Health Savings Accounts
A Shelter in the Healthcare Storm?

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Healthcare is at the top of the news right now. The one thing we all can agree on is that the system is broken. Unfortunately, there is no "one-size-fits-all" answer and the cure Congress has presented looks worse than the disease. However, for several years now, we've had an option for saving money on health insurance expenses while building tax-deferred savings accounts for future healthcare costs. The problem is, most people either haven't heard of it or don't know enough about it to make it an appealing choice.

I'm referring to **Health Savings Accounts**, generally referred to as "HSAs". Established in 2003, HSAs were intended to enable more Americans to gain access to health coverage and to allow them to take more control over their health-care costs. Although there were over eight million HSAs in use in 2009, many more consumers could benefit from them but aren't using them.

An HSA is similar to an IRA account that is used for medical and health-care costs. It is a tax-deductible savings account that may be set up and funded by individuals, employers, or both. The insured under an HSA must be covered by a **High Deductible Health Plan** ("HDHP") that requires them to pay a deductible before coverage under the HSA begins. Here is a simplified version of the steps to starting and using an HSA:

- Become covered under a HDHP for insurance (for 2010, the minimum deductibles are $1,200 single/$2,400 family)
- Set up your HSA account with a custodian (the website hsafinder.com is a great place to begin your search). In 2010, you can contribute $3,050 single/$6,150 family, and an additional $1,000 if you are age 55 or older.
- Set up a system to keep track of your medical expenses. (See IRS publication 969 at irs.gov for a list of qualified medical expenses.) By the way – over-the-counter drugs are deductible in HSAs.
- Your HSA custodian will give you a card to use for qualified costs. You can use this card, submit a periodic request for reimbursement to your HSA custodian, or both. You do not submit receipts to your custodian – as with your income tax return filing, you must keep your receipts to prove your claims in the event you are audited.
- You will receive an annual income tax filing form from your custodian showing the amount you have contributed to your HSA account and your distributions. No matter how much money you spend *out* of your account for medical expenses, you are allowed to deduct the full amount you contributed to your account from your taxable income (up to the annual limit).
- Money remaining in your account will carry forward indefinitely to be used for future medical expenses. There is no "use it or lose it" provision as there is with flex account funds.
- Your HSA is portable, i.e., if it is established by your employer, you take the money with you even if you change jobs or leave the work force.
- Your spouse can inherit your HSA tax-free. If your beneficiary is not your spouse, the HSA will lose its tax-advantaged status when transferred.

Additional rules that apply to HSAs and HSA holders:

- You can take money out tax free for the qualified medical expenses of the person covered by the HDHP, their spouse, and any dependent.
- You will report your distributions on IRS Form 8889. You owe no taxes as long as the distribution is used to pay for a qualified medical expense. If you use the money for other purposes, it is included in income and a 10% penalty <u>may</u> be applicable.
- You cannot use your HSA for health insurance premiums, but you can use it for COBRA and any health plan coverage while receiving unemployment compensation, qualified long-term care premiums, and some Medicare-related coverage.
- Contributions to your HSA must stop once you are enrolled in Medicare.
- For years beginning in 2007, you can make a one-time transfer of funds from your IRA to a HSA. The amount of the IRA transfer reduces your HSA contribution for the year

What makes HSAs a good choice for some?

- They provide a tax advantage for many who are otherwise not able to deduct healthcare costs
- They lower overall insurance costs for the average healthy person

- Payments to healthcare providers are typically at the insurance company's lower negotiated rates.
- They give consumers more control over their healthcare dollars and enable them to compare costs and services
- They provide a safety net for unforeseen accident or illness since they plan typically covers all costs once the deductible is met.
- Unused funds can be invested and viewed as an additional retirement plan (some companies designate specific mutual funds for HSA investments)
- Children who can no longer be covered under their parents' policies may find this to be a low-cost effective solution
- Entrepreneurs and small business employers can better provide coverage for themselves and their employees at a lower cost.

In 2008, only 7% of taxpayers were able to claim a deduction for their medical costs. An HSA changes all that – you get to deduct even more than your costs if you have a balance left in your account.

The tax savings are real. I used to be in the 93% of taxpayers who received no tax break on medical expenses. Since setting up an HSA, I take a nice deduction every year *and* have savings for the future. If you would like more information or to discuss if an HSA could be right for you, please email or give me a call.