



4942

VITA/TCE Health Savings Accounts (HSA)

Volunteer Income Tax Assistance (VITA) / Tax Counseling for the Elderly (TCE)

2021 RETURNS



Take your VITA/TCE training online at **www.irs.gov** (keyword: Link & Learn Taxes). Link to the Practice Lab to gain experience using tax software and take the certification test online, with immediate scoring and feedback.



How to Get Technical Updates?

Updates to the volunteer training materials will be contained in Publication 4491-X, VITA/TCE Training Supplement. The most recent version can be downloaded at: <https://www.irs.gov/pub/irs-pdf/p4491x.pdf>

Volunteer Standards of Conduct

VITA/TCE Programs

The mission of the VITA/TCE return preparation programs is to assist eligible taxpayers in satisfying their tax responsibilities by providing **free** tax return preparation. To establish the greatest degree of public trust, volunteers are required to maintain the highest standards of ethical conduct and provide quality service.

All VITA/TCE volunteers (whether paid or unpaid workers) must complete the Volunteer Standards of Conduct (VSC) certification and agree to adhere to the VSC by signing Form 13615, Volunteer Standards of Conduct Agreement, prior to working at a VITA/TCE site. In addition, return preparers, quality reviewers, and VITA/TCE tax law instructors must certify in tax law prior to signing this form. This form is not valid until the site coordinator, sponsoring partner, instructor, or IRS contact confirms the volunteer's identity and signs and dates the form.

As a volunteer in the VITA/TCE Programs, you must:

1. Follow the Quality Site Requirements (QSR).
2. Not accept payment, solicit donations, or accept refund payments for federal or state tax return preparation from customers.
3. Not solicit business from taxpayers you assist or use the knowledge you gained (their information) about them for any direct or indirect personal benefit for you or any other specific individual.
4. Not knowingly prepare false returns.
5. Not engage in criminal, infamous, dishonest, notoriously disgraceful conduct, or any other conduct deemed to have a negative effect on the VITA/TCE Programs.
6. Treat all taxpayers in a professional, courteous, and respectful manner.

Failure to comply with these standards could result in, but is not limited to, the following:

- Your removal from all VITA/TCE Programs;
- Inclusion in the IRS Volunteer Registry to bar future VITA/TCE activity indefinitely;
- Deactivation of your sponsoring partner's site VITA/TCE EFIN (electronic filing ID number);
- Removal of all IRS products, supplies, loaned equipment, and taxpayer information from your site;
- Termination of your sponsoring organization's partnership with the IRS;
- Termination of grant funds from the IRS to your sponsoring partner; and
- Referral of your conduct for potential TIGTA and criminal investigations.

TaxSlayer® is a copyrighted software program owned by Rhodes Computer Services. All screen shots that appear throughout the official Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) training materials are used with the permission of Rhodes Computer Services.

Confidentiality Statement:

All tax information you receive from taxpayers in your volunteer capacity is strictly confidential and should not, under any circumstances, be disclosed to unauthorized individuals.



VITA/TCE – Health Savings Accounts (HSA)

Table of Contents

| | |
|-------------------------------------|---|
| Health Savings Accounts (HSA) | 3 |
|-------------------------------------|---|

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.



Health Savings Accounts (HSA)



Introduction

This course was developed to help volunteers assist taxpayers who have an HSA. HSAs allow individuals with high-deductible health insurance to use tax-deductible contributions to pay qualified medical expenses. The course covers:

- HSA eligibility, contributions, and distributions
- Reporting HSA activity on Form 8889, Health Savings Accounts
- Determining the HSA deduction

Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Define an HSA and other tax-favored arrangements
- Determine eligibility to contribute to an HSA
- Calculate the limits on contributions to an HSA
- Identify information documents, Forms 5498-SA, W-2, and 1099-SA, used in reporting contributions and distributions
- Determine when and how to report HSA contributions on Form 8889 and calculate the tax deduction, if any
- Determine when and how to report HSA distributions on Form 8889
- Explain the effects of distributions not used for qualified medical expenses

What do I need?

- ☐ Form 13614-C
- ☐ Publication 17
- ☐ Publication 502
- ☐ Publication 969
- ☐ Publication 4012, Health Savings Accounts (HSA) pages
- ☐ Publication 4885, HSA Screening Sheet
- ☐ Form 1040
- ☐ Form 8889 and Instructions
- ☐ Form 5498-SA and Instructions
- ☐ Form 1099-SA and Instructions
- ☐ Form W-2 and Instructions
- Optional:**
- ☐ Form 1040 Instructions

The Background on HSA

A health savings account (HSA) is a tax-favored medical savings account available to taxpayers. HSAs enable taxpayers to pay for current medical expenses and save for future qualified medical expenses on a tax-free basis.

HSAs are owned by individuals, but contributions may be made by an employer or any other person. Amounts in an HSA may be accumulated over the years or distributed on a tax-free basis to pay for or reimburse qualified medical expenses.



Contributions are amounts added to an HSA account by an individual, an employer, or any other person.

Deductions are the amounts allowed as adjustments to income.

Distributions are amounts an individual withdraws from the HSA for qualified medical purposes.

Intake/Interview Process

Use Form 13614-C, Intake/Interview & Quality Review Sheet, to determine if the taxpayer had HSA contributions or distributions. The intake and interview sheet is a starting point for a comprehensive interaction with the taxpayer. This interaction, along with the source documents provided by the taxpayer, will help you prepare an accurate return.

Form 5498-SA, HSA, Archer MSA, or Medicare Advantage MSA Information, is used to report HSA contributions. Form 1099-SA, Distributions from an HSA, Archer MSA, or Medicare Advantage MSA, is used to report HSA distributions. These information documents are issued by the HSA trustee to taxpayers who have HSA contributions or distributions, for use in tax return preparation.

HSA Information and Screening Sheet

The HSA pages under the Adjustments Tab of Publication 4012 provides an at-a-glance summary of the HSA topic. Use these references if HSA questions arise during the interview with the taxpayer. You can download and print a copy of Publication 4885, Screening Sheet for Health Savings Accounts (HSA) from www.irs.gov.

Types of Tax-Favored Arrangements

What are tax-favored arrangements?

Various programs are designed to give individuals tax advantages to offset health care costs. This section provides general definitions of other tax-favored arrangements. These definitions will help you distinguish the **differences** in these programs and help with your overall understanding of tax-favored arrangements. While these programs may have features similar to an HSA, it is important to know they are different.

Types of tax-favored arrangements are:

- Archer Medical Savings Accounts
- Medicare Advantage MSA
- Health Reimbursement Arrangements
- Flexible Spending Arrangements

Archer Medical Savings Accounts (MSA)

The Archer MSA represents the first generation of HSA. MSA contributions may be received from either an eligible individual or his or her employer but not in the same tax year. Contributions by the individual are taken as an adjustment to income and are deductible whether or not the individual itemizes deductions. Employer contributions are not included in taxable income. As long as distributions from an MSA are used to pay qualified medical expenses, they are not taxed, but MSA eligibility is restricted to employees of small employers and the self-employed, which rules out participation for many taxpayers.

Medicare Advantage MSA

A Medicare Advantage MSA is an Archer MSA designated by Medicare to be used solely to pay the qualified expenses of the account holder who is enrolled in Medicare. Contributions can only be made by Medicare. The contributions are not included in the individual's income and are not deductible by the individual. Distributions from a Medicare Advantage MSA that are used to pay qualified medical expenses are not taxed.

Health Reimbursement Arrangements (HRA)

An HRA must receive contributions from the employer only. Employees may not contribute. Contributions are not includible in income. Reimbursements from an HRA that are used to pay qualified medical expenses are not taxed.



Refer taxpayers with an Archer Medical Savings Account, Medicare Advantage MSA, or a Health Reimbursement Arrangement to a professional tax preparer. These topics are out of scope and the information is provided for your awareness only.

Flexible Spending Arrangements (FSA)

A health Flexible Spending Arrangement (FSA) allows an employee to be reimbursed for medical expenses. An FSA is usually funded through a voluntary salary reduction agreement with the employer. No employment tax or federal income tax withholding is deducted from an employee's contribution. The employer may also contribute. The FSA is not a health plan but only a means of reimbursing the FSA participant for qualified medical expenses. Do not confuse FSA with HSA; FSA activity is not reported on an individual tax return.

What is an HSA?

An HSA is a tax-exempt trust or custodial account that a taxpayer sets up with a qualified HSA trustee. Distributions from an HSA are nontaxable if the funds are used for qualified medical expenses. A taxpayer must be an eligible individual to qualify to contribute to an HSA.

No permission or authorization from the IRS is necessary to establish an HSA. To set up an HSA a taxpayer will need to work with a trustee. A qualified HSA trustee can be a bank, an insurance company, or anyone already approved by the IRS to be a trustee of an individual retirement arrangement (IRA) or Archer MSA. The HSA can be established through a trustee that is different from the taxpayer's health plan provider.

An HSA is created by:

- Enrolling in a High-Deductible Health Plan (HDHP) and then
- Opening a tax-exempt trust or custodial account, with a qualified HSA trustee, to pay for qualified medical expenses

HSA Benefits

The benefits of having an HSA include:

- Amounts contributed to an HSA, except for employer contributions, can be used as an adjustment to income.
- Contributions to an HSA by an employer may be excluded from gross income; this includes contributions made through a Section 125 cafeteria plan.
- The contributions remain in the account and are carried over, without limit, from year to year until the taxpayer uses them.
- The interest and other earnings on the assets in the account are tax-free.
- Distributions will be tax-free if used to pay unreimbursed qualified medical expenses.
- An HSA is portable, so it stays with taxpayers even if they change employers or leave the work force.
- There is no deadline by which qualifying expenses must be reimbursed by the HSA.



EXERCISES

Answers are at the end of the lesson.

Question 1: Does an HSA stay with the taxpayer even if the taxpayer changes jobs?

☐ Yes ☐ No

Question 2: Which of the following statements is false?

- A. Taxpayers' contributions to an HSA are tax deductible.
- B. Interest earned on an HSA is tax-free if used for unreimbursed qualified medical expenses.
- C. Taxpayers pay taxes on HSA earnings when they take distributions for unreimbursed qualified medical expenses.
- D. Unused funds and interest are carried over, without limit, from year to year.

Individuals Who Qualify for an HSA

To be an **eligible individual** and qualify for an HSA, the taxpayer must meet the following requirements:

- Be covered by a high-deductible health plan (HDHP) on the first day of the month
- Not be covered by other health insurance (see Publication 969 for exceptions)
- Not be enrolled in Medicare (the individual can be HSA-eligible for the months before being covered by Medicare)
- Not be eligible to be claimed as a dependent on someone else's tax return (see Caution)



CAUTION If another taxpayer is entitled to claim the individual as a dependent, the individual cannot claim a deduction for an HSA contribution. This is true even if the other person does not actually claim the dependent.

Rules for Married Individuals

In the case of married individuals, each spouse who is an eligible individual who wants to have an HSA must open a separate HSA. Married couples cannot have a joint HSA, even if they are covered by the same HDHP; however, distributions can be used to cover the qualified expenses of the other spouse.

In the event of the death of one of the married individuals, the HSA will be treated as the surviving spouse's HSA if the spouse is the designated beneficiary of the HSA.



CAUTION An employee covered by an HDHP and a health FSA or an HRA that pays or reimburses qualified medical expenses generally cannot make contributions to an HSA.

High-Deductible Health Plan

Taxpayers must be covered by a high-deductible health plan (HDHP) to take advantage of HSA. An HDHP generally has lower premiums than traditional health care coverage.

An HDHP is health coverage with a:

- Higher annual deductible than typical health plans and
- Maximum limit on the sum of the annual deductible and out-of-pocket medical expenses that the taxpayer must pay for covered expenses. Out-of-pocket expenses include copayments and other cost sharing but do not include premiums.

The IRS has ruled that an HDHP can cover certain types of **preventive care** without a deductible, or with a deductible that is less than the annual deductible applicable to all other services. Generally, preventive care services do not include any service, benefit, or medication to treat an existing illness, injury, or condition. In situations where the treatment is incidental or ancillary to a preventive care service or screening, the treatment may fall within the safe-harbor for preventive care. See IRS Notices 2004-23, 2004-50, 2013-57 and 2019-45, available on www.irs.gov, for details on these situations.

If an HDHP has a deductible for preventive care expenses, those expenses, up to the deductible, are qualified medical expenses for HSA purposes. If the HDHP has no deductible for these preventive services, the plan – not the HSA – covers the expenses. Taxpayers who are uncertain if their plan is an HDHP should be advised to contact their insurer.



In addition to preventive care, the high deductible requirements are not necessary for dental or vision coverage.

HDHP Deductible Limits

There are limits for annual deductible and out-of-pocket expenses for an HDHP.

For more information, refer to Publication 969.



EXERCISES (continued)

Question 3: There are maximum limits on the total of the annual deductible and out-of-pocket medical expenses that the taxpayer may pay for covered expenses for an HDHP. ☐ Yes ☐ No

Question 4: Frank is retired and has no other health coverage except for Medicare. He would like to open an HSA to cover his additional medical expenses. He's been shopping for high-deductible health plans. Provided he gets an HDHP, is he eligible for an HSA? ☐ Yes ☐ No

Question 5: Bill and Ann are married. They are both self-employed, and each is enrolled in a self-only HDHP. Can Bill and Ann set up a joint HSA? ☐ Yes ☐ No

Question 6: John is 18 years old and a full-time student. He also works and is covered under his employer's HDHP (self-only). John's parents are eligible to claim him as a dependent on their tax return, but they choose not to claim him. Does John qualify for an HSA? ☐ Yes ☐ No

Contributions to HSA

Any eligible individual can contribute to an HSA. For an employee's HSA, the employee, employer, or both may contribute to the employee's HSA in the same year. For an HSA established by a self-employed (or unemployed) individual, the individual can contribute.

Family members or any other person may also contribute on behalf of an eligible individual. Contributions to an HSA must be made in cash. Contributions of stock or property are not allowed.

Amounts contributed to an HSA, except for employer contributions and qualified HSA funding distributions from IRAs, can be used as an adjustment to income for the account owner.

Employer Contributions

Employer contributions (including an employee's contribution through a cafeteria plan) are allowed to be made to an employee's HSA. Generally, employer contributions are excluded from an employee's income. Employer contributions are reported on Form W-2, Box 12 using code W. Taxpayers must reduce the amount they, or any other person, can contribute to their HSA by the amount of any contributions made by the taxpayer's employer that are excludable from income. This includes amounts contributed to the taxpayer's account

by the employer through a cafeteria plan. For example, if the employer contributed \$1,000 to a taxpayer's HSA who had a self-only HDHP, the remaining contribution limit would be reduced by that \$1,000. Refer to Publication 4012, Volunteer Resource Guide, for current year contribution limits.



EXERCISES (continued)

Question 7: Arnold has a high-deductible health plan with an HSA with his company. His mother contributed to his HSA as a gift on his 40th birthday. Is this an allowable contribution? ☐ Yes ☐ No

HSA Limits on Contributions

The amount the taxpayer or another other person can contribute to the taxpayer's HSA depends on the type of HDHP coverage (individual or family) the taxpayer has, the taxpayer's age, the date the taxpayer became an eligible individual, and the date the taxpayer ceases to be an eligible individual.

Eligible individuals who are 55 or older by the end of the tax year can increase their contribution limit up to \$1,000 a year. This extra amount is the catch-up contribution allowed for an HSA.

Refer to HSA contribution limits in Publication 4012, Volunteer Resource Guide.



CAUTION Taxpayers with excess contributions (contributions over the limits) must withdraw the excess to avoid an additional 6% tax. If the excess is not timely withdrawn, refer the taxpayer to a professional tax preparer. Review Forms 5329 and 8889 Instructions and Publication 969 for details.



EXERCISES (continued)

Question 8: Taxpayers must reduce the amount that they or any other person can contribute to their HSA by the amount of any employer contributions that are excludable from income. ☐ Yes ☐ No

Question 9: Marie is 56 years old. Is she eligible to make catch-up contributions to her HSA account?
☐ Yes ☐ No

Rules for Married People

The rules for married people apply only if both spouses are eligible individuals. If either spouse has family HDHP coverage, the family contribution limit applies; both spouses are treated as having family HDHP coverage.

If **both** spouses are 55 or older and not enrolled in Medicare:

- Each spouse is entitled to increase his or her contribution limit with an additional contribution.
- Their maximum total contributions under family HDHP coverage would include a catch-up contribution for each spouse.
- The contribution limit is divided between the spouses by agreement. If there is no agreement, the contribution limit is split equally between the spouses.
- Any additional contribution for age 55 or over must be made by each spouse to his or her own HSA.

example

This year, Mr. Auburn and his wife are both eligible individuals. They each have family coverage under separate HDHPs. Mr. Auburn is 58 years old and Mrs. Auburn is 53. Mr. and Mrs. Auburn can split the family contribution limit equally, or they can agree on a different division. If they split it equally, each can contribute one-half the maximum contribution for family coverage. Mr. Auburn can contribute an additional \$1,000 because he is age 55 or over. Refer to HSA contribution limits in Publication 4012, Volunteer Resource Guide, and Publication 969.



EXERCISES (continued)

Question 10: When one spouse is age 55 or older, either spouse can add the catch-up contribution to their HSA. ☐ True ☐ False

Limit on Contributions

While many taxpayers do not contribute the maximum amount allowed to their HSA, you may need to explain these limits to taxpayers. The amount that can be contributed to an HSA depends on the:

- Type of HDHP coverage (self-only or family coverage)
- Taxpayer's age
- Date the taxpayer became an eligible individual, *and*
- Date the taxpayer ceases to become an eligible individual.

If the taxpayer is an eligible individual on the first day of every month with the same coverage for the entire year, the full contribution amount is allowed.

If the taxpayer was not an eligible individual for the entire year or changed his or her coverage during the year, the contribution limit is:

- **Last-month rule** allows eligible individuals to make a full contribution for the year even if they were not an eligible individual for the entire year. They can make the full contribution for the year if:
 - They are eligible individuals on the first day of last month of their taxable year. For most people, this would be December 1, and
 - They remain eligible individuals during the testing period. The testing period runs from December 1 of the current year through December 31 of the following year (for calendar taxpayers).
 - If the taxpayer does not qualify to contribute the full amount for the year, the contribution is determined by using the sum of the monthly contribution limits rule.

OR

- **Sum of the monthly contribution limits rule** (use Limitation Chart and Worksheet in Form 8889 Instructions). This is the amount determined separately for each month based on eligibility and HDHP coverage on the first day of each month plus catch-up contributions. For this purpose, the monthly limit is 1/12 of the annual contribution limit, as calculated on the Limitation Chart and worksheet.

A taxpayer who cannot use the last-month rule **must** use the sum of the monthly contribution limits rule to determine the maximum HSA contribution.

example

Chris, age 53, became an eligible individual on December 1 of the tax year. He has family HDHP coverage on that date. He fully expects to meet the testing period by remaining eligible through December 31 of the following tax year. Under the last-month rule, he can contribute up to the maximum family contribution limit for the current tax year.

example

Maria, age 48, was an eligible individual with self-only HDHP coverage. She was covered from January through September. She was not an eligible individual for the remaining months of October, November, and December. Use the limitation chart and worksheet in Form 8889 Instructions to calculate her maximum contribution.



EXERCISES (continued)

Question 11: From January through June, Adele, age 30, participated in her employer's HDHP (with self-only coverage) and made monthly contributions to her HSA. Adele was laid off in July and remained unemployed and without health insurance for the remainder of the tax year. Adele can use the last-month rule to figure her contribution limit. ☐ True ☐ False

HSA Contribution Timeframe

Taxpayers and employers can make contributions to the taxpayer's HSA until the filing deadline without regard to extension. If taxpayers were not eligible individuals for the entire year, they can still make contributions until the filing deadline without regard for extension, for the months they were eligible individuals.

Setting up an HSA

While there is no deadline for setting up an HSA, the taxpayer must have HDHP coverage during the year in order to make a contribution. Also, the HSA must be set up with an authorized trustee.

HSA Rollovers or Transfers

Rollover Contributions

Generally, a rollover is a tax-free distribution to the taxpayer of cash or other assets from one HSA that the taxpayer contributes to another HSA. The contribution to the second HSA is called a rollover contribution. These contributions:

- Are not included in taxpayers' income
- Are not deductible
- Do not reduce taxpayers' contribution limit

Taxpayers can also roll over amounts from Archer MSAs into an HSA. They do not have to be eligible individuals to make a rollover contribution from their existing HSA to a new HSA.



CAUTION Remember, Archer MSAs are out of scope for VITA/TCE. Refer taxpayers who have issues that involve Archer MSA to a professional tax preparer.

Rollovers are not subject to annual contribution limits and a rollover contribution is not always cash; for example, it could be a Certificate of Deposit (CD). The taxpayer must roll over the amount within 60 days after the date of receipt, and may only make one rollover contribution to an HSA during a one-year period.

See Publication 969 for more information on rollover contributions.

example

Mary became unemployed during the current tax year. She was required by her previous employer to move her HSA. She rolled over the amount within 60 days to a new HSA.



If the taxpayers have their HSA funds transferred directly into another HSA in a trustee-to-trustee transfer, this is not considered a rollover. There is no limit on the number of these transfers. Do not include the amount transferred in income, deduct it as a contribution, or include it as a distribution on Form 8889.



EXERCISES (continued)

Question 12: Doris moved to a new job. She asked the HSA trustee to transfer her funds into her new job's HSA. Is this allowable? ☐ Yes ☐ No

Distributions from an HSA

Distributions for Qualified Medical Expenses

Generally, taxpayers will pay medical expenses during the year without being reimbursed by the HDHP until the plan's annual deductible is reached. When the taxpayer pays these medical expenses that are not reimbursed by the HDHP, the taxpayer can request a distribution from the HSA trustee. The taxpayer can receive tax-free distributions from an HSA to pay or be reimbursed for qualified medical expenses incurred after the taxpayer establishes the HSA.

Qualified medical expenses are expenses that *generally* would qualify for the medical and dental expenses deduction. Examples include unreimbursed expenses for doctors, dentists, and hospitals. "The CARES Act of 2020 expanded allowable medical expenses to include the purchase of over-the-counter medical products, including those needed in quarantine and social distancing, without a prescription from a physician. This applies to amounts paid and expenses incurred after December 31, 2019. "

See Publication 502, Medical and Dental Expenses, for more information.

Taxpayers must keep records to show that HSA distributions were used to pay or reimburse qualified medical expenses and the medical expense had not been taken as an itemized deduction in any year. For recordkeeping requirements on HSA distributions see Publication 969, Distributions from an HSA. Taxpayers are not required to take annual distributions from their HSA. However, taxpayers who have taken HSA distributions will receive Form 1099-SA, Distributions from an HSA, Archer MSA, or Medicare Advantage MSA, from their HSA trustee and must provide it before the return can be completed.



Expenses incurred before establishing an HSA are not qualified medical expenses. If a taxpayer is considered to be an eligible individual for the entire year under the last-month rule, only those expenses incurred after actually establishing the HSA are qualified expenses.

Mistaken Distributions

If amounts were distributed during the year from an HSA because of a mistake of fact due to reasonable cause, the account beneficiary may repay the mistaken distribution no later than April 15 following the first year the account beneficiary knew or should have known the distribution was a mistake. See the instructions for Form 1099-SA for further information.

example

Laura established an HSA in July. She incurred medical expenses in May and wants to pay those from her HSA. The expenses incurred in May before she established her HSA are not qualified medical expenses for purposes of her HSA.

example

Vikki's doctor suggested she take some exercise classes. Vikki signed up for yoga, swimming classes, and a health club. Since these are for general health improvement, they cannot be considered as qualified medical expenses.



Preventive services, not reimbursed by the HDHP, can be paid from an HSA.



EXERCISES (continued)

Question 13: Adriane purchased over-the-counter medicine (without a prescription) in June. Is this a qualified medical expense for HSA purposes? ☐ Yes ☐ No

Qualified Insurance Premiums for HSA Purposes

A taxpayer **cannot** treat insurance premiums as qualified medical expenses **unless** the premiums are for:

- Long-term care insurance based on premium limits shown in Publication 4012, Volunteer Resource Guide, or the Instructions for Schedule A, Itemized Deductions
- Health care continuation coverage, such as coverage under COBRA
- Health care coverage while receiving unemployment compensation
- Medicare and other health care coverage if the taxpayer was 65 or older (other than premiums for a Medicare supplemental policy, such as Medigap)



EXERCISES (continued)

Question 14: Johnnie, who is 49 years old, used funds from her HSA to pay her premium for COBRA coverage. Is this a qualified distribution? ☐ Yes ☐ No

Whose medical expenses qualify?

Qualified medical expenses are those incurred by the following persons:

- The taxpayer and spouse
- All dependents claimed on the tax return

- Any other person who could have been claimed as a dependent on the taxpayer's return except that:
 - The person filed a joint return
 - The person had gross income of the exemption amount or more, or
 - The taxpayer or spouse (if filing jointly) could be claimed as a dependent on someone else's tax return



A child of parents who are divorced, separated, or living apart for the last six months of the calendar year is treated as the dependent of both parents (for medical expenses) whether or not the custodial parent releases the claim to the child's dependency.



Taxpayers cannot deduct qualified medical expenses as an itemized deduction on Form 1040, Schedule A, that are equal to the tax-free distribution from their HSA. Since the medical expenses have been paid from HSA funds, the taxpayers cannot include the same expenses on Schedule A.



Even taxpayers who have a self-only HDHP may use the money in their HSA to pay the unreimbursed medical expenses for their spouse or other family members (as described previously).

Reporting HSA Contributions, Distributions, and Deductions

Form 5498-SA, HSA, Archer MSA, Medicare Advantage MSA Information

Form 5498-SA shows the amount contributed during the year for any HSA, Archer MSA, or Medicare Advantage MSA. Generally, contributions made by the taxpayer or someone other than the taxpayer's employer are deductible on the taxpayer's tax return. In addition to being included on Form 5498-SA, employer contributions will also be shown on Form W-2, box 12, with code W. Contributions made by an employer are not included in the income of the taxpayer. Contributions to an employee's account by an employer using the amount of an employee's salary reduction through a cafeteria plan (also known as a "125 plan") are treated as employer contributions. HSA contribution limits are reduced by employer contributions.



Form 5498-SA is issued by the HSA Trustee showing the amount of HSA contributions.

Excess contributions will be included in income and are also subject to a 6% excise tax. Excess contributions that are not withdrawn in a timely fashion are out of scope for the VITA/TCE programs. Refer taxpayers in this situation to a professional tax preparer.



Taxpayers may not receive Form 5498-SA before the filing deadline, but they should have the information regarding contributions to their HSA.

Form 8889, Health Savings Accounts (HSA)

A taxpayer must complete Form 8889 with Form 1040 if the taxpayer (or spouse if filing a joint return) had any activity in an HSA. This is true even if only the taxpayer's employer or the spouse's employer made contributions to the HSA.

Taxpayers who are filing jointly and who each have separate HSAs will each complete a separate Form 8889. Married taxpayers cannot have a joint HSA.

Ask taxpayers during the interview process if their HDHP coverage is "self-only" or "family," and check the corresponding box on Form 8889. To view Form 8889, link to <https://www.irs.gov/pub/irs-pdf/f8889.pdf>.

Form 8889, Part I

Form 8889, Part 1, is used to report all HSA contributions and to compute the allowable HSA deduction. This includes contributions made by the filing deadline that are designated for the tax year. Contributions made by an employer are also shown in Part I, but are not included in the deductible amount.

An HSA may receive contributions from an eligible individual or any other person, including an employer or a family member, on behalf of an eligible individual.



EXERCISES (continued)

Question 15: Sylvia has HDHP coverage for herself only. She contributed \$2,000 to her HSA. Her employer also contributed \$1,000 to her HSA. Using Form 8889, what is her HSA deduction?

- A. \$1,000
- B. \$2,000
- C. \$3,000

Question 16: Form 8889, Part I, is used to report HSA contributions made by ____.

- A. An employer
- B. A taxpayer
- C. A person on behalf of the taxpayer
- D. All of the above

Question 17: Employer contributions to an HSA will be included in the taxpayer's HSA deduction on Form 1040. ☐ True ☐ False

Form 8889, Part II

Form 8889, Part II, is used by taxpayers to report distributions from an HSA. Taxpayers receive tax-free distributions from an HSA to pay or be reimbursed for qualified medical expenses. The taxpayer will have to tell you what types of expenses were paid or reimbursed with the distribution.

Form 1099-SA reports distributions to a taxpayer. Box 5 will indicate whether the distribution is from an HSA, Archer MSA, or a Medicare Advantage MSA. The code in Form 1099-SA, box 3, identifies the distribution the taxpayer received. Code 1 is a normal distribution. Refer to Form 1099-SA for an explanation of the other codes.

If distributions are received for reasons other than qualified medical expenses, the amount withdrawn will be included in income and reported on Form 1040. HSA distributions included in income are subject to an additional 20% tax unless the account beneficiary:

- Dies
- Becomes disabled (see Form 8889 instructions)
- Turns age 65

This tax is computed on Form 8889 and reported on Form 1040. Taxpayers do not have to take distributions from their HSA each year.



Tax Software Hint: Amounts entered on Form 8889 are automatically carried over to the applicable lines of Form 1040. The amount of HSA distributions not used for qualified medical expenses will be included in income.

Form 8889, Part III

Form 8889, Part III, is out of scope for the VITA and TCE programs.



EXERCISES (continued)

Question 18: Barbara incurred \$3,000 of unreimbursed qualified medical expenses. She received a \$2,000 distribution from her HSA to pay for these medical expenses. Using Form 8889, determine Barbara's taxable HSA distribution.

- A. \$0
- B. \$2,000
- C. \$3,000
- D. \$5,000

Question 19: Joe paid \$4,000 in unreimbursed qualified medical expenses. He received an HSA distribution of \$4,000. Where is this information reported on his tax return?

- A. Form 8889, Part I
- B. Form 8889, Part II
- C. Does not need to be reported
- D. Both A and B

Question 20: Assume Joe paid \$3,000 in unreimbursed qualified medical expenses and received an HSA distribution of \$4,000. What amount is taxable?

- A. \$4,000
- B. \$3,000
- C. \$1,000
- D. \$0

Summary

An HSA is a tax-exempt trust or custodial account that a taxpayer sets up with a qualified HSA trustee to pay for or reimburse certain medical expenses a taxpayer incurs.

Eligibility

A taxpayer must be an **eligible individual** to qualify for an HSA. See specific qualifications outlined earlier. A high-deductible health plan (HDHP) is health coverage with:

- A higher annual deductible than typical health plans, and
- A maximum limit on the sum of the annual deductible and out-of-pocket medical expenses that the taxpayer must pay for covered expenses. Out-of-pocket expenses include co-payments and other amounts, but do not include most premiums.

An HSA is created by:

- Enrolling in an HDHP, and
- Establishing the HSA

Contributions, Distributions, Deductions, and Form 8889

The amount the taxpayer or any other person can contribute to the taxpayer's HSA depends on the type of HDHP coverage, the taxpayer's age, the date the taxpayer became an eligible individual, and the date the taxpayer is no longer an eligible individual. In addition, the contribution limit for an HSA is reduced by employer contributions.

HSAs enable taxpayers to pay for current medical expenses and save for future qualified medical expenses on a tax-free basis. The following forms are used to report HSA activities:

- Form 5498-SA to report contributions to a taxpayer's HSA. Employer contributions will also be shown in Form W-2, box 12 – may include employee contributions under a Section 125 Cafeteria Plan (pretax dollars).
- Form 1099-SA to report HSA distributions for the year.
- Form 8889, Health Savings Accounts, Part I, to report contributions and calculate the HSA deduction.
- Form 8889, Health Saving Accounts, Part II, to report HSA distributions and report qualified medical expenses. Amounts that are taxable are calculated, and the 20% additional tax is also shown here.
- Form 8889, Health Savings Accounts, Part III, to report income and additional tax for failure to maintain HDHP coverage. This part of the form is out of scope. Refer taxpayers with these issues to a professional tax preparer.

Funds in an HSA can remain in the account and are carried over, without limit, from year to year until the taxpayer uses them. Interest or other earnings on the assets in the account are tax-free.

Taxpayers can receive tax-free distributions from their HSA to pay or be reimbursed for qualified medical expenses that are incurred after establishing the HSA.

Qualified medical expenses are those expenses that would generally qualify for the medical and dental expense deduction on Schedule A of Form 1040.

There are recordkeeping requirements for HSA distributions. See Publication 969 for additional information.

What situations are out of scope for the VITA/TCE programs?

Refer taxpayers with these issues to a professional tax preparer:

- Excess contributions to an HSA that are not withdrawn in a timely fashion
- Qualified HSA funding distributions from an IRA
- Death of an HSA holder (when spouse is not the designated beneficiary)
- Additional Tax for Failure to Maintain HDHP Coverage
- Deemed distributions from an HSA due to prohibited transactions, such as using an HSA as a security for a loan
- Archer Medical Saving Accounts (MSA)
- Medicare Advantage MSA
- Health Reimbursement Arrangement
- Form 8889, Part III

For more information, see Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.



EXERCISE ANSWERS

Answer 1: Yes. An HSA is portable, so it stays with the taxpayer even if the taxpayer changes employers or leaves the work force.

Answer 2: C. With an HSA, distributions for unreimbursed qualified medical expenses are tax-free.

Answer 3: Yes. There are maximum limits on the sum of the annual deductible and out-of-pocket medical expenses that the taxpayer must pay for covered expenses.

Answer 4: No. To set up and contribute to an HSA, an individual must not be enrolled in Medicare.

Answer 5: No. Spouses cannot have a joint HSA. Each spouse who is an eligible individual must open a separate HSA.

Answer 6: No. Any person eligible to be claimed as a dependent by another individual does not qualify for an HSA. This is true even if the person is not actually claimed.

Answer 7: Yes. Family members or any other person may also contribute on behalf of an eligible individual.

Answer 8: Yes. Taxpayers must reduce the amount that they or any other person can contribute to their HSA by the amount of any employer contributions that are excludable from income.

Answer 9: Yes. She is eligible to make catch-up contributions to her HSA account because she is over age 55.

Answer 10: False. Only the spouse who is age 55 or older can make the catch-up contribution.

Answer 11: False. Adele was not an eligible individual on the first day of the last month of her tax year (December 1); therefore she must use the sum of monthly contribution limits rule.

Answer 12: Yes. This is allowed because Doris transferred her HSA funds directly into another HSA in a trustee-to-trustee transfer. This is not considered a rollover; there is no limit on the number of these transfers.

Answer 13: Yes. Over-the-counter nonprescription medicines do qualify for HSA purposes.

Answer 14: Yes. Premiums for COBRA coverage is a qualified medical expense.

Answer 15: B. Employer contributions are not deductible.

Answer 16: D. Form 8889, Part I, is used to report contributions made by taxpayers, contributions made by any other person on behalf of the taxpayer, and the contributions made by the taxpayer's employer.

Answer 17: False. Only contributions made by the taxpayer or by any other person, other than the employer, can be included in the taxpayer's HSA deduction on Form 1040.

Answer 18: A. If the HSA distribution is for qualified medical expenses it is tax-free. If the distribution is more than the amount of qualified expenses, the difference is then taxable income.

Answer 19: B. Unreimbursed qualified medical expenses are reported on Form 8889, Part II.

Answer 20: C. The difference between the total distributions and the unreimbursed qualified medical expenses is taxable.

Link & Learn Taxes

Link & Learn Taxes is web-based training designed specifically for VITA/TCE volunteers. Each volunteer's ability to prepare complete and accurate returns is vital to the credibility and integrity of the program. Link & Learn Taxes, as part of the complete volunteer training kit, provides the path to achieving this high level of quality service.

Link & Learn Taxes and Publication 4012, VITA/TCE Volunteer Resource Guide, work together to help volunteers learn and practice.

Link & Learn Taxes for 2021 includes:

- Access to all VITA/TCE courses
- Easy identification of the VITA/TCE courses with the course icons
 - As you progress through a lesson, the content for Basic, Advanced, Military, or International will display, depending on the level of certification you selected
- PowerPoint presentations that can be customized to fit your classroom needs
- VITA/TCE Central to provide centralized access for training materials and reference links
- The Practice Lab
 - Gives volunteers practice with an early version of the IRS-provided tax preparation software
 - Lets volunteers complete test practice problems
 - Lets volunteers prepare test scenario returns for the test/retest



Go to www.irs.gov, type “Link & Learn” in the Keyword field and click Search. You’ll find a detailed overview and links to the courses.

FSA (Facilitated Self Assistance) empowers taxpayers to prepare their own returns with the assistance of a certified volunteer. Taxpayers complete their own returns using interview-based software supplied by leaders in the tax preparation industry. Volunteers assist taxpayers with tax law questions.

Virtual VITA allows partners to initiate the intake process for taxpayers in one location, while utilizing a certified volunteer to prepare the return in an entirely different location. By incorporating this flexibility, partners can provide taxpayers with more convenient locations to file their taxes.

For more information contact your SPEC Relationship Manager to see if you should start a FSA or Virtual VITA site in your community.



Your online resource for volunteer and taxpayer assistance

Partner and Volunteer Resource Center

<https://www.irs.gov/Individuals/Partner-and-Volunteer-Resource-Center>

- What's Hot!
- Site Coordinator's Corner

Quality and Tax Alerts for IRS Volunteer Programs

<https://www.irs.gov/individuals/quality-and-tax-alerts-for-irs-volunteer-programs>

- Volunteer Tax Alerts

Volunteer Training Resources

<https://www.irs.gov/Individuals/Volunteer-Training-Resources>

Outreach Corner

<https://www.irs.gov/Individuals/Outreach-Corner>

Interactive Tax Assistant (ITA)

<https://www.irs.gov/help/ita>

Online Services and Tax Information for Individuals

<https://www.irs.gov/Individuals>

Plan

- Tax Withholding (Paycheck Checkup)
- When to File
- Recordkeeping
- Choosing a Tax Professional
- Get Answers to Your Tax Questions Online
- Year-round Tax Planning is for Everyone, Publication 5349

Tools

- View Your Tax Account
- Get Your Transcript
- Where's My Refund?

Identity Theft Protections

Get Help Now

File

- IRS Free File
- How to File
- Filing Past Due Returns
- Correcting Your Tax Return
- Social Security Benefit Statement

Pay

- Tax Withholding
- Estimated Taxes
- Options for Paying Your Taxes
- How to Choose a Payment Option
- Understanding Your IRS Notice or Letter
- What to Do If You Can't Pay

eBooks

Want to view our training products on your mobile or tablet devices? Click here to access our eBooks: <https://www.irs.gov/Individuals/Site-Coordinator-Corner>

Mobile App

Another device to use for additional information is IRS2Go. Click here to download IRS2Go mobile app: <https://www.irs.gov/newsroom/irs2goapp>

and much more!

Your direct link to tax information 24/7: www.irs.gov