What is a Health Savings Account (HSA)?

A health savings account is a special tax-advantaged account owned by an individual where contributions to the account are to pay for current and future medical expenses.

- A HSA allows individuals to pay for current qualified health expenses and save for future qualified health expenses on a tax-free basis.
- An HSA must be used with a High Deductible Health Plan (HDHP).
- You, your employer, or a family member may contribute money to a HSA for you to have money available to pay your health care costs.
- HSA dollars accumulate interest over time.
- Unused funds will be carried over to the next year.

In order to contribute to a HSA, the participant

- MUST be covered by a high deductible health plan (HDHP).
- CANNOT be covered by any other medical plan that is not a high deductible plan including Medicare.
- CANNOT be claimed as a dependent on another person’s tax return.

What is a High Deductible Health Plan?

The High Deductible Plan that is coupled with a Health Savings Account is insurance that does not cover first dollar medical expenses such as diagnostic office visits, lab work, and prescriptions until you have met your deductible (NO COPAYS). Preventative care is covered at 100%, with no cost sharing involved.

- The HDHP must have a minimum annual deductible of $1,300 and a maximum out-of-pocket of $6,550 for an individual plan, and a
  - $2,600 deductible and $13,100 maximum out-of-pocket for a family plan.

An individual must satisfy the annual deductible on the HDHP but can use HSA funds to pay this deductible, coinsurance and any other qualified expenses not covered by the health plan.

NEXT:
Eligibility guidelines of a Health Savings Account.
Health Savings Accounts

Four Basic Eligibility Rules

An individual must satisfy all four of the basic eligibility rules. In order to be eligible for a Health Savings Account, the individual must be:

1. Covered by a qualified High Deductible Health Plan (HDHP):
   - Must have a minimum annual deductible at or above the statutory minimum ($1,300 for an individual plan) and an out-of-pocket limit at or below the statutory maximum ($6,550 for an individual plan)
   - The plan may not reimburse expenses before the deductible is satisfied. The only exception is for preventive care.

2. Not covered by any non-HDHP plan
   - Coverage under a spouse’s health plan – unless that plan is also a qualified HDHP
   - Coverage under a Flexible Spending Account (plan with no grace period) unless the Flexible Spending Account does not reimburse any expenses until the HDHP statutory deductible has been satisfied; or is limited to reimbursing permitted coverage such as dental, vision and preventive care expenses.
   - Coverage under a Flexible Spending Account (with grace period) – individuals enrolled in these FSAs will not be eligible to contribute to a HSA during the grace period unless the individual had a $0 balance on a cash basis on the last day of the plan year; the individual had a $0 balance on a cash basis after a qualified transfer of funds from a FSA or HRA; or the health care FSA automatically converts to a limited purpose or post-deductible FSA (HSA compatible FSA) during the grace period for all participants.
   - Coverage under a HRA – there are some exceptions.


4. Not eligible to be claimed as a dependent on another individual’s tax return – this is true even if the other person does not claim the individual as a dependent (note: a spouse is not a dependent under the Internal Revenue Code).

The eligibility rule works on a monthly basis. If an individual satisfies all 4 rules on the first day of the month, he is eligible for the entire month. If he first satisfies the 4 rules on the 2nd day of the month, he becomes eligible on the 1st day of the following month.
Four Basic Characteristics

1. A trust or custodial account that is established by a bank, insurance company or other entity approved by the IRS as a HSA trustee.
   Note: An employer may select a HSA trustee as long as there are not restrictions on the employee’s taking the money out of the account.

2. The individual who establishes the HSA account is the owner of the account and is fully vested in his/her HSA account at all times. Individuals may use their account for family members (e.g. pay expenses for the spouse and tax dependents), but there are no joint accounts.

3. Sources of funding can be the account holder (e.g. employee), employer, or both. There is no rule preventing another individual from contributing money to the HSA account; however, the annual contribution limits are based on aggregate contributions to the HSA (or all HSAs if the individual has more than one). In addition, only the account holder may make contributions on a pre-tax basis.
   Note: Contributions to a HSA account (except roll-overs from another HSA) must be made in cash.

4. Investment rules apply. There are some restrictions on how the account is invested (e.g., no portion of the account may be invested in life insurance products); earnings on contributions accumulate tax-free within the account; and contributions and earnings carry forward from year to year (there is no use-it-or-lose-it rule).

Contribution Limits:

<table>
<thead>
<tr>
<th>Calendar Year 2017</th>
<th>Maximum Annual Contributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single</td>
<td>$3,400</td>
</tr>
<tr>
<td>Family</td>
<td>$6,750</td>
</tr>
<tr>
<td>Catch-up (55 &amp; older)*</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

* amount set by law, not indexed.

General Rules for Contributions—the aggregate amount that can be contributed to a HSA (or HSAs) in any given year is based on the individual’s age, coverage status under the HDHP, and the annual statutory limit (indexed each year). Two additional rules apply:

1. The catch-up amount applies separately to each HSA account holder who is age 55 or older. If both the employee and spouse are eligible to make catch-up contributions, each must make the catch-up contribution to his/her own account. There are no joint HSA accounts.

2. There is a special rule for individuals who become HDHP eligible during the year. (example: If the maximum annual contribution is $3,400, they can contribute the full amount but if they leave the plan before December of the following year they would owe taxes for the months that they were not on the qualified HDHP).
**HSA Distributions:**
A Health Savings Account holder always has 100% ownership of the funds in his/her account. Neither the trustee (banking institution), nor an employer who has contributed to the HSA, may restrict how the account holder uses the funds. Trustees are permitted to limit the number of withdrawals per month or require a minimum dollar amount for disbursements. For example, a trustee may require a minimum withdrawal of $50 or allow only six withdrawals per month.

The use of funds determines the tax status of the withdrawals. Funds withdrawn from a HSA account to pay for “qualified expenses” are tax free distributions. Funds used to pay for “nonqualified” expenses are taxable and an additional 20% tax penalty will apply.

**Qualified Expenses:**
Amounts used to pay for health expenses for the account holder, spouse (federal definition) and/or tax dependents of the account holder.
Health care expenses can include:
- Medical
- Drugs (note that over-the-counter drugs must have a doctor’s prescription in order to be eligible)
- Dental
- Vision
- Hearing
- Qualified long term care expenses
- Other health care expenses that are tax deductible and not reimbursed under another plan (e.g., a medical plan)
- Premiums for the following:
  - COBRA premiums
  - Qualified Long Term Care premiums (up to specific dollar limits)
  - Premiums paid for health coverage during a period of unemployment (individual must be receiving unemployment benefits)

**Non-qualified Withdrawals:**
- Health care expenses that are not deductible (e.g., cosmetic treatments)
- Payment of MediGap premiums
- Payment of health care contributions under an employer’s retiree health care plan for individuals under age 65
- Payment of health care expenses for a non-tax dependent

Nonqualified withdrawals are taxable income to the account holder. In addition a 20% tax penalty applies to nonqualified withdrawals.
What happens when your employment ends?

Termination of Employment:

If your employment terminates, you are no longer eligible to contribute to your Health Savings Account unless you enroll in another qualified HDHP (COBRA coverage). You can continue to take distributions from your account to pay for eligible expenses regardless of whether or not you remain covered on a High Deductible Health Plan.

Retirement from your Company:

If you retire, you are no longer eligible to contribute to your HSA unless you remain active on a qualified HDHP. You can still take distributions to cover your out-of-pocket medical expenses.

Once you enroll in Medicare Part A or B you are no longer eligible to contribute to your HSA. You may use the money in your account for any qualified expenses you incur while on Medicare.

Funds in a HSA may be used for the following items:

- COBRA Premiums while unemployed
- Long Term Care Policy Premiums (up to certain dollar limits)
- Premiums for health coverage during unemployment (must be receiving unemployment benefits).

NEXT:

Health Savings Accounts and Flexible Spending Accounts
Interaction of Health Savings Accounts & Flexible Spending Accounts

Individuals who are covered under a non-HDHP health care plan are not eligible to contribute to a Health Savings Account. If an employer offers a HDHP/HSA plan, an employee who has a general purpose healthcare Flexible Spending Account would be able to change to the HDHP, but cannot establish or contribute to a HSA while enrolled on the FSA.

If an employee’s spouse participates in a Flexible Spending Account with another employer, the employee is not eligible to establish or contribute to a HSA but could still enroll in an HDHP health care plan.

Some FSA plans can be used along with a Health Savings Account

Currently most FSA plans are general purpose FSAs which reimburse a wide variety of health care expenses (e.g., medical, drug, dental, vision expenses). These FSAs are non-HDHP health care plans. Individuals covered under one of these general purpose FSAs are not HSA eligible (this applies if your spouse participates in one at their employer). There are several ways that an FSA can be structured to make it HSA compatible:

- **Limited purpose FSA**—the FSA only reimburses permitted benefits such as dental and vision expenses.
- **High deductible FSA**—the FSA only reimburses health care expenses after a high deductible (the minimum amount required by law) has been satisfied. **Note: only expenses covered under the HDHP may be counted toward the satisfaction of the deductible before the FSA begins to reimburse expenses.**
- **Employee-Only FSA**—if an FSA covers only the employee (not the spouse or dependents), only the employee would be ineligible for the HSA.

Some key differences between an FSAs and HSAs:

- FSAs have the “use it or lose it” provision- HSAs allow funds to accumulate year to year.
- In a Flexible Spending Account, claims must be paid without regard to amount contributed. In a Health Savings Account, funds must be present before a withdrawal is made.
- Non-medical expense withdrawals cannot be made in a FSA. In a HSA, non-medical expense withdrawals can be made, but the amount is taxable and subject to 20% penalty (no penalty if age 65 or older or disabled as defined by Code Section 72).

NEXT:
More about Health Savings Accounts
Health Savings Accounts

What are the advantages to a participant enrolled in a Health Savings Account?

HSAs offer the benefit of tax-advantaged savings and reduced taxable income, which can appeal to a number of different income-level workers. Individuals can set aside income that is tax-free and are able to build an asset that they can use in their retirement years; and/or can reduce the cost of coverage. HSAs give individuals the opportunity to plan for future health expenses. They provide options to support retiree benefit strategies and/or the needs of employers interested in portability of coverage. The tax advantages of the accounts are valuable to both employer and employee.

Will my employer or insurance carrier need to verify that distributions from the Health Savings Account are qualified services?

No. The participant needs to make that determination and should maintain records of their medical expenses to verify the expenses are qualified services and therefore excludable from their gross income. The IRS may request receipts during a tax audit.

How do participants access funds from a Health Savings Account?

Depending on the financial institution used, a participant may use checks, a Health Savings Account debit card, automated debits (ACH transfers) or a check request to withdraw funds from the HSA.

Can the participant use the HSA for services that were obtained prior to enrollment in the HSA?

No. The expenses must be incurred after the participant is enrolled in the HSA to be eligible for tax-free reimbursement (assuming that they are qualified medical expenses).
In the simplest terms, health care consumerism is about giving employees the information and incentives they need to get actively involved in making decisions about their health care. Many companies are offering a consumer-driven high deductible health plan (HDHP) that works in conjunction with a Health Savings Account (HSA).

A HDHP is a relatively new concept in health benefits plan design that gives you freedom of choice and control over your health care dollars in return for your greater involvement and responsibility in managing your health care needs. Generally, these plans give you the freedom to see physicians in and out-of-network as well as access to specialists without a referral. After you satisfy the plan’s annual deductible, you may pay coinsurance or copays for covered services up to your plan’s out-of-pocket maximum. Many of these plans cover everything at 100% after you have met the deductible.

Because a HDHP relies on your involvement as an active partner in all aspects of health care, the plan empowers you with health information and decision-support tools to assist you in making decisions that are right for you. You will have access to reliable information about self-care, preventive care (covered at 100%), health improvement, the risks and benefits of proposed treatment plans, patient advocates, and more.

A consumer-driven high deductible health plan also provides you with a tangible tax savings and the opportunity to invest your HSA contributions so you can grow your account balance. The contributions you make to your HSA are deducted before your federal and FICA taxes are taken out, so your current tax bill is automatically lower. In addition, the HSA offers many of the benefits of an IRA or 401(k) and offers a variety of investment options for your account balance. Any contributions you make that you don’t use for health care expenses are yours to keep—unused contributions rollover to the following year. Your account could easily grow into tens of thousands of dollars, which you can use for anything you want (without penalty) once you reach age 65. Keep in mind, however, that you will pay income tax on any withdrawals not used for health care expenses.