381.01 What are the rules regarding moving money from an IRA to an HSA?

The law allows individuals a one-time movement of IRA assets to fund an HSA provided: (1) they are eligible for an HSA, (2) they have a permitted IRA with sufficient funds, and (3) they have not already completed an IRA to HSA funding distribution.[[1]](#endnote-1) The amount moved may not exceed the amount of one year’s HSA contribution limit. The technical term for this transaction is a “qualified HSA funding distribution,” not “transfer,” although the transaction is commonly referred to as a transfer.

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Planning Point: The IRA funding option is important for HSA account holders with current or anticipated medical expenses and no source of funds for an HSA contribution other than an IRA. Taxpayers seeking to maximize contributions to tax deferred accounts are generally best served funding the HSA with new funds and preserving the IRA. Essentially, HSA account holders are trading one tax-favored account, the IRA, for another, the HSA. A person facing large medical expenses prior to having the time to build up an HSA balance is a candidate for funding an HSA with an IRA. This rule gives taxpayers a method to avoid paying taxes and penalties on an IRA distribution necessary to pay medical expenses.

Some taxpayers will move IRA money to an HSA sooner than needed for medical expenses because the HSA is arguably a better tax-favored account than an IRA and they prefer to have their limited assets in an HSA. The key HSA benefit not available to IRAs is that the HSA can be used to pay for qualified medical expenses tax-free. A key benefit of an IRA, over an HSA, is the ability to access money for any reason at age 59 ½ rather than the age 65. HSAs also often provide less investment options and may charge higher fees.

Moving money from a Roth IRA or non-deductible traditional IRA makes the choice more complex and often less desirable. Roth IRA contributions can already be withdrawn tax and penalty free at any time. Both Roth IRAs and nondeductible traditional IRAs contain basis that could be lost in a move to the HSA. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

A qualified HSA funding distribution relates to the taxable year in which the distribution is actually made.[[2]](#endnote-2) This means that HSA account holders are not allowed to complete the transfers in the following year before their tax due date and have the contribution count for the previous tax year (regular HSA contributions can be made until the tax due date and are deemed to have been made on the last day of the preceding tax year for tax deductibility purposes).

HSA account owners are not allowed to deduct the amount moved from an IRA to an HSA. The distribution from the IRA is treated as a "qualified HSA funding distribution" and is not subject to taxes or penalty (if an early withdrawal). HSA account owners do not pay taxes on the IRA distribution and they do not get to claim that tax deduction for the subsequent HSA contribution.

The tax situation becomes more complicated if an individual moves money from a Roth IRA or a non-deductible traditional IRA with basis, see Q 521 . The IRA to HSA rules allow the entire basis to stay with the IRA where it can be recovered at the time of distribution from the IRA. No basis transfers to the HSA. This is very favorable treatment, albeit a bit complex to track. If an individual does not have enough non-basis money in an IRA and still chooses to move the money into the HSA, the individual will lose the basis in that amount moved into the HSA.[[3]](#endnote-3)

An IRA to HSA qualified funding distribution is generally not a good option for an IRA account holder that is taking a series of substantially equal periodic payments from an IRA (a method to avoid the early withdrawal penalty from an IRA). A qualified HSA funding distribution from an IRA that modifies the series of substantially equal periodic payments will result in the recapture rules applying to the payments made in the series prior to the qualified HSA funding distribution.[[4]](#endnote-4) This rule will prevent most taxpayers that are in engaged in a series of substantially equal periodic payments from moving those IRA funds to an HSA.

If an HSA account holder moves money from an IRA to an HSA, the HSA account holder will be subject to a testing period

Only certain types of IRAs are permitted for movement to an HSA: traditional IRAs (both deductible and non-deductible), Roth IRAs, SEP IRAs (if not part of an ongoing plan), and SIMPLE IRAs (if not part of an ongoing plan). SEP and SIMPLE IRAs are only permitted if they are not ongoing plans. Ongoing plans are plans that continue to receive employer contributions. A SEP or SIMPLE is considered to be ongoing if an employer contribution is made for the plan year ending with or within the IRA account holder’s taxable year in which the qualified HSA funding distribution would be made. This provision essentially recognizes the fact that a non-active SEP or SIMPLE is a traditional IRA. The feature that distinguishes them as a SEP or a SIMPLE is the contributions coming into the accounts.

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1. IRC Sec 408(d)(9); Notice 2008-51. [↑](#endnote-ref-1)
2. IRS Notice 2008-51. [↑](#endnote-ref-2)
3. IRS Notice 2008-51. [↑](#endnote-ref-3)
4. IRS Notice 2008-51. [↑](#endnote-ref-4)
5. IRS Notice 2008-51. [↑](#endnote-ref-5)