HSAs and IRA Transfers

Cash flow can be a challenge in the first year of being covered by a high deductible health plan (HDHP). Often times, individuals do not realize their drug costs $300, instead of the $60 copay they are accustomed to paying. An expensive prescription can be tough to pay for in the first month of the plan year if the person doesn't have enough money to cover it in their HSA.

This is one situation where an IRA transfer to an HSA may make sense.

The IRS permits an HSA-eligible individual to transfer an IRA in their name to an HSA in their name. There are just a few rules to follow.

The Basics

- Eligible IRA transfers to an HSA are not included in an individual's gross income.
- You may transfer a traditional and/or a ROTH IRA to an HSA.
- Transfers may NOT be made from ongoing SEPs or ongoing SIMPLE IRAs to an HSA.
- With the exception of an inherited IRA, the transfer must be made from an IRA in a person's name to an HSA in the same person's name.
- The transfer must be a direct trustee-to-trustee transfer from the IRA custodian directly to the HSA custodian.
- Qualified transfers **do count** against the annual IRS HSA contribution limit + catch-up for the taxable year in which the IRA is contributed to the HSA.
- An IRA transfer relates to the taxable year in which the distribution is actually made. There is no rule allowing IRA transfers that are contributed to an HSA between January 1 and April 15 to relate back to the prior taxable year.
- The HSA trustee/custodian reports the IRA transfer in Box 2 of IRS Form 5498-SA.
- There is a testing period after the IRA transfer where an individual must remain HSA-eligible. (See "Requirements to Maintain HSA Eligibility" on page 2).
- IRA transfers may be made once-in-a-lifetime.

IRA Transfer Subject to IRS Maximum

IRA transfers **do count** against the HSA contribution limit + catch-up for the taxable year in which they are contributed to the HSA.

The maximum amount that can be contributed to an HSA from an IRA transfer is based on:

- The IRS HSA maximum for the year in which the transfer is made $3,500/single, $7,000/family for 2019
- Family HDHP vs single HDHP coverage
- If the person is age 55+ and eligible for $1000 catch-up contribution.

Example: Family Coverage, No Catch-Up

- January 1, 2018, Matt, age 45, enrolls in family HDHP coverage.
- IRS maximum annual HSA contribution for 2018 is $6,900.
- Matt owns an IRA with a balance of $2,000.
- On April 2, 2018, Matt initiates a direct trustee-to-trustee transfer of $2,000 from his IRA trustee to his HSA trustee.
- The $2,000 IRA transfer is not included in Matt's gross income.
- Matt's testing period for the IRA transfer began in April 2018 and ends on April 30, 2019.
- After the qualified HSA funding distribution of $2,000, Matt may contribute an additional $4,900 to his HSA for 2018.

Maximum Number of IRA Transfers

In general, an individual may make only one IRA transfer during his lifetime. This means that if an individual has more than one IRA to roll to his HSA, he must first transfer all IRA amounts to a single IRA (direct IRA-to-IRA transfer) before transferring funds to the HSA.

There is one exception to the "once-in-a-lifetime" rule. If an individual transferred his IRA to his HSA during a month in which he had self-only HDHP coverage as of the first day of the month, and then switched to family HDHP coverage during a subsequent month within that same year, then the individual may transfer one more qualified IRA into his HSA.

Example: Exception to the Once-In-a-Lifetime Rule

- On January 1, 2018, Claudia, age 38, enrolls in self-only HDHP coverage and is HSA-eligible.
- She owns an IRA with a balance of $12,550.
- On June 4, 2018 Claudia initiates an IRA transfer of $3,450 from her IRA trustee directly to her HSA trustee.
- Her testing period for the first IRA transfer begins in June 2018 and ends on June 30, 2019.
- On August 1, 2018, Claudia enrolls in family HDHP coverage.
- In August 2018, she then makes an IRA transfer of $3,450 from her IRA trustee directly to her HSA trustee.
- Her testing period for the second IRA transfer begins in August 2018 and ends on August 31, 2019.
- The two distributions from the IRA are not included in Claudia's gross income.
- The IRA transfers of $6,900 ($3,450 + $3,450) equal Claudia's 2018 maximum annual HSA contribution.
- No further qualified HSA funding will be permitted.

If an individual switches from family HDHP coverage to self-only HDHP coverage, the IRS does not require the individual to reduce his IRA transfer to the HSA.

Requirement to Maintain HSA Eligibility throughout the Testing Period

The individual must continue to be an eligible individual for HSA purposes during a testing period. Being "eligible" means being covered by an HSA-qualified high deductible health plan without other first dollar medical coverage. This testing period begins with the month in which the IRA is contributed to the HSA and ends on the last day of the 12th month following such month.

If during the testing period, the individual ceases being an eligible individual (other than death or disability), the amount of the IRA contribution is included in the individual's gross income for the taxable year in which eligibility was lost. In addition to the contribution being taxable, the individual will be subject to an additional 10% tax.

For testing period purposes, an individual who changes from family HDHP coverage to self-only HDHP coverage (or vice versa) during the testing period remains considered an HSA-eligible individual.

Using Your HSA

You can use the money in the account to pay for any "qualified medical expense" as permitted under federal tax law.

In order to be considered an eligible expense, the date of service must be after the effective date of your high deductible health plan and after your HSA has been established (opened and funded). If your HDHP is effective mid-month, dates of service must be the first of the following month and forward in order to be considered eligible.

You can use the money in the account to pay for medical expenses for yourself, your spouse and your dependent children.

You may use your HSA funds for your "adult child" if they could qualify as your tax dependent (other than the income limitation).

You can pay for expenses of your spouse and dependent children even if they are not covered by your HDHP.

Should you use your HSA for ineligible expenses, you must report these purchases on your tax return and pay taxes plus penalty. If you are 65 or older, you must only pay tax.

You may withdraw funds from your HSA tax-free for eligible expenses even after you are no longer HSA-eligible.

Contact FlexBank as you have questions.
937.299.5515 ~ 888.677.8373
HSA@FlexBank.net