

Insurance / Risk Advisory / Employee Benefits

**HORTON**

# ABC Company

## Health Savings Account Overview





# What You Need to Know about an HSA

# What is a Health Savings Account (HSA)?



A Health Savings Account (HSA) is a tax beneficial savings account that can be used in conjunction with a “Qualified High-Deductible Health Plan (QHDHP).” The funds put into an HSA may be used on future, eligible health care expenses without any taxation.

*Triple-tax advantaged* is often used to describe an HSA because:

- The owner of the HSA can contribute to the account on a pre-tax basis (lowering their taxable income)
- Any interest or investment income accrues tax-free
- Any funds withdrawn from the account are not taxed as long as they are used for qualified medical expenses.

Another important feature of an HSA is the funds are owned by the account holder and ‘rollover’ year to year. An HSA is limitless in regards to how much can be kept in it (but there are annual contribution limits which will be discussed later). You will also keep the funds in the account if you leave the company offering the QHDHP or cease enrollment in the QHDHP at some future date. Even though you own the account and the funds, anyone can contribute to the HSA, including your employer.

## Who is Eligible for an HSA?

Anyone covered by a QHDHP that is *not* covered by other\* health insurance coverage and cannot be claimed as another person’s dependent (for tax purposes) can have an HSA. Other health covered could any of the following:

- Traditional PPO coverage, such as a copay of HMO (a plan that is not QHDHP)
- A Flexible Spending Account (FSA) with Medical Reimbursement (Limited FSA plan may be allowed)
- A spouse’s insurance plan
- Medicare

*\*Other health insurance does not include the following items: specific diseases or illness insurance, accident, disability, dental care, vision, and long-term care insurance.*



## How exactly does an HSA's Tax Advantage Work?

What does it mean to be “tax advantaged?” Sometimes we have difficulty conceiving how a tax advantage will lead to cash in our pockets. Let’s try to illustrate why this tax-advantaged status is important.

Below we’ll consider an example of Bob and Jane who put money into their HSA and compare it to a similar circumstance without an HSA. You’ll be able to see the real value of the HSA’s tax-advantaged status when you see that both spent \$5,000 in healthcare costs. The only difference is that Bob and Jane paid their medical expenses out of their tax-advantaged HSA and saved money!

	Without HSA	With HSA
Gross Income	\$30,000	\$30,000
HSA Contributions	\$0	\$5000
Net Income	\$30,000	\$25,000
<b>Estimated Taxes</b>		
Federal	-\$2,550*	-\$1,776*
State	-\$900**	-\$750**
FICA	-\$2,295	-\$1,913
<b>After-tax earnings</b>		
Eligible out-of-pocket medical care expenses	-\$5,000	\$0
Remaining spendable income	\$19,925	\$20,561
Spendable income increase	-	\$1,306

Bob and Jane’s combined gross income is \$30,000. They have two children and file their income taxes jointly. Bob and Jane are both enrolled in Bob’s employer’s HDHP and open an HSA. They contribute \$5,000 to the account the first year.

*\*Assumes standard deductions and four exemptions*

*\*\*Varies, assumes a 3 percent*

*This example is for illustrative purposes only. All scenarios are different. Please make sure to contact your legal, tax or medical professional(s) for information specific to your needs.*

# How does an HSA work with the QHDHP?

An HSA requires enrollment in a High-Deductible Health Plan (QHDHP). Often we fear to lose our coverage with copays or taking on a higher deductible because we don't want to risk paying more for healthcare. So, is enrollment in a QHDHP worth the additional exposure to obtain an HSA?

An HSA plan is not necessarily for everyone! An HSA is a good option for someone who is healthy and has a reasonable idea of their annual health care expenses. If you can save premiums by enrolling in the QHDHP and save on taxes with the HSA, you can budget and keep a good deal of money. Even someone with chronic conditions may be able to take advantage of the premium savings a QHDHP and HSA have to offer if they can budget for the exposure to their deductible that often falls early in the benefit year. It's also important to remember that preventative care is mandated to be covered by the insurance plan at no cost to the insured member, so your HSA dollars won't need to pay for those services. Let's consider a 'case study.'

## HSA CASE STUDY

Justin is a healthy 28-year old single man who is active. He and his employer contribute a total of \$1,000 each year to his HSA. His plan's annual deductible is \$1,500 for individual coverage, and his out-of-pocket is \$3,000. If Justin uses his HSA to pay for covered services, this will reduce his out-of-pocket amount needed to meet his deductible before traditional health coverage begins.

**Year 1** - Justin stays healthy except he goes to the doctor once and obtains an antibiotic for a sinus infection.

HSA - \$1,000 contribution	\$1,000
<b>Total Expenses:</b>	
Office Visit: \$100	-\$100
Prescription Drugs: \$50	-\$50
<b>HSA Rollover to Year 2</b>	<b>\$850</b>
Since Justin did not spend all of his HSA, he did not need to pay any additional amounts out-of-pocket this year.	

**Year 2** - Justin sees his doctor due to another sinus infection and is given a strong antibiotic. He also sees his doctor for a routine annual exam.

HSA Balance - \$850 from Year 1, plus \$1,000 contribution from Year 2	\$1,800
<b>Total Expenses:</b>	
Office Visit: \$100	-\$100
Preventative Care Services: \$150 (paid for by insurance benefits)	\$0
Prescription Drugs: \$200	-\$200
<b>HSA Rollover to Year 3</b>	<b>\$1,550</b>
Since Justin did not spend all of his HSA, he did not need to pay any additional amounts out-of-pocket this year.	

**Year 3** - Justin turns his knee at an intermural soccer game and needs ACL surgery.

HSA Balance - \$1,550 from year 2, plus \$1,000 contribution for Year 3	\$2,550
<b>Total Expenses:</b>	
Surgery: \$3,000	-\$3,000
<b>HSA Rollover to Year 4</b>	<b>\$0</b>
Justin pays \$2,550 of the \$3,000 out-of-pocket for the insurance plan with the balance from his HSA. Justin owes out-of-pocket = \$450	

# What are HSA Contribution Rules & Limits?

Contributions that you make to your HSA can be tax deducted when you file your personal income taxes or if your employer offers a direct deduction into your account and offers a cafeteria pre-tax plan you can make the contributions into your HSA through your paycheck without any federal or income tax withholdings applied to the contribution amount.

Your eligibility to contribute to an HSA is determined on a monthly basis (you must be enrolled in a QHDHP on the 1st of each month) in which you may contribute one-twelfth of the annual allowed amount. An exception does exist for individuals that are eligible to contribute to an HSA on December 1st of the calendar year that became covered under a QHDHP in a month other than January. In this case, a full year's contribution may be made to the HSA. However, they must remain HSA eligible over the next 13 months to take advantage of this exception. This is called the "Full-Contribution Rule."

The IRS determines limits that may be contributed to an HSA each year.

Annual Contribution Limit		2019	2020
HSA Contribution Limit	Self-only	\$3,500	\$3,550
	Family	\$7,000	\$7,100

Individuals that are age 55 or older can also make annual "Catch-up Contributions." This allows older HSA plan participants to increase their annual HSA contributions to prepare for retirement and higher healthcare costs. These amounts are over and above the standard yearly contribution limits.

Annual "Catch-Up Contributions" Limit		2019	2020
HSA Catch-Up Contribution	Age 55 or Older	\$1,000	\$1,000

**It is imperative to understand that contribution limits consider amounts contributed to an HSA account by *either* the account owner, an employer, or any other individual.** For example, if an employer contributes \$1,000 to an employee's HSA in 2019 and the employee has single coverage, he'd only be able to contribute \$2,500 of his own money.

Contributions to the account must stop upon Medicare enrollment. However, you would still be able to use the fund in the account for eligible medical expenses on a tax-free basis.

Do recall that contributions into an HSA, regardless of who makes them, are in turn explicitly owned by the account holder and will remain in the account year over year until a distribution is made.

# What are the HSA Distribution Rules & Limits?

The funds in an HSA belong solely to the account holder and may be used as the owner of the HSA sees appropriate. However, misusing HSA funds on expenses that are not eligible medical expenses can result in a 20% tax penalty in addition to regular income taxes.

Even if an account holder ceases to be eligible to receive contributions into their HSA, after they have lost enrollment in a QHDHP for example, they may still make distributions out of an existing HSA to pay for eligible medical expenses. However, eligible medical expenses must have been incurred following the date the HSA was established. For example, funds in an HSA that were first established on the 10th of October could not be withdrawn on a tax-preferred basis to pay for an eligible medical expense that was incurred on the 20th of September of that same year.

HSA distributions are tax-free when used on eligible, or qualified, medical expenses. These expenses may be for the HSA owner, but may also be for HSA owner's spouse or dependent children (generally defined as age 19 or younger or up to age 24 if the dependent is enrolled as a full-time student).

***Misusing HSA funds on expenses that are not eligible medical expenses can result in a 20% tax penalty in addition to regular income fees.***



## What is an Eligible, or Qualified Medical Expense?

Eligible medical expenses are defined by the Internal Revenue Service Tax Code under Section 213(d). The expenses must be primarily to alleviate or prevent a physical or mental defect or illness. Eligible medical expenses can include dental or vision expenses as well as medical costs. Generally speaking, it also includes expenses that apply towards your medical insurance plan's deductible and out-of-pocket limits.

The listing on the following page are examples of eligible and ineligible medical expenses set forth by the IRS. Over time, the IRS is at liberty to change the list of eligible expenses. Please keep this in mind. Also, make sure to consult your tax advisor should you require specific tax advice.

## **Eligible Medical Expenses May Include:**

Acupuncture  
Alcoholism  
Ambulance  
Annual Physical Examination  
Artificial Limb  
Artificial Teeth  
Autoette  
Bandages  
Birth Control Pills  
Body Scan  
Braille Books and Magazines  
Breast Pumps and Supplies  
Breast Reconstruction Surgery  
Capital Expenses  
Car  
Chiropractor  
Christian Science Practitioner  
Contact Lenses  
Crutches  
Dental Treatment  
Diagnostic Devices  
Disabled Dependent Care Expenses  
Drug Addiction  
Drugs  
Eye Exam  
Eye Glasses  
Eye Surgery  
Fertility Enhancement  
Founder's Fee  
Guide Dog or other Service Animal  
Health Institute

Health Maintenance Organization (HMO)  
Hearing Aids  
Home Care  
Home Improvements  
Hospital Services  
Insurance Premiums  
Intellectually and Developmentally Disabled, Special Home  
Laboratory Fees  
Lactation Expenses  
Lead-Based Paint Removal  
Learning Disability  
Legal Fees  
Lifetime Care - Advance Payments  
Lodging  
Long-Term Care  
Meals  
Medical Conferences  
Medicinal Information Plan  
Medicines  
Nursing Home  
Nursing Services  
Operations  
Optometrist  
Organ Donors  
Osteopath  
Oxygen  
Physical Examination  
Pregnancy Test Kit  
Prosthesis  
Psychoanalysis

Psychologist  
Special Education  
Sterilization  
Stop-Smoking Programs  
Surgery  
Telephone  
Television  
Therapy  
Transplants  
Transportation  
Trips  
Tuition  
Vasectomy  
Vision Correction Surgery  
Weight-Loss Program  
Wheelchair  
Wig  
X-Ray

## **Ineligible Medical Expenses May Include:**

Any babysitting, child care or nursing for normal, healthy babies  
Controlled substances  
Cosmetic surgery  
Dancing Lessons  
Diaper Service  
Electrolysis or Hair Removal  
Flexible Spending Account  
Funeral Expenses  
Future Medical Care  
Hair Transplant

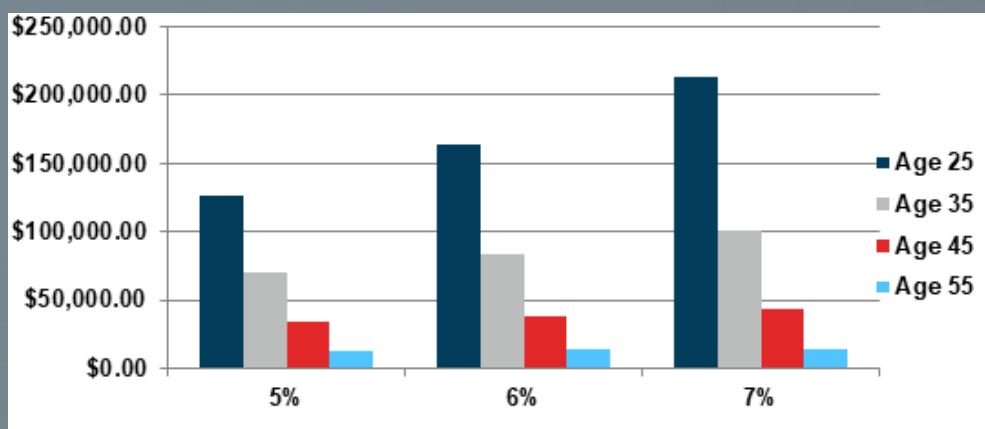
Health Club Dues  
Health Coverage Tax Credit  
Health Savings Accounts  
Household Help  
Illegal Operations and Treatments  
Insurance Premiums  
Maternity Clothes  
Medical Savings Account (MSA)  
Medicine and Drugs from other Countries  
Nonprescription Drugs and Medicines

Nutritional Supplements  
Personal Use Items  
Swimming Lessons  
Teeth Whitening  
Veterinary Fees  
Weight Loss Program

# Can My HSA help save for Retirement & Medical Expenses after Age 65?

One of the most attractive features of an HSA is that if the funds are not used, the money will roll over from year to year and continue to grow through the accrual of tax-free interest or investment earnings. While virtually all HSAs accrue some level of interest, many other banks offer more robust investment options. The same types of investments that are permitted for retirement accounts are approved for HSAs as well, such as mutual funds, stocks, bonds, annuities or certificates of deposit. With tax-free earnings, an HSA can supplement an individual's 401k, individual retirement account (IRA), or another retirement offering.

Due to the opportunity to invest HSA funds in the market with tax-free earnings, the potential for account growth is great! If desired, owners of an IRAs or Roth IRAs may make a one-time rollover into an HSA if the account owner is HSA eligible, up to the maximum annual HSA contribution limit.



Starting contributions to an HSA at a younger age allows for the tax-free earnings to accumulate on a compound basis and can assist significantly once the account owner is in their retirement years.

After age 65, despite the fact that most Americans lose eligibility because they enroll in Medicare, the HSA can offer a significant advantage to handling medical expenses in our elderly years. At age 65, you may use maintain the account's tax-free advantages and use HSA dollars to pay for:

- Medicare Part A, Part B, and Part D premiums
- Medicare Advantage (Part C) premiums
- A Qualified Long-Term Care plan

*(Note: You cannot use HSA funds to pay for "Medigap," or Medicare Supplement policies)*

After age 65, even if an HSA owner chooses not to use their HSA funds towards healthcare expenses or Medicare premiums, the funds are available to them in their entirety without paying a 20% tax-penalty! However, if goods are purchased that are not eligible medical expenses, normal income taxes on those HSA funds would apply (similar to a distribution from a retirement account).

## What Records...

### Do I need to Keep for my HSA?

Because funds in an HSA are owned by the **account holder**, the responsibility for using those funds appropriately is the responsibility of the **account holder**.

Be sure to maintain records and receipts of HSA transactions that show the funds from the HSA account were spent on eligible medical expenses. It is a good idea to maintain explanations of benefits (EOBs) on claims you incurred which were paid using the funds in the account. If the expense is not covered by your insurance provider, it is important to be even more diligent in maintaining receipts. Keeping account statements from your HSA provider is also helpful. Documentation is critical in the event you were audited by the IRS so you may validate the funds in your HSA were not subject to income tax or a penalty.

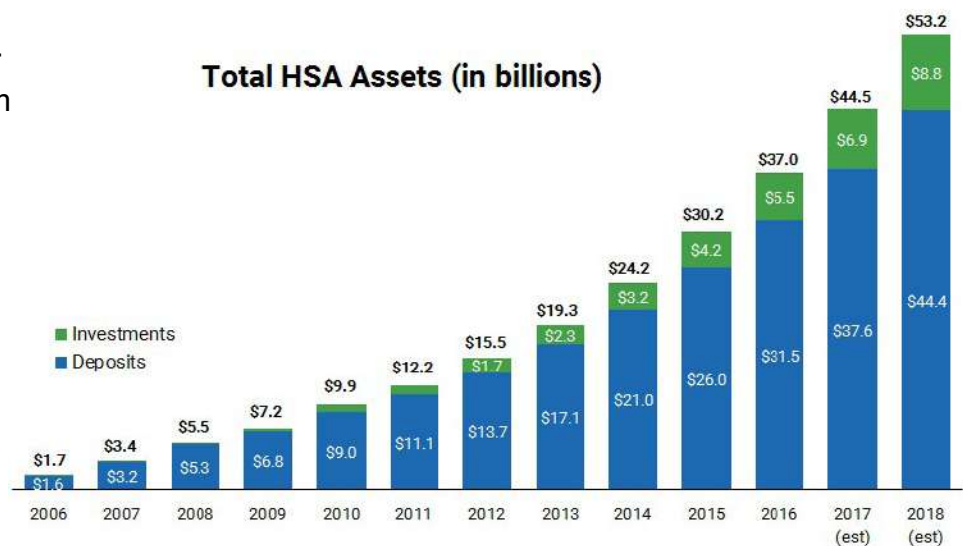
# HSAs are Growing Strategies for Healthcare

More and more employers are offering QHDHPs and HSAs as a solution to their employees' healthcare and insurance needs. As these accounts become more common and desirable, more Americans are going to have assets set aside to assist them in paying for emergency healthcare expenses, in both in their younger years and post-retirement.

According to Devenir, a national leader in customized investment solutions for HSAs, the number of HSA accounts at the end of 2016 exceeded 20 million nationwide. Those accounts held over \$37 billion in assets. <sup>(1)</sup>This has grown substantially from when the accounts were first introduced by Congress in 2004.

Because these plans are designed to empower consumers, many employers are implementing them with decision-support making technology tools, which allow individuals to navigate the healthcare system at a lower cost.

Taking advantage of the lower premiums of high-deductible health plans, a triple tax-advantaged status, account interest and investment opportunities, improved technology, and better retirement strategies make Health Savings Accounts a vital part of healthcare today!



Source: Devenir Research

1. Devenir. <http://www.devenir.com/health-savings-account-assets-up-22-percent-in-2016/>

## About the **Horton Group**

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