Written evidence of prior health coverage—required under HIPAA—and provided by the insurer once coverage ends. The PPACA has eliminated the need for this certificate by prohibiting denial of coverage for pre-existing conditions.

Chronic condition
A condition that lasts indefinitely or recurs frequently and can be treated but not cured.

COBRA
Acronym for the Consolidated Omnibus Budget Reconciliation Act of 1985, which provides for the temporary continuation of group health coverage after a qualifying event to certain employees, retirees, and family members who qualify as beneficiaries. An HSA can pay for COBRA premiums.

Coinsurance
The percentage of an insurance claim that the patient must pay.

Comparable contributions
Employer contributions are considered comparable if the employer makes similar contributions (the same dollar amount or the same percentage of the deductible) on behalf of all eligible employees with similar coverage during the same period.

Contribution (for HSA)
Deposit to the Health Savings Account (HSA).

Copayment
Fixed-dollar payments the patient makes for a doctor visit or prescription. For example, many HMOs and PPOs impose a copayment (sometimes referred to as a copay) for an in-network doctor's visit.

Covered services
The medically necessary treatments a plan pays for, at least in part.

Custodian
An entity responsible for the maintenance or administration of an account (such as an HSA or IRA) that has no investment or management responsibilities.

Deductible
The amount of covered expenses that an individual pays for, out of pocket, before the health plan starts making payments.

Dependent

> **For a health plan**
> A dependent that a health insurance company covers under an individual's health plan—this may not be the same as a tax dependent.
>
> In most cases, health insurance companies and state laws decide who qualifies as a dependent under the health plan—except the federal

mandate under the PPACA that requires parents' family plans to cover adult children up to age 26 if the child doesn't have access to health coverage from his or her own employer. The parent does not pay taxes on this coverage. However, the child can only receive distributions from the parent's HSA if the child also qualifies as a tax dependent on the parent's return. If a parent's family HSA-qualified health plan covers an adult child who does not qualify as a tax dependent, the child can open his or her own HSA.

For tax purposes
A person who can be claimed as a dependent on an individual's federal tax return— this may not be the same as a dependent on your health plan.

You can receive distributions from your HSA for qualified medical expenses incurred by your spouse and people you can claim as dependents on your tax return (with a couple of small exceptions related to adult children and other relatives), whether or not your family health coverage includes them.

Direct Primary Care Arrangement
For the purposes of treatment under an HSA, a direct primary care service arrangement means, with respect to any individual, an arrangement under which such individual is provided medical care consisting solely of primary care services provided by primary care practitioners, if the sole compensation for such care is a fixed periodic fee. The fee cannot exceed $150/month for individual coverage or $300/month for family coverage (amounts indexed). Primary medical care services do not include procedures that require the use of general anesthesia, prescription drugs (other than vaccines), and laboratory services not typically administered in an ambulatory primary care setting.

Distribution (for HSA)
Reimbursement from a Health Savings Account (HSA).

Eligible individual (for HSA)
An individual who meets all the IRS criteria for contributing to his or her own HSA.

Emergency
The sudden onset of a condition or an accidental injury requiring immediate medical or surgical care to avoid permanent disability or death.

Employee Assistance Plan/Program (EAP)
An employee benefit that covers all or part of the cost for employees to receive counseling, referrals, and advice in dealing with stressful life issues.

ERISA (Employee Retirement Income Security Act)
A federal law that governs private-sector employee benefits plans.

Excess contribution (for HSA)
An HSA contribution higher than what the IRS allows based on your HSA-qualified coverage level.

Exchange
A government-regulated marketplace established by PPACA of health insurance plans with different tiers, or levels of coverage, offered to individuals without healthcare or to small companies; also referred to as a health exchange.

Exclusions
Medical services or conditions for which a particular healthcare plan or policy won't pay.

Family deductible
A stated maximum amount of expenses any combination of family members must incur before receiving benefits.

First-dollar coverage
Certain services that are covered by the health plan without requiring a deductible.

Flexible Spending Arrangement (FSA)
An arrangement that allows employees to set aside pre-tax earnings to pay for expenses not covered by their insurance or benefit plans, as a part of a

cafeteria plan. The employee forfeits all unspent funds at the end of the plan year unless the employer allows a carryover or grace period.

Formulary
The list of drugs covered fully or in part by a health plan.

Full contribution rule
Also called the last-month rule. See the entries for Last-month rule and Testing period.

Gatekeeper
The doctor, usually a primary care doctor, pediatrician, or internist, responsible for overseeing and coordinating all aspects of a patient's care. In some plans, the gatekeeper must preauthorize all referrals, except emergencies.

Grace period (for FSA)
A provision the employer can provide which allows a period of no more than two and a half months following the end of the plan year for the account holder to continue to incur expenses and submit reimbursements. After the end of the grace period, the employee forfeits any unused funds from the previous plan year back to the employer.

A plan can have a carryover/rollover or a grace period or neither, but it cannot have both a grace period and carryover feature.

Grandfathered plan
A health plan that an individual was enrolled in prior to passage of the PPACA on March 23, 2010.

PPACA requirements do not apply to grandfathered plans. In addition, employers may add new employees to grandfathered group plans, including employees' family members.

Healthcare reform law
See Patient Protection and Affordable Care Act (PPACA)

Health Insurance Portability and Accountability Act (HIPAA)
A federal law that limits the exclusion of pre-existing conditions, permits special enrollment when certain life or work events occur, prohibits discrimination against employees and dependents based on health status, and guarantees availability and renewability of health coverage to certain employees and individuals. It also establishes strict standards for using and sharing private health information (PHI).

Health Reimbursement Arrangement (HRA)
An employer-owned and funded account that reimburses employees for eligible expenses, such as copayments, deductibles, vision care, prescriptions, long-term care, medical insurance, and most dental expenses. Neither the employee nor the employer pays tax on reimbursements.

Health Savings Account (HSA)
An individually owned account that reimburses qualified medical expenses, such as copayments, deductibles, vision care, prescriptions, long-term care, medical insurance, and most dental expenses. Coverage under an HSA-Qualified health plan and no other impermissible coverage is required.

Neither the individual nor the employer pays tax on distributions if they are for qualified medical expenses. Distributions for non-qualified expenses are taxed and subject to a penalty (the penalty is waived for distributions after age 65 and in other limited circumstances).

HSA-qualified health plan
A type of health insurance plan that, compared to traditional health insurance plans, generally requires higher out-of-pocket spending, usually offering lower premiums. An HSA-qualified plan must meet strict statutory requirements for an individual to be eligible to contribute to an HSA.

HIPAA
See Health Insurance Portability and Accountability Act (HIPAA).

HMO (health maintenance organization)
A corporate entity (for-profit or not-for-profit) that provides or arranges for coverage of certain health services for a fixed, prepaid premium.

Home healthcare
Skilled nursing and related care supplied to a patient at home.

Hospice care
Care given to terminally ill patients (generally those with six months or less to live) that emphasizes emotional needs and pain management—either in the patient's home or at a facility.

Hospital outpatient department
A facility or area that provides a range of non-urgent medical care under the supervision of a physician.

Impermissible Coverage
Plans that disqualify you from contributing to an HSA, including:

- Other non-HSA-qualified health coverage
- General Purpose FSA or HRA
- General Purpose Excepted Benefit HRA (EBHRA)
- Employee Assistance Programs or Onsite clinics that provide significant medical care
- Indian Health Service
- Medicare
- TRICARE
- VA Coverage unless for a service-related disability

Indemnity plan
A plan that pays health insurance benefits in the form of cash payments rather than services.

Individual coverage requirements
Requirement for most individuals to obtain acceptable health insurance coverage.

Individual Retirement Account (IRA)
An account that allows individuals to save for retirement on a tax-deferred

basis. The tax-deductible amount depends on the individual's eligibility, income tax filing status, and adjusted gross income.

In-network provider
A healthcare provider (such as a hospital or doctor) contracted through a network for a managed care organization (such as an HMO or PPO). The provider agrees to the managed care organization's rules and fee schedules to participate in the network. In addition, in-network providers agree not to balance-bill patients for amounts above and beyond the agreed upon fee.

Last-month rule
IRS rule that allows a participant who enrolls in an HSA-qualified health plan mid- year to contribute the entire yearly maximum contribution for his or her age and coverage level if the participant opens an HSA-qualified health plan by the first day of the last month of the tax year (December 1 for most taxpayers). Also referred to as the full contribution rule.

The participant must remain eligible for the entire testing period to avoid incurring taxes and penalties.

See the entry for testing period.

Life event
A change in a participant's personal situation that results in the gain or loss of eligibility for a health plan, or a spouse's or dependent's employer's plan.

Participants who experience a qualified life event may make changes to their benefit coverage. Life events include, but are not limited to:

- Marriage or beginning a domestic partnership
- Divorce or termination of a domestic partnership
- Birth or adoption of a child
- Death of a spouse, domestic partner, or child
- Spouse loses coverage
- Child loses eligibility

- Change in employment status
- Loss of qualified health coverage

Note that HSA accountholders can change, start, or stop their contribution as often as monthly without a life event.

Limited benefits plan (sometime called a Limited Duration plan)
A type of health plan that provides coverage for only certain specified healthcare services or treatments or provides coverage for healthcare services or treatments for a certain amount during a specified period.

Managed care plan
A health plan that limits costs by limiting the reimbursement levels paid to providers and by monitoring healthcare utilization by participants or both.

Mandated benefit
A requirement in state or federal law that all health insurance policies provide specific coverage for a specific healthcare service.

Matching contributions
Employer contributions paid to the employee's account (HSA, FSA, 401(k)) only if the employee also contributes a minimum specified amount.

Medicare
A federal government health insurance program for people 65 and older, the disabled, and people with end-stage renal disease who require dialysis or a transplant. Part of the Social Security system.

- Medicare Part A. Pays for inpatient hospital stays, care in a skilled nursing facility, hospice care, and some home healthcare
- Medicare Part B. Helps pay for doctors' services, outpatient hospital care, durable medical equipment, and some medical services not covered by Part A

- Medicare Part C. (Medicare Advantage Plans). A combination of Part A and Part B provided through private insurance companies approved by Medicare
- Medicare Part D. A stand-alone prescription drug coverage insurance

Medicare Part D "donut hole"
The gap between the maximum spending amount Medicare Part D will cover and the minimum spending amount to qualify for catastrophic prescription drug coverage. The beneficiary must pay 100% of these costs.

Medicare supplement (Medigap) insurance
Private insurance that supplements Medicare and Medicare Advantage Plans. It reimburses out-of-pocket costs not covered by Medicare and that are the beneficiary's responsibility.

Medicare Supplement or Medigap insurance cannot be paid from an HSA.

Medical loss ratio
The percentage of health insurance premiums spent by the insurance company on actual healthcare services rather than administrative costs. The PPACA requires that large group plans spend 85% of premiums on clinical services and other activities for the quality of care for enrollees. Small group and individual market plans must devote 80% of premiums to these purposes.

Medically necessary treatments
Treatments appropriate for the diagnosis, care, or treatment of a certain injury or condition. Check your plan's definition, because whether they cover the service may depend on who provides it and where.

Mistaken distribution (for HSA)
Mistaken distribution from a Health Savings Account (HSA), such as a non-qualified medical expense or an over-payment to a healthcare provider. A participant can avoid paying income tax and a 20% penalty on the amount by returning the money to the HSA administrator for renewed contribution into the HSA before the tax-filing deadline.

Network plan
A plan that generally provides more favorable cost-sharing for services provided by its network of providers than for services provided outside the network because of the negotiated rates and other cost-containment measures.

Open enrollment
The time during which employees may change health plans without incurring costs or penalties.

Out-of-network provider
A healthcare provider (such as a hospital or doctor) not included in a network (such as an HMO or PPO).

Depending on the health plan's rules, patients may either have to pay a higher portion of the total costs or may not even receive coverage at an out-of-network provider, except in the event of an emergency. In addition, a health plan may not apply out-of-network provider costs to the deductible or may apply different limits to out-of-network providers.

Out-of-pocket limit
The maximum financial exposure on out-of-pocket expenses a participant pays during the plan year. Amounts a participant pays for deductibles, copays, or coinsurance are included in out-of-pocket expenses and kept as a running total. Insurance premiums do not count toward out-of-pocket limits.

Once a participant reaches the plan's out-of-pocket limit for the year, remaining eligible expenses are covered at 100% regardless of the plan's copayment or coinsurance arrangements.

Patient Protection and Affordable Care Act (PPACA)
Legislation (Public Law 111-148) signed by President Obama on March 23, 2010. Commonly referred to as the healthcare reform law, or the Affordable Care Act.

Permitted coverage
Coverage an individual may maintain, in addition to an HSA-qualified health plan, without losing eligibility for an HSA, even though the coverage may provide first- dollar coverage for certain medical expenses.

PHI
Protected health information (PHI), strictly protected by HIPAA.

Plan administrator
The term “plan administrator” or “administrator” means the person specifically so designated by the terms of the instrument under which the plan is operated. If an administrator is not so designated, the plan administrator is the plan sponsor, as defined in ERISA §3(16)(B).

Plan participant or beneficiary
An employee or dependent of that employee who participates in, receives benefits from, or qualifies to receive benefits from an employee benefit plan.

Plan year
The calendar year (January 1 to December 31) or another 12-month period the employer or insurer chooses for managing a health plan and keeping track of deductibles and other limits.

Point of service (POS)
A point-of-service plan (POS) is a type of managed care plan that is a hybrid of HMO and PPO plans. Like an HMO, participants designate an in-network physician to be their primary care provider. But like a PPO, patients may go outside of the provider network for healthcare services. When patients venture out of the network, they’ll have to pay most of the cost, unless the primary care provider has made a referral to the out-of-network provider.

Portable account
An account owned by the employee and carried from job to job or from a group plan to individual coverage.

Pre-existing condition exclusion
A limitation (now prohibited) that paid no benefits under a health benefit plan for an illness or medical condition for which the individual received medical advice, diagnosis, care, or treatment within a specified period prior to the date of enrollment in the health benefit plan.

Preferred provider organization (PPO)
An arrangement between doctors and other medical service providers and a health plan or insurer to offer services at a discounted rate in exchange for the health plan sending patients to their doctors or facilities. Usually includes some utilization review and other cost containment measures.

Premium
The periodic payment required to keep an insurance policy in force.

Preventive benefits
Covered services intended to prevent or identify a medical condition when more easily treatable. The PPACA requires insurers to provide coverage for preventive benefits without charging deductibles, copayments, or coinsurance.

Primary payer
The healthcare plan that pays its share of covered expenses first, if a consumer has access to more than one health plan. The secondary payer covers some (or all) of the rest—even if that amount is less than the secondary plan might otherwise pay. This applies to Medicare when the participant also has coverage under an employer plan. This is often referred to as coordination of benefits.

Prohibited transaction
Both the Code and ERISA have rules that prohibit certain transactions. These "prohibited transaction rules" are intended to prevent persons with decision-making authority, or who are otherwise closely associated with a plan (e.g., through a service provider relationship), from abusing their position by engaging in potentially self-interested or self-dealing transactions with a plan. Even though HSAs are seldom subject to ERISA, they will be subject to nearly the same prohibited transaction rules as ERISA-covered plans under the Code's provisions. These include the sale, exchange, or lease of property; borrowing or lending money; furnishing goods, services, or facilities;

transferring to, used by, or for the benefit of the HSA account beneficiary of any assets contained in the account. Pledging account assets—as security for a loan, for example—constitutes a prohibited transaction.

Provider
Whoever provides healthcare under a health plan, including doctors, therapists, nurse-practitioners, and anyone else who provides medical services.

Provider discount
The reduced rate a doctor, hospital, or other healthcare professional or facility agrees to accept when they enroll in a health plan's network.

Prudent layperson standard
Under this standard, a healthcare plan covers emergency care if the decision to go to the ER was one that an average person with average medical knowledge would make at the time. This has implications for the payment of out-of-network charges at an emergency room, which under the No Surprises Act must be covered at in- network rates effective January 1, 2022.

Qualified health plan
A health insurance policy sold through an exchange or healthcare.gov. Individuals in states that do not participate in the federal exchange can link to their state's exchange from healthcare.gov. The PPACA requires exchanges to certify that qualified health plans meet minimum standards outlined in the law.

Qualified medical expense
An expense paid by the account beneficiary or owner, his or her spouse, or his or her dependents, for medical or dental care as defined in §213(d) of the Internal Revenue Code—generally, the same expenses that individual taxpayers can deduct on federal income tax returns. Code §§106 and 223 have

added additional expenses that can be paid from an FSA, HRA or HSA, including over-the-counter drugs and supplies related menstrual care.

Referral
A recommendation of a medical professional. HMOs and other managed care

plans usually require a referral to see any practitioner or specialist other than a gatekeeper physician.

Release of Protected Health Information
Permission to provide specified medical information to a specific person or entity.

Repricing
The adjustment of healthcare providers' "sticker price" to reflect discounts the providers may have negotiated with a health plan.

Rescission
The process of voiding coverage under a health plan from its inception usually based on the grounds of material misrepresentation or omission on the application for coverage that would have resulted in a different decision by the health plan with respect to issuing coverage. The PPACA prohibits rescissions except in cases of fraud or intentional misrepresentation of a relevant fact.

Rollover or Carryover (for FSA)
A provision the employer can provide that allows unused funds (up to 20% of the statutory employee contribution limit or $680 for 2026 funds carried into 2027). The employee forfeits any unused funds in excess of the carryover limit back to the employer.

A plan can have a carryover/rollover or a grace period or neither, but it cannot have both a grace period and carryover feature.

Rollover contribution
Distribution of an account balance from one financial institution to another, or from one type of account (MSA) to another (HSA).

Safe harbor
Certain conditions that eliminate legal or regulatory liability. For example, the Coronavirus Aid, Relief, and Economic Security (CARES) Act created a temporary safe harbor that allows (but does not require) an HSA-qualified health plan to cover telehealth and remote care services prior to the member

reaching their plan's deductible. As of January 6, 2025, the telehealth safe harbor for high deductible health plans (HDHPs) with health savings accounts (HSAs) expired for plan years starting on or after January 1, 2025. However, Congress renewed and made this safe harbor permanent for plan years

beginning after December 31, 2024, retroactively bringing the safe harbor back for the 2025 calendar year.

Screening services
Medical tests designed to detect treatable diseases or conditions.

Self-insured plan
A plan under which the employer pays for medical claims as they arise rather than contracting for coverage from an insurer.

Stop-loss limit
See out-of-pocket limit.

Testing period
The length of time an individual must remain in an HSA-qualified health plan to avoid taxes and penalties if he or she makes the maximum yearly contribution to an HSA under the last-month rule.

If the individual enrolled in a qualifying health plan mid-year but contributed the full yearly maximum contribution to the HSA under the last-month rule, he or she must remain an eligible individual during the testing period. For the last-month rule, the testing period begins with the last month of the tax year and ends on the last day of the twelfth month following that month. For example, December 1, 2026, through December 31, 2027. See the entry for Last-month rule.

Third party administrator
The person or firm designated by a health plan or employer to handle day-to-day details of recordkeeping, claims handling, and report filing.

Transition rule
A gradual adaptation to a law to ease the impact of a change on affected taxpayers.

Trend
Medical cost inflation; for example, the yearly increase in the cost of premiums.

Trust
Legal instrument allowing one party (the trustee) to control property for the benefit of another.

Trustee
An entity or individual that directs the investment of the funds in a trust account and has management responsibilities.

Usual, customary, and reasonable charge (UCR)
A cost associated with a healthcare service that's consistent with or a percentage of the going rate for identical or similar services within a particular geographic area.

Health plans may set reimbursement rates for out-of-network providers as a percentage of the usual, customary, and reasonable (UCR) charge, which may differ from what the provider charges for a service.

Waiting period
A period that an individual must wait, either after becoming employed or after applying for a health coverage, before such coverage becomes effective and the plan can pay claims.

The individual pays no premiums during this period and cannot make HSA contributions until the first day of the month after the waiting period ends and HSA- qualified health coverage begins.

Appendix B

Resources

IRS forms[1]

US individual income tax return

- Form 1099-SA: www.irs.gov/pub/irs-pdf/f1099sa.pdf
- Form W-2 (includes a section for HSA reporting): www.irs.gov/pub/irs-pdf/fw2.pdf
- Form 1040/1040EZ: www.irs.gov/pub/irs-pdf/f1040.pdf

Distributions from an HSA, Archer MSA, or Medicare Advantage MSA

- Form 5329: www.irs.gov/pub/irs-pdf/f5329.pdf

Taxes on qualified plans (including IRAs) and other tax-favored accounts

- Form 5498-SA: www.irs.gov/pub/irs-pdf/f5498sa.pdf

HSA, Archer MSA, or Medicare Advantage MSA information

- Form 5305b: www.irs.gov/pub/irs-pdf/f5305b.pdf

Health Savings Custodial Account

- Form 5305c: www.irs.gov/pub/irs-pdf/f5305c.pdf
- Form 8889: https://www.irs.gov/pub/irs-pdf/i8889.pdf

IRS publications

- IRS Publication 502: Medical and Dental Expenses
- IRS Publication 969: Health Savings Accounts and Other Tax-Favored Health Plans
- IRS Publication 15-B: Employer's Tax Guide to Fringe Benefits

Other resources

- Investopedia
- Ask Mr. HSA
- FAQs about Families First Coronavirus Response Act (FFCRA) & Coronavirus Aid, Relief, and Economic Security (CARES) Act
- CRO: A Comparison of Tax-Advantaged Accounts for Healthcare Expenses
- Should I enroll in Medicare at 65?

1. URLs were valid on 6/2/2026

Appendix C

Qualified Medical Expenses

Medical expenses are the costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and for the purpose of affecting any part or function of the body. The Internal Revenue Service (IRS) does not publish one comprehensive list of medical and dental expenses that qualify for payment from an HSA. Instead, they provide information in two key publications (*Publication 502* and *Publication 969*) that, when taken together, create a resource for determining if an expense qualifies.

One overarching rule defines most expense qualification issues:

- Qualified expenses include services and products that diagnose, treat, or prevent specific physical or mental disabilities or illnesses.

According to this rule, qualified expenses include items like medications, office visit fees, equipment, and more. Expenses for items that benefit general health—such as multi-vitamins, spa treatments, and gym memberships—do not qualify, with a few minor exceptions.

Publication 502: Eligible Medical and Dental Expenses describes tax-deductible expenses. Most of the expenses listed in this publication qualify for payment from an HSA. Note that you can either deduct a qualified expense from your taxes or pay for it from your HSA—but not both. Double dipping is strictly prohibited.

One major exception exists. According to *Publication 502,* you can potentially deduct health insurance premiums from your taxes—but you cannot pay health insurance premiums from your HSA, with a couple of exceptions. You can only pay the following insurance premiums with HSA funds:

- Long-term care insurance
- Health care continuation coverage (such as coverage under COBRA)
- Health care coverage while receiving unemployment compensation under federal or state law
- Medicare and other health care coverage for those 65 or older (other than premiums for a Medicare supplemental policy, such as Medigap)

On the other hand, you can pay for some items not listed in *Publication 502* from your HSA (though obviously, they are not tax-deductible). Most of these additional items are listed in *Publication 969: Health Savings Accounts and Other Tax-Favored Health Plans.*

HSA-qualified items not listed in *Publication 502 i*nclude the following:

- Over-the-counter medications
    - Treatment for illness-related symptoms (for example, pain relievers, cold medication, cough syrup, etc.)
    - Treatment for conditions such as acne, colds and flu, eczema, heartburn, seasonal allergies, etc.
- Menstrual products
- Face masks and other personal protective equipment (PPE) used to prevent the spread of COVID-19
    - COVID-19 diagnostic tests, hand sanitizer, masks, rubbing alcohol, hand sanitizing wipes.
    - But not sanitizing wipes for surfaces, or latex or nitrile gloves

Note that general toiletry items such as soap and shampoo do not qualify.

Some items require a letter of medical necessity. For example, over-the-counter vitamin supplements do not usually qualify—unless they are prescribed to treat a specific illness or condition. In this instance, you must obtain a letter of medical necessity from your healthcare provider.

Because a few HSA-qualified items are not tax-deductible (and vice versa), and because Congress makes small changes to the relevant laws from time to time, always use the current versions of both *IRS Publications 969* and *502* for

the most comprehensive and up-to-date information about HSA-qualified expenses.

HealthEquity posts an easy-to-read list of qualified and non-qualified medical expenses, but always consult IRS Publications 502 and 969 for the most accurate information.

FSAs and HRAs

HSA-qualified FSAs cover medical and dental expenses—and sometimes other medical expenses, only after the member reaches their deductible.

In general, if an item qualifies for reimbursement from an HSA, then FSAs and HRAs also reimburse for the item—with a few insurance-related exceptions. or details see IRS Publication 969.

HSA, FSA, and HRA exceptions

	HSA	FSA	HRA
COBRA premiums *Post-tax only*	•		•
Insurance premiums *Post-tax only*			•[1]
Long-term care premiums and expenses *Post-tax. Limitations apply; see IRS Publication 502 for details.*	•		•
Retiree (post-65) medical insurance premiums	•		•

1. QSERA and ICHRA