HSAs and Medicare

The following are some questions and answers dealing with the interaction between Medicare and health savings accounts ("HSAs").

Q 1: ARE INDIVIDUALS ELIGIBLE FOR MEDICARE ABLE TO MAKE HSA CONTRIBUTIONS?

A 1: Yes, unless they are actually signed up for Medicare.

An "eligible individual" can establish and contribute to an HSA. An eligible individual is, with respect to any month, any individual who: (1) is covered under a high-deductible health plan ("HDHP") on the first day of such month; (2) is not also covered by any other health plan that is not an HDHP (with certain exceptions for plans providing certain limited types of coverage); (3) is not enrolled in Medicare (mere eligibility is disregarded); and (4) may not be claimed as a dependent on another person's tax return (not including the spouse).

A Medicare-eligible individual who is not actually enrolled in Medicare Part A, Part B, Part D, or any other Medicare benefit may contribute to an HSA until the month that he or she is enrolled in Medicare.

For age-based Medicare, if the individual already receives Social Security benefits, he is automatically enrolled in Medicare Parts A and B, effective the first day of the month he is age 65. However, if he is not receiving Social Security benefits, he must take the affirmative step of applying for Medicare.[1] Therefore, someone age 65 is not necessarily enrolled in Medicare.

However, note that if Medicare Part A is delayed, the individual should stop HSA contributions at least 6 months prior to filing for Medicare benefits as Part A may be retroactive and begin 6 months prior to the month the individual actually applied for the benefits.

A participant can delay Part A coverage when it is not automatic; he can waive Part B when it is automatic or delay Part B coverage when it is not.

An individual must sign up for Parts C and D.

Q 2: DOES MEDICARE ELIGIBILITY OR ENROLLMENT AFFECT HDHP COVERAGE?

A 2: Employers subject to the Medicare as Secondary Payer Rule cannot encourage or force participants to drop group health coverage in favor of Medicare or make Medicare-eligible individuals ineligible under the group health plan. Therefore, someone enrolled in Medicare can still participate in a group health plan, including an HDHP.

An individual on Medicare may drop group health plan coverage voluntarily, if the employer allows; if an employee, spouse, or dependent who is enrolled in an accident or health plan of the employer becomes entitled to coverage (i.e., becomes enrolled) under Part A or Part B of Medicare, a cafeteria plan may permit the employee to make a prospective election change to cancel or reduce coverage of that employee, spouse, or dependent under the accident or health plan.

Generally, when a participant is covered under both a group health plan and Medicare, Medicare will be a secondary payer unless the participant is covered as a retiree.

[1] Note that when there is a delay Social Security benefits, once the participant applies for Medicare Part A, benefits are effective retroactively 6 months.

Q 3: HOW ARE HSA CONTRIBUTION LIMITS CALCULATED WHEN AN INDIVIDUAL ENROLLS IN MEDICARE MID-YEAR?

A 3: The annual contribution limit depends on the number of full months the person is an eligible individual.

Example. For 2018, the maximum annual contribution is $3,450 for self-only coverage. Jerry enrolls in Medicare, effective July 1, 2018. His maximum contribution is $1,725 ($3,450 x 6/12 months). In addition, Jerry can make a catch-up contribution of $500 ($1,000 x 6/12).

Q 4: WHAT ARE THE SPECIAL RULES FOR MARRIED COUPLES?

A 4: Code § 223 contains a special rule for married individuals which provides that if either spouse has family coverage, then both spouses are treated as having only that family coverage. The HSA contribution limit is a joint limit, which is to be divided equally between the married couple if both are HSA-eligible unless they agree on a different division. So, if either spouse is HSA-eligible and has family HDHP coverage, the spouses' combined contribution limit is the annual statutory maximum amount for individuals with family HDHP coverage ($6,900 for 2018).

Each spouse who is an eligible individual and wants to make contributions to an HSA must open a separate HSA. Thus, only one person may be the account beneficiary of an HSA.

When One Spouse Is Not HSA-Eligible – Full Year

If only one spouse is enrolled in Medicare (i.e., one spouse is HSA-eligible and the other is not), the contribution limit of the HSA-eligible spouse is calculated based on whether the eligible individual has self-only or family coverage. The HSA-eligible spouse can contribute the full amount – no allocation is made to the ineligible spouse.

Example 1. Velma and Wilber are a married couple with family HDHP coverage. Velma is an eligible individual. Wilber also has coverage under Medicare so is not an eligible individual. Velma may contribute $6,900 to an HSA for 2018 while Wilbur may not contribute to an HSA.

Example 2. In 2018, Maureen and Steve are married and have a child. Maureen has family HDHP coverage with a $5,000 deductible that covers Maureen and one of the children. Maureen otherwise meets the requirements of being an eligible individual for HSA purposes. Steve is enrolled in Medicare. Maureen may contribute up to $6,900 to her HSA. Steve is not eligible to make an HSA contribution.

When One Spouse Is Not HSA-Eligible – Partial Year

The annual contribution limit depends on the number of full months the person is an eligible individual.

Example. Larry and Beatrice are a married couple with family HDHP coverage and are both HSA-eligible. Beatrice signs up for Medicare, effective August 1, 2018. Beatrice can only contribute up to $4,025 ($6,900 x 7/12). If Larry has an HSA, he can contribute the remainder ($2,875) or he could, for example, contribute the full amount ($6,900) if Beatrice contributed $0.

Catch-Up Contributions

A married couple may also make two HSA catch-up contributions, so long as both spouses are at least age 55, but in order for a married couple to make two HSA catch-up contributions ($2,000 total), a separate HSA must be established in the name of each spouse. The annual contribution limit depends on the number of full months the person is an eligible individual.

Example. Daisy and Bubba are married. Daisy signs up for Medicare effective August 1, 2018. She can only contribute $583.33 ($1,000 x 7/12). If Bubba is on Medicare for the full year, he could contribute $0. If Bubba is not on Medicare for the full year, he could contribute $1,000.

Example 2. An individual who is covered by an HDHP for nine months (9/12ths of a year), with no disqualifying coverage, before enrolling in Medicare after turning age 65.

She is allowed an HSA contribution of either $5,175 if enrolled in family coverage ($6,900 × 9/12), or $2,587.50 if enrolled in self-only coverage ($3,450 × 9/12). In addition, she would be allowed a catch-up contribution of $750 ($1,000 × 9/12) into her HSA.[2]

Example 3. A married couple covered by an HDHP with no disqualifying coverage during 2018 has family HDHP coverage for four months (4/12ths of a year) before the wife enrolls in Medicare when she turns 65 in May. In this situation, the couple would be allowed an HSA contribution of $2,300 ($6,900 × 4/12), reflecting the annual family coverage amount multiplied by their 4 months of coverage, that could be divided between the couple's HSAs in any way they choose. In addition, since the wife turned 65 in May, she would be allowed a catch-up contribution of $330 ($1,000 × 4/12) into her HSA, because for four months of the year she was under age 65.

The husband turns 65 in October and enrolls in Medicare. Assuming he continues with self-only HDHP coverage, he would be allowed an additional HSA contribution of $1,437.50 ($3,450 × 5/12) (the numerator "5" representing the five months of self-only coverage that he had following the four months of family coverage, and before he turned 65 and enrolled in Medicare in October). Also, the husband would be allowed a catch-up contribution of $750 ($1,000 × 9/12) into his HSA (for the nine months of the year that he was under age 65 and not enrolled in Medicare).[3]

Q 5: HOW DOES MEDICARE ENROLLMENT AFFECT DISTRIBUTIONS?

A 5: An account beneficiary can continue to receive distributions from his HSA when he is no longer an eligible individual (e.g., is enrolled in Medicare). However, contributions can no longer go into his HSA.

An HSA is a trust or custodial account established exclusively for the purpose of paying qualified medical expenses[4] of the account beneficiary, his spouse, and/or his tax dependents.

Qualified expenses include premiums in the case of an account beneficiary who has attained the age 65 for any health insurance (e.g., premiums for Medicare Part A, B, or D, Medicare HMO, and the employee's share of premiums for employer-sponsored health insurance, including premiums for employer- sponsored retiree health insurance), <u>but not for</u> a Medicare supplemental policy.

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[2] Information Letter 2016-0014.
[3] Information Letter 2016-0003.
[4] "Qualified medical expenses" are those described in Code Sec. 213(d) (See IRS Publication 502) including nonprescription drugs with a prescription paid for the account beneficiary, his spouse, and/or his dependent, even if the spouse or dependent is not an eligible individual as long as the expense isn't reimbursed elsewhere. Premiums cannot be reimbursed except for:

- COBRA premiums;
- qualified long-term care insurance coverage;
- premiums while the individual is receiving unemployment compensation; and
- premiums in the case of an account beneficiary who has attained the age 65 for any health insurance (e.g., premiums for Medicare Part A, B, or D, Medicare HMO, and the employee's share of premiums for employer-sponsored health insurance, including premiums for employer- sponsored retiree health insurance), <u>but not for</u> a Medicare supplemental policy.

Q 6: WHAT IS THE TAX TREATMENT OF INTEREST AND DISTRIBUTIONS?

A 6: HSA earnings accumulate tax-free and distributions to pay qualified medical expenses are also tax-free, even if the individual is not currently eligible to make contributions to the HSA at the time of distribution.

Distributions not used exclusively to pay for qualified medical expenses under IRC 213(d) are included in income and subject to a 20% tax. The 20% tax does not apply when an individual is age 65 (eligible for Medicare), is disabled, or has died during the year.