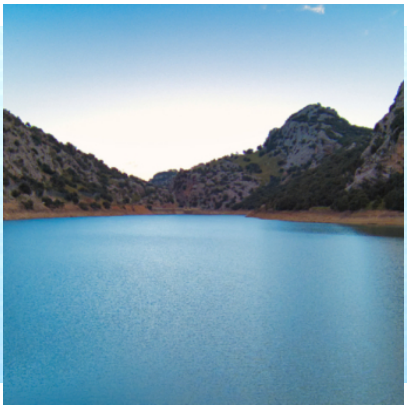

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Health Savings Accounts: The Fundamentals

Healthcare is one of the hardest household expenses to predict. A quiet year may include only checkups and prescriptions. The next may bring surgery, therapy, dental work, or a large deductible.

A Health Savings Account, or HSA, can help manage that uncertainty. It provides a tax-advantaged way to pay medical bills today while allowing unused money to remain available for the future. However, the benefits only work when the account is paired with the right health plan and used under the proper rules.

This article is the first in a two-part series on HSAs. It is most relevant for individuals and families who are enrolled in, or evaluating, a high-deductible health plan that is compatible with a Health Savings Account.

Part one focuses on the fundamentals: what an HSA is, who is eligible to contribute, how the tax benefits work, and what rules need to be followed. Part two will look at how an HSA may be used more strategically as part of broader health care, tax, and retirement planning.

WHAT AN HSA IS, AND WHAT IT IS NOT

An HSA is an individually owned account used to pay or reimburse qualified medical expenses. It works alongside eligible health insurance; it is not health insurance itself.

Unlike many Flexible Spending Accounts, or FSAs, HSA money does not need to be spent by the end of the year. The balance carries forward, belongs to the individual, and remains available after a job change or retirement. Depending on the HSA provider, the money may also be invested.

That makes an HSA useful for two purposes: paying current medical bills and building a longer-term reserve for future health care costs.

WHO CAN CONTRIBUTE?

Generally, an individual must be covered by an HSA-compatible high-deductible health plan, or HDHP, and cannot have other coverage that disqualifies them from contributing.

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The word "compatible" matters. A health plan can have a high deductible without qualifying for an HSA. During benefits enrollment, one of the simplest but most critical questions to ask is: "Is this plan HSA-eligible?"

Other health coverage can also affect eligibility. For example, Medicare enrollment, dependent status, or certain additional health benefits may prevent someone from contributing. Because these rules can become technical, eligibility should be confirmed whenever health coverage or employment benefits change.

Losing eligibility stops new contributions; it does not eliminate the account. Existing HSA funds can still be used for qualified expenses.

HOW MUCH CAN BE CONTRIBUTED?

For 2026, the annual HSA contribution limit is $4,400 for self-only coverage and $8,750 for family coverage. An eligible person who is age 55 or older can contribute an additional $1,000.

The limit includes all contributions made by the employee, employer, or anyone else on the owner's behalf. An employer contribution is valuable, but it is not an additional amount above the annual limit.

HSAs are individual accounts, even for married couples. Spouses with family coverage share the family contribution limit. If both spouses are at least 55 and eligible for catch-up contributions, each spouse must contribute their catch-up amount to an HSA in their own name.

Eligibility is usually determined monthly. A midyear change in health coverage or enrollment in Medicare can reduce the permitted contribution, so HSA elections should be reviewed whenever benefits change.

UNDERSTANDING THE TRIPLE TAX ADVANTAGE

HSAs receive unusually favorable federal tax treatment:

1. Eligible contributions can reduce taxable income.
2. Interest and investment earnings can grow without current federal income tax.
3. Withdrawals are federally tax-free when used for qualified medical expenses.

How the money enters the account also matters. Contributions made through an employer's cafeteria plan are generally excluded from federal income tax withholding and Social Security and Medicare taxes. Contributions made directly by the account owner may still qualify for a federal income-tax deduction, but they typically do not provide the same payroll-tax savings. important for families who hold taxable investments in a child's name.

WHAT CAN HSA MONEY PAY FOR?

HSA money can pay unreimbursed qualified medical expenses for the account owner, spouse, and eligible dependents.

Common examples include deductibles, copayments, prescriptions, dental and vision care, therapy, and many over-the-counter medicines. Menstrual-care products also qualify.

Not every health-related purchase is eligible. A gym membership, vitamins, nutritional supplements, or general wellness

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expense will not qualify simply because it may improve someone's health. Certain expenses may qualify only when they treat a diagnosed medical condition and are supported by appropriate documentation.

Health insurance premiums generally do not qualify, but important exceptions include:

- COBRA premium
- health coverage while receiving unemployment compensation
- certain qualified long-term-care insurance premiums
- certain Medicare premiums after age 65

Medigap premiums are not eligible HSA expenses.

PAY NOW OR REIMBURSE YOURSELF LATER

An HSA owner can pay an eligible expense directly from the account or pay personally and reimburse themselves later.

There is no federal deadline for taking the reimbursement, provided the expense occurred after the HSA was established, was not reimbursed from another source, and was not previously claimed as an itemized medical deduction.

This creates useful flexibility. Someone with sufficient cash flow may pay medical bills personally, leave the HSA invested, and retain the receipts for a potential tax-free reimbursement years later. Someone who needs the money today can use the HSA immediately.

Neither approach is automatically better. The right choice depends on cash flow, investment risk, taxes, and expected medical expenses.

Documentation is essential. Account owners should keep receipts, explanations of benefits, proof of payment, and records showing that an expense was not reimbursed elsewhere. The taxpayer—not the HSA provider—is responsible for proving that a withdrawal was qualified.

HSA contributions and distributions are traditionally reported on IRS Form 8889 with the owner's federal income-tax return.

WHAT HAPPENS WITH A NONQUALIFIED WITHDRAWAL?

Before age 65, a withdrawal used for something other than qualified medical expenses is generally subject to ordinary income tax and an additional 20% federal tax.

After age 65, the additional 20% tax disappears. Nonmedical withdrawals remain taxable as ordinary income, while qualified medical withdrawals remain tax-free. This creates added flexibility in retirement, but it does not make every HSA withdrawal tax-free.

Medicare requires special attention. HSA contributions must stop once an individual is enrolled in Medicare. For people

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enrolling after age 65, Medicare Part A may become effective up to six months before the application date. Continuing to fund an HSA during that retroactive period can create excess contributions and additional taxes.

COMMON MISTAKES TO AVOID

Most HSA problems come from a few avoidable mistakes:

- assuming that any high-deductible plan qualifies
- overlooking a spouse's FSA or other disqualifying coverage
- forgetting that employer contributions count toward the annual limit
- contributing after Medicare enrollment
- using HSA money for a nonqualified purchase
- reimbursing the same expense twice
- failing to keep adequate records

Excess contributions should be corrected promptly because amounts left in the account may create additional tax.

A DISCIPLINED PLANNING PERSPECTIVE

An HSA's tax benefits can be valuable, but they should not determine the health-plan decision by themselves.

Households should compare premiums, deductibles, out-of-pocket maximums, employer contributions, provider networks, prescription coverage, expected medical use, and their ability to absorb a large, unexpected bill.

For some households, an HDHP and HSA may reduce total costs while creating a valuable long-term asset. For others—particularly those expecting substantial or recurring medical care—another health plan may provide better overall protection.

The fundamental HSA strategy is straightforward: confirm eligibility, understand the full economics of the health plan, coordinate all contributions, use withdrawals carefully, and keep strong records.

When those basics are handled well, an HSA can be more than a place to pay medical bills. It can become a flexible part of a broader health care, tax, and retirement plan.

This article is part of an ongoing series aimed to help build overall financial literacy and was authored by Grimes & Company's 2026 Intern John Grimes. While not a comprehensive deep dive into every single topic, it is designed to provide a helpful overview to key topics within the world of investing and financial planning. Please ***reach out to connect*** *with an advisor or expert on the subject to learn more and start planning for your financial future.*

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