Dear HR Knowledge, what are Health Savings Accounts?

We all need health insurance and we all would like to save money and reduce taxes. Health Savings Accounts can help with all those objectives.

Health Savings Accounts (HSAs) are tax advantaged personal savings accounts to be used for medical expenses created by federal law in 2003. Congress's objectives in creating these accounts were to encourage all individuals to have medical insurance, save for current and future medical expenses, reduce the overall costs of medical care and have individuals take ownership of managing their medical expenses. In many ways, HSAs for medical expenses are like IRAs for retirement expenses.

A Health Savings Account works in conjunction with a High Deductible Health Plan

A "High Deductible Health Plan" (HDHP) is a specific type of health insurance policy generally does not cover the first several thousand dollars of health care expenses. These HDHPs are usually available at lower costs than traditional health insurance policies. You must have an HDHP to be eligible for a HSA. HSA accounts are not available for those enrolled in Medicare.

In 2017, the deductible must be at least $1,300 for individuals or $2,600 for families, and the annual out-of-pocket expenses cannot exceed $6,550 for an individual or $13,100 for a family, including the deductible and co-payments (but not premiums). Beginning in 2017, there are slightly higher out-of-pocket limits for insurance plans offered under the Affordable Care Act. Consult your insurance advisor for more details.

Individuals can buy high-deductible policies on their own or through their employers. You should speak with your employer or insurance provider to see if your health insurance plan qualifies.

Benefits of a Health Savings Account

With this type of arrangement, you establish a HSA with a financial institution, make tax deductible contributions to the HSA and use funds from the HSA to pay medical expenses that are not covered by your HDHP. Funds within the HSA grow tax free until withdrawn and are never taxed if they are used for qualified health care expenses. Distributions that are not used for qualified expenses are subject to regular income tax and a 10% penalty.

Using a Health Savings Account

HSAs are available from many financial institutions. They often work like an interest-bearing checking account with a debit card to use to pay medical expenses. There are also HSAs available from some investment firms and mutual fund companies that enable you to invest the funds within the HSA.

The amount you can contribute to an HSA and take as a tax deduction is set by the IRS. The limits are not impacted by your income level, type of income or whether you itemize deductions or not.

For 2017, the limit is $3,400 for individuals and $6,750 for those with family coverage. In addition, for 2017, an individual age 55 and above can make an extra contribution of $1,000. If both spouses are 55 or over, the extra contribution limit is $2,000.

Once you establish and funds an HSA, you take distributions from it to pay or reimburse qualified health care costs that are not covered by your insurance. The definition of qualified health care costs is similar to what the IRS uses for determining an expense qualifies as an itemized deduction for your tax return.

Key Points to Consider

- The combination of an HSA and an HDHP requires you to pay the first several thousand dollars of medical costs.
- Compare the cost of an HDHP with your existing medical insurance plan. If you decide to switch to an HDHP, do not cancel your existing insurance until you are approved for the new plan.
- Establish an HSA with an institution that provides the type of features you want. Consider the convenience of a debit card to pay expenses and how you want the funds invested.
- Keep good records because they must be used to support the deduction on your tax return.
- The tax rules can be complex and you may want to consult your tax advisor to learn how an HSA would work in your situation.

Summary

The result of this type of arrangement is that you have medical insurance to cover large expenses, you get a tax deduction for your contributions to the HSA, HSA funds grow tax free and you have funds available for current and future medical expenses that are not covered by insurance.

About HR Knowledge

Founded in 2001, HR Knowledge, Inc. is a privately funded company providing integrated outsourced HR services tailored to our clients' needs. Our full array of offerings includes managed payroll, employee benefits administration, and HR consulting and support services, such as training, compliance, custom-built software solutions, and Hiring Process Management™, our comprehensive recruitment service that takes you from finding to onboarding new talent. Our major markets are fast-growing small- and medium-sized businesses, many of which are venture-capital-backed; foreign companies expanding into the states; and charter schools. Partnering with HR Knowledge can reduce your administrative costs, minimize your legal risk, help you find and develop talent, and alleviate the HR burden so that you can focus on your core business.

This content is provided with the understanding that HR Knowledge is not rendering legal advice. While every effort is made to provide current information, the law changes regularly and laws may vary depending on the state or municipality. The material is made available for informational purposes only and is not a substitute for legal advice or your professional judgment. You should review applicable law in your jurisdiction and consult experienced counsel for legal advice. If you have any questions regarding this advisory, please contact HR Knowledge at 508.339.1300 or email us.