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Spending HSA Funds

By Elaine Floyd, CFP®

Health savings accounts (HSAs) are such excellent savings vehicles that people rarely ask about distributions, or how to take money out without it being taxed. They're too focused on putting money in—as they should be while they're healthy and working.

In 2025 an HSA-eligible person (meaning: not enrolled in Medicare) who has a high-deductible health plan can contribute up to $4,300 for an individual or $8,550 for a family, plus another $1,000 catchup if age 55 or older. The funds going in are tax-deductible, and the earnings are not taxable in the year earned. The money comes out tax-free if used for qualified medical expenses. Hence the moniker "triple tax free" sometimes attached to HSAs.

HSAs are often the last account to be drawn from (thanks to all the tax benefits), but it's not a good idea to leave them to the very end because any funds remaining in the account at death will be fully taxable in one year to a nonspouse beneficiary (minus any funds used to pay the decedent's outstanding medical bills within one year of death).

Fortunately (or not, I guess), it's easy to rack up medical expenses after age 65, in the form of Medicare premiums if nothing else. A person not subject to the IRMAA will pay

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$185 per month in Part B premiums in 2025. They could withdraw $2,220 from their HSA at the end of the year and pay themselves back for all the premiums deducted from their monthly Social Security check throughout the year. If they also had unreimbursed, out-of-pocket costs for other qualified medical expenses, these could be paid out of the HSA as well.

HSA distributions are tax free if they are used to pay qualified medical expenses for self, spouse, or dependents—generally defined as any expense that would qualify for the medical and dental expenses deduction as defined in IRS Publication 502, such as unreimbursed expenses for doctors, dentists, and hospitals.

Insurance premiums generally won't qualify for tax-free HSA distributions unless the premiums are for:

- Medicare for someone age 65 or older—but NOT Medigap premiums
- Long-term care insurance
- COBRA
- Health care coverage while receiving unemployment compensation under state or federal law

So, an early retiree going off the employer plan and not yet eligible for Medicare would not be able to use HSA funds to pay insurance premiums unless the insurance falls under COBRA. Because COBRA is expensive, marketplace insurance, especially with subsidies, would probably be a better deal—but HSA funds could not be used to pay those premiums. Again, there should be plenty of opportunities to use HSA funds later in retirement.

HSA distributions do have to be reported using Form 8889. If all distributions are used for qualified medical expenses, there will be no tax.

Elaine Floyd, CFP® is Director of Retirement and Life Planning for Horsesmouth, LLC, where she helps people understand the practical and technical aspects of retirement income planning.

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