Should You Consider an HSA?

The Tax Relief and Health Care Act of 2006 (TRHCA) that went into effect this year made it a bit easier for both employers and their workers and self-employees to obtain Health Savings Accounts, a kind of IRA for health care expenses.

Health savings accounts were created as part of the Medicare Modernization Act of 2003 but have not been wildly popular because they're complicated. Anyone under age 65 who buys a *qualified* high-deductible health plan (HDHP) can open an HSA. However, you can still own an HSA and be covered under other types of insurance policies that cover liability, dental, vision and long-term care needs, as long as the same expenses are not covered by both your HSA and the insurance policy.

How do I find a qualified policy? If you're employed, your employer obviously selects a qualified option and makes that available to you. However, for individuals or sole proprietors buying such policies, you need to put in some research to make sure you get the right plan for you. You need to ask if your current insurer has a qualified plan, and there are Web sites you can search for ideas -- www.hsainsider.com and www.healthdecisions.org.

Will I automatically qualify for the HSA option at my company? No. Under the new law, employers have the right to offer such plans to those who own 5 percent or less of the company or make less than $100,000 a year. However, if you are self-employed, there are no income restrictions.

What are the maximum contributions? In 2007, individuals can deposit up to $2,850 in their HSA, even if the minimum single person deductible of $1,100 is selected. Insured individuals with family coverage can deposit up to $5,650, even if the minimum family deductible of $2,200 is selected. For HSA holders 55 and up, they're allowed to make an extra catch-up deposit each year until the date they enroll in Medicare. In 2007, the maximum allowable catch-up deposit is $800. This catch-up amount will increase to $900 in 2008 and will remain at $1,000 beginning in 2009.

How do I get started? The new law allows employees the one-time opportunity to roll over their existing balances in flexible spending accounts or health reimbursement accounts into an HSA. The new rules also allow a one-time opportunity for an individual to transfer in funds equal to the relevant HSA contribution maximum for the year.

If I find a policy, should I automatically buy it? No. Since this is a tax issue as well as an insurance issue, it makes sense to discuss this decision with your tax adviser or financial planner.

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What's the difference between an HSA and a medical flexible spending account (FSA)? One important difference is that HSAs allow balances to be carried forward year-to-year, growing on a tax-free basis as long as they're used for medical expenses. On the other hand, Medical FSAs generally require that the money you contribute each year has to be spent by a particular date (yearend or otherwise) or you'll lose it. But in certain cases, such as when you incur medical expenses early in a year, you can be reimbursed by your FSA without having to fully fund it – so FSAs might be a better deal. Get help from your tax or human resources professional.

Can I have both an HSA and a flexible spending account? It depends. In any one year you may maintain both accounts but each year the FSA must be used up and can't be carried forward. You may want to split your money between both to cover non-qualified expenses under the HSA rules. If your FSA provides for limited reimbursement for items not covered by your health insurance plan (such as dental, vision, or wellness care), you can use an HSA for items covered by your plan and your FSA for medical expenses that are not. Obviously, double-check this with an expert.

What happens if I need to use my HSA dollars for any non-medical reason before age 65? You'll get hit with additional tax of 10 percent, plus any withdrawals will be taxed at ordinary income tax rates. After age 65, you're free to use the funds for any purpose without penalty, but non-medical withdrawals are still taxable.

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