Medicare & Health Savings Accounts

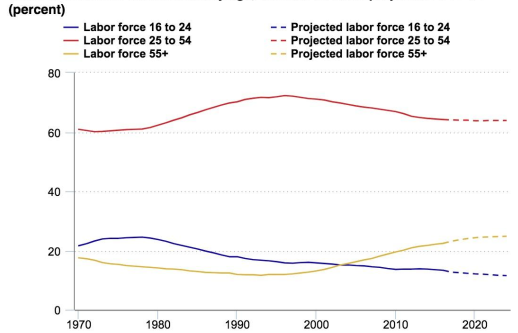
Current Trends

Baby boomers are becoming eligible for Medicare and many are still continuing to work and stay on their employer's health plan. It's estimated that 1 in 4 Americans are planning on working past 65. In particular, individuals aged 65-74 and individuals aged 75 or older have the highest workforce growth than any other age groups. [1]

To limit rising healthcare costs, many employers are implementing high deductible health plans (HDHPs) and health savings accounts (HSAs), which shift most upfront healthcare costs from employers to the individual. [2,3] In 2017, enrollment in HDHPs with an HSA increased to 19% of adults covered by employer-sponsored insurance. [2,3]

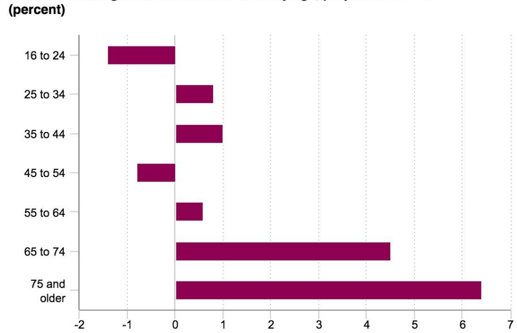
However, the intricacies of how HSAs work with Medicare can often be a confusing topic for both human resource professionals as well as individuals. The goal of this whitepaper is to outline the most important key points in order to avoid unnecessary taxes and penalties for people on HSAs and over age 65.

Chart 1. U.S. labor force shares by age, 1970 to 2014 and projected 2014–24 (percent)



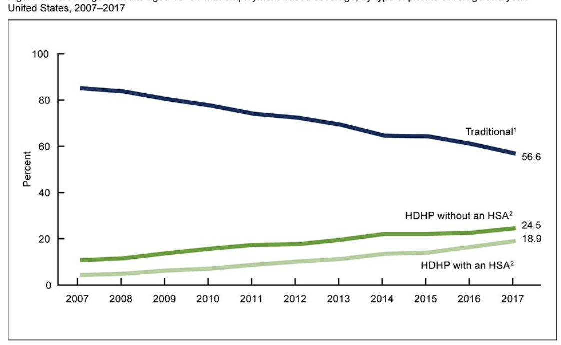
Click legend items to change data display. Hover over chart to view data.
Source: U.S. Bureau of Labor Statistics.

Chart 2. Annual growth rate in labor force by age, projected 2014–24 (percent)



Hover over chart to view data.
Source: U.S. Bureau of Labor Statistics.

Figure 1. Percentage of adults aged 18–64 with employment-based coverage, by type of private coverage and year: United States, 2007–2017



[1]Significant linear decrease from 2007 through 2017 ($p < 0.05$).
[2]Significant linear increase from 2007 through 2017 ($p < 0.05$).
NOTES: HDHP is a high-deductible health plan. HSA is a health savings account. Estimates are based on household interviews of a sample of the civilian noninstitutionalized population. Due to rounding, percentages may not add up to 100 within each year.
Access data table for Figure 1 at: https://www.cdc.gov/nchs/data/databriefs/db317_table.pdf#1.
SOURCE: NCHS, National Health Interview Survey, 2007–2017.

What is Medicare?

Medicare is a federally funded health insurance program for Americans age 65+ or on disability for 24 months.

Original Medicare is comprised of Part A to cover inpatient hospital costs and Part B to cover outpatient costs. Private insurance such a Supplemental (Medigap) plan with Part D prescription coverage or a Medicare Advantage plan can be purchased to cover the remaining medical costs not covered by Original Medicare.

For a more in depth overview of Medicare, please visit www.DoctorsChoiceU.com

What is a High Deductible Health Plan?

Enrollment in an HDHP qualifies an individual for a HSA. Enrolling in an HSA has many benefits:

1. Contributions made to an HSA are tax deductible.
2. Contributions made by employers to the HSA are excluded from the employee's gross income.
3. Any earnings made on the HSA during the year is tax-free.
4. Any withdrawls from the HSA used on qualified medical expenses are tax free
5. HSAs will hold all contributions for the individual until they are spent (versus the use it or lose it arrangement with many Flexible Savings Accounts) and the account remains with the employee regardless of a change in employment. [4]

For someone who is healthy and would like to put away money tax-free to save for healthcare costs down the road (as well as let the account potentially grow), HSAs can be very attractive. However, being on Medicare, having additional health coverage, and being claimed as a dependent may disqualify someone from contributing to an HSA tax-free.

Rules Regarding Medicare & Health Savings Accounts

Rules around how Medicare works with HSAs can be confusing. Although having Medicare does not prevent someone from having a HSA, having any parts of Medicare (including just Part A) prevents someone from further contributing money tax free.

If an individual enrolls in Medicare after age 65, Part A will be retroactively reinstated to the month of the 65th birthday or 6 months prior to the application for Medicare, whichever is later. [5] Contributions made during these retroactive months will be considered excess contributions and subject to penalties. [4]

If someone contributes to their HSA while on Medicare, there are two main penalties that can apply :

1. Penalties on excess contributions (or contributions made once enrolled in Medicare).
2. Penalties on contributions made when the testing period is not met, or the individual does not maintain HSA eligibility for the whole year to warrant the full HSA contribution amount.

Not only are excess contributions not tax deductible, excess contributions by an employer are included in gross income and a 6% excise tax can be applied to all excess contributions for each year excess contributions remain in the HSA (including what the individual puts in). The excise tax can be avoided if all excess contributions are withdrawn by the tax return deadline for the year the contributions were made and any income earned on the excess contributions are also withdrawn and included as income on the tax return for the year the contributions and earnings were withdrawn.

The second penalty that can apply to Medicare is regarding the last-month rule and testing period. The last-month rule allows an individual that is eligible on the first day of the last month of the tax year to contribute to their HSA as if they were eligible for the entire year. Under this rule, the individual must remain eligible for the HSA for the following 12 months, known as the testing period. If they become ineligible during the 12 month testing period (such as going on Medicare), any contributions made under the last-month rule would be counted as income during the year that the individual lost coverage and subject to an additional 10% tax.

If you have Medicare, do not contribute any additional money into your HSA. If you are retiring after 65, you must stop contributing 6 months prior to going to Medicare. You can still keep and use the money in the account for qualified expenses (see the IRS guidance for a list of qualified medical expenses)

Guidance on Medicare & Health Savings Accounts

Our guidance for individuals working past age 65 and continuing employer-sponsored coverage with an HSA include:*

1. Do not enroll in Medicare (Part A or B) if continuing to work past 65, on a HDHP and would like to continue HSA contributions.
2. Adjust their contributions based on their retroactive Medicare coverage
    a. If the individual is planning to retire within 6 months after their 65th birthday, stop making contributions to their HSA (including employer contributions) starting with the month of their 65th birthday.
        i. Exception: if their birthday is on the first of the month, stop making contributions starting with the month before their birthday. In this case, their coverage will be retroactive to the month before their 65th birthday.
    b. If the individual is planning to retire more than 6 months after their 65th birthday, stop making contributions to their HSA (including employer contributions) six months before they plan to retire.
3. For the months they are still eligible to make HSA contributions, adjust their maximum contribution limit. Their maximum contribution will be equal to:

(maximum contribution limit for the year × number of months eligible to make contributions)/12

* Additional penalties may apply if subject to the last-month rule and plan to retire and enroll in Medicare during the testing period. There is no penalty to delay enrolling in Medicare as long as the employer plan is creditable and the employee maintains an active status.

Examples

Mr. Smith turns 65 on March 5th. He plans to continue working after March and will remain on his employer-sponsored coverage, which is a high deductible health plan (HDHP) with a health savings account (HSA). Mr. Smith has been on this plan for the past two years; he is not making contributions under the last-month rule and is not subject to the testing period.

A. Mr. Smith decides he wants to retire in June of the same year (within 6 months after his 65th birthday). Guidance for Mr. Smith:

1. Do not enroll in Medicare (Part A or B) at age 65.
2. Upon enrolling in Medicare in June, Mr. Smith will have retroactive coverage starting the month of his 65th birthday (March). To avoid penalties, Mr. Smith should not make any contributions to his HSA (including employer contributions) starting in March.
3. Mr. Smith can contribute to his HSA in January and February; however, his contribution limit needs to be adjusted. If his maximum contribution limit for the year is normally $4,450, then his new contribution limit for this year becomes $741.67 (=[4450*2]/12).
4. In the event he or his employer did contribute in the month of March or later, Mr. Smith can take the money and any interest earned out of his HSA before the end of the tax period and claim it as income to avoid the penalties

B. Mr. Smith decides he wants to retire in December of the same year (more than 6 months after his 65th birthday). Guidance for Mr. Smith:

1. Do not enroll in Medicare (Part A or B) at age 65.
2. Upon retiring in December, Mr. Smith will have the full six months of retroactive coverage for Part A, starting in June (Part B will still start January 1st). To avoid penalties, Mr. Smith should not make any contributions to his HSA (including employer contributions) starting in June.
3. Mr. Smith can contribute to his HSA from January through May; however, his contribution limit needs to be adjusted. If his maximum contribution limit for the year is normally $4,450, then his new contribution limit for this year becomes $1,854.17 (=[4450*5]/12).
4. In the event he or his employer did contribute in the month of March or later, Mr. Smith can take the money and any interest earned out of his HSA before the end of the tax period and claim it as income to avoid the penalties

References

1. https://www.bls.gov/careeroutlook/2017/article/older-workers.htm
2. https://www.kff.org/report-section/2018-employer-health-benefits-survey-summary-of-findings/
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