HSA
OWNER'S MANUAL

What Every Accountholder, Employer and Benefits Consultant Needs to Know about Health Savings Accounts – and How to Use Them Strategically

Todd Berkley

I highly recommend this book to anyone owning or contemplating a health savings account.

—Roy Ramthun (“Mr. HSA”)
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Todd Berkley
I’d like to thank my Dad for encouraging my passion for education and business. He published a daily paper for many years, I hope my book will make him proud. I’d also like to thank my wife, Kelly, and my family for their love and support and for enduring my passion for all things HSA. I am indebted to my colleagues throughout the HSA industry who dedicate themselves to helping people understand, embrace, and benefit from the differences a Health Savings Account can bring to the health care and retirement planning experience.

I’d also like to thank Ewell Brown for his assistance with the organization of the topics in the book. And a big thank-you to Cynthia M., my top-notch editor, who made the text more consistent and readable.

Please note that I am not a lawyer. This book does not represent legal advice. Instead, I merely attempt to distill extraordinarily complex information that may prevent you from choosing an HSA-qualified plan (or paralyze your decision making if your employer has made the plan choice for you) and present it in easy-to-understand portions. I have included references to original sources where practical. I encourage you to share this information with your personal tax advisor to make sure that you comply with all IRS rules and regulations governing HSAs.
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This book is the owner’s manual that did not come with your HSA.

Health Savings Accounts are becoming a more common part of average Americans’ lives. Paired with HSA-qualified health plans, they cover a growing number of Americans’ health care costs. And the trends indicate that they’ll become an even more important part of more people’s health care in the future.

This book is designed to help you understand HSAs and HSA-qualified health plans. When you enroll in these plans, you often receive a mass of literature about the health plan, outlining what services are covered, your cost-sharing, exclusions, rules to follow, and how to appeal a claim denial, among other topics. You probably received some information about the HSA itself from your trustee. It most likely came in the form of a glossy twelve-page brochure with pictures of smiling families and caring doctors, plus some very basic information about how to set up your account, how much you could contribute, and a partial list of expenses eligible for tax-free distribution.

That level of information is simply inadequate for you to manage your HSA. If you rely on that information alone, you’ll probably end up doing something inadvertently that runs afoul of HSA rules and regulations. Even if your HSA custodian is the rare one that provides adequate and easy-to-understand information in its printed materials and online to keep you in
compliance, you’ll never learn how to maximize the benefit of your HSA. HSA trustees simply do not provide this information.

So where do you turn for complete information on remaining compliant with HSA rules and regulations and maximizing the short-term and long-term tax advantages of your HSA? Right here, with this book. *HSA Owner’s Manual* is the most comprehensive guide to HSAs available anywhere. *This book is the owner’s manual that did not come with your HSA*. If you follow the advice in this book, you’ll keep your HSA in compliance with current HSA rules and regulations. You’ll also learn about sources of updated information as the IRS releases new rules and interpretations and as the Department of Health and Human Services issues health care reform regulations that impact HSAs.

Your HSA trustee may offer similar information, but probably not in an easy-to-understand format and certainly not in a single volume.

In addition, **this book delivers information that no HSA trustee offers—strategies to help you maximize your financial opportunity** as an HSA accountholder. You’ll learn how to integrate your HSA into your short-term tax savings and long-term asset building strategies. You’ll receive information that will help you determine when you should use your HSA as a reimbursement account and when you’ll benefit from utilizing it as a long-term financial asset.

May your journey through the pages of this book reduce your confusion about your HSA and help you embrace it to unlock its hidden value for your long-term financial health.

If you would like to receive updates as HSA rules change, please visit AskMrHSA.com, an educational service run by my company, HSA Consulting Services, LLC.
HOW THIS BOOK IS ORGANIZED

This book contains four sections.

Part 1: You’ll learn about the “rules of engagement” that govern HSAs. Each chapter gathers the rules associated with one broad topic, like *Eligibility*, *Contributions* and *Distributions*. If you have a question about a specific topic, you can review that chapter and find a brief discussion of that specific topic. In many cases, you’ll also see a reference to the original legislation or an IRS interpretation that will guide you further in your understanding of the topic.

Part 2: This section contains much of the information included in Section 1, but it arranges that information by specific situations. For example, if you are wondering how Medicare impacts your HSA, you can turn to the “HSAs and Medicare” chapter and find a discussion of the eligibility, contribution, and distribution rules specific to Medicare.

Part 3: In this section, you’ll learn about specific strategies that you can adopt to get the most out of your HSA. You’ll need to read Section 1 first, since these strategies will
not make sense without a solid foundation in HSA “rules of engagement.”

**Part 4:** This section contains original source reference material. You may want to refer to it to gain additional knowledge about a very specific topic.
How to Read This Book

Authors of novels do not have to instruct readers on how to read their books. You know to start at the beginning and read through to the end. If you read it any other way, you’ll miss too much, and the ending will not make sense.

Reference books like *HSA Owner’s Manual* are different. They do not read like a novel. So here’s the best way to read this book:

- **Read Part 1 first.** You need to understand the basic “rules of engagement” that apply to HSAs. Without this foundation, you cannot manage your HSA successfully. Regardless of your personal situation, most of the information in Section 1 applies to you.

- **Read specific topics in Part 2 that apply to your personal situation.** Part 2 summarizes the key points based on personal situations, rather than delivering information by broad topic. For example, if you are divorced, you need to understand the specific rules around HSA eligibility, contributions, and distributions for individuals who are divorced. These topics are included in the *Eligibility*, *Contributions*, and *Distributions* sections, but they are scattered among topical sections. Part 2 brings all the information related to personal situations into one place.

- **Glance at Part 3 when you open your HSA.** You may find a topic relevant when you first open your HSA (for
example, Strategies 1, 2, and 3 may be relevant to you immediately). Read in depth the particular strategies that immediately make sense to you.

- **Read Part 3 in depth within a year.** Once you begin to manage your HSA and become comfortable with making deposits, identifying and reimbursing eligible expenses, understanding what expenses are subject to the deductible under your HSA-qualified plan, and matching up insurance statements (often called Explanations of Benefits) with provider bills, you’ll be ready to absorb higher-level information. At that point, you may find a strategy that will help you manage your HSA more effectively or maximize your tax savings or build your wealth faster.

- **Read Part 4 as appropriate.** It contains some original sources such as the full text of Section 223 of the Internal Revenue Code (IRC), the HSA law, plus a list of other resources. You’ll want to consult the online resources at times to receive the most up-to-date information on HSAs.

The keys to your success in managing your HSA are your willingness to learn, the principles presented in this book, and your patience and discipline as you strive to understand a program that may seem very confusing at first.

If you are totally frustrated after three months, remain patient. If you are still totally frustrated after six months, remain patient. If you are committed to understanding how HSAs work and how your health plan and HSA can work for you, you’ll get it. In my experience, most people are dragged into HSAs against their will (“Why don’t I get to keep my Cadillac plan?”), but over time, the overwhelming majority of folks learn to love it. Your understanding may be gradual, or you may be totally confused one day and find that everything clicks the next day. In the end,
you’ll master the information that you need to manage your HSA and integrate it into your personal financial plan.

The author is not a lawyer, and this book does not constitute legal advice. You must consult your own personal legal or tax advisor to receive counsel appropriate to your situation. Also, as the IRS periodically issues new guidance, Congress passes legislation and tax courts interpret the law, the information in this book may no longer be correct at the time that you read and apply it. That’s another reason why it is important to receive good, timely advice from your personal legal or tax advisor.
An important revolution is taking place in health care.

You may already be participating. If not, you almost certainly will be during the next five years, whether you continue to buy insurance through your employer or move to individual coverage on your own.

The front lines in this revolution include those who signed up voluntarily and those who were conscripted. It does not matter how you arrived or whether you’ve arrived yet. Your time is coming. You may fight it, but when you embrace it, you will find it changes the lens with which you view your current and future health care interactions.

The revolution is the Health Savings Account (HSA) program. Actually, it is two programs in one. First, there’s an HSA-qualified health plan, which includes a broad up-front deductible. In this sense, it is similar to traditional insurance lines like homeowner’s, renter’s, and automobile insurance. An HSA-qualified plan provides comprehensive health coverage, but only after the policyholder pays the cost of services before reaching the dollar figure at which insurance begins to reimburse expenses.

Second, there’s a Health Savings Account, a tax-advantaged vehicle that allows eligible individuals to divert a portion of their income or assets from the taxable income stream and set the funds aside in an account from which they can reimburse
eligible expenses tax-free and efficiently save for future health care expenses.

The two plans essentially work in unison. An individual cannot have an HSA account without enrolling in the HSA-qualified health plan (and meeting certain other eligibility criteria). An individual enrolled on an HSA-qualified health plan does not have to open and contribute to an HSA, but failure to do so results in a lost financial opportunity.

Because the health plan includes a broad deductible, its premium is generally lower than more traditional health insurance plans that have lower cost sharing. Insurers price the product lower for two reasons. First, the policyholder shares more of the up-front costs that the insurer otherwise would reimburse. Second, the insurer factors in a change of behavior that naturally occurs when a policyholder bears more of the cost of services. Since, as the late Nobel laureate Milton Friedman astutely observed, “[v]ery few people spend other people’s money as carefully as they spend their own,” insurers reason that policyholders who are responsible for up-front costs, and can bank the savings, are more likely to spend their money prudently, which impacts utilization of the healthcare system.

While the pain of moderate out-of-pocket expenses is felt directly by the insured party, once the underlying insurance kicks in, it provides substantial security against catastrophic loss. In fact, an HSA-qualified policy is the only type of health insurance that always has a maximum out-of-pocket limit by law. The HSA-style maximum limits will soon be adopted by all insurance policies sold as the Affordable Care Act rolls out and initial waivers expire.

The program is designed to introduce deductibles (or higher deductibles) without diluting the value of insurance, whether the policyholder purchases insurance through his employer or in the individual market. Let’s look at the economics in the employer-based insurance scenario, assuming a health plan with a $4,000
deductible and a savings of $3,000 in premium, split in a 1:2 ratio between employee ($1,000 saved) and employer ($2,000 saved). The employee directs his $1,000 pre-tax into his HSA, and the employer contributes 80% of its savings into the employee’s HSA. The employee has covered $2,600 of his $4,000 deductible in the form of deposits to his HSA account.

For many employees, $2,600 will more than cover their deductible expenses for the year. In other cases, they’ll need to make additional contributions, which they can make on a pre-tax or after-tax basis. An employee who contributes an additional $1,400 to cover his entire deductible will generate tax savings of about $500, leaving him $900 worse off (covering only $3,100 of his deductible before he begins to feel the financial impact). The same individual who contributes an additional $3,850 (up to the $6,550 maximum HSA contribution in 2014) saves about $1,200 in taxes, effectively reaching a break-even point even if he incurs his entire $4,000 deductible.

The math is important. Moving to a higher deductible does not constitute a reduction in the value of employer-based insurance. Instead, it is often a rational change instituted by the employer that results in overall savings for most employees. In fact, studies show that when individuals purchase insurance in the individual market or on a health insurance exchange, they consistently choose a combination of lower premiums and higher deductibles than their former employer-based plan. And when employers offer two or more plans with fixed-dollar contributions (the employer pays the same amount of each policy’s premium, so that the employee who wants to buy the plan with a lower deductible pays the entire premium difference between the two plans), employees consistently choose lower premiums and higher deductibles.

Thus, the introduction of an HSA-qualified plan with an up-front deductible does not reduce the value of insurance. Rather, the program rearranges the same dollars in a way that gives individuals
an incentive to be more prudent in their purchases and rewards them (by allowing them to retain funds that they’d otherwise spend on premiums and deposit those funds into a tax-advantaged account) by reducing their taxable income. Put another way, there is a 100% chance you will pay a premium, but only some chance that you will pay out-of-pocket costs. It is often smart to take some risk of potentially higher out-of-pocket cost for a sure reduction of premium going to the insurance company.

HSA programs have broad appeal once consumers understand how they work. When HSAs were introduced in 2004, critics scoffed that they benefitted only the “healthy, wealthy and wise,” while leaving lower-income, higher utilizing and less sophisticated individuals worse off. The experience of the last ten years has not borne out this criticism.

In fact, many policyholders pay less in total out-of-pocket costs (premium and cost-sharing) than they did under their old health plan with higher premiums and lower out-of-pocket costs. For many, HSAs are the alternative to the tax-advantaged Health Flexible Spending Arrangements (Health FSAs) to which they did not have access because either their employer could not afford the administrative costs or they were business owners who were not eligible to participate. But unlike FSAs, they do not need to accurately predict out of pocket costs for the year and be pressured to spend everything in the calendar year.

For others, the lower premium has “reset the premium baseline,” allowing their employer to continue to offer employer-based insurance at premiums that both employer and employee can afford. For many lower-income accountholders, the money their employer deposits into their HSA account is very empowering; it is often the first time they have ever owned a savings account. And for those with lower utilization due to youth, sheer luck, or adoption of a healthy lifestyle, HSAs represent an opportunity to build a financial asset and save for future healthcare costs in retirement.
This book is not written to make the case for HSAs, to evaluate whether they are the best insurance option for an individual or employee population, or to evaluate employer program design and implementation strategies. Instead, it is written for individuals (and in the case of employer-based insurance, employers and brokers or benefit consultants) who are already covered by an HSA-qualified health plan and want to make the most of it. The goal of this book is to provide comprehensive information for HSA accountholders so that they can use the flexibility written into the HSA legislation to apply the program in a way that makes the most financial sense for them.

The most basic confusion I encounter when answering questions for people at AskMrHSA.com is mixing up the rules between making a tax-free contribution to an account and how you can use the money once it is in the HSA account. There is actually a strong dividing line between the two. There is a very rigid set of rules regarding which individuals can open and contribute to an HSA and how much they can deposit each year. **HSA contribution eligibility is all about carrying the right insurance coverage at the right time.**

Once the money is placed into the HSA, the rules shift dramatically. Now coverage does not matter. **Using your HSA to pay for medical expenses tax-free is all about paying the right expenses at the right time for people who are related to you in the right way,** either through marriage or through your tax return.

Most of this book is devoted to helping you sort out these basic rules but also to move beyond them to take advantage of the powerful set of options those simple rules open up to you. You may not have asked for an HSA plan and may have even hated the idea at first, but my hope is that, now that you are here, this book will help you make the most of the current situation and even help you embrace your HSA to see the worlds of health care and financial planning in a whole new light.