Internal Revenue Code Section 223(f)(1)

Health savings accounts.

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(f) Tax treatment of distributions.

(1) Amounts used for qualified medical expenses. Any amount paid or distributed out of a health savings account which is used exclusively to pay qualified medical expenses of any account beneficiary shall not be includible in gross income.

(2) Inclusion of amounts not used for qualified medical expenses. Any amount paid or distributed out of a health savings account which is not used exclusively to pay the qualified medical expenses of the account beneficiary shall be included in the gross income of such beneficiary.

(3) Excess contributions returned before due date of return.

   (A) In general. If any excess contribution is contributed for a taxable year to any health savings account of an individual, paragraph (2) shall not apply to distributions from the health savings accounts of such individual (to the extent such distributions do not exceed the aggregate excess contributions to all such accounts of such individual for such year) if--

      (i) such distribution is received by the individual on or before the last day prescribed by law (including extensions of time) for filing such individual's return for such taxable year, and

      (ii) such distribution is accompanied by the amount of net income attributable to such excess contribution.

      Any net income described in clause (ii) shall be included in the gross income of the individual for the taxable year in which it is received.

   (B) Excess contribution. For purposes of subparagraph (A), the term "excess contribution" means any contribution (other than a rollover contribution described in paragraph (5) or section 220(f)(5)) which is neither excludable from gross income under section 106(d) nor deductible under this section.

(4) Additional tax on distributions not used for qualified medical expenses.

   (A) In general. The tax imposed by this chapter on the account beneficiary for any taxable year in which there is a payment or distribution from a health savings account of such beneficiary which is includible in gross income under paragraph (2) shall be increased by 20 percent of the amount which is so includible.
(B) Exception for disability or death. Subparagraph (A) shall not apply if the payment or
distribution is made after the account beneficiary becomes disabled within the meaning of
section 72(m)(7) or dies.

(C) Exception for distributions after medicare eligibility. Subparagraph (A) shall not apply to
any payment or distribution after the date on which the account beneficiary attains the age
specified in section 1811 of the Social Security Act.

(5) Rollover contribution. An amount is described in this paragraph as a rollover contribution
if it meets the requirements of subparagraphs (A) and (B).

(A) In general. Paragraph (2) shall not apply to any amount paid or distributed from a health
savings account to the account beneficiary to the extent the amount received is paid into a health
savings account for the benefit of such beneficiary not later than the 60th day after the day on
which the beneficiary receives the payment or distribution.

(B) Limitation. This paragraph shall not apply to any amount described in subparagraph (A)
received by an individual from a health savings account if, at any time during the 1-year period
ending on the day of such receipt, such individual received any other amount described in
subparagraph (A) from a health savings account which was not includible in the individual’s
gross income because of the application of this paragraph.

(6) Coordination with medical expense deduction. For purposes of determining the amount of
the deduction under section 213, any payment or distribution out of a health savings account for
qualified medical expenses shall not be treated as an expense paid for medical care.

(7) Transfer of account incident to divorce. The transfer of an individual’s interest in a health
savings account to an individual's spouse or former spouse under a divorce or separation
instrument described in subparagraph (A) of section 71(b)(2) shall not be considered a taxable
transfer made by such individual notwithstanding any other provision of this subtitle, and such
interest shall, after such transfer, be treated as a health savings account with respect to which
such spouse is the account beneficiary.

(8) Treatment after death of account beneficiary.

(A) Treatment if designated beneficiary is spouse. If the account beneficiary's surviving
spouse acquires such beneficiary's interest in a health savings account by reason of being the
designated beneficiary of such account at the death of the account beneficiary, such health
savings account shall be treated as if the spouse were the account beneficiary.

(B) Other cases.

(i) In general. If, by reason of the death of the account beneficiary, any person acquires the
account beneficiary's interest in a health savings account in a case to which subparagraph (A)
does not apply--

(I) such account shall cease to be a health savings account as of the date of death, and
(II) an amount equal to the fair market value of the assets in such account on such date shall be includible if such person is not the estate of such beneficiary, in such person's gross income for the taxable year which includes such date, or if such person is the estate of such beneficiary, in such beneficiary's gross income for the last taxable year of such beneficiary.

(ii) Special rules.

(I) Reduction of inclusion for predeath expenses. The amount includible in gross income under clause (i) by any person (other than the estate) shall be reduced by the amount of qualified medical expenses which were incurred by the decedent before the date of the decedent's death and paid by such person within 1 year after such date.

(II) Deduction for estate taxes. An appropriate deduction shall be allowed under section 691(c) to any person (other than the decedent or the decedent's spouse) with respect to amounts included in gross income under clause (i) by such person.