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**Compliance Focus Issue Brief**

# Correcting HSA Excess Contributions

## Date Issued: March 2023

## Background

The IRS sets the maximum annual HSA contribution each year and contributing more than an individual HSA account holder is eligible for is known as an excess HSA contribution. All excess contributions are subject to income tax and a 6% excise tax each year until corrected.

Excess contributions can occur for several reasons, including the following:

* Failing to account for HSA contributions made by an employer or another individual. All contributions made by the HSA account holder, an employer, or by any other individual count toward the annual contribution limit.
* Failing to account for being HSA-eligible for only a portion of the year. HSA-eligibility is determined monthly, and an individual may generally contribute 1/12 of the annual limit for each month of HSA-eligibility. Individuals who are HSA-eligible for only a portion of the year can generally contribute only a pro rata portion of the annual contribution limit.
* Administrative error. For example, mistakes in payroll deduction amounts, incorrect tracking in a benefits administration system, or delays in transfers of contributions to the HSA vendor.

## How are Excess HSA Contributions Corrected?

There are two primary ways to correct an excess HSA contribution. The first is to remove the excess funds in the same year they were made, before the tax deadline. The second is to apply your excess contributions towards next year’s amount.

**Option 1: Removing excess funds in the same year they were made**:

1. Withdrawing the excess contribution(s) through a curative distribution by the tax filing deadline of the year the contribution was made (e.g., April 18, 2023, for 2022 contributions); and
2. Withdrawing any income earned, also referred to as attributable earnings, on the excess contribution(s) and including it on your tax return for that year.
   1. In the case of pre-tax contributions, both the earnings and the contribution should be included in the employee’s gross income on the individual tax return.
   2. In the case of post-tax contributions, the earnings attributable to the excess contribution would be taxable as income for the year in which the distribution is made, but the removed excess contribution would not be taxable as income.

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| Calculating Attributable Earnings Net income = Excess Contribution × ((Adjusted Closing Balance − Adjusted Opening Balance) ÷ Adjusted Opening Balance))   * The “Adjusted Opening Balance” is the sum of the excess contribution and the balance immediately before that excess contribution was made (i.e., the balance at the start of the computation period). * The “Adjusted Closing Balance” is the balance immediately prior to distribution of the excess contribution (i.e., the balance at the end of the computation period), plus any distributions or transfers made in the interim (i.e., during the computation period). |

An HSA account holder with excess contributions should contact their HSA trustee or custodian to request a curative distribution of the excess contributions. The trustee/custodian will report the distribution on Form 1099-SA, coded as an excess contribution. The total distribution (excess and attributable earnings) is reported in Box 1, Gross distribution, on Form 1099-SA and only the attributable earnings are reported in Box 2, Earnings on excess contribution. To indicate that the distribution is the removal of an excess contribution, code 2, Excess contributions, must be entered in Box 3. The Form 1099-SA instructions indicate that HSA owners must include the attributable earnings distributed with the excess as income for the year the distribution is received. If insufficient funds remain in the individual’s HSA to accomplish the distribution (because of prior distributions), the account holder can ask the trustee/custodian to report earlier distributions as including a distribution of the excess contribution, plus earnings. The employer should include the excess contributions as the employee's wages on the W-2; but if that doesn’t happen, the HSA account holder should report this amount as "other income" on their federal income tax return.

The HSA custodian (vendor) will likely help with determining the attributable earnings. The formula for calculating net income (i.e., earnings) attributable to excess contributions is the same formula established for IRAs under Treas. Reg. §1.408-11.

**Option 2: Current-Year Deduction for Undistributed Excess Contributions from Previous Year.**

The Instructions for Form 8889 state that an HSA-eligible individual may be able to deduct excess contributions for previous years that remain in the individual's HSA. The current-year deduction is limited to the lesser of (1) the individual's maximum HSA contribution limit for the current year, minus any amounts contributed to his or her HSA for that year; or (2) the total excess contributions in the individual's HSA at the beginning of the current year. Any excess contributions remaining in the individual's HSA at the end of the taxable year (i.e., the undistributed excess contributions) would be subject to the 6% excise tax on excess contributions.

This option is a bit more complicated, especially if there are earnings from any of the excess contributions and requires the use of Form 5329 to report the deduction. It is recommended to consult with your HSA administrator and/or tax advisor.

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| **Example: Current-Year Deduction for Undistributed Excess Contributions from Previous Year.**  HSA-eligible individual, Beth, age 45, had self-only HDHP coverage for all of 2021. The maximum HSA contributions that could be made to Beth's HSA for 2021 is $3,600. Beth unintentionally contributed $4,600 to her HSA for 2021, resulting in a $1,000 excess contribution, which remains in her HSA. Beth also had self-only HDHP coverage for all of 2022 and the maximum amount that could be contributed to her HSA for 2022 is $3,650. However, Beth only contributed $2,700 to her HSA for 2022. So, for the 2022 taxable year, Beth may deduct $900 of the prior year's excess contribution, which is the lesser of (1) $900 (i.e., the difference between the $3,600 contribution limit for 2021 and her $2,700 contribution for 2022); or (2) the $1,000 excess contributions remaining in her HSA at the beginning of 2022. Beth would report this deduction on Form 8889 for 2022. |

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