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Health Savings Accounts

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HSA Overview

- A Health Savings Account (HSA) is a special account used to pay for current and future medical expenses. In concept, it is similar to an individual retirement account (IRA).
- A HSA is used in conjunction with a “High Deductible Health Plan” (HDHP).
- For FY12, the State will again offer two plans that are HSA-qualified HDHPs



What is a “High Deductible Health Plan” (HDHP)?

- Health insurance plan with minimum deductible of (for 2011):
 - \$1,200 (self-only coverage)
 - \$2,400 (family coverage)
- Annual out-of-pocket, including deductibles and co-pays cannot exceed (for 2011):
 - \$5,950 (self-only coverage)
 - \$11,900 (family coverage)
- These amounts are indexed annually for inflation



What is a “High Deductible Health Plan” (HDHP)?

- All covered benefits must apply to the plan deductible, including prescriptions
- There is an exception for preventive care
 - Preventive care generally does not include any service or benefit intended to treat an existing illness, injury or condition.



Preventive Care Safe Harbor

Preventive care that HDHP can provide as first-dollar coverage before minimum deductible is satisfied:

- Periodic health evaluations (e.g., annual physicals)
- Screening services (e.g., mammograms)
- Routine pre-natal and well-child care
- Child and adult immunizations
- Tobacco cessations programs
- Obesity weight loss programs



Who may establish an HSA?

Any individual that:

- Is covered by an HDHP
- Is not covered by any other health insurance
- Is not enrolled in Medicare
- Cannot be claimed as a dependent on someone else's tax return



What do you mean, “any other health insurance”?

You may not establish or contribute to an HSA if you are enrolled in or participate in any of the following:

- Any health insurance plan that is NOT an HDHP
- Tricare
- Flexible Spending Account (HCFSA)
- Health Reimbursement Arrangements



Exceptions to the Rule

- Employee Assistance Program (i.e., CSEAP), disease management program, wellness program
- Specific disease or illness insurance and accident, disability, dental care, vision care, and long-term care insurance.
- These programs must not provide significant benefits in the nature of medical care or treatment



Near-Perfect Tax Shelter

- Contributions to an HSA reduce taxable income (“above the line” tax deduction)
- Any interest earned on an HSA is tax-exempt
- Distributions for qualified medical expenses of account holder and dependents are tax-exempt.
- *No other retirement savings account, including 401(k) plans or IRAs, provides all three of these tax advantages.*



HSA Contribution Rules

- For 2011, the maximum amount that can be contributed to an HSA from all sources is:
 - \$3,050 (self-only coverage)
 - \$6,150 (family coverage)
 - These amounts are indexed annually
- For individuals age 55 and older, an additional \$1000 “catch-up” contribution is allowed each year
- Contributions must stop once an individual is enrolled in any type of Medicare or other plan that is not a HDHP.



HSA Distributions

- Distribution is tax-free if taken for “qualified medical expenses”.
- Qualified medical expense must be incurred on or after the HSA was established.
- Tax-free distributions can be taken for qualified medical expenses of:
 - Individual covered by the high deductible health plan
 - Spouse of the individual (even if not covered by the HDHP)
 - Any qualified dependent of the individual (even if not covered by the HDHP)



Important Considerations

- Your eligibility to contribute to an HSA for each month is generally determined by whether you have HDHP coverage on the first day of the month.
- Your maximum contribution for the calendar year (tax year) is the greater of:
 - The full contribution
 - The pro-rated amount



Full contribution or Pro-rata

- The full contribution is the maximum annual contribution for the type of coverage you have on December 1 of the tax year (\$3050 individual or \$6150 family in 2011)
- The pro-rated amount is 1/12th the maximum annual contribution for the type of HDHP you have times the number of months you have that type of coverage.
- If your contribution is greater than the pro-rated amount, and you fail to remain covered by an HDHP for the entire following year, the extra contribution above the pro-rated amount is included in income and subject to an additional 20% tax.



In other words ...

- A full year's contribution (plus the catch-up, if applicable) may be made to an HSA for someone who first becomes eligible during that year, even if they start in December.
- If someone contributes a full year's contribution but is eligible only part of the year, they will be subject to taxes and penalties if they don't remain eligible for 12 months after the year in which they first become eligible.
- Excess may be withdrawn before April 15



Illustration

- Joe enrolled in one of the State's HSA-qualified HDHPs effective July 1, 2010. Although he was only covered under a HDHP for 6 months in 2010, he contributed \$3050, the maximum annual contribution to his HSA for 2010.
- During open enrollment in 2011, Joe plans to elect a plan that is not a HDHP. Since his contribution for 2010 was greater than the prorated annual contribution, the extra contribution above the prorated amount (\$1525 in this case) is included in income and subject to an additional 20% penalty tax.
- Unless Joe was sure he would re-enroll in the HDHP in 2011, he would have been wise to limit his contribution for 2010 to the prorated amount, 6/12ths of the maximum, or to withdraw the excess contribution before filing his 2010 tax return.



Other Withdrawals

If the HSA maximum contribution limit is not reached for the year, any withdrawal for the year that is not for qualified medical expenses will be subject to both income tax and a 20% penalty

Penalty does not apply if distribution taken after:

- Individual dies or becomes disabled
- Individual is age 65



Tax-free Distributions

Tax-free distributions can be taken for qualified medical expenses of:

- Individual covered by the high deductible health plan
- spouse of the individual (even if not covered by the HDHP)
- any dependent of the individual (even if not covered by the HDHP)
- Health insurance premiums, including dental or vision care premiums are not “qualified medical expenses”

Health insurance premiums, including dental or vision care premiums are not “qualified medical expenses”



Exceptions

An individual may take tax-free distributions for:

- COBRA continuation coverage
- Any health plan coverage while receiving unemployment compensation
- For individuals enrolled in Medicare:
 - Medicare premiums and out-of-pocket expenses
 - Employee share of premiums for employer-based coverage
- Qualified long-term care insurance premiums



Record-keeping Requirements

- Individual must keep records sufficient to prove that:
 - the expenses were incurred,
 - they were not paid for or reimbursed by another source or taken as an itemized deduction

- HSA Distributions can be used to reimburse prior years' expenses as long as they were incurred on or after the date the HSA was established.

- No time limit on when distribution must occur



HSA Trustees and Custodians

HSA Trustees and Custodians may be:

- Banks, credit unions
- Insurance companies
- Entities approved by the IRS to be a trustee or custodian

Trustee or custodian fees

- Can be paid from the assets in the HSA account without being subject to tax or penalty
- Can be directly paid by the account holder without being counted toward the HSA contribution limits
- Trustee may put reasonable limits on size and frequency of distributions



HSA Trustees and Custodians

- State employees are free to open an HSA account in a financial institution of their own choosing.
- After an employee has opened a personal HSA, they may arrange for a portion of their paycheck to be directly deposited to their HSA.
- Alternatively, an employee may set up direct deposit from a personal checking or savings account, or simply make periodic deposits at will.



HSA Trustees and Custodians

- HSA trustee reports all distributions annually to the individual (Form 1099 SA)
- Trustee does not determine whether distributions are used for medical purposes; the individual does that.
- Individual reports on annual tax return amount of distribution used for qualified medical expenses
- Account holders must file Form 8889 as part of their annual tax return.



Review

HSA accounts are owned by the individual who decides:

- Whether he or she should contribute
- How much to use for medical expenses
- Which medical expenses to pay from the account
- Whether to pay for medical expenses from the account or save the account for future use
- Which company will hold the account
- How the funds will be invested to grow the account



Advantages of HSA

No “use it or lose it rules” like Flexible Spending Arrangements (FSAs).

- All amounts in the HSA are fully vested
- Unspent balances in accounts remain in the account until spent

Accounts can grow through investment earnings, just like an IRA.

- Same investment options and investment limitations as IRAs
- Same restrictions on self-dealing as with IRAs



Additional Information

Website - www.treas.gov (Click on "Health Savings Accounts")

- Frequently asked questions
- IRS forms and publications
- HSA statute
- Examples of tax savings from HSA contributions
- Links to other useful sites



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Anecdotal Example Pre-tax premium and Tax-exempt OOP (HCFSA or HSA)

	Premium	OOP	Net Cost
Opt 1	\$4,022.64	\$ 360.00	\$4,382.64
Opt 2	\$2,384.16	\$1,760.00	\$4,144.16

Tax-qualified options fully-leveraged.

Tax savings for Opt 1	\$1,460.88
Tax savings for Opt 2	\$1,381.39



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Distribution of Claims*

\$122,532,498 Total Claims / 30,572 Claimants = Average \$4008

44% of claimants (13,559) had less than \$500 in claims

69.4% of claimants (21,202) had less than \$1,500 in claims

79.5% of claimants (24,318) had less than \$3,000 in claims

91.9% of claimants (28,085) had less than \$10,000 in claims

**1.2% of claimants (379) with claims in excess of \$50,000 incurred
35.3% of total claims. Average claim for this group was
\$114,262.**

*** 12 month period ending Sept 09**



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Strategy for optimizing your tax-qualified benefits

- Enroll in HDHP of your choice during open enrollment for July 1, 2011.
- As early as possible in July, set up HSA at financial institution of your choice, preferably one that offers
 - multiple investment options, including no load mutual funds
 - electronic banking capabilities that allows you to manage your account online.
 - low monthly service fees, waived for maintaining a reasonable minimum balance (e.g., \$1000)
- Make a lump sum deposit (transfer from low interest savings account) to avoid monthly fees.



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- When you set up your HSA, you will be provided a debit card and/or checks.
- Pay for out-of-pocket medical expenses from your HSA (first making sure you have sufficient funds in the account)
- Or pay with credit card and withdraw funds from your HSA account to pay credit card charges in full to avoid monthly interest charges.
- Make additional deposits during the year, especially if you've drawn on the account or you anticipate additional expenses.



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- Keep careful records of transactions, including receipts for any medical expenses that may be deductible.
- Before April 15, 2012 prepare 2011 tax return. If you use a professional tax-preparation service, ask your preparer to evaluate your receipts to identify deductible expenses, even though you will NOT be deducting them on Schedule C.
- Before April 15, deposit up to maximum contribution to reduce your taxable income for 2011, including the \$1000 catch-up provision if you are 55 or older.



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- If you are not sure if you'll enroll in the HDHP again, be sure to pro-rate your maximum contribution (6/12th of the maximum).
- You may withdraw excess contributions from your account without penalty before April 15
- If in subsequent years you enroll in a plan that is not a HDHP, you do not need to close your account, but you cannot make contributions for any month in which you are not enrolled in a HDHP.
- Your HSA is portable, so even if you retire early, you may continue to contribute as long as you are enrolled in a HDHP and not eligible for Medicare.



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Distributions

- After age 65, you may withdraw funds from your HSA for any purpose without penalty, but distributions that are not used for medical expenses are included in income.
- The higher your tax bracket, the greater the potential savings.



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Thank You!



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