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DECISION GUIDE

Should You Roll Over an IRA to an HSA?

For many people, health savings accounts (HSAs) provide an affordable way to pay for medical expenses. To make pre-tax contributions to an HSA, you must be enrolled in a high-deductible health plan. You can use your HSA to pay for qualified medical expenses.

Pros and Cons of an HSA

A major advantage of an HSA is that any unused funds roll over and can accumulate year after year, allowing an individual to save for future medical expenses.

However, a challenge exists for individuals as they initially move from a traditional, low-deductible health plan to a high-deductible health plan and HSA, as it takes time to build up the balance in an HSA to ensure adequate funds are available to cover medical expenses.

A potential solution can be to initiate a tax-free rollover from an individual retirement account (IRA) to fund the HSA. Here, we examine this option and provide insight into whether a rollover might make sense for your particular situation.

Annual HSA Rollover Limit

If you have an HSA-eligible, high-deductible health insurance plan, you may be eligible to make one tax-free rollover in your lifetime.

The rollover amount is limited to the maximum HSA contribution for the year minus any other contributions you’ve made during the year.

Process for IRA Transfer to HSA

The transfer must be considered a direct rollover, meaning the IRA holder cannot gain direct access to the funds. The best approach is to coordinate between the IRA custodian and the HSA custodian to ensure the funds are sent directly to the HSA.

Permitted IRAs

Only certain types of IRAs may be rolled over to an HSA. Permitted accounts include traditional IRAs, Roth IRAs and, under certain circumstances, SEP and SIMPLE IRAs. (SEP and SIMPLE IRAs may not be rolled over if they have received employer funding within the plan year ending with or within the tax year of the IRA funding.) In addition, HSAs may not be directly funded from a 401(k); however, the 401(k) owner may roll over from a 401(k) to an IRA and then roll funds from the IRA to the HSA.

It is important to note that, while new HSA contributions can be made until the tax-filing deadline, an IRA-to-HSA rollover counts within the calendar year it is made.

Eligibility Rules for Rollover

The IRA-to-HSA rollover includes a testing period that requires you to remain eligible for your HSA for 12 months following the transfer. This means you must stay in your HDHP at least until the testing period expires. If you don't remain eligible (for example, you switch to a non-HDHP), you'll need to include the money you rolled over as income when you file your taxes. In addition, the amount will be subject to a 10% penalty.[1]

Impact of Medicare Enrollment on the Testing Period Rule

According to IRS rules, you are only eligible to contribute to an HSA if you are enrolled in a high-deductible health plan (HDHP) and are not enrolled in Medicare. If you are within 12 months of enrolling in Medicare, your Medicare enrollment will automatically disqualify HSA rollover contributions and the testing period will fail since Medicare enrollment typically begins the first day of the month you turn 65. Individuals who want to do an IRA-to-HSA rollover should roll over money from an IRA to an HSA more than 12 months before they plan to sign up for Medicare.

What Makes the Most Sense?

As with most financial decisions, the answer to the question of whether an IRA-to-HSA rollover makes sense depends on your specific financial situation and objectives. If it would take you a significant amount of time to build up your HSA, it could make sense to initiate a rollover to ensure you have adequate funds available to pay for medical expenses. For clients nearing retirement, building up a balance in an HSA can provide another "bucket" of money for health care expenses in retirement. Note that at age 65 or if you have a disability at any age, you can use money from your HSA to pay for non-medical expenses. Keep in mind you'll pay taxes on those distributions.

On the other hand, if you have enough money to directly fund the HSA without initiating a rollover, it is often wise to do so. Common sense (and most advisors) would encourage us to save as much as possible in tax-advantaged accounts. Therefore, for individuals who are able, it is advised to leave an IRA as is and use other funds to build up the HSA.

With regard to which type of IRA to roll over, it is often better to roll over money from a traditional IRA rather than a Roth IRA. Because Roth IRAs are funded with after-tax contributions, those contributions can be withdrawn tax and penalty free at any time. Traditional IRA contributions, on the other hand, are subject to taxes and potential penalties upon withdrawal.

For more information visit: **mariner.com**

[1] "Transferring IRA Money to an HSA"