HSAs: A New Strategy for Managing Health Care Expenses

With rising health care and health insurance premium costs, you may be looking for new ways to control and manage these expenses. The federal government's recent approval of tax-advantaged Health Savings Accounts (HSAs) may present you with a new option for saving money to cover future medical expenses.

What is an HSA?

An HSA is an account that allows you, if eligible, to accumulate funds that can be used to pay for current and future qualified medical and health care costs on a tax-free basis. It was created to provide people with high health insurance deductibles a tax-advantaged method of saving for qualified expenses that fall below their deductible threshold. You will find HSAs available at a growing number of financial institutions, and the terms and fees associated with these accounts vary by organization.

HSAs carry some excellent benefits:

- Your contributions to an HSA are tax deductible (or pre-tax, if contributions to your account are made by your employer).
- HSAs can accrue interest, and the interest on these accounts is tax-free.
- Your withdrawals for qualified health expenses are also tax-free.
- You can decide how much money to save and how the funds will be used.
- Unlike Flexible Savings Accounts (FSAs), which require that all accumulated funds be used up at the end of each year, your HSA savings can roll over from year to year.
- Your HSA is portable; so it will stay with you even if you move, change employer, or shift to a new bank.
- Many HSA accounts offer easy access to your funds, through check writing and/or a debit card.
- At age 65, you can continue to use your HSA funds for medical expenses not covered by Medicare or other resources, or you can access the funds just like an IRA (although in this case, distributions would be subject to income tax reporting).

Who is eligible to open an HSA?

To be eligible for an HSA, you must meet several specific requirements, including:

- You must be enrolled in a qualified High Deductible Health Plan (HDHP). HDHPs can help you save money because they have significantly lower premiums than other healthcare coverage, but they carry high annual deductibles (for individuals, $1,000 or more, and for families, $2,000 or more). If you are currently enrolled in high deductible coverage, you may want to consult with your company's human resources representative or your tax advisor to determine whether your plan qualifies. (Some plans may not, due to prescription drug or other coverage issues, so it is important to confirm your plan's eligibility.)
- You cannot be covered by any other health insurance. (This does not include specific injury and accident, disability, dental, vision or long-term care policies, however.)
- You are not eligible for Medicare coverage.
- You cannot be claimed as a dependent on another person's tax return.

What types of expenses can be covered with HSA funds?

You can use funds in your HSA to cover qualified health expenses for yourself, your spouse and your dependent children, even if they are not covered by your HDHP. HSA funds can pay for expenses that go toward meeting your annual health insurance deductible, and they can also be used for items that may not be covered by your HDHP.

Examples of qualified out-of-pocket expenses include medical care and services, such as for the prevention, diagnosis, treatment and cure of disease or injury; dental and vision care expenses; over-the-counter medications, such as aspirin; and transportation to and from a medical facility. You cannot generally use HSA funds to pay for health insurance premiums, with these specific exceptions:

- Health coverage while receiving government unemployment benefits
- COBRA coverage, after you have left an employer with a health insurance plan
- Qualified long-term care insurance
- Specified Medicare premiums (not including premiums for Medicare supplement insurance) and out-of-pocket costs

If you use HSA funds for any purpose other than “qualified medical expenses”, they become taxable as income and subject to an additional 10% tax penalty.

How much can you contribute to an HSA each year?

For individuals, you can contribute a maximum of your annual health insurance plan deductible, or $2,650, whichever is less. And for families, you can contribute your annual deductible, or $5,250 – again, whichever amount is less. Please note that these 2005 maximums will be adjusted annually in line with the rate of inflation.

If you are over 55 years of age, you may be eligible for a higher annual “catch-up” contribution to your account, to enable you to build up a high balance for use after retirement. In 2005, regulations allow you a maximum “catch up” contribution of $600.

Is an HSA right for you?

Consult with your financial or tax advisor to determine your eligibility for an HSA and any tax implications it may have. You may also refer to the Treasury Department’s website (http://www.treas.gov/offices/public-affairs/hsa/) for further details about the advantages and limitations of HSA accounts.

Consider the value of switching from a lower deductible plan to an HDHP. You may find that opening an HSA, as a companion to an HDHP, will give you added flexibility in managing your health care, allow you to save money on insurance premiums, and help you tackle your ongoing out-of-pocket health care expenses in a tax-advantaged way.

Common Acronyms

HSA (Health Savings Account) – A Health Savings Account allows people with High Deductible Health Plans (HDHPs) to save pre-tax funds to cover qualified out-of-pocket medical expenses.

HDHP (High Deductible Health Plan) – A High Deductible Health Plan is health insurance coverage with an individual annual deductible of $1,000 or higher, or a family deductible of at least $2,000. Out-of-pocket expenses (not including premiums) cannot exceed $5,100 for individuals, or $10,200 for families.

FSA (Flexible Spending Account) – A Flexible Savings Accounts is a benefit option offered by some employers to allow employees to accumulate funds for out-of-pocket health and dependent care expenses. FSAs are funded by pre-tax salary reductions, and in some cases, the employer may contribute to these accounts. FSAs carry two important restrictions – employees cannot change their contribution amount or drop out of the plan during the year (unless they change employers or have a change in family status), and all funds in the account must be used or forfeited at the end of each year.

MSA (Medical Savings Account) - Medical Savings Accounts are the predecessor to HSAs, allowing people to save money for medical expenses in a tax-advantaged way. Funds from an MSA can be rolled over into an HSA.

Eligibility to Open an HSA

If all of the following apply, you may be eligible to open an HSA:

1) Covered by a HDHP (with deductible of $1,000 or more for individuals, or $2,000 or more for families – see above)
2) Not covered by any other health insurance
3) Not entitled to Medicare
4) Cannot be claimed as another’s dependent

Be sure to consult with your tax advisor, financial advisor, or accountant with any questions you may have regarding HSA eligibility and tax implications.