HSA GPS Fact Sheet Series

HSAs and Medicare

Many individuals are confused at the intersection of Health Savings Accounts (HSAs) and Medicare. Two different federal agencies have primary responsibility for these programs, the Department of Health and Human Services (HHS) for Medicare and the Department of the Treasury (specifically the Internal Revenue Service, or IRS) 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 can open and contribute to an HSA at age 65 or later as long as you meet HSA eligibility requirements, which are:

- You're covered on an HSA-qualified medical plan,
- You're not someone's tax dependent, **and**
- You don't have any disqualifying coverage (including enrollment in Medicare).

Turning age 65 does not, in and of itself, preclude you from remaining HSA-eligible absent any disqualifying coverage.

2. Does enrollment in Medicare affect my HSA eligibility?

Yes. Medicare doesn't offer an HSA-qualified option. You can't make contributions to your HSA for any months after you enroll in any Part of Medicare, even if you're also covered on an HSA-qualified plan and meet all other HSA eligibility requirements.

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

No. You're enrolled in Medicare automatically only if you're age 65 or older and receive Social Security or Railroad Retirement benefits. In that situation, you're automatically enrolled in Part A (inpatient services) and Part B (outpatient services like doctor visits, lab work and imaging). You can defer coverage in Part B. Most people defer Part B coverage if they (or their spouse) continue to work and remain covered on their (or their spouse's) employer's group plan, since beneficiaries must pay a monthly premium of at least $135.50 (2019 figure) for Part B coverage.

If you work for a company with fewer than 20 employees, Medicare is your primary insurer and the employer-sponsored plan is secondary coverage. The employer's insurer may require that you enroll in Part A and Part B once you turn age 65. This is not a federal requirement, but rather an insurer rule. Some insurers require employees at these smaller companies and their enrolled dependents to enroll in Medicare when they're first eligible, while other insurers don't. Be sure to check with your employer and insurer.

For more information on Medicare enrollment, refer to pages 23 and 24 of *Medicare & You 2019* (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 he open an HSA?

Yes, if he is otherwise HSA-eligible. Individuals don't have to be the medical plan subscriber to be HSA-eligible. You or your spouse can then make tax-deductible contributions into his HSA, up to the family maximum if you remain covered on a family contract (even if only he 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 medical plan. As long as you meet your employer's and the medical insurer's eligibility requirements, you can enroll in an HSA-qualified medical plan. If you're not HSA-eligible, though, you can't open or contribute to an HSA. Your employer may offer a Health FSA or Health Reimbursement Arrangement (HRA) through which you can reimburse qualified expenses tax-free.

Medicare and HSA Contributions

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

No. You lose HSA eligibility 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 is May 6 and you enroll in Medicare immediately, your effective date of Medicare coverage is May 1. You can 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 these retroactive contributions.

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

Yes. If your spouse is HSA-eligible and has an HSA, you – or anyone else – can contribute to his HSA. Your enrollment in Medicare doesn't disqualify him from contributing to (or accepting contribution from others into) his HSA.

You can contribute personal funds, either through post-tax payroll (you can set up a payroll deduction to send money directly to your spouse's HSA) or with funds that you possess already. He then deducts these contributions on his (or if you're filing jointly, your joint) personal income tax return.

Medicare and HSA Distributions

8. I'm no longer HSA eligible. Can I make tax-free distributions for qualified expenses?

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

9. Which expenses can I reimburse tax-free from my HSA once I'm enrolled in Medicare?

You can still reimburse tax-free all qualified out-of-pocket expenses not reimbursed by other insurance or other sources, including medical plan deductibles, copays, 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 Part B and Part D, Medicare Part C (Medicare Advantage – plans offered by private insurers that replace traditional Medicare coverage).

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

You can reimburse your own, your spouse's, and any tax dependents' expenses tax-free from your HSA. These other family members need not be HSA-eligible themselves or covered on your medical plan for you to make tax-free distributions from your HSA to reimburse their qualified expenses tax-free.

Note: You can't reimburse your own or anyone else's Medicare *premiums* tax-free until you, the account owner, turn age 65. If you have an older spouse and want to reimburse his Medicare premiums tax-free, he must open an HSA (if he is eligible to do so) before he enrolls in Medicare. He can then contribute at least the $1,000 annual catch-up to cover his Medicare premiums until you turn age 65 and can reimburse his premiums tax-free from your HSA. In additional, when you're both HSA-eligible and covered on a family HSA-qualified medical plan, you can split the $7,000 (2019 figure) family maximum contribution between your two HSAs as you wish.

Once you turn age 65, you can reimburse your own and your spouse's Medicare premiums tax-free.

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. You can't combine accounts. You may choose to reimburse both your own and your spouse's expenses from one HSA to exhaust the balance in that account. Then, you have to manage (and perhaps pay monthly administration fees) on only one account without losing the ability to reimburse an expense that either of you incurs (as long as you remain married).

Alternatively, you may choose to retain one or more accounts owned by each of you.

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

No. Distributions for non-qualified expenses are *always* included in your taxable income, putting these withdrawals on par in terms of tax treatment with distributions from a traditional 401(k) plan or traditional IRA.

Once you turn 65 or meet Social Security's definition of disabled, distributions for non-qualified items are not subject to the 20% additional tax (penalty) otherwise assessed on distributions for non-qualified expenses.

13. If I pass away first, can my HSA continue to reimburse my spouse's qualified 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 him with balances and tax advantages intact. He can then reimburse his own qualified expenses tax-free. In addition, if he remarries, he can reimburse his new spouse's qualified 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. I continue to work, participate in my employer's HSA program, and deferred Medicare enrollment when I turned age 65. Do I face a penalty when I later enroll in Medicare?

Possibly. Here are the potential tax consequences if you delay enrolling in Medicare around your 65th birthday, when you're entitled to an Initial Enrollment Period:

Part A: If you (or your spouse) worked 40 employment quarters with income above the Medicare threshold, you receive Part A premium-free. You face no penalties for delaying enrollment past your Initial Enrollment Period. If you're required to pay a premium (which is rare) and don't enroll in Part A when you're first eligible (which is rare among people subject to the penalty),

you pay a 50% premium surcharge for double the number of months that you delayed enrollment after age 65. In other words, if you don't enroll in Part A until the month of your 66th birthday, you pay 150% of the standard premium for two years before you revert to the standard premium. You also may face a coverage gap when you decide to enroll in Part A, since you can enroll only as of the effective date following a general enrollment period (coverage effective July 1).

Part B: If you don't enroll during the Initial Enrollment Period, you must maintain group coverage from your 65th birthday until you do enroll in Part B. For every 12 months past your 65th birthday that you don't maintain group coverage, you pay a 10% surcharge on your monthly Part B premium for the rest of your life. In addition, you may face a gap in coverage when you do want to enroll, since you'll have to wait until the next General Enrollment Period to enroll in benefits effective the following July 1.

Note that COBRA continuation *does not* constitute group coverage. If you retire and your spouse covers the gap until he enrolls in Medicare by continuing your group coverage via COBRA, he must enroll in Medicare when he's first eligible or faces a potential penalty when he enrolls in Medicare. He can avoid the penalty and possible gap in coverage gap by enrolling in Medicare when he turns age 65 during his Initial Enrollment Period.

Part D (prescription drug coverage): If you don't enroll during the Initial Enrollment Period, you must maintain group or nongroup coverage that offers prescription drug benefits at least as rich as Part D. If you don't, you're assessed a permanent surcharge of 1% of the national base beneficiary premium ($35.02 in 2019, making the penalty $0.35 for each month) for every month since your 65th birthday that you're drug benefit doesn't meet the standard of what's called Medicare Creditable Coverage (MCC). In addition, you may face a gap in coverage when you want to enroll. You'll have to wait for the next General Enrollment Period to enroll in benefits effective the following Jan. 1.

15. Given the penalty, should I just enroll in Part B and Part 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. Although your initial reaction might be to avoid penalties at all costs, note that (1) the penalties aren't a punishment for doing something illegal or immoral and (2) you may be better off financially by remaining in your HSA program, building HSA balances to cover future expenses, enjoying tax savings and later facing penalties.

To gain a perspective on the benefits and costs of enrolling when first eligible or delaying enrollment and facing potential penalties to enjoy the financial advantages of an HSA, it may help to reframe the penalty. Think of it as a surcharge rather than a penalty. A surcharge has a

more positive connotation. It doesn't imply that you've done anything wrong, but rather that you've made a trade-off that requires you to incur a cost when you pursue a course of action for which you receive a benefit. When the benefit outweighs the surcharge, you proceed and accept the surcharge as a consequence.

Key considerations:

- What's the difference in current cost among (1) remaining covered on my employer's plan without enrolling in Medicare, (2) enrolling in Medicare only, or (3) 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 qualified for tax-free reimbursement.

This information is accurate as of Nov. 5, 2018. 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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Benefit Strategies, LLC
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