

HSA Distribution Worksheet

Purpose: Use this worksheet to guide you in the federal income tax consequences of HSA distributions. Please consult with your tax or legal counsel. We do not provide tax or legal advice. See p.2 for details.

1 Is your distribution for an “eligible” medical expense? The primary purpose of an HSA is to use the funds to pay for the health care expenses of yourself and dependents. Distributions for eligible medical expenses are tax-free and penalty-free.

a. Was the expense incurred by yourself or a family member? HSA funds may only be used for yourself, your spouse and your dependents. Note: there is no requirement that you or your family member be currently covered by a HDHP. Coverage under a HDHP is only important when contributing to an HSA, not in being allowed to use the funds. See [Eligibility and Contribution Worksheet](#) for detail on contributing to an HSA.

b. Was the expense incurred after the HSA was established? You must open your HSA before you incur the medical expense. This is a good reason to open your HSA when your policy becomes effective. Once your HSA is open you can use your HSA funds to pay for eligible medical expenses incurred now or in the future. You can even pay for current expenses out of future contributions or reimburse yourself for eligible medical expenses that you paid for with other funds, just reimburse yourself from you HSA.

Example: you incur a \$2,000 eligible medical expense this year but only have \$500 in your HSA. You can pay \$500 out of the HSA and the other \$1,500 out of other funds. You can then pay yourself back with future year HSA contributions (provided you remain eligible to make HSA contributions).

c. Is your expense “eligible”? Most traditional medical expenses such as doctor visits and prescriptions are covered, see page 2 for a list of eligible expenses.

Note: The HSA custodian/trustee does not review your medical expenses for eligibility. You should save receipts and keep a tax record in case of an IRS audit.

2 Does your distribution qualify for another tax-free and penalty-free exception?

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|---------------------------|---|
| Long-term Care | Long-term care insurance is an eligible expense subject to dollar limitations – see page 2. |
| COBRA Benefits | Paying for COBRA continuation health benefits is eligible (see also “Insurance Premiums” below). |
| Insurance premiums | Health coverage for an HSA owner aged 65 is eligible (see back for detail). Also, COBRA health care coverage, and health care coverage while receiving unemployment compensation is eligible. |
| Medicare Premiums | Where premiums for Medicare are deducted from Social Security benefits, an HSA distribution to reimburse the Medicare beneficiary equal to the Medicare premium deduction is a qualified medical expense. |
| Rollover/Transfer | A rollover or transfer to another HSA is not taxed or penalized so long as the rollover is completed within 60 days and you have not completed another rollover within the previous 12 months. |

3 Does your distribution qualify for a taxable, but penalty-free exception?

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|--------------------------|---|
| Age 65 or over | Non-medical distributions after age 65 are not penalized but are taxable (similar to IRAs and 401(k)s). |
| Death/Inheritance | Distributions to named beneficiaries of HSAs are not penalized but are taxed. Spouse beneficiaries can treat the HSA as their own and are not subject to tax or penalty – see page 2. |
| Disability | Distributions taken by disabled persons are not penalized. |

4 Fail to meet any of the above? You are subject to taxes plus a 20% penalty.

See back (p.2) for additional exceptions and distribution reasons.

Example: a 25 year old takes a \$1,000 distribution from his HSA to pay for a new motorcycle for recreation. The motorcycle is not an eligible medical expense so the \$1,000 distribution is taxable and subject to a 20% penalty (\$1,000 x 20% = \$200). Non-eligible distributions are reported on IRS Form 8889 along with your income tax return.

HSA Distribution Guide – Additional Detail

This Worksheet is based on IRS guidance regarding HSAs including IRA Notice 2004-2, IRS Notice 2004-50, and IRS Publication 969. The following list of qualified and non-qualified medical expenses is intended to provide a quick guide. For more information refer to IRS Publication 502, and talk to a tax or financial advisor. This Worksheet does not cover state taxes issues. Many, but not all, states provide similar tax treatment for HSAs.

Qualified Medical Expenses

| | | |
|--------------------------------|-----------------------------|---------------------------|
| Abortion | Guide Dogs | Orthopedist |
| Acupuncture | Gynecologist | Osteopath |
| Alcoholism* | Hearing Aids | Oxygen |
| Ambulance Services | Hospital Services | Pediatrician |
| Anesthetists | Insulin | Physician |
| Artificial Limbs | Laboratory Tests | Postnatal Treatments |
| Artificial Teeth | Prepaid Insurance Premiums* | Prenatal Care |
| Bandages | Lab Fees | Prescription Drugs |
| Breast Recon. Surgery* | Lead Based Paint Removal* | Prosthesis |
| Birth Control Pills | Legal Fees* | Psychiatric Care |
| Blood Tests | Lodging* | Psychoanalysis |
| Braces | Long Term Care* | Psychologist |
| Braille Books and Magazines* | Long Term Care Services* | Registered Nurse |
| Car - modifications* | Meals* | Spinal Fluid Test |
| Cardiographs | Medical Information Plan | Splints |
| Chiropractor | Medical Services | Sterilization |
| Christian Science Practitioner | Medicines - prescriptions | Stop Smoking Programs* |
| Contact Lenses | Mentally Retarded, Homes* | Surgeon |
| Contraceptives | Nonprescription medicine* | Telephone* |
| Crutches | Neurologist | Therapy |
| Dental Treatment* | Nursing Home* | Transplants |
| Dermatologist | Nursing Services | Transportation |
| Diagnostic Devices and Fees | Obstetrician | Vaccines |
| Disabled Dependent Care | Operating Room expenses | Vasectomy |
| Drug Addiction Therapy* | Operations | Vision Correction Surgery |
| Eyeglasses | Ophthalmologist | Weight Loss Programs* |
| Eye Surgery | Optician | Wheelchair |
| Fertility Treatments | Oral Surgery | Wigs* |
| Future Medical Care* | Orthopedic Shoes | X-rays |

Non-Qualified

Over-the-counter drugs (see below)
Child Care
Cosmetic Surgery
Hair Transplants*
Health Club Dues
Household Help
Insurance Premiums*
Maternity Clothes
Nutritional Supplements
Teeth Whitening
Vitamins

Over-the-Counter Drugs

Over-the-counter drugs and medicines are no longer eligible medical expenses starting January 1, 2011. If you get a prescription for an over-the-counter drug then you can still use your HSA. Insulin is an exception. This rule does not apply to non-drug over-the-counter items; such as, bandages or blood pressure monitors.

* Additional rules apply – more information at IRS Publication 502, or a tax professional.

Additional Distribution Events and Other Details on Distributions:

- 1. Divorce.** In the case of a divorce with a “divorce or separation agreement,” an HSA owner may transfer HSA assets to the spouse without taxes or penalties. A private separation agreement is not sufficient for this tax treatment.
- 2. Spouse as Beneficiary.** A spouse named as a beneficiary is automatically deemed to be the HSA owner upon death of the original HSA owner. The surviving spouse may rollover, transfer and use the HSA as his or her own.
- 3. Long-Term Care Premiums.** Long-term care distributions are limited in amount based on age (for 2011 it ranges from \$340 for individuals under age 40 to \$4,240 for individuals age 71 or over). The amount adjusts annually for cost-of-living increases. See Revenue Code 213(d)(10).
- 4. Prohibited Transactions.** HSA owners engaging in “prohibited transactions” face potentially severe consequences and should seek professional help. The rules surrounding prohibited transactions are too complex for this Worksheet. Basically, a prohibited transaction occurs when a disqualified person (the HSA owner and others) engages in dealings with the HSA that permit opportunities for tax fraud. For example, an HSA owner cannot sell his or her HSA an asset the HSA owner owns (e.g., real estate).
- 5. Pledging the HSA as Security for a Loan.** An HSA owner is not allowed to pledge the HSA as security for a loan and the amount so pledged is treated as a distribution and is subject to taxes and a penalty.
- 6. Mistaken Distributions.** If there is clear and convincing evidence that amounts were distributed from an HSA because of a mistake of fact due to reasonable cause, the account owner can repay the mistaken distribution no later than April 15 following the first year the account owner knew or should have known the distribution was mistaken (subject to the custodian’s allowance of this).
- 7. Return of Excess Contributions.** If you contribute more to your HSA than you are eligible to contribute, you must remove the excess amount by your tax filing due date plus extensions. If you fail to remove the excess amount, plus any earning (e.g. interest) attributable to the excess by your tax filing due date, plus extensions, you will be subject to a 6% excise tax for years that you allow the excess to remain.
- 8. Reimburse Yourself.** You can reimburse yourself for medical expenses that you pay for with other funds.
- 9. Use Contributions for Future Expenses.** You can use a current year contribution to pay for future medical expenses.
- 10. Use Future Contributions to Pay Current Expenses.** Assuming you established an HSA, you can pay for current medical expenses (expenses incurred after HSA established) with future year contributions.
- 11. Insurance Premiums at Age 65.** Individuals over the age 65 can use the HSA to pay for premiums for Medicare Part A or B, Medicare HMO, and the employee share of premiums for employer-sponsored health insurance, including premiums for employer sponsored retiree health insurance. Premiums for Medigap policies are not qualified medical expenses. This applies to both insured and self-insured plans.