15th edition

THE COMPLETE HSA GUIDEBOOK

How to make Health Savings Accounts work for you

Stephen D. Neeleman, MD

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How to make Health Savings Accounts work for you

FIFTEENTH EDITION

Includes healthcare reform and tax change updates

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 17 years since then, people have developed an understanding of and appreciation for this important consumer-directed health benefit. Millions of Americans now 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 the Devenir 2020 Year-End HSA Market Statistics & Trends, there are more than 30 million HSAs, covering 63 million people, holding over $80 billion in funds.

I founded HealthEquity in 2002 with a simple mission: to “connect health and wealth.” As this edition goes to print, HealthEquity members have saved more than $14 billion dollars in their HSAs. Our team of more than 3,000 HSA enthusiasts is committed to helping more and more Americans understand and use HSAs to protect themselves against unexpected healthcare expenses.

We intend to make HSAs more common than 401(k)s, because of their tax savings and their potential to lower overall healthcare expenditures for both consumers and businesses.

HealthEquity focuses on helping employers and employees manage out-of-pocket healthcare costs, which continue to increase every year. We believe that HSAs remain 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.

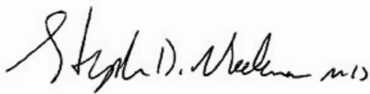
As our company grows, I stand amazed at the passion and commitment with which our teammates build relationships with and provide remarkable service for our members, clients, and partners. As a result of their skill and expertise, we are now one of the largest non-bank custodians of HSA funds in the United States.

In 2019, HealthEquity purchased WageWorks, a leading provider of consumer-directed spending accounts, including FSAs, HRAs, commuter accounts, and COBRA services. This acquisition strengthened HealthEquity, enhancing our ability to meet our clients' needs by expanding our range of products and continuing our commitment to help Americans manage out-of-pocket expenses for healthcare, dependent day care, and commuting expenses.

In 2021, HealthEquity purchased Luum, best known for its powerful Commute platform. Commute goes beyond merely managing complex mobility and parking programs; it does so in a way that also reduces drive-alone rates, which protects the environment and promotes employee health and flexibility.

On behalf of our entire team, I hope this publication helps you understand HSAs and encourages you to consider investing in one.

Sincerely,



Stephen D. Neeleman, M.D. HealthEquity Founder and Vice Chairman

Salt Lake City, Utah
October 2021

This publication provides a general explanation of HSAs—not legal, financial, or tax advice.

HealthEquity, Inc. is a publicly traded (NASDAQ:HQY) non-bank custodian of Health Savings Accounts. Examples, results, and calculations included in this publications are for illustrative purposes only. HealthEquity bases its opinions and decisions on sound research and data and knows that readers' experiences with HSAs may vary.

In this edition, we cite the Internal Revenue Code (IRC) and have made every effort to ensure accuracy. Even so, we cannot guarantee that all citations are complete or up to date. We will neither provide corrections to this edition, nor take responsibility for typographical errors.

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.

As always, consult your own legal, tax, and financial advisors for the best advice tailored to your specific needs.

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CHAPTER 1

Introduction

Health Savings Accounts benefit individuals.

Because Health Savings Accounts (HSAs) provide more tax advantages than any other savings vehicle in the United States today, you should learn how to become eligible to open one so you can start reducing your tax burden, increasing your retirement savings, and protecting yourself against rising medical costs.

Like other retirement savings plans, HSAs allow you to roll over unused funds every year for future use, transfer the account to your spouse upon death, or distribute the funds to your heirs…but HSAs provide additional important advantages over other retirement accounts.

If you contribute to an IRA or 401(k), you don't pay tax on your contributions or account earnings, but you do pay tax when you withdraw the funds during retirement. Though you don't pay tax on distributions from a Roth IRA, you do pay tax on the money you contribute.

If you use a Health Flexible Spending Account (FSA), you contribute and spend tax-free dollars, but will lose any funds you have not spent at the end of the year.

Only HSAs provide what is known as a triple tax advantage: you make tax-deductible contributions, your account grows and earns interest free of federal (and most state) income tax, and your distributions (when used for qualified medical expenses) are also free of these taxes. You also have the flexibility to invest your HSA funds which, while riskier, increases your potential for growth.

Because of these significant tax savings, the IRS restricts ownership of HSAs somewhat. Only individuals covered by a high-deductible health plan (HDHP) may open an HSA. An HSA-qualified HDHP 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.

Several other restrictions exist:

- You may have no other health coverage (except certain permitted coverage).
- You may not be enrolled in Medicare.
- You may not be claimed as a dependent on someone else's tax return.

HSAs provide significant tax benefits, and solve several important insurance-related problems: by design, they directly reward wellness, provide more choice and flexibility than traditional healthcare, and help individuals manage chronic illness by encouraging the development of more knowledgeable and engaged healthcare consumers.

Heath Savings Accounts benefit employers.

HDHPs and HSAs provide a means of controlling soaring healthcare costs in a way that does not impair employees' access to quality healthcare. Besides saving money on overall reductions in premium costs, employers also pay fewer taxes because contributions to their employees' HSAs are tax deductible.

Health Savings Accounts benefit healthcare.

Because an HSA-qualified HDHP provides financial incentives to manage healthcare expenses and increase influence over healthcare decisions, participants are encouraged to become careful healthcare consumers who demand and receive better value for their healthcare dollars—increasing accountability, competitive pricing, and responsible consumption.

This publication is organized into three sections so you can 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 as to 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—all presented in an easy-to-read, sequential format. Topics include:

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

Section 3 helps you set up a record keeping system, explains the paperwork you will receive, and provides information for employers who are considering making HSAs available to their employees.

Choosing an HDHP/HSA combination may require you to make some changes in the way you think about and use healthcare, but you do not need to compromise the quality of the healthcare you receive. 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, because according to the Employee Benefit Research Institute (EBRI), a married couple will need approximately $270,000 on average to pay for their medical needs in retirement.[1]

Employees of all ages should start taking advantage of this retirement strategy. It's never too early or too late to save for retirement. If you are young and just starting out in your career, thinking of your HSA as a type of retirement vehicle and contributing with that mindset means that you have the potential to save hundreds of thousands of dollars in your HSA to help meet your financial objectives when you retire.

If you will retire soon and have recently discovered the usefulness of an HSA as an additional retirement account, you still have time to take advantage of the many benefits of an HSA.

1 https://www.ebri.org/docs/default-source/ebri-press-release/pr-1264-savingstargets-28may20.pdf?sfvrsn=5e993d2f_2

Summary

- HSAs provide a triple-tax benefit: pre-tax contributions, tax-free account growth, and tax-free distributions, if used for qualified medical expenses. Other health savings and retirement savings offer only one or two of the three tax advantages.

- HSAs solve several important insurance-related problems: they reward wellness, allow for tax-free funds to pay out-of-pocket medical expenses, provide more choice and flexibility than traditional healthcare, protect from post-retirement medical expenses, and help manage chronic illness, creating more knowledgeable and engaged healthcare consumers.

- HSAs also benefit employers by reducing their tax burden (because employer contributions to employees' HSA are tax deductible).

- HSAs benefit healthcare in general by increasing consumer awareness—especially through comparison shopping and research.

CHAPTER 2
Definitions and Explanations

Chapter overview

This chapter defines and explains foundational concepts used throughout the rest of the publication. Mark this chapter so you can refer back to it as you read.

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

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

- You must be covered under an HSA-qualified high-deductible health plan (HDHP) on the first day of the month in which you open an HSA or make a contribution to an HSA.[1]
- You may have no other health coverage, unless permitted under IRS guidelines.[2]
- You cannot be enrolled in Medicare.[3]
- You cannot be claimed as a dependent on someone else's tax return.[4]

Although you must be an eligible individual to open or contribute to an HSA, you do not have to be covered under an HDHP to maintain the account, earn tax-free interest and investment dividends, or distribute money from the account for qualified medical expenses. You get to keep, grow, and spend all of the money in the account even if you leave your employer or lose your qualifying HDHP coverage.[5]

Health coverage terms

Deductibles

HealthCare.gov defines a deductible as the amount of covered expenses that you must pay before your health coverage company (which may be an insurance company or a third-party administrator) starts paying covered medical claims, with the exception of preventive care. (See the section on "First-dollar coverage" 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 even allow deductibles to accumulate for more than 12 months. (See the "Carry-over deductible" section later in this chapter.)

1 IRC §223(c)(1)(A)(i)
2 IRC §223(c)(1)(A)(ii)
3 IRC §223(b)(7)
4 IRC §223(b)(6)
5 IRS Notice 2004-2 Q&A 20

In order to qualify as an HSA-qualified HDHP, an HDHP must adhere to limits for both minimum deductible and maximum out-of-pocket expenses. These limits may change year to year because of increases in the consumer price index (CPI). The IRS typically announces changes in May or June before the change takes effect.[6]

2021	Single	Family
Minimum annual deductible	$1,400	$2,800
Out-of-pocket maximum	$7,000	$14,000
2022	**Single**	**Family**
Minimum annual deductible	$1,400	$2,800
Out-of-pocket maximum	$7,050	$14,100

Embedded deductible

Some HDHPs provide multiple deductibles or embedded deductibles. In such plans, the lowest deductible determines if the HDHP qualifies for an HSA.[7] If you meet the individual deductible for one family member under plans that qualify, you are not required to meet the higher annual deductible for the family.

If either the deductible for the entire family or the deductible for an individual family member is less than the minimum annual deductible for family coverage allowed by the IRS, then the plan is not considered an HSA-qualified HDHP.

Examples: Embedded deductible

Elliott has family health insurance coverage for 2021, with an annual deductible of $3,500 and an individual deductible (or embedded deductible) of $1,500 for each family member.

6 Rev. Proc. 2020-32
7 IRS Notice 2004-50 Q&A 20

The plan does not qualify as an HSA-qualified HDHP, because the deductible for an individual family member is below the minimum annual deductible of $2,800 for family coverage in 2021.[8]

Sheela's family health insurance coverage for 2021 has an annual deductible of $6,000 and an individual deductible (or embedded deductible) of $3,000 for each family member.

Sheela's plan qualifies as an HSA-qualified HDHP, because the deductible for an individual family member is above the minimum annual deductible of $2,800 for family coverage in 2021.[9]

Carry-over deductible

Some health plans allow expenses that were applied to the previous deductible to be applied, or carried over, to the new policy when the plan year resets. Usually, the carry-over deductible is applied for expenses incurred at the end of the plan year during a certain period of time (usually three months before the plan year ends.)[10]

This is not a requirement, but it is an added benefit when expenses occur late in the year. In some circumstances, this type of carry-over deductible will cause your HDHP to lose HSA eligibility. Because the deductible includes more than 12 months, recalculate the IRS minimum deductible limit to see what deductible limits would be required for your plan to remain HSA qualified.

(# months in plan ÷ 12) x annual deductible

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.

- Individual policy minimum deductible for 2021: **15/12 x $1,400 = $1,750**
- Family policy minimum deductible for 2021: **15/12 x $2,800 = $3,500**

8 IRS Notice 2004-2 Q&A 3
9 IRS Notice 2004-2 Q&A 3
10 IRS Notice 2004-50 Q&A 24

Instead of the limits listed in the previous table, Matt's HDHP must satisfy these higher amounts to qualify for an HSA.

Copayments vs. coinsurance

A copayment is a fixed-dollar payment a patient makes per doctor visit, treatment, test, prescription, etc. For example, you might pay $35 for each office visit and $50 for an x-ray.

Coinsurance is the percentage of a medical expense for which the patient is responsible. For example, after you meet your deductible, you might pay 20% of your 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 during a plan year. In some HDHPs, the out-of-pocket maximum and the deductible are the same amount.

With HDHPs, the amounts you pay for in-network deductibles, copayments, or coinsurance (but not insurance premiums) are included toward your out-of-pocket maximum.[11] Whether out-of-network charges are included in your 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, eligible expenses, regardless of the plan's usual copayment or coinsurance arrangements. Some plans refer to this maximum out-of-pocket limit as the stop-loss limit.

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 $14,000 in 2021.

11 IRS Notice 2004-50 Q&A 21

Example: Out-of-pocket maximum

Tricia has a deductible of $1,500 and an out-of-pocket maximum of $3,000.

Tricia pays up to her $1,500 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 eligible expenses after she reaches her deductible, she pays 20% of those bills until she spends another $1,500 out of her own pocket. These limits may not apply to out-of-network or ineligible expenses.

When her total spending for eligible 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 specifies that each family member's in-network, out-of-pocket maximum is $3,000 (and $12,000 for the entire family), after which the plan pays 100%.

Because the 2021 HDHP out-of-pocket maximum per family is $14,000, their plan qualifies them to make HSA contributions.

$$4 \times \$3{,}000 = \$12{,}000$$

$$\$12{,}000 < \$14{,}000$$

However, if they had three children, their plan would not qualify because the maximum out-of-pocket limit would be higher than the legal maximum.

$$5 \times \$3{,}000 = \$15{,}000$$

$$\$15{,}000 > \$14{,}000$$

12 IRS Notice 2004-50 Q&A 20, Example 1

Yearly or lifetime benefit limits

The Patient Protection and Affordable Care Act (PPACA) prohibits insurers from imposing lifetime limits on benefits. Before healthcare reform, if you exceeded your plan's yearly or lifetime benefit limits for a medical condition, you had to use your HSA or other funds to make up the difference. This provision, which became effective September 23, 2010, affects all existing insurance plans.

Preventive care

First-dollar coverage

Your insurance company may cover some of your medical costs, especially for preventive care and some chronic conditions, at no cost to you and before you meet your deductible (referred to as "first-dollar coverage").

Beginning September 23, 2010, the PPACA requires all new group health plans and plans in the individual market to provide first-dollar coverage for preventive services, including immunizations, preventive care for infants, children, and adolescents, and preventive care and screenings for women.

On July 17, 2019, the IRS and Health and Human Services expanded the list of preventive services that health plans may select for first-dollar coverage without jeopardizing the HSA eligibility of an HDHP.[13] This expanded list includes treatments for conditions such as congestive heart failure, asthma, diabetes, and depression.[14]

The definition of preventive care that applies to HSA-qualified HDHPs generally excludes any service or benefit intended to treat an existing illness, injury, or condition. However, in some situations, treatment beyond strictly preventive care screening is allowed.

Employers and health plans will have flexibility to incorporate items from this list into their plan designs, so check with your plan administrator to find out what is included. Preventive care includes, but is not limited to, the following:[15]

- Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals

13 www.irs.gov/newsroom/irs-expands-list-of-preventive-care-for-hsa-participants-to-include-certain-care-for-chronic-conditions
14 IRS Notice 2019-45
15 IRS Notices 2004-23 and 2019-45