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Health Savings Account

Dear Client,

Given the ever-escalating cost of providing employee health care benefits, we are writing to advise you of a more cost-effective method of providing these benefits; namely, a health savings account (HSA). For eligible individuals, HSAs offer a tax-favorable way to set aside funds (or have their employer do so) to meet future medical needs. Here are the key tax related elements:

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

Who is eligible?

To be eligible for an HSA, you must be covered by a "high deductible health plan" (discussed below). You must also not be covered by a plan which (1) is not a high deductible health plan, and (2) provides coverage for any benefit covered by your high deductible plan. (It's okay, however, to be covered by a high deductible plan along with separate coverage, through insurance or otherwise, for accidents, disability, or dental, vision, or long-term care.)

For 2025, a "high deductible health plan" is a plan with an annual deductible of at least $1,650 for self-only coverage (*$1,700 for 2026),* or at least $3,300 for family coverage (*$3,400 for 2026*). For self-only coverage, the 2025 limit on deductible contributions is $4,300 (*$4,400 in 2026*). For family coverage, the 2025 limit on deductible contributions is $8,550 (*$8,750 for 2026*).

An individual, and the individual's covered spouse as well, who has reached age 55 before the close of the tax year and is an eligible HSA contributor may make additional "catch up" contributions for 2024 (or 2025) of up to $1,000.

A high deductible health plan does not include a plan if substantially all of the plan's coverage is for accidents, disability, or dental, vision, or long-term care, insurance for a specified disease or illness, or insurance paying a fixed amount per day (or other period) of hospitalization.

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

Deduction Limits

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

However, if you are enrolled in Medicare, you are no longer an eligible individual under the HSA rules, and so contributions to your HSA can no longer be made.

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

Earnings

If the HSA is set up properly, it is generally exempt from taxation, and there is no tax on earnings. However, taxes may apply if contribution limitations are exceeded, required reports are not provided, or prohibited transactions occur.

Distributions

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

Distributions from an HSA exclusively to pay for qualified medical expenses are excludable from the gross income of the account beneficiary even though the beneficiary is no longer an "eligible individual," e.g., the individual is over age 65 and entitled to Medicare benefits, or no longer has a high deductible health plan.

As you can see, HSAs offer a very flexible option for providing health care coverage, but the rules are somewhat involved. Again, please call if you would like to discuss this topic further.

Yours truly,

Green, Polack & Company
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