# Health Savings Accounts

Presented by: **Kenneth Sapon, CLU, CLTC, LUTCF, R.Ph.**
Champion Agency, Inc.

Prepared for:

## What Is a Health Savings Account?

**A Health Savings Account (HSA) is a tax-advantaged personal savings account designed to provide funds to pay qualified medical expenses, including health insurance deductibles and co-payments.** An HSA is available to eligible individuals only in conjunction with a high-deductible health plan provided by an employer or purchased by an individual.

The tax benefits of an HSA are significant. **Your contributions to a Health Savings Account are tax deductible on an "above the line" basis,** resulting in a dollar-for-dollar reduction in adjusted gross income. What might this mean to you? For example:

| Annual HSA Contribution | $3,000 |
|---|---|
| Marginal Federal Income Tax Rate | 25% |
| Tax Savings per Year | $750 |
| Net Cost to You | $2,250 |

**If your employer contributes to your HSA, those contributions are not taxable income to you** and are not subject to withholding.

**Funds in an HSA can be invested, with earnings not subject to income tax** so long as they remain in the HSA.

**Distributions from an HSA may be made at any time.** If used to pay for qualified medical expenses, the distributions are not subject to federal income tax. If used for non-medical expenses, HSA distributions are considered taxable income to you and are subject to a 20% penalty tax if you are under age 65 when the distribution is taken.

# Health Savings Account in Action

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Champion Agency, Inc.

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## How Does a Health Savings Account Work?

**Health Savings Account** + **High-Deductible Health Insurance Plan**

**Health Savings Account**

You establish a Health Savings Account, into which you make tax-free contributions up to specified maximums each year.

If an illness or injury strikes, funds can be withdrawn tax free from the HSA to pay for qualified medical expenses.

Funds not withdrawn to pay for qualified medical expenses remain in the HSA and grow from year to year in an investment account whose earnings grow free of tax.

HSA funds may be withdrawn for purposes other than paying qualified medical expenses, but are subject to income tax plus a 20% penalty tax. Beginning at age 65, HSA funds may be withdrawn for any reason, subject to regular income tax without penalty, or can continue to be used to pay qualified medical expenses without tax.

**High-Deductible Health Insurance Plan**

You purchase a qualifying high-deductible health plan.

Once the health insurance deductible is satisfied, insurance benefits become available to pay for covered expenses.

## What Are the Advantages of a Health Savings Account?

By combining a high-deductible health plan with tax-advantaged personal savings, a Health Savings Account offers you these advantages:

- The high-deductible health plan provides protection against the financial impact of a serious illness or injury.
- Tax-deductible savings are set aside today in a Health Savings Account to pay for future health care expenses, including the high-deductible health plan's deductible and out-of-pocket expenses.
- You own your Health Savings Account and you decide how to invest your HSA contributions.
- You control when and how HSA funds are spent.
- As needed, tax-free HSA distributions can be used to pay for qualified medical expenses not covered by the high-deductible health plan.
- If you need little or no health care, the unspent funds remain in your HSA and accumulate tax free.
- You can spend the funds in your HSA as you choose. In fact, if not needed to pay future medical expenses, HSA funds can be withdrawn and used for any purpose (subject to income tax and a 20% penalty tax if under age 65).
- Funds may be rolled over (transferred) tax free from one HSA to another HSA.
- You may be able to roll over funds from an IRA into an HSA, making additional funds available on a tax-advantaged basis to pay the plan's deductible or qualified medical expenses not covered by the high-deductible health plan.

# Health Savings Account Eligibility (2014)

Presented by: **Kenneth Sapon, CLU, CLTC, LUTCF, R.Ph.**
Champion Agency, Inc.

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## Who is eligible to establish an HSA?

A Health Savings Account can be established by an "eligible individual"…someone who:

- is covered under a qualified high-deductible health plan;
- is not also covered by any other health plan that is not a high-deductible health plan;
- is not entitled to benefits under Medicare (generally under age 65); and
- may not be claimed as a dependent on another person's tax return.

## What is a high-deductible health plan (HDHP)?

A high-deductible health plan, or HDHP, is a health plan that satisfies certain requirements with respect to deductibles and out-of-pocket expenses, which are adjusted annually for inflation:

| Type of Coverage | 2014 | |
|---|---|---|
| | Minimum Annual Deductible | Maximum Annual Out-of-Pocket Expenses |
| Individual | $1,250 | $6,350 |
| Family | $2,500 | $12,700 |

Except for preventative care, the high-deductible health plan may not provide benefits for any year until the deductible for that year is met.

## What other health coverage can I have and still qualify for an HSA?

You can maintain certain types of "permitted insurance" in addition to the high-deductible health plan and still remain eligible for an HSA. Types of "permitted insurance" include workers' compensation, auto insurance, insurance for a specified disease or illness that pays a fixed amount per day (or other period) of hospitalization, accident and disability insurance, dental and vision care and long-term care insurance.

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# Health Savings Account Contributions (2014)

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## How much can I contribute to an HSA?

Contributions must be made in cash to an HSA that you establish with a qualified HSA trustee or custodian, such as an insurance company or bank, and cannot exceed a maximum annual limit, which is indexed annually for inflation:

| Type of Coverage | 2014 Maximum Annual HSA Contribution |
|---|---|
| Individual | $3,300 |
| Family | $6,550 |

In addition, individuals between ages 55 and 65 can make an additional "catch-up" contribution of up to $1,000 each year.

## Must I contribute the maximum to an HSA?

While there is no requirement that you contribute the maximum to your HSA each year, doing so will enable you to take full advantage of the powerful tax benefits provided by an HSA.

## Who can make contributions to an HSA?

Contributions to an HSA can be made by an eligible individual, directly or through a cafeteria plan, by a family member on behalf of an eligible individual or by the eligible individual's employer. In addition, you may be able to roll over (transfer) unused funds from an IRA to an HSA on a tax-free basis. Regardless of who makes the contributions, you own the HSA.

## When must HSA contributions be made?

Contributions may be made at any time of the year in one or more payments, but must be made no later than April 15 of the year following the year for which the deduction is taken.

## How am I taxed on HSA contributions?

You deduct your HSA contributions on an "above the line" basis, resulting in a dollar-for-dollar reduction in your adjusted gross income. Any contributions made by an employer to an HSA are not included in your gross income for tax purposes and are not subject to withholding.

You can contribute up to the maximum annual HSA contribution regardless of when during the year your HSA coverage begins. If, however, your coverage begins during the year, you must maintain the high-deductible health plan during the "testing period" or pay tax on a portion of your HSA contribution plus a 10% penalty.

You must be eligible for an HSA on the first day of a month to take an HSA deduction for that month. If you are eligible for an HSA on the first day of the last month of your tax year (December 1, 2014 for most taxpayers), you are considered to be an eligible individual for the entire 2014 tax year and may contribute up to the maximum HSA contribution ($3,300 single/$6,550 family) for 2014. This is known as the "last-month rule."

You must then remain an eligible individual during what is called the "testing period." The testing period begins with the last month of your tax year and ends on the last day of the 12th month following that month (December 1, 2014 – December 31, 2015 for most taxpayers). If you fail to remain eligible for an HSA during this period, other than because of death or becoming disabled, you will have to include in income the total contributions made that would not have been made except for the last-month rule. You include this amount in income in the year in which you fail to be eligible for an HSA. This amount is also subject to a 10% additional tax.

For example, let's say that Sam is eligible for a single-only HSA on November 1, 2014 and makes and deducts the maximum $3,300 contribution for 2014. He then fails to be eligible for an HSA beginning in March 2015, resulting in Sam not meeting the testing period requirement. As a result, since he didn't meet the testing period requirement, Sam was eligible for only two months in 2014 and must include 10 months of his 2014 HSA contribution in his 2015 taxable income ($3,300 ÷ 12 x 10 = $2,750 taxable income), plus an additional 10% penalty tax.

# Additional HSA Funding Sources (2014)

Presented by: **Kenneth Sapon, CLU, CLTC, LUTCF, R.Ph.**
Champion Agency, Inc.

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## What sources other than annual contributions are available to fund an HSA?

If you have immediate health care needs, there may be insufficient funds in an HSA, especially in its initial phase, to pay for the health insurance policy deductible and/or any qualified medical expenses not covered by the health insurance policy. To help compensate for this potential problem, funds may be rolled over from an IRA into an HSA on a tax-free basis.

## What are the requirements to fund an HSA with funds from an IRA?

A one-time tax-free transfer of funds from an IRA to an HSA may be made. The amount rolled over cannot exceed the annual HSA statutory maximum contribution for the year ($3,300 for individual coverage or $6,550 for family coverage in 2014). The transfer of funds from an IRA to an HSA can be done only once during your lifetime and, once rolled over to the HSA, the funds cannot be transferred back to the IRA.

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| Type of Coverage | 2013 Maximum Annual HSA Contribution |
|---|---|
| Individual | $3,250 |
| Family | $6,450 |

In addition, individuals between ages 55 and 65 can make an additional "catch-up" contribution of up to $1,000 each year.

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While there is no requirement that you contribute the maximum to your HSA each year, doing so will enable you to take full advantage of the powerful tax benefits provided by an HSA.

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Contributions to an HSA can be made by an eligible individual, directly or through a cafeteria plan, by a family member on behalf of an eligible individual or by the eligible individual's employer. In addition, you may be able to roll over (transfer) unused funds from an IRA to an HSA on a tax-free basis. Regardless of who makes the contributions, you own the HSA.

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You can contribute up to the maximum annual HSA contribution regardless of when during the year your HSA coverage begins. If, however, your coverage begins during the year, you must maintain the high-deductible health plan during the "testing period" or pay tax on a portion of your HSA contribution plus a 10% penalty.

You must be eligible for an HSA on the first day of a month to take an HSA deduction for that month. If you are eligible for an HSA on the first day of the last month of your tax year (December 1, 2013 for most taxpayers), you are considered to be an eligible individual for the entire 2013 tax year and may contribute up to the maximum HSA contribution ($3,250 single/$6,450 family) for 2013. This is known as the "last-month rule."

You must then remain an eligible individual during what is called the "testing period." The testing period begins with the last month of your tax year and ends on the last day of the 12th month following that month (December 1, 2013 – December 31, 2014 for most taxpayers). If you fail to remain eligible for an HSA during this period, other than because of death or becoming disabled, you will have to include in income the total contributions made that would not have been made except for the last-month rule. You include this amount in income in the year in which you fail to be eligible for an HSA. This amount is also subject to a 10% additional tax.

For example, let's say that Sam is eligible for a single-only HSA on November 1, 2013 and makes and deducts the maximum $3,250 contribution for 2013. He then fails to be eligible for an HSA beginning in March 2014, resulting in Sam not meeting the testing period requirement. As a result, since he didn't meet the testing period requirement, Sam was eligible for only two months in 2013 and must include 10 months of his 2013 HSA contribution in his 2014 taxable income ($3,250 ÷ 12 x 10 = $2,708.33 taxable income), plus an additional 10% tax.

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# Health Savings Account Distributions

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## When can funds from an HSA be withdrawn tax free?

HSA funds can be withdrawn tax free at any time to pay for the qualifying medical expenses of yourself, your spouse and dependents. These expenses include:

- Prescribed medicines and drugs*
- Doctors visits, lab, x-ray and other diagnostic and treatment services
- Dental, vision and psychiatric care services
- Qualifying long-term care services and long-term care insurance premiums
- Medicare Part A and B premiums, Medicare HMO or Medicare Advantage premiums (but not Medicare supplemental policy premiums)
- COBRA health continuation coverage premiums and health insurance premiums for those on unemployment compensation

* Effective January 1, 2011, only prescribed medicines or drugs (including over-the-counter medicines and drugs **that are prescribed**) and insulin (even if purchased without a prescription) are considered qualifying medical expenses that can be paid for by tax-free HSA withdrawals.

It is your responsibility to ensure that expenses paid from the HSA are qualifying medical expenses and to keep adequate records concerning the use of HSA funds.

## Can HSA funds be withdrawn to pay for non-medical expenses?

Yes, but such withdrawals are subject to income tax plus a penalty tax of 20% of the amount withdrawn. The penalty tax applies to HSA withdrawals used to purchase over-the-counter medicines and drugs **without a prescription** on or after January 1, 2011. Any such withdrawals made after you reach age 65, die or become disabled are not subject to the 20% penalty tax.

## What happens if I become ineligible for an HSA?

In this event, no additional contributions can be made to your HSA. The funds in the HSA, however, can still be used as described above. If used solely to pay for qualifying medical expenses, the distributions will be free of income tax.

## What happens if I die?

If the beneficiary listed on the HSA is your surviving spouse, she/he becomes the new account owner and can use the HSA subject to the normal rules that apply to all HSAs. If the beneficiary is other than your surviving spouse, the funds in the HSA are taxable income to your beneficiary in the year of death, except for any of your qualifying medical expenses paid from the HSA within one year of death.