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165 Court Street
Rochester, NY 14647

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Health Savings Accounts (HSAs) and Medicare

A health savings account (HSA) is an account that someone who has a high deductible health plan (HDHP) can contribute to on a tax-free basis. HSA funds are not taxed as long as they are used to pay for qualified medical expenses. Your current employer may oversee your HSA or you may have an individual HSA that is overseen by a bank, credit union or insurance company. If you have an HSA and you will soon be eligible for Medicare, it is important to plan ahead and understand how enrolling in Medicare will affect your HSA.

In order to qualify for an HSA, you must be a part of a high deductible health plan (HDHP). An HDHP is health insurance coverage that does not cover members until they meet their costly deductible. This means that HDHP members must pay in full for the first few thousand dollars of yearly health care services. After HDHP members meet this deductible, all costs are covered by their plan. HDHPs are either offered by employers or purchased by individuals.

If you enroll in Medicare Part A and/or B you can no longer contribute to your HSA. The month you enroll in Medicare (typically the month of your 65th birthday), the account overseer switches the contributing balance to your HSA to zero dollars per month. By law, people with Medicare are not allowed to put money into an HSA. This is because you generally cannot have any health coverage other than an HDHP if you are putting money into an HSA. However, you may withdraw money from your HSA after you enroll in Medicare to help pay for medical expenses (deductibles, premiums, copays or coinsurances). If you use the account for qualified medical expenses, it will continue to be tax-free.

Whether you should delay enrollment in Medicare so you can continue contributing to your HSA depends on your circumstances. If you work for a small employer, you typically need to take Medicare when you first qualify even though you will lose the tax advantages of your HSA. Health care coverage from small employers pays secondary to Medicare. This means that if you fail to enroll in Medicare when you are first eligible, you may have little or no health coverage. Health care coverage from large current employers pays primary before Medicare so you may not need to have Medicare in order to pay your health expenses. This means that if you are currently working for a large employer and you wish to decline Medicare Part B, you can do so and enroll in Part B later when you lose your current employer coverage. However, you cannot decline Medicare Part A. An exception to this is, if you're not accepting Social Security benefits. As long as you are not accepting Social Security benefits, you can choose to decline Part A also, which preserves your HSA tax benefit. As soon as you want to stop contributing to the HSA (and are if you are still currently working) you can enroll in Part A and get 6 months of retroactive coverage.

If you qualify for Medicare because you are 65 or older, an employer is small if it has fewer than 20 employees. If you qualify for Medicare because of a disability, an employer is small if it has fewer than 100 employees. Remember that if you delay enrollment in Medicare when you are first eligible, you must enroll when you lose your current employer coverage.

If you are collecting Social Security retirement benefits when you become eligible for Medicare, you will be automatically enrolled in Medicare Part A and Part B. If you are not collecting Social Security retirement benefits when you become eligible for Medicare, you must actively enroll yourself during your initial enrollment period. You can actively enroll by calling your local Social Security office. Whether you are enrolled in Part A and Part B automatically or you enroll yourself, you cannot continue to contribute to an HSA once you have Medicare.

Importantly, if you do not take Medicare when you first qualify, you must take special precautions if and when you do decide to collect Social Security benefits (either while working or when you retire). You need to be sure to stop all contributions to your HSA up to six months before you collect Social Security. This is because when you apply for Social Security, Medicare Part A will be retroactive for up to six months (as long as you were eligible for Medicare during those six months). If you do not stop contributing the six months before you apply for Social Security, you may have a tax penalty. The penalty is because you were not supposed to put money into your HSA while you had Medicare.