

Frequently Asked Questions Health Savings Account

Go Ahead Ask

What is an HSA?

A Health Savings Account ("HSA") is a special tax-sheltered savings account that is similar to a traditional IRA, only for medical expenses. It's been called a "Medical IRA" and a "Super IRA".

How does it work?

The way it works is simple. The savings account (HSA) works in conjunction with a special "high-deductible" health insurance policy to give you comprehensive health insurance coverage at the lowest possible net cost. All the money you deposit into the HSA is 100% tax-deductible, which makes those dollars "tax-free." The insurance company pays the "big" bills (covered expenses in excess of the deductible amount) and you pay the "small" bills with pre-tax money from the HSA. You can even use these tax-free dollars to pay for medical expenses not covered under the insurance policy, such as dental, vision and alternative medicines. What you don't need to use every year for the "small" bills is yours to keep...and accumulate toward your own retirement...just like an IRA!

What is required in order to open an HSA?

In order to open and make tax-deductible contributions to an HSA, you must first be insured under a qualified high deductible major medical insurance policy ("QHDHIP"). Please note that the deductible under a family plan is one deductible "per family per calendar year"--it is not "per person".

Once the qualifying high deductible health insurance policy is issued and in effect, you are then eligible to establish and make contributions to your own HSA savings account.* The account must be established and maintained by a bona fide HSA custodian, which simply means a financial institution that has been approved by the IRS as an HSA administrator.

Can I choose my own doctor?

Yes! With an HSA, you are free to use any doctor and any hospital you choose. Although under pricing schemes employed by most insurance companies that write the HSA-qualified plans, significant savings are available to you for choosing to participate in a PPO (preferred provider) network. The available networks offer a wide variety of physicians and service providers at discounted rates.

What happens if my medical expenses exceed the amount of my deductible?

If your covered medical expenses for the year reach the deductible of your HSA major medical insurance policy, the policy will take over and pay the balance of the qualified expenses at the co-insurance rate. In other words, you are fully insured for covered medical expenses over the amount of your HSA policy deductible, while self-insuring the small bills below the deductible with tax-free dollars.

What if my medical expenses do not reach my deductible? What happens to the money in my savings account that I don't need to spend on medical bills?

The money in your HSA is all yours! The less money you spend on medical expenses, the more will remain in your HSA, and, again, that money is yours. It will earn bank interest or better while in the custodial account, and depending on the Health Savings Account administrator you choose, you can

invest all or some of it in any IRS approved securities you may prefer, including mutual funds, stocks and bonds.

Does that mean I can contribute to my HSA every year, even if I didn't meet my deductible in the previous year?

Absolutely! Remember, an HSA is, for all practical purposes, just like an IRA--you're allowed to contribute to the account every year in which you are otherwise eligible to participate--and fully deduct your contributions 100% every year.

What are the co-pays for Dr. visits and prescriptions?

Zero. You "self-insure" these small bills with tax-free dollars from your HSA. When you think about it, your HSA is really like an insurance company that is just responsible for the "little" bills--those under your deductible amount. And quite literally, that insurance company pays 100% of the Dr. visits and prescriptions with no co-pays--it's actually better than paying \$20, \$30 or more in co-pays with a higher priced co-pay plan. Plus, best of all, you get to keep the profits from that insurance company every year instead of some big ole' insurance company! You get a nice tax-break for funding that insurance company--even if you don't incur any medical expenses for the year! Of course, you are assuming some risk, but that risk is "capped" at your deductible amount!

What about taxes on the money in the account not used for medical expenses?

All dollars you deposit in the account are 100% tax-free while they remain in the account. Earnings you generate on those dollars are also tax-free while in the account. (Incidentally, you select your own investment vehicle. You can invest in a "safe" fixed account, stocks, bonds, or mutual funds.) At age 65, you may retain the balance in your account to be used for future medical expenses, in which case you will never pay the taxes on the interest or the principal, or you can start using your HSA like an IRA--it's always your money, your choice.

The only time tax is ever paid on principal or interest from the HSA is if the money is withdrawn for non-medical expenses. There is also a 10% penalty for withdrawing funds for non-medical expenses prior to age 65 (considered a "premature withdrawal" unless an exception applies, such as disability). Upon reaching age 65, you will only be liable for taxes on the money you withdraw that is not used for medical expenses, with no penalty for "early" withdrawal--since, by definition, a withdrawal can only be "early" under the HSA law prior to age 65. This also means you can withdraw funds to pay for medical expenses at any time after turning age 65 and never pay taxes on those dollars! (After all, medicare doesn't cover *everything*!)

What if I die before using up all the funds in my HSA?

Just like an IRA, the HSA is an inheritable account.

Is there a limit on how much I can contribute to my HSA and write off on my taxes each year?

Of course! After all, this is a special tax-favored account--our friends in Washington are not going to let you write-off unlimited amounts under this program.

Under current 2010 tax law, if you have an individual plan, the maximum contribution is \$3,050. If you have a family plan, the maximum contribution is \$6,150.

Will this amount increase in the future?

Maybe. Maybe not. It's all up to Congress. One thing is for sure though--the amount will never be lowered--it's grandfathered into the law so that people establishing HSAs will have a sense of security in knowing the "floor" limit.

Can I have an HSA in addition to an IRA or other qualified retirement plan?

Yes! Although an HSA operates under many of the same rules that apply to traditional IRAs, it is not an IRA. In other words, an HSA is not a "retirement" plan--it is a "savings account" plan for medical expenses. Plus, unlike an IRA, there are no special income restrictions!

Will I still be able to deduct the premiums I pay for the HSA qualified insurance policy?

Yes. Premiums for the underlying HSA qualified high deductible health insurance policy are 100% tax-deductible to the same extent as premiums for any non-HSA qualified insurance policy, including traditional HMO and PPO plans (this applies equally to group plans as well as individual plans for the self-employed). The main difference, of course, is that the actual amount of the deduction will be smaller because the premiums will be smaller (usually). In other words, the HSA doesn't take away any tax-deduction you currently have (for premiums); it gives you a whole new deduction--for saving your own money--and a 100% deduction at that!

Does this mean that Uncle Sam is really "paying" me to save money for medical expenses?

Yes! That's exactly what an HSA does--the government is essentially "paying" you to save money for medical bills by allowing you to deduct 100% of your HSA contributions! When you think about it, the HSA is a spiffy way to by-pass the 7.5% AGI limit for deducting medical expenses. (Ordinarily, medical expenses are only deductible when you itemize on Schedule A, and then only when medical expenses exceed 7.5% of your Adjusted Gross Income.) Actually, it's even better than that because the HSA allows you to deduct money you're saving to cover future medical expenses--expenses that may, in fact, never occur!

Is it fair to say that the Government subsidizes my routine medical bills with an HSA?

Yes, because that's the reality of paying for your routine medical bills with tax-free dollars! Let's use a typical family scenario as an example. If the family HSA is fully funded, a total of \$6,150 a year will be deposited into the savings account. This entire amount is 100% deductible on line 25 of your 1040 Form (regardless of whether you itemize). Well, what is the real impact of getting a \$6,150 tax write-off? For most people, it is worth about \$2,029 a year (assuming a hypothetical 33% tax-bracket--1/3 of \$6,150 is \$2,029). This is \$2,029 you otherwise would have sent to the Government in taxes! Now, it's yours to keep--but--it is important to recognize that without the HSA, you would have sent this \$2,029 off to Uncle Sam, never to see it, or any interest off of it in the future. So now, when you have a routine medical bill, just remember that the first \$2,029 coming out of your HSA each year is really money that the Government was entitled to--until you took the initiative to establish your HSA.

(If you really want to be the envy of your friends--and enemies--tell 'em that you've got a special health plan set up whereby the Government subsidizes your routine medical and dental bills!)

Who can have an HSA?

The program is open to anyone under the age of 65.

Other Criteria: The covered individual must be covered by an HSA qualified high deductible major medical insurance policy; and not covered under "other health insurance"; and must have net income at least equal to the annual contribution.

Exceptions: "Other health insurance" does not include coverage for: dental care, disability, supplemental health care plans, long-term care, vision care, Medicare supplements, and worker's compensation. (These are insurance plans you are permitted to carry in addition to an HSA qualified plan)

Can my HSA be used to pay premiums?

No, this would be a non-medical withdrawal subject to taxes and penalty.

Exception: No penalty will apply if the money is withdrawn to pay premiums for Qualified long-term care insurance.

Why can't I just do the same thing with my own health insurance plan in combination with an IRA?

Typically, this question is asking why a person can't take out the health insurance policy of their choice and fund an IRA instead of an HSA. The only way we know how to answer this question is straight-up. First, Congress wrote the rules--we didn't. At this time, Congress allows only one type of qualified health insurance plan to work in conjunction with an HSA account. With respect to funding an IRA instead of an HSA, again, our answer is straightforward: If you are not fully funding an IRA, you may not be a good candidate for an HSA. (In general, a good candidate for an HSA is a person who pays taxes, wants to pay less taxes legally and is probably maxing out any and all available retirement programs available to him or her. Of course, ultimately, the ability to withdraw dollars tax-free to pay for medical bills is an option available only with an HSA, not with an IRA.)

What's the biggest benefit of an HSA?

That's easy--it's the opportunity to offset the amount of premiums paid over time with tax-free dollars growing with compounded interest on a tax-free basis--that's the "real genius" of an HSA. As you may know, Einstein referred to the "magic" of compound interest as one of the wonders of the world. Who knows what terminology he would have used to describe compound interest on a tax-free basis?!? Who are we to argue with Einstein?

(It's amazing how many people carry \$20 co-pays on their health plans yet carry \$500 and \$1000 deductibles on their car insurance and \$2,500 to \$5,000 deductibles on their homeowners insurance. These folks wouldn't dream of buying insurance to cover a flat tire or a broken door knob, yet, the risk of having to use the health insurance for a major claim is actually less than having a car accident or having a house burn!)

Why doesn't it make more sense to pay higher health insurance premiums to have smaller deductibles and co-pays for Dr. visits and prescriptions?

Stop and think about what's really being "bought" with high priced health insurance premiums today. Simply stated, there is NO WAY to ever recoup the amount of money you pay in premiums today for health insurance...unless...you have a "huge" catastrophic-type claim!

To illustrate the point, assume an "average" family (both adults in their early 40's) pays a monthly premium of \$550, which is \$6,600 per year. If the family has 3 doctor's visits during the year at \$100 each (\$300 total) plus 4 prescriptions at \$50 each (\$200 total), that's a total in medical expenses for the year of \$500. Assuming the co-pay for each doctor visit (3) and each prescription (4) was \$20, that's a total in co-pays of \$140 (7 x \$20). When you subtract the total bills from the co-pays, you get a total of \$360. What

this means is that this family has paid \$6,600 in premiums to an insurance company in order to pay them to do the paper shuffling and pay a mere \$360 in bills! That's rather ridiculous, don't you agree?

What it all gets back to is the age old principle that, if you can pay for it yourself, you don't need to buy insurance for it, and the fact of the matter is, we can all pay for minor medical expenses out of our own pockets! Most of us, however, are overpaying an insurance company to do the paper shuffling to pay a very small amount of claims each year.

The only real financial exposure any of us has when it comes to our health is the major, "catastrophic" type of medical expense claim. That's where policies like the HSA make the most sense. These types of policies allow you to be fully covered for the big bills, while self-insuring yourself for the small bills (with tax-free dollars) while saving a small fortune in premiums along the way.

What's the alternative?

HSAs ARE the alternative! In case you haven't yet noticed, health insurance premiums are officially OUT OF CONTROL. If you stay in the same health insurance game, you are going to pay a FORTUNE in health insurance premiums--and you'll never get ANY of that money back! (Or, you'll end up dropping the coverage at some point in the future, exposing your family to the risk of no coverage when it is needed most.)

What is the biggest mistake people make when deciding not to establish an HSA?

Probably the biggest mistake people make when deciding NOT to establish an HSA is that they tend to treat it like just another "traditional" health insurance plan. They will sit down and try and "compare" the benefits and the premiums, etc. What they are missing when they do this is, of course, is the real genius of the HSA--the ability to grow tax-free dollars on a compound interest basis over an extended period of time! In other words, when someone treats an HSA like just another traditional health insurance plan, they are failing to look at their health insurance from a long-term perspective--ignoring the fact that they are going to be paying health insurance premiums until age 65!

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