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Correcting Excess HSA Contributions

By Elaine Floyd, CFP®

Oops.

It's easy to violate a rule when the rule doesn't make much sense to begin with.

We are talking, in this case, about the rule that prohibits contributions to a Health Savings Account for anyone enrolled in any part of Medicare.

As HSAs have become the plan of choice for a growing number of employers, people are unwittingly violating this rule when they: 1) enroll in Medicare Part A because they heard it offers good hospital insurance to supplement the employer plan, not realizing that starting with the month of enrollment neither they nor their employer can contribute to an HSA on their behalf, or 2) apply for Social Security, not realizing Medicare Part A is mandatory and is automatically backdated by six months (or to age 65), which means that any HSA contributions made during that period are not allowed.

For the purpose of determining HSA eligibility, contributions are considered prorated monthly, even if they were made all at once.

Example: Jim makes his annual HSA contribution in January. In September he turns 70 and applies for Social Security. His Medicare Part A enrollment is backdated to March. Since Jim was HSA-eligible in January and February only, ten of the 12 monthly prorated contributions were not allowed. This amount will be added to Jim's taxable income along with any interest earned on that money. If the contributions and interest are removed from the account, Jim can avoid the 6% excise tax charged on the overcontributions.

To be clear: a prorated contribution to an HSA cannot be made for any month the person is enrolled in Medicare. If excess contributions are left in the account, they (and any interest earned on them) will be taxable and subject to a 6% excise tax for each year they remain in the account.

Yes, it's crazy that this rule even exists, especially the part about backdating Part A: it practically guarantees that a person contributing to an HSA who is filing for Social Security will be in violation of the law, unless they have the knowledge and foresight to stop the contributions six months before they apply for benefits.

Fortunately, it's easy to fix. If the excess contributions are backed out before your tax filing deadline, including extensions, there will be no penalty. Ideally, you will remove the excess contributions before filing your taxes. However, if the tax return has already been filed, you can file an amended return as late as six months after the due date of the return, including extensions. The exact procedure for backing out HSA contributions will vary with each employer and HSA administrator.

There have been proposals in Congress to allow people on Medicare to contribute to an HSA, but so far there has been no action on such bills.

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