A LEGAL PERSPECTIVE

Health Savings Accounts - They Save You Real Money

This article is perhaps directed more toward the smaller Self-Storage operators and managers who purchase their own health insurance or who for economic reasons have health insurance with high deductibles. For the rest of you, the article may be interesting, or not. Tune in to this column in two months for something more relevant to those of you who have low-deductible health insurance provided as an employee benefit.

The Health Savings Account ("HSA") was created by the United States Congress in December, 2003 and is essentially a simple custodial account in which you or your employer can deposit money to pay for certain health-related expenses. This type of account is similar to what you may already have set up as an IRA. In an IRA, you deposit the money, you direct the investments or turn the money over to a professional to invest for you, and, depending on the type of IRA you may have, the money either goes into the account as a tax deductible contribution, or the earnings on the money are not taxed until withdrawn (hopefully at a lower tax rate). An HSA is a similar account that can be set up in a bank or other financial institution, or with a health insurance company, for the specific limited purpose of paying for health-related expenses. However, when used properly, this "limited purpose" can save you hundreds of dollars in taxes. An HSA is like an IRA for health care in that it allows the payment of many medical costs and your insurance deductibles with pre-tax dollars.

Who is eligible? First, you must be an individual or family who is covered, under the definition below, by a high-deductible health insurance plan. Second, you may not be covered by any other health plan that is not a high-deductible policy (there are certain minor exceptions). Third, you can not currently be eligible for Medicaid. Fourth, you can not be claimed as a dependent on anyone else's tax return. A "high deductible" in this case is characterized as a deductible of at least $1,000.00 per person and $2,000.00 per family. This deductible amount may include co-pays, but not the premium itself. However, as those of you who have these types of health insurance plans are aware, a high-deductible insurance policy can sometimes cost as little as half the cost of a low deductible insurance policy. The HSA may encourage you to save money on your health insurance premiums by opting for a higher deductible and “saving that difference” in an HSA. One word of caution, prescription drug benefits which pay for a part of drugs before you meet the deductible may affect your eligibility for this plan. The premium for your health insurance is not itself tax deductible. However, the costs associated with “diagnosis, treatment, prevention of illness or injury” are eligible. Expenses which can be paid for from your HSA include (this list is not exclusive) doctors’ visits, prescription drugs, over-the-counter drugs, vision, dental care, orthodontia, laser eye surgery, long-term care insurance premiums, long-term care, and even COBRA insurance premiums.

Let me explain how this works. Assuming your insurance qualifies as a high-deductible insurance policy, you can make deposits to the HSA, either lump sum or in installments. The deposits must be cash, as opposed to other assets like stock. Your employer can also make contributions to your HSA account as an employee benefit, which payments are tax deductible to your employer and are not taxable to you. Therefore, this might be an excellent employee benefit to request of your employer if your employer does not or can not provide health insurance or to supplement your employer’s high-deductible insurance.

While you must pay your insurance premiums outside of the account, virtually everything else you spend money on for health care purposes, including meeting your insurance deductible and the expenses listed above, can be paid out of the money you “saved” in this account. The contributions you are making to this account can be made with what are called “pre-tax dollars”, which are “above the line” deductions from your gross income. Therefore, the contributions you make to this account, which are subject to a cap discussed below, are not included in the tax calculation of gross income that is subject to taxation at the end of every year. That makes these dollars saved in an HSA “pre-tax dollars”. You, as the insured, can draw from the account to pay for medical expenses throughout the year. In creating the HSA, Congress expressed the belief that if you are spending your own money, you will be more cost-conscious in your medical decisions and will in theory spend less on medical expenses each year, if you can. The tax benefit is the added motivation to try to engage people in your position to begin shopping for the price of both medical insurance (and the deductible) and medical services rather than just relying on the insurance for payment of all of your expenses.

Another benefit of an HSA that is similar to an IRA is that interest on deposited funds is not taxable. The dollars you pay out of the account for eligible expenses are also not taxable, and, as an added benefit, any dollars left at the end of each tax year can be used to increase the account "reserve" for future years.

As mentioned earlier, however, there are limitations. You must have a deductible of at least $1,000.00 per person and a $2,000.00 per family deductible. The maximum amount you can deposit into an HSA for 2004 is equal to your individual or family deductible, but not to exceed $2,600.00 for an individual and $5,150.00 for a family. This amount is scheduled to adjust each year hereafter. For example, if you are single and have a $1,000.00 individual deductible, you or your employer may contribute only up to $1,000.00, then you pay out of this account for medical expenses, drugs, etc., that are not covered by your health insurance benefits. If you do not incur enough medical expenses, such as insurance deductible payments, in 2004 to use up your $1,000.00 savings (as in this example), you can either (a) roll it over for future years; or (b) use pre-tax dollars for other medical items or necessities which are not covered by health insurance, such as prescription or non-prescription drugs, or the laser eye surgery you have always dreamed of. If you incur $1,000.00 worth of uncovered medical expenses this year, the tax savings is the amount of the tax you could have paid on the $1,000.00 if it had been included in your gross income, plus the savings on any interest on the money.

There are penalties for withdrawing the money to use for non-health related expenses, including imposition of the previously avoided tax and a 10% additional penalty.

When you begin to view an HSA this way, a little shrewd planning, especially in the latter part of 2004, can not only save you the equivalent of your insurance deductible (as capped above) in taxes, but can also become a tidy little savings mechanism for other medical-related expenses or for an elective procedure now or in the future. Any way you slice it, this little step will, essentially at no cost to you, save you at least the tax dollars on the equivalent of a minimum of $1,000.00 worth of insurance deductible this year.

This article is at best a simple explanation of a complicated subject. As with any Congressional creation regulated by the IRS, there are rules and tests that should be reviewed before opening an HSA.

Please consult with an attorney, tax advisor, or financial advisor before making any financial decisions, including creation and funding of HSA. However, some of you who set up an HSA may find your wallet feels a little thicker come tax time next year.

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