Health Savings Accounts (HSA)

The Healthcare Expense Tax Shelter

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Important Notice

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How a Health Savings Account Works

A Health Savings Account (HSA) is a tax-favored account established exclusively to pay certain medical expenses of the account owner, spouse, and dependents. Health insurance coverage must be provided under a qualifying high-deductible health plan.

Account Owner

Makes deductible contributions

Employer

Optional Contributions (non-taxable to employee and no payroll taxes)

Health Savings Account

- Growth in the account is not currently taxed.
- If the account owner changes employers, the HSA moves with him or her, even if the employer contributed to the account.

Medical Expenses

- Distributions used to pay for “qualified” medical expenses are received income tax-free.
- Qualified medical expenses generally follow the definition used for deductibility as an itemized deduction on form 1040, Schedule “A”.

Other Distributions

- Distributions for other purposes are included in the account owner’s income and a 20% penalty is added.
- The 20% penalty does not apply if distribution is made because of the account owner’s death, disability, or reaching age 65.

Health Savings Account

A Health Savings Account (HSA) is a tax-favored[1] account set up exclusively to pay certain medical expenses of the account owner, spouse, and dependents. Health insurance coverage must be provided under a high-deductible health plan. Qualified contributions by the account owner are deductible from gross income and growth inside the account is not taxed. Distributions to pay for qualified medical expenses are received income tax-free. Funds not used during one year can be held over and used to pay qualified medical expenses in a later year even if no further contributions are permitted.

Similar in nature to an Individual Retirement Account (IRA) or Archer Medical Savings Account (Archer MSA), an HSA is owned by an individual and is thus portable. If an individual changes employers, the HSA moves with the individual and does not stay with the former employer even though that employer may have contributed to the HSA.

Key Concepts

There are a number of key concepts involved in understanding HSAs:

- **Eligible individual:** Only an "eligible individual" may establish, and then contribute to, an HSA. This is someone who on the first day of any month: (1) is covered by a high-deductible health plan (HDHP); (2) is not also covered by another health plan that is not a HDHP[2]; (3) is not enrolled in Medicare (generally, under age 65); and (4) may not be claimed as a dependent on someone else's tax return.
- **High-deductible health plan:** A health plan that meets certain requirements (adjusted annually for inflation) regarding deductibles and out-of-pocket expenses:

Coverage Type	2013 Minimum Deductible	2013 Maximum Out-of-Pocket	2014 Minimum Deductible	2014 Maximum Out-of-Pocket
Self-Only	$1,200	$6,050	$1,250	$6,250
Family	2,400	12,100	2,500	12,500

  As a general rule, the HDHP may not provide benefits (except for certain preventive care) until the minimum deductible for the year has been met.
- **Permitted insurance:** An individual is considered to be "eligible" without regard to any coverage he or she may have under certain "permitted" insurance such as worker's compensation, tort liability, or liability arising from the use or ownership of property (e.g., auto insurance). Also disregarded is insurance for a specific illness or disease or that pays a fixed amount (per day or other period) for hospitalization. Coverage for accidents, disability, dental care, vision care, and long-term care is also disregarded.

[1] The rules discussed here concern federal income tax law. State or local law may differ.
[2] Certain limited exceptions apply.

- **Flexible Spending Accounts:** FSAs are allowed if they are "limited purpose," covering accidents, disability, dental or vision care, or are a "post-deductible" FSA, providing benefits only after the minimum annual deductible amount under the HDHP is met.
- **A trust or custodial account:** An HSA must be in the form of a trust or custodial account, established with a qualified trustee or custodian, such as an insurance company, bank, or similar financial institution.

Contributions To An HSA

Contributions to an HSA generally must be in cash:

- **Annual contribution limit:** For 2013 and 2014, the maximum deductible contribution to an HSA is as follows:

Coverage Type	2013 Specified Maximum	2014 Specified Maximum
Self-Only	$3,100	$3,250
Family	6,250	6,450

Federal law allows an individual who becomes covered under a high-deductible plan in a month other than January to make a full, deductible HSA contribution for the year; certain restrictions and limitations apply. Individuals over age 55 may also make "catch-up" contributions of $1,000 per year.

- **Individuals who may contribute:** Contributions may be made by an eligible individual, either directly or through a cafeteria plan, or by the individual's employer. Any person, including family members, may also contribute on behalf of an eligible individual.
- **Deadline for making contributions:** Contributions may be made in one or more payments and must be made no later than the due date for filing the eligible individual's federal income tax return for the year, generally April 15 of the following year. Contributions may not be made before the first day of the year to which they apply.
- **Income tax treatment of contributions:** Qualified contributions (including contributions by family members) to the HSA by an eligible individual are deductible from the eligible individual's gross income. Employer contributions to an HSA are excludable from an employee's income and are not subject to withholding for federal income taxes or for federal payroll taxes.[1] Growth or earnings on the contributions are not taxable while held inside the account. Excess contributions may be subject to a 6% excise tax.
- **Other:** Rollover contributions from an Archer MSA (or another HSA) to a HSA are permitted and need not be made in cash.

[1] Such as the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax (FUTA), or the Railroad Retirement Act (RRA).

Health Savings Account

Distributions From a HSA

Distributions from an HSA may be made at any time. Distributions used solely to pay for qualified medical expenses for the account owner, spouse, and dependents are excludable from gross income (i.e., tax-free).

- **Qualified medical expenses:** Qualified medical expenses are expenses (incurred after the HSA has been established) for "medical care" as that term is used in IRC Sec. 213(d). Generally, this includes amounts spent for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, to the extent not reimbursed by insurance. Qualified medical expenses do not generally include health insurance premiums.[1]
- **Taxation of amounts not used for qualified medical expenses taxed:** Any distribution from an HSA that is not used for qualified medical expenses is included in the income of the account owner and a 20% penalty is added. The penalty does not apply if a distribution is made because of an account owner's death, disability, or reaching age 65.
- **No longer an eligible individual:** If an account owner is no longer an "eligible individual" (for example, by enrolling in Medicare), the HSA account may continue to be used. No additional contributions may be made, but distributions used solely to pay for qualified medical expenses continue to be received income tax-free.
- **Death of the account owner:** At death, funds in an HSA pass to a named beneficiary. If the beneficiary is a surviving spouse, the account becomes the HSA of the surviving spouse, subject to the normal rules that apply to all HSAs. If the funds in an HSA pass to a non-spousal beneficiary, the account ceases to be an HSA as of the date of death, and the non-spousal beneficiary must include in taxable income the value of HSA assets as of the date of death.[2]

Tax Relief and Health Care Act of 2006

The Tax Relief and Health Care Act of 2006 (TRHCA 2006) contained a number of provisions designed to promote the use of HSAs. Among these provisions were:

- **Full contribution for months preceding becoming an "eligible" individual:** An individual who becomes an "eligible" individual during a month other than January is allowed to make contributions for the months in the year preceding the month he or she enrolls in a HDHP. If an individual makes contributions under this provision, he or she must remain an eligible individual for a "testing period." The testing period is the period beginning with the last month of the taxable year and ending on the 12th month following such month. If an individual makes deductible contributions under this provision and does not remain an eligible individual during the testing period, the amount of contributions made for the months preceding the month the individual became eligible are included in income and a 10% additional tax applies.

[1] Certain exceptions apply to qualified long-term care insurance, COBRA health continuation coverage, and health insurance premiums paid by an individual while receiving unemployment compensation. For those over age 65, premiums paid for Medicare Part A, Part B, Part D, a Medicare HMO, or premiums paid under an employer-sponsored health insurance plan also qualify.
[2] Less any qualified medical expenses of the deceased account owner, paid within one year after death.

- **One time rollovers from IRAs:** This provision allows for a once-in-a-lifetime distribution of amounts from an IRA (either a Traditional IRA or a Roth IRA), in a direct trustee-to-trustee transfer. Amounts distributed under this provision are not includible in income to the extent that they would otherwise be includible in income, and they are not subject to the 10% penalty tax on early distributions. The maximum amount that may be distributed from the IRA and contributed to the HSA is limited to the otherwise maximum deductible contribution amount to the HSA. No deduction is allowed for amount contributed from an IRA to an HSA.

  An individual who makes such a transfer must remain an eligible individual during a 12-month "testing" period, beginning with the month of the contribution and ending on the last day of the 12th month following that month. If the individual does not remain an eligible individual during this testing period, any amounts transferred are included in income and a 10% additional tax applies.[1]

Seek Professional Guidance

Heath Savings Accounts provide a tax favored means to accumulate funds to pay for qualified health care expenses. Because of the complexity of such accounts, the guidance of trained tax and financial professionals is strongly recommended.

Traditional Health Insurance Plan vs HSA Plan

	Traditional PPO Plan	HSA PPO Plan
	Three Times Single Deductible: $1,000	**Common Family Deductible: $5,100**
Coinsurance:	**80/20 Doctor/Office Co-Pay**	**100%**
Premium Paid:	**$7,115**	**$3,125**
Your Share - Medical Care Expenses:	$1,000 For Deductible, $100 For Coinsurance,	$1,500 For Medical Expenses
($1,500 Claim):	$550 Non-Covered Eye Exam, Eyewear, Dental, Etc.	$550 Non-Covered Eye Exam, Eyewear, Dental, Etc.
	$1,650	**$2,050**
Expenses Subtotal:	**$8,765**	**$5,745**
Tax Savings on HSA Deposits:	**$0**	**$1,428***
Net Expenses (Out -Of-Pocket Minus Savings)	**$8,765**	**$3,747**
Total Net Savings With HSA Plan		**$5,018**

*** Assumes $5,100 deposit in a HSA at a 28% federal tax bracket.**

This sample is for comparison purposes only and your individual premiums and claims experience may vary.

Five Steps to Establish a Health Savings Account

1. Determine if this type of medical expense payment method is right for you. Health Savings Accounts are not for everyone. Cloud, Minturn & Associates will help you conduct a financial analysis to help determine if a Health Savings Account will benefit you and your family.

2. Purchase a High Deductible Health Plan (HDHP). There are multiple insurance carriers that provide these types of plans. Cloud, Minturn & Associates is constantly tracking this market and will help you choose the right plan that fits your lifestyle and budget.

3. Set-up a HSA with a participating financial institution. There are many vendors that are authorized to administrate your Health Savings Account. Whether you want to establish a Health Savings Account with your existing bank or explore other investment opportunities (ie. no load Vanguard Funds) Cloud, Minturn & Associates will help with the decision of which financial institution will best fit your needs. You can always change financial institutions anytime.

4. Make deposits into your HSA. As your account grows, determine what investments will best fit your needs. Think of this account as your own personal 401(k) or IRA. Ultimately you should invest the same way you would in a retirement account.

5. Shop for the best price when medical attention is needed. Being in control of your healthcare costs requires a certain amount of responsibility. Just as you would shop for any big ticket item (new TV, computer, etc.) you can shop for medical care. As Health Savings Account's expand, more organizations are being formed to help consumers obtain the best price for their healthcare needs. Cloud, Minturn & Associates will help provide the resources needed to get the best possible price for your healthcare dollars.

Cloud, Minturn & Associates (CMA), with its years of expertise can help guide and assist you with all of the five steps that are required in order to set-up and properly administrate a Health Savings Account (HSA).