



HEALTH SAVINGS ACCOUNTS

The Medicare Prescription Drug, Improvement, and Modernization Act in 2003, created an opportunity for eligible individuals to establish a Health Savings Accounts (HSAs) after December 31, 2003. HSAs, when used in combination with a high deductible health plan, receive tax-favored contributions and are also distributed tax free for qualified medical expenses. These accounts often help individuals control health care costs and put the individual in charge of their own account and spending.



What is a Health Savings Account?

A Health Savings Account, or HSA, is a tax-advantaged vehicle that allows individuals to pay for current and future medical expenses. These accounts are invested and grow on a tax free basis for the future expenses of the beneficiary, spouse, or other dependants'. These funds are owned by the individual and must be used in conjunction with a high deductible health insurance plan (HDHP). Funds distributed from the HSA are not taxed if they are used to pay for qualified medical expenses.

What is a high deductible health insurance plan?

A high deductible health plan, or HDHP, is a fairly inexpensive health insurance plan that is sometimes known as a "catastrophic health insurance plan." You must be covered by a HDHP to open an HSA. The minimum deductible for your HDHP is \$1,000 for self-only coverage and \$2,000 for family coverage in 2005. The annual out-of-pocket expenses (including deductibles and co-pays) cannot exceed \$5,100 for self-only coverage and \$10,200 for family coverage for 2005.

Who is eligible for a HSA?

Individuals covered by a HDHP and who are not covered by another health insurance plan (other than specific injury and accident insurance, disability, dental care, vision care, and long-term care) that provides coverage for any of the benefits covered by the HDHP, are generally eligible for an HSA. Also, you must not be eligible for Medicare and cannot be claimed as a dependent on someone else's tax return. There is currently no income limit for individual's eligible to contribute to an HSA.

What do HSAs cover?

HSA funds can be used to cover the health insurance deductible and any co-payments for medical services, prescriptions, or products. In addition, these accounts can also fund an individual's purchases of over-the-counter

drugs, long-term care insurance, and even help pay health insurance premiums during any period of unemployment. Many dental and vision care procedures and expenses can also be found on the qualified medical expenses list.

What are some advantages of having a HSA?

HSAs are a significant improvement over previous health savings vehicles. Contributions to HSAs are tax deductible, even if the taxpayer does not itemize their deductions. Contributions that are made by the employer are not included in the individual's taxable income. The individual, the employer, or both can contribute tax deductible funds each year up to the amount of the HDHP annual deductible (subject to a cap of \$2,650 for individuals or \$5,250 for families in 2005).

Another advantage is that the individual owns the account; not the employer. The individual is in charge of their own health care purchasing decisions. The individual decides how much to contribute, how much to use for medical expenses, which medical expenses should be paid from the account, whether to pay for medical expenses from the account or save them for the future, and who shall be the account's trustee. With ownership in the individual's hands, the HSA holds the same advantages as an IRA in many respects.

HSA funds can also be built up and rolled over from one year to the next. There is no "use it or lose it" policy that applies with many Cafeteria plans. Money not spent in the current year will remain in the account and gains interest earnings, tax free.

Lastly, HSAs have favorable tax treatments for contributions, disbursements, and investment earnings. Your personal contributions receive an "above-the-line deduction." This type of deduction reduces your taxable income by the amount of your contributions. Employer contributions to employee HSAs are not subject to FICA or FUTA taxes.

What are the contribution rules for HSAs?

Both the employer and the individual can make contributions. Employer contributions to HSAs must be comparable for all employees that participate. As mentioned earlier, contributions made by the employer are not taxable to the employee.

They are excluded from income. Contributions can also be made by others on behalf of the individual, and then deducted by the individual. Contributions can also be made through cafeteria plans or rolled over from existing Archer MSAs (or an existing HSA). However, you cannot roll an HSA fund over into an IRA fund.

What happens to your HSA if you change jobs?

If you decide to change jobs, your HSA remains intact. Because the money in the HSA belongs to the individual, the HSA does not dissolve or become obsolete. You can still withdraw from the account as usual. However, if you are no longer covered by a HDHP, you cannot make additional contributions. You are only allowed to withdraw from the account until the funds are completely spent.

Do HSAs have catch up contributions?

An individual age 55 or older may make catch up contributions to their HSA. The catch up amount for 2005 is \$600. This amount will increase by \$100 each year, until it reaches \$1,000 in 2009. The catch up contributions enjoy the same tax advantages as normal contributions.

How are HSAs distributed?

HSA funds can be distributed for expenses whether they are qualified medical expenses or not. If the expenses are qualified for the account beneficiary, spouse, or dependents, the distribution is tax free. Note that spouses and dependants do not need to be covered by the HDHP. If the distribution is used for an unqualified medical expense, the distribution is subject to tax. If the individual is under age 65 there will also be a penalty tax of 10%. The penalty is waived for certain circumstances, such as death, disability, or Medicare eligibility. Once the age of 65 is reached, the HSA can be used for health expenses and to pay for some health insurance premiums like Medicare A & B, Medicare HMO, and the employee's share of retiree medical insurance premiums. The account can also be used for any other types of purchases or expenses. When it is used for medical expenses, the distribution will be withdrawn tax free, and when used for other expenses, the distribution will be taxed without penalty.

HSA – till death do us part?

The value of an HSA on the date of death of the beneficiary will be includible in the deceased beneficiary's estate for Federal Estate Tax purposes. If a surviving spouse is

not the inheriting beneficiary, the HSA will no longer be a HSA. No part of the assets in an HSA can be invested in life insurance contracts and the assets cannot be associated with other property, except a common trust fund or common investment fund.

What is the role of the account beneficiary?

The account beneficiary should keep all receipts related to the distributions of the HSA. An important responsibility of the account beneficiary is, if necessary, prove to the IRS that the HSA distributions were for medical expenses, that the deductible was met under the HDHP, and that not all of the medical expenses paid from the HSA had been charged against the deductible (such as dental and vision)

What is the role of the account trustee?

The HSA trustee must report all distributions. The trustee is not required to determine whether the distributions were used for medical purposes; this is the job of the individual.

What documents need to be reported for tax purposes?

At the end of the year, the trustee or custodian of your HAS is required to file Form 2498-SA (HSA, Archer MSA, or Medicare+Choice MSA Information), with the Internal Revenue Service. The form must be filed on or before May 31st following the end of the tax year. A copy of this form will also be provided to the individual that owns the HSA account. The form provides information such as the trustee's name and address and Federal identification number, the participants name and address and social security number, the account number, the total contributions made for the year (including rollover contributions), and the fair market value of the HSA.

What is the difference between HSAs, HRAs, and FSAs?

The difference between a HSA and a HRA is that HRA plans are provided by the employer; the individual does not own the account. The other main difference is that a HRA is not transferable if an individual changes jobs. The difference between a HSA and a FSA is that like cafeteria plans and other medical savings programs, FSA funds must be used by the end of the calendar year or they are lost forever. There is no rollover as with HSAs.

How do you open a HSA?

An individual must first purchase HDHP coverage. This coverage can be found through your current insurance company or by contacting a licensed agent or broker. Once this is completed, a trustee can be established. The trustee or custodian of the account must be different than the HDHP provider. Banks, credit union, or insurance companies are common providers of HSA accounts.