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Man vs. Machine: Protect Your HSA: The Dangers of Not Naming a Beneficiary

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Get expert insights into the IRS rules for HSA inheritance when a beneficiary is missing.

In our ongoing series to see how generative AI responds to technical financial questions, we recently posed a relatively straightforward question to Chat GPT: What happens if I die without naming a beneficiary for my HSA?

Then we ran the AI answer by one of our industry subject matter experts to see how the automated answer stacked up against the IRS rules. Here’s what Marcia Mantell, RMA®, founder and president of Mantell Retirement Consulting, Inc., had to say about the AI’s answer.

Chat GPT

If you die without naming a beneficiary for your Health Savings Account (HSA), the account will be treated differently depending on whether you have a surviving spouse or not.

Surviving Spouse as Default Beneficiary: If you are married and do not name a beneficiary, your spouse automatically becomes the beneficiary of the HSA by default. In this case, the HSA continues as your spouse’s own HSA, and they can use the funds exactly as you could, including paying for qualified medical expenses tax-free.

Mantell’s comments: This answer is correct based on IRS rules and information for the transfer of an HSA to a spouse upon the owner’s death. However it is not complete. A spouse does not magically become the owner of the account.

There are steps the surviving spouse will need to take to become the owner of the HSA. They will need to contact the financial institution holding the HSA and go through the process of having the account retitled. Generally, the surviving spouse will need to provide a death certificate and fill out paperwork to open a new HSA in their name. The surviving spouse should also name beneficiaries on this HSA.

Or, if the surviving spouse has their own existing HSA, they may be able to directly roll over the deceased spouse's into their own.

In addition, the survivor will need to fill out IRS Form 8889 each year as long as there are assets in the HSA, the same as the original owner would do.

Chat GPT

No Surviving Spouse: If you do not have a surviving spouse, or if you do not name a spouse as the beneficiary, the account will no longer be treated as an HSA upon your death.

Mantell's comments: Clearly there is something off with the AI that I've nicknamed "Chatty Cathy" answer here. She says if you do not name your spouse as the beneficiary, the HSA loses its tax-advantaged properties. Not so. See answer above. If the original HSA owner fails to name a beneficiary, *and they have a spouse*, the spouse by default becomes the owner. Not sure where the wheels fell off here.

However, Chatty is correct that if you do not have a surviving spouse, the HSA is dissolved upon death of the owner.

Chat GPT answer continued

Instead, the fair market value of the account will be taxable to the estate *[or to the person who inherits the account. This amount must be included in the beneficiary's gross income for the tax year in which you die, but they may deduct any of your qualified medical expenses that are paid by the HSA within one year after your death.]*

Mantell's comment: Here again, Chatty is off in la-la land. The question asked was about the status of an HSA if the owner never named a beneficiary. So, it can't go to the "person who inherits the account." There is no person who is not a spouse who can inherit the HSA unless the owner named such a human beneficiary.

Everything in the bracketed part of the Chat GPT answer above is irrelevant to the question asked. The only correct part of her answer is the first phrase.

Chatty is correct that the HSA loses its tax-advantaged properties as of the date of death and the account must be included in the final estate tax return of the deceased owner. But as a non-person, the estate cannot deduct any qualified expenses the deceased owner incurred in that tax year or for medical expenses still payable within one year of the owner’s death.

Basically, Chatty mixed up the answer here or didn’t understand the question.

It’s also important to note that the HSA plan document must be reviewed to determine the rules for handling the HSA when an owner dies without naming primary and/or contingent beneficiaries.

And a really big miss by Chatty is that the distribution of the HSA assets to the deceased owner’s estate is not subject to the additional 20% tax. Generally, any distributions of HSA assets must be used for qualifying medical expenses. Otherwise, those distributions are subject to ordinary income tax plus a 20% penalty. Except in the case of a distribution due to the owner’s death. Hmmm…that’s a pretty big miss by Chatty.

Last, she missed that any earnings from investments in the HSA must be reported as income on the deceased owner’s final tax return.

Chat GPT answer continued

Naming a beneficiary can simplify the process and potentially provide more favorable tax treatment, especially if the beneficiary is a spouse. It’s usually recommended to review and update your HSA beneficiary designation periodically, especially after major life events like marriage, the birth of a child, or divorce.

Mantell’s comment: Well, now you’ve got it Chatty! It is helpful to provide best practices for managing an HSA. Naming beneficiaries while the owner is alive is very important. Most financial industry experts recommend reviewing beneficiaries on all accounts, including HSAs, annually. The best time to confirm your beneficiaries are current and correct is when pulling together your tax return information in the first quarter of each year.