

*HSA*s

Health Savings Accounts, Affordability, Flexibility, Choice, Control and Savings

by Scott Ann Setzer

My dad was a visionary. Whether I had a cold, broken bone, or general ache, I could always count on hearing his favorite line, "How bad does it hurt?" He wanted to make sure it really hurt before he stepped up to spend his healthcare dollars – he was a true practitioner of consumer driven healthcare.

In the 1960s, my father paid 50 cents of every dollar spent on healthcare for our family. Today, under traditional insurance coverage, individuals pay only 15 cents of every dollar for healthcare. The other 85 cents is paid by third parties, employers, insurance companies, and governments.

This increased expense is forcing small businesses to look at alternatives to traditional health insurance. Ninety-one percent of the 500 small-business owners surveyed said rising healthcare costs were a top priority, according to a survey by Small Business California, a non-partisan statewide advocacy group. The annual premium averaged nearly \$10,000 in 2005 for an employer health plan covering a family of four. Employers are passing these additional costs to employees as never before. Most employers want to provide insurance coverage for their employees, but with premiums costs sky rocketing, they need an alternative.

A step in this direction has been the creation of the Health Savings Account (HSA). As premiums for traditional health insurance keep rising, employers can budget their healthcare tabs more precisely using HSA linked plans. HSAs were created by the Medicare Bill signed by President Bush on December 8, 2003. They are designed to allow individuals, employers, and employees to invest tax-free dollars in health accounts to pay for certain healthcare needs. Federal law allows money in these accounts to roll over from year to year and grow tax-free through investment earnings. As third party administrators of flexible spending accounts (FSAs) and health reimbursement accounts (HRAs), we see brokers offering clients multiple health plan platforms. Employers have new options to offer to employees including a traditional health plan with a flexible-spending account, a high deductible health plan (HDHP) with an HSA, and health reimbursement arrangements are expanding the choices employers are offering their employees. Even Kaiser Permanente is introducing an HSA program for its California clients.

Neither employers nor employees can afford the one health plan fits all attitude and more brokers are coming to their clients with options and opportunities. The Target chain of stores has begun offering HDHPs in conjunction with HSAs and HRAs in addition to their more traditional health plans. For Target employees who enroll in HDHP health plans with HSAs, Target contributes \$400 annually to the HSA account for individuals and \$800 annually for family coverage. Depending on the product placed, employees can fund additional amounts into their HSA. In addition, Target offers lower deductible plans with higher monthly premiums and funds into a HRA for the benefit of employees selecting these options. The success of HSAs, FSAs, and HRAs, will undoubtedly take time and education. Educating consumers on personal responsibility, the true cost of healthcare, and how these account based health plans work is vital to transforming employees into consumers with choice and control.

Today's broker cannot afford to be without HSA compatible product offerings. Creating options, flexibility, and savings is the key to client loyalty. A phone call announcing yet another premium increase without solutions just isn't value added service.

How Do HSAs Work?

HSAs are open to individuals and are covered by high deductible health insurance plans. The annual deductible limits for 2006 are \$1,050 for individual coverage and \$2,100 for family coverage. These HDHPs must also be HSA-qualified. In general, this insurance does not cover first-dollar medical expenses. In addition to the deductible, out-of-pocket expenses (including deductibles, co-pays, and co-insurance) must not exceed \$5,250 for individual coverage or \$10,500 for family coverage. Clients want their brokers to select and present the compatible products. Insurers must determine whether their products meet the requirements of federal law. There is no entity or agency that reviews, approves, or qualifies HSA-compatible plans. It is important to note that plans can pay for preventive care services on a first-dollar basis without violating the HDHP rules of the road.

An HSA can be funded by the employee and employer. When funded by the employer, the contributions are deductible (see California Tax Note below) to the employer and not taxable to the employee if used to reimburse qualifying medical expenses. When funded by the employee, the contributions are an above-the-line deduction when completing federal income tax returns.

In California

California has not adopted state tax provisions permitting deductible HSA contributions. Individuals must add back the amount deducted for federal tax purposes or the amount contributed by the employer for California income taxes. In addition, interest earned on HSAs is taxable in California. Perhaps most significantly, employer HSA contributions are subtracted from wages for FICA and federal withholding purposes. However, HSA contributions are included as wages for California payroll and withholding tax purposes. With the pressure on California and other non-compliant states from the federal government and consumers, California can come along and recognize the deduction.

The maximum annual contribution that can be made to an individual's HSA for 2006 cannot exceed the HDHP deductible. It cannot exceed \$2,700 for individual coverage and \$5,450 for family coverage. In addition, individuals age 55 and older can make additional catch-up contributions. The maximum catch-up contribution for 2006 is \$700. The HSA contributions must be funded by the April 15th following the applicable calendar year. If coverage under the HDHP is not for an entire year, individuals must pro-rate the annual contribution including any catch-up contribution.

Most HDHPs that are HSA qualified come with their own trustee or custodian. banks, credit unions, or any other entity that meets the IRS standards for being an IRA trustee or custodian can be an HSA trustee or custodian. The rules regarding the investment of HSAs are identical to the rules that apply to IRA investments. HSA funds cannot be invested in life insurance contracts or in collectibles as defined by the Internal Revenue Code. Most investment limitations are leveled by the trustee/custodian rather than by IRS limitation. HSA custodians can impose more restrictions on the HSA account investments than they do on IRAs. In many cases, these HSA account will experience frequent withdrawals. Investments can include bank accounts, annuities, certificates-of-deposit, stocks, bonds, mutual funds, and the like.

Withdrawing Funds from an HSA

Funds can be withdrawn from an HSA account at anytime. The funds are tax-free if they are disbursed to pay for or reimburse the participant, the participant's spouse, or the participant's qualifying dependent for qualified medical expenses. These qualified medical expenses cover most medical, dental, and vision care, and they can cover over-the-counter items, such as aspirin. The account holder cannot use the money to pay for medical insurance except under very specific circumstances such as the following:

- Premiums while receiving federal or state unemployment.
- COBRA continuation coverage.
- Qualified long-term care insurance.
- Medicare premiums and out-of-pocket expenses including deductible, co-pays, and coinsurance for Medicare Part A, Part B, Part C, and Part D.

You might be asking with all these rules and regulations who administers these HSAs and how much does it cost? Regardless of who funds the HSA, the individual is the owner and administrator of the account once it is funded. The individual HSA owner is responsible for determining what a qualified expense is. The trustee or custodian is not the responsible party. If certain non-qualified expenses have been reimbursed in error, the account owner can repay the HSA account by April 15th following the year they found out that the reimbursed expenses were not qualified. Everyone who has an HSA is required to keep all receipts showing expenditures from their account in case they are audited.

Account holders can use funds from the HSA account to reimburse expenses from previous years when the individual had HSA coverage. There is no requirement for third-party adjudication of a reimbursement from the HSA. Trustees and custodians can charge fees for establishing, maintaining, and issuing payment from HSA accounts. Unlike with FSAs and HRAs, there is no formal third party reimbursement. The participant simply incurs the expenses and issues reimbursement when desired. No TPA or custodial fees can be paid from the HSA.

If an individual incurs no expenses and request no reimbursement, they can disburse the HSA funds for non-qualified expenses. If the individual has not reached 65 when funds are dispersed for non-qualified purposes, the individual will pay ordinary income tax plus a 10% penalty tax. If the account holder is at least 65 years old and decides to take funds for non-qualified purpose, then they simply pay income tax on the withdrawals.

HSAs continue to be attractive even after the account holder's death. If a married account holder dies, the HSA becomes the spouse's HSA. The spouse has the same benefits as the original owner. If an individual is not married, the account will no longer be treated as an HSA and will be subject to applicable taxes.

With the health-savings account, we can reduce health insurance premiums paid by the employer and employer and shift some or all of the savings into an HSA, which can be used tax-free for qualified reimbursements or an addition retirement benefits later in life. The Dept. of Treasury projects that between 7 million and 21 million Americans will have HSAs within the next four years. Wherever these employees go, their HSA goes. The target model can be exactly on target changing our attitude about how we approach healthcare with choice, control, and flexibility as the key components to the success of consumer driven healthcare. q

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