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## Help for High Medical Insurance Deductibles

“HSA” is the newest acronym in health insurance savings. The Health Savings Account, created by the 2003 Medicare Prescription Drug, Improvement and Modernization Act, is a tax-favored savings plan that can be used to pay for qualified medical expenses. Here are some answers to frequently asked questions that will help you determine if you can benefit from an HSA.

### **Who is eligible to open an HSA?**

Effective January 1, 2004, anyone who is covered by a high-deductible health insurance policy and it not eligible for Medicare can open an HSA. To qualify, you cannot be claimed as a dependent by another person. A high-deductible plan is defined as one with an annual deductible of at least \$1,000 for individual coverage and at least \$2,000 for family coverage. In general, the high-deductible policy must be your only health insurance, although there are exceptions if you participate in certain flexible or reimbursement arrangements (see below) or if you have a qualifying separate plan for prescription drug benefits.

### **How do HSAs work?**

The purpose of an HSA is to allow an “above the line” tax deduction up to the annual deductible amount if your medical insurance has a high annual deductible amount if your medical insurance has a high annual deductible. HSAs allow you and your employer to make contributions each year that can be used to pay for qualified health expenses for you, your spouse, and your dependents.

### **What are the tax benefits of an HSA?**

First, the money you contribute to an HSA is tax-deductible up to the amount of the policy deductible, even if you don’t itemize. Next, the interest and investment earnings are not taxable, so the money in your HSA grows tax-free. Finally, you can take tax-free distributions to pay for qualified medical expenses.

### **How much can I contribute to an HSA?**

The annual deposit limit is equal to the amount of the health insurance deductible. (HSA owners born before 1950 can contribute an additional \$500) The tax write-off cannot exceed \$2,600 for individuals and \$5,150 for families. Contributions must be made in cash, not with stocks or other property, and like IRAs, contributions may be made through April 15 for the previous tax year.

**What expenses are qualified?**

HSAs can be used to cover IRS-approved medical expenses not covered by insurance, including doctor visits, prescription drugs, over-the-counter remedies, and long-term care insurance. Funds can also be used to pay for the health insurance deductible, COBRA benefits, health insurance premiums you pay while you are unemployed, and for Medicare premiums in certain situations.

To deter the use of HSAs for nonmedical purposes, funds withdrawn before age 65 for nonmedical purposes are subject to a 10 percent penalty, as well as taxes on the amount withdrawn. Taxpayers who are age 65 or over are exempt from the penalty, but must pay taxes on amounts not used for medical purposes.

**What happens if I don't use the funds in my HSA by year end?**

Unlike flexible spending accounts (FSAs) that require employees to forfeit unused money at year end, unused balances in an HSA can be carried over from year to year, accruing tax-free investment earnings.

**How does an HSA differ from a Medical Savings Account?**

HSAs are more flexible and more individuals qualify for them. Archer Medical Savings Accounts (MSAs) required health insurance policies with much higher deductibles and were restricted to employees of small businesses with fewer than 50 employees and the self-employed. An individual with an existing MSA can either retain it or roll the amount over into a new HSA.

**Are these special rules for preventive-type medical expenses?**

To qualify for an HAS, you must have medical insurance with a high annual deductible. However, even these high-deductible plans may have no deductible for preventive-type expenses, such as periodic exams or immunizations. Earlier this year, the IRS specified that you may still establish an HAS even if the plan has no annual deductible for certain preventive-type expenses.

**If I participate in my employer's flexible health spending account (FSA) and health reimbursement arrangement (HRA) am I still eligible?**

The general rule to qualify for an HAS is that the high-deductible insurance must be your only health coverage. However, under Revenue Ruling 2004-45, you may be eligible if you are covered under certain restrictive FSAs or HRAs, such as limited purpose FSAs and HRAs that restrict reimbursement to certain permitted benefits such as vision, dental, or preventive care benefits. There are other unusual situations which may also allow you to participate in both types of plans.

### **Should I open an HSA?**

If you have a medical insurance plan with a high annual deductible, you should consider the pros and cons of an HSA. Whether an HSA will work for you depends on a number of factors, including the amount of your other medical expenses and your adjusted gross income, among others. In addition, if you have any other type of health care insurance or reimbursement arrangement, it may be especially difficult to navigate the rules. Please call us to discuss whether an HSA can help you ease the pain of high medical insurance deductibles.

