UNDERSTANDING
HEALTH SAVINGS ACCOUNTS

HSA BASICS

DEFINITION:
An HSA is a special type of savings account – a tax-advantaged way to pay for qualified medical expenses incurred while covered by an HDHP. HSAs can be held in simple interest-bearing savings accounts. Some plans will also allow you to invest in higher-earning instruments, allowing your contributions to grow significantly when invested properly.

ELIGIBILITY:
To be eligible to open and contribute to an HSA, you must be over 18 and covered by an HDHP that conforms to IRS standards. You may not have any other kind of medical insurance plan in addition to the HDHP, including Medicare. Finally, you cannot be claimed as a dependent on someone else's tax return. Employers that offer an HDHP usually offer and manage an HSA as well. If you have individual health insurance you can sign up for an HSA through your insurance company or many banks/credit unions.

CONTRIBUTIONS:
If you are an individual covered by an HDHP, you can contribute $3,250 in 2013 ($270/month). Covered families (including participant plus spouse, children, or both) can contribute $6,450. Your employer may contribute, but total contributions cannot exceed the above limits. Individuals can also contribute an additional $1,000 per year if they are 55 or over. These amounts are reduced if you do not remain covered by the plan for the entire year. You cannot contribute once you stop being covered by an HDHP due to retirement, employer changes, or plan changes, but the accumulated contributions and earnings are yours to keep.

WITHDRAWALS:
Withdrawals for qualified medical expenses are tax-free. Many HSAs will provide you with a debit card so that you can pay expenses directly. Others will require you to file paperwork for reimbursement. Withdrawals for non-medical expenses will be taxed as ordinary income. A 20% penalty will also apply unless you are over 65 or disabled.

QUALIFIED EXPENSES:
All normal medical expenses, including anything that your HDHP deductible would apply to, such as prescriptions, are qualified expenses. You can also pay for dental or vision expenses as well as long term care insurance premiums or expenses. Finally, Medicare premiums and COBRA premiums are qualified expenses, as are other health insurance premiums if you are unemployed. Cosmetic surgery cannot be paid for out of an HSA.

How can an HSA work for you?

An HSA is tax-advantaged in three ways:

1. It provides an up-front tax deduction, reducing your taxable income by the amount of your contribution.
2. It allows for contributions to grow with no taxes on earnings.
3. You can make tax-free withdrawals for qualified medical expenses. The withdrawals can be made at any time, even if you are not covered by an HDHP at the time of the expense!

Choosing an HDHP will always save you money in premiums when compared to traditional medical plans. The only downside is meeting your higher deductible. An HSA helps you save to meet that deductible and spread medical expenses evenly throughout the year so that they do not have to impact your everyday budget. In addition, your employer may contribute to your HSA, thus paying a portion of your annual deductible. Employer contributions and tax savings are in addition to other savings you may realize by selecting an HDHP. If your employer does not offer an HDHP option, consider getting quotes on private health insurance-even without an employer subsidy, the HDHP/HSA combined savings might be enough to make it worth it!

Because there are no income limits for HSA eligibility, HSAs are a great way to plan for increased medical expenses in retirement. If you have an HDHP/HSA for multiple years, and choose to pay for medical expenses out-of-pocket instead of an HSA, you can even treat your HSA as a "super Roth" and make tax-free withdrawals later instead of in the year they are incurred – this strategy allows the money to grow tax-free as long as possible!

To open an HSA, select it during open enrollment with your employer or check with your private health insurance company, bank, or credit union. Be aware that non-employer sponsored HSAs may incur management fees. While those fees can be frustrating, they are almost certainly outweighted by the savings!

FINAL THOUGHTS:
If you have the option of choosing an HDHP at work, spend some time running the numbers to see how much the combination of an HDHP and HSA can save you. JP Morgan Chase provides three easy-to-use calculators, including a tax savings calculator. If you are already covered by an HDHP, there is no reason NOT to open and contribute to an HSA. HSA money never expires – the account and any incurred tax benefits are yours to keep throughout your life. Combined with HDHPs, they can save you thousands of dollars over the course of your lifetime.