Estate planning encompasses far more than most people realize. The better you coordinate your plans with your existing circumstances, the easier it is to avoid waste, reduce complexity, and ensure that your resources flow in the direction you want.

One financial aspect that often gets overlooked is health savings accounts, generally referred to as HSAs. Let's take a look at how they operate and how they fit with estate plans.

What to Know About Health Savings Accounts

With an HSA, workers can set aside pre-tax earnings in a special account earmarked to use for medical expenses that meet certain qualifications. This enables employees to reduce the cost of expenses such as deductibles and copayments since the employee doesn't have to pay tax on the income used for HSA purposes.

The federal government sets a limit each year on the amount an employee can contribute to their HSA account. For 2023, workers can deposit up to $3,850 for themselves individually or up to $7,750 for family coverage, or a little more if they are over age 55 and not enrolled in Medicare. A certain percentage of that amount can be carried over into the following year if not used. Currently, that amount is 20%.

So while not as substantial as a house or new vehicle, an HSA can still be a significant asset that needs to be considered as part of an estate plan.

When the Account Holder Passes Away

If someone passes away with funds remaining in their HSA, those funds can pass to another person. Generally, this happens through a beneficiary clause in the account. If the spouse was named as the primary beneficiary, then the account remains a health savings account, and the spouse can use funds in it to pay for qualified medical expenses. The HSA belongs to the spouse, so it does not become part of the original account holder’s estate.

However, if the beneficiary designated for the HSA is not the spouse, then the account will be handled differently. After the original owner’s death, the account becomes a taxable distribution. The amount goes directly to the beneficiary, and the beneficiary must include the amount as income on their tax return. If any of the HSA balance is used to pay the original account holder’s medical expenses within a year after their death, those amounts are not taxable.

None of the funds become part of the estate, but they still need to be considered as part of the estate plan. The recipient of the funds will face tax liability. Some HSA owners may prefer to list a charity as the beneficiary and allow loved ones to receive more tax-advantaged assets. It is also possible to designate the estate as beneficiary of the HSA in which case the amount is taxable as income reported on the earner’s final tax return.

Review Your HSA Options with Your Attorney

It is a good idea to review and update your estate plans regularly. So if you have not considered your HSA as part of your plan, add that to the list of factors to discuss as part of your next update.

At The Nordhaus Firm, we would be happy to review your plans to determine if they meet your needs and cover all the necessary factors. Just schedule a consultation to get started.