When the taxpayer has modest wages or other compensation and traditional or Roth IRA contributions, confirm that the limit has not been exceeded.

The withdrawn excess contribution is not included in the taxpayer's gross income before the tax return is due if both of the following conditions are met:

- No deduction was allowed for the excess contribution
- All interest or other income earned on the excess contribution is withdrawn

If taxpayers timely filed the tax return without withdrawing a contribution that they made during the tax year, they can still have the contribution returned to them within 6 months of the due date of the tax return, excluding extensions.

Taxpayers must include in gross income the interest or other income that was earned on the excess contribution. Taxpayers must report it on their return for the year in which the excess contribution was made. The withdrawal of interest or other income may be subject to an additional 10% tax on early distributions.

example

Maria, age 35, made an excess contribution of $1,000, which she withdrew by the due date of her return. At the same time, she also withdrew the $50 income that was earned on the $1,000. She must include the $50 in her gross income (for the year in which the excess contribution was made). She must also pay an additional tax of $5 (the 10% additional tax on early distributions because she is not yet 59½ years old), but she does not have to report the excess contribution as income or pay the 6% excise tax. Maria receives a Form 1099-R showing that the earnings are taxable for the current year.

Form 1099-R

Taxpayers will receive Form 1099-R indicating the amount of the withdrawal. If the excess contribution was made in a previous tax year, the form will indicate the year in which the earnings are taxable.

How do I handle Health Savings Accounts?

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.

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)

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 Flexible Spending Account (FSA) or an Health Reimbursement Arrangement (HRA) that pays or reimburses qualified medical expenses generally cannot make contributions to an HSA.

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 the Volunteer Resource Guide,Tab E, Adjustments, for current year contribution limits.

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 the Volunteer Resource Guide, Tab E, Adjustments.

> **example**
>
> 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, which is an allowable contribution.

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 Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, Form 8889, Health Savings Accounts (HSAs) Instructions, and Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans, for details.

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 and 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 the Volunteer Resource Guide, and Publication 969.

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 in the current or prior year, but after the taxpayer establishes the HSA.

Qualified medical expenses include the medical expenses of the taxpayer, their spouse, or a dependent at the time the expense was incurred. It does not matter whether the taxpayer has self-only or family HDHP coverage.

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 Coronavirus Aid, Relief, and Economic Security (CARES) Act modifies the rules that apply to various tax-advantaged accounts (HSAs, Archer MSAs, Health FSAs, and HRAs) so that additional items are "qualified medical expenses" that may be reimbursed from those accounts. Specifically, the cost of menstrual care products is now reimbursable. These products are defined as tampons, pads, liners, cups, sponges or other similar products. In addition, over-the-counter products and medications are now reimbursable without a prescription. The new rules apply to amounts paid after Dec. 31, 2019. Health insurance premiums are not included as qualified medical expenses except for Medicare premiums.

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

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.

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.

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, click to view **Form 8889**.

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.

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 not offset with 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

Form 8889, Part III

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

Tax Software Hint: Refer to Tab E, Adjustments, in the Volunteer Resource Guide for software entries.