Distribution of Funds from a Health Savings Account

Distributions for Qualified Expenses

When distributions from a Health Savings Account (HSA) are used to pay for qualified medical expenses of the account owner, his or her spouse, or dependents, the distributions are excluded from gross income -- even if the individual is not currently eligible to make HSA contributions.

Distributions not used for Qualified Expenses

Distributions not used for qualified medical expenses are includable in gross income and, for applicants under age 65, subject to an additional 10% tax.

For Ineligible Individuals

If the Health Savings Account (HSA) beneficiary is no longer "eligible" (e.g., over age 65, entitled to Medicare or no longer enrolled in a High-Deductible Health Plan (HDHP), distributions used to pay qualified medical expense continue to be exempt from gross income.

Determination of Qualified Medical Expense

The person who establishes an HSA makes the qualified medical expense determination and should maintain verifying expense records. The HSA Trustee or Custodian makes no judgments on what may or may not be a qualified medical expense. They simply accept the judgment of the HSA owner.

In addition, employers who make contributions to an employee's HSA cannot make a qualified medical expense determination. Determining qualified medical expense is always the job of the HSA owner.

HSA Disbursements for "Old" Expenses

For the calendar year 2005 and beyond, you can only reimburse yourself for qualified medical expenses incurred after you have set up your HSA, not when you purchased your HDHP.

HSA Distributions are Optional

When you incur a qualified medical expense, you are not obligated to pay the expense with available Health Savings Account (HSA) funds. You face a trade-off: You can spend after-tax income (not good), in return maximizing the long-term savings in your HSA (good).

Financial professionals advise, in most circumstances, using your HSA funds to pay necessary qualified medical expenses. Keep in mind, if HSA funds are not used to pay qualified medical expenses, those HSA funds will eventually be subject to income tax.

HSA Distributions after Death

If the Health Savings Account (HSA) owner dies, the HSA becomes the property of the named beneficiary. If the spouse is the beneficiary, the surviving spouse is subject to income tax only on HSA distributions not used for qualified medical expenses.

If the HSA passes to a person other than the spouse, the HSA terminates as of the date of death, and the person is required to include in gross income the assets of the HSA at the date of death. The taxable amount is reduced by any HSA payments for the decedent's qualified medical expenses, if paid within one year after death.