benefit strategies LLC

HSA GPS Fact Sheet Series

HSAs and Medicare

Many individuals are confused at the intersection of HSAs and Medicare. Two different federal agencies have primary responsibility for these programs – the Dept. of Health and Human Services for Medicare and the Dept. of the Treasury for HSAs. Each agency issues rules related to its products without consideration of the interaction with the other product, leaving Americans confused. This paper is designed to help you navigate this confusion so that you remain in compliance with HSA rules.

Medicare and HSA Eligibility

1. Do I lose my HSA eligibility at age 65?

No. You lose your ability to open and contribute to an HSA when you're no longer covered by an HSA-qualified health plan, you enroll in other coverage that's not HSA-qualified or you become someone's tax dependent. Turning age 65 doesn't automatically terminate your HSA eligibility.

2. Does enrollment in Medicare impact my HSA eligibility?

Yes. Medicare doesn't offer an HSA-qualified option. You can't make contributions to your HSA after you enroll in any Part of Medicare, even if you also remain covered on an HSA-qualified plan.

3. Aren't I automatically enrolled in Medicare Part A at age 65?

No. You are enrolled in Part A (inpatient services) only if you are age 65 or older and receiving Social Security or Railroad Retirement Board (RRB) benefits. You're enrolled in Parts A and B (outpatient services like doctor visits, lab work and imaging) automatically if you're collecting Social Security disability benefits or are diagnosed with amyotrophic lateral sclerosis (ALS, or Lou Gehrig's Disease). Otherwise, you must sign up to receive Medicare benefits.

For more information on Medicare enrollment, please refer to pages 23 and 24 of *Medicare & You 2016* (available online) or call the Social Security Administration customer service center at 1-800-772-1213.

4. If my spouse and I are enrolled on my employer's HSA-qualified plan and I enroll in Medicare, can my spouse open an HSA?

Yes, if your spouse is otherwise HSA-eligible. Individuals don't have to be the health plan subscriber to be HSA-eligible. You or your spouse can then make tax-deductible contributions into his or her HSA, up to the family maximum if you remain covered on a family contract (even if only your spouse is HSA-eligible). For some couples, this provision in the law allows them to continue to contribute to an HSA (and build tax-free balances for distribution in retirement) for several years after the older spouse enrolls in Medicare.

5. If I'm not HSA-eligible, can I enroll in my employer's HSA-qualified plan?

Yes. HSA eligibility refers to your ability to open and contribute to an HSA, not whether or not you can enroll in a health plan. As long as you meet your employer's and the health insurer's enrollment requirements, you can enroll in the health plan. If you're not HSA-eligible, though, you can't contribute to an HSA to reimburse your eligible expenses tax-free. Your employer may offer a Health FSA or Health Reimbursement Arrangement (HRA) through which you can reimburse eligible expenses tax-free.

Medicare and HSA Contributions

6. Can I continue to contribute to my HSA once I'm enrolled in Medicare?

No. You won't be HSA-eligible once you enroll in Medicare, so you can't make additional contributions. You can contribute for months that you were eligible before you enrolled in Medicare. For example, if your 65th birthday was May 6 and you enrolled in Medicare immediately, your effective date of Medicare coverage would be May 1. You could make contributions for the months of January, February, March and April at any point up to the date that you file your personal income tax returns for that year, even though you may not be HSA-eligible at the time that you make your final contribution for those months.

7. Can I contribute to my spouse's HSA if I'm enrolled in Medicare and no longer HSA-eligible?

Yes. Anyone can contribute to anyone else's HSA. If you remain employed and enrolled in Medicare, and if your spouse is HSA-eligible, your spouse can open an HSA. You (and your spouse) can contribute to his or her HSA.

Medicare and HSA Distributions

8. If I'm no longer HSA eligible, can I make tax-free distributions for eligible expenses?

Yes. HSA eligibility relates to your ability to make contributions. Once you open an HSA, you can make tax-free distributions for the rest of your life, as long as you still have funds in your HSA.

9. What expenses can I reimburse from my HSA once I'm enrolled in Medicare?

You can still reimburse tax-free all eligible out-of-pocket expenses not reimbursed by other insurance, including health plan deductibles, copay and coinsurance; dental and vision expenses; insulin and diabetic supplies; over-the-counter equipment and supplies; and over-the-counter drugs and medicine with a prescription.

In addition, you can reimburse certain insurance premiums, including premiums for Medicare Parts B and D, Medicare Advantage (plans offered by private insurers that replace Medicare coverage) and some Medicare supplement plans.

10. Whose eligible expenses can I reimburse tax-free from my HSA?

You can reimburse your own, your spouse's and any tax dependents' (such as an adult disabled child) expenses tax-free from your HSA. These other family members don't need to be HSA-eligible themselves or be covered on your health plan for you to make tax-free distributions from your HSA to reimburse their eligible expenses.

Note: You can't reimburse your own or anyone else's Medicare or Medicare supplement premiums tax-free until you turn age 65. If you are the family's HSA owner and have an older spouse, your spouse will need to open an HSA while he or she is still eligible and contribute a $1,000 catch-up contribution and/or a portion of the family contribution to cover his or her Medicare premiums until you turn age 65 and can reimburse them from your HSA.

11. My spouse and I both have an HSA. Do we have to limit distributions from each HSA to our own expenses?

No. You can reimburse each other's expenses from your respective HSAs as long as you remain married.

12. Can I make tax-free distributions from my HSA when I turn age 65?

No. Once you turn 65 or meet Social Security's definition of disabled, you can make distributions for items that are not HSA-qualified without incurring the 20% additional tax (penalty). Distributions for ineligible items are always included in your taxable income,

regardless of age. In this sense, once you turn age 65 or are disabled, distributions for ineligible items receive the same tax treatment as distributions from your qualified retirement account [traditional IRA, 401(k), 403(b), etc.].

13. If I pass away first, can my HSA continue to reimburse my spouse's eligible expenses tax-free?

You name a beneficiary when you enroll in your HSA, and you can change the designation at any time. If you name your spouse as beneficiary (the most common situation), upon your death your HSA passes to your spouse with balances and tax advantages intact. The only change is in the owner's name. Your spouse can then reimburse his or her own eligible expenses tax-free. In addition, if your spouse remarries, he or she can reimburse the new spouse's eligible expenses tax-free. If you name any other person or entity as the beneficiary, the HSA is liquidated and the assets pass to that person or entity, who may incur a tax liability. That beneficiary doesn't enjoy the tax benefits and isn't constrained by the rules of an HSA.

Delaying Enrollment in Medicare When First Eligible to Enroll

14. Do I face a penalty if I defer Medicare enrollment when I'm first eligible (65th birthday for most individuals?

Possibly. You won't face a penalty for delaying enrollment in Part A. If you delay enrollment in Parts B and D, you won't face a penalty if you maintain "creditable coverage" – coverage deemed at least as rich as Medicare. Insurers test their plans annually against a formula that the Medicare regulators issue. Insurers then send a letter to individuals enrolled in the plan (and send reports to Medicare officials) telling them whether or not the plan represents creditable coverage.

If the coverage isn't creditable, penalties are applied if you eventually enroll in Medicare. Penalties:

Part B: Penalty is a 10% per year (0.833% per month) additional Part B premium for each month that you don't maintain creditable coverage between the date that you first became eligible to enroll and the date that you finally enroll.

Part D: Penalty is a 1% per month (12 per year) additional Part D premium for each month that you don't maintain creditable coverage between the date that you first became eligible to enroll and the date that you finally enroll.

15. Given the penalty, should I just enroll in Parts B and D when I'm first eligible and stop contributing to my HSA?

That's a personal decision that you should discuss with your financial advisor. While your initial reaction might be to avoid penalties at all costs, note that (1) the penalties aren't a punishment for doing something wrong or immoral and (2) you may be better off financially by remaining in your HSA program, contributing to your HSA and later facing penalties. Key considerations:

- What's the difference in current cost between remaining enrolled in my employer's plan without enrolling in Medicare, enrolling in Medicare only or enrolling in both programs?
- What's the difference in benefits covered and financial responsibility between enrolling in either program or both programs?
- What tax advantages do I give up if I'm no longer HSA-eligible? Remember, you won't be able to reduce your taxable income through HSA contributions if you enroll in Medicare.
- What will be the financial consequences of my penalties? Remember, since the penalties represent additional premiums, they're eligible for tax-free reimbursement from your HSA.
- Will I ever enroll in Parts B and D and face those penalties, or will I choose coverage (such as a Medicare Advantage plan) that doesn't require enrolling in and paying premiums for that coverage.

This information is accurate as of May 1, 2016. Please note that this discussion is for informational purposes only and is based on current regulations. It doesn't represent, and shouldn't be construed as a substitute for, professional advice. Please consult your personal legal, financial or tax counsel to discuss your personal situation and refer to IRS Publication 969.

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