How a Health Savings Account Works

A Health Savings Account (HSA) is a tax-favored account established exclusively to pay certain medical expenses of the account owner, spouse, and dependents. Health insurance coverage must be provided under a qualifying high-deductible health plan.

ACCOUNT OWNER

Makes deductible[1] contributions

EMPLOYER

Optional Contributions (non-taxable to employee and no payroll taxes)

HEALTH SAVINGS ACCOUNT

- Growth in the account is not currently taxed.
- If the account owner changes employers, the HSA moves with him or her, even if the employer contributed to the account.

MEDICAL EXPENSES

- Distributions used to pay for “qualified” medical expenses are received income tax-free.
- Qualified medical expenses generally follow the definition used for deductibility as an itemized deduction on form 1040, Schedule “A”.

OTHER DISTRIBUTIONS

- Distributions for other purposes are included in the account owner’s income and a 20% penalty is added.
- The 20% penalty does not apply if distribution is made because of the account owner’s death, disability, or reaching age 65.

[1] The discussion here concerns federal income tax law. State or local law may differ.