College Tax Strategy

Health Savings Acount (HSA)

STRATEGY
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Basic Tax Strategy # 5
– The Health Savings Account

A health savings account (HSA) is a tax-exempt trust or custodial account that you set up with a qualified HSA trustee to pay or reimburse certain medical expenses you incur. No permission or authorization from the IRS is necessary to establish an HSA.

A qualified HSA trustee can be a bank, an insurance company, or anyone already approved by the IRS to be a trustee of individual retirement arrangements (IRA). The HSA can be established through a trustee that is different from your health plan provider

How To Qualify For The HSA Strategy

You must be an eligible individual to qualify for an HSA. To be an eligible individual and qualify for an HSA, you must meet the following requirements:

1) You must be covered under a high deductible health plan (HDHP) on the first day of the month.

   HDHPs:

   - Have a higher annual deductible than typical health plans,
   - Have a maximum limit on the sum of the annual deductible and out-of-pocket medical expenses that you must pay for covered expenses. Out-of-pocket expenses include co-payments and other amounts, but do not include premiums,
   - May provide preventive care benefits without a deductible or with a deductible below the minimum annual deductible.

   The following table shows the minimum annual deductible and maximum annual deductible and other out-of-pocket expenses for HDHPs for 2013:

Type Of Coverage	Minimum Annual Deductible	Maximum Annual Deductible*
Self-only	$1,250	$6,250
Family	$2,500	$12,500

* Including other out-of-pocket expenses

2) You have no other health coverage except what is permitted under your HDHP,

3) You are not enrolled in Medicare, and

4) You cannot be claimed as a dependent on someone else's 2013 tax return.

If you meet these requirements, you are an eligible individual even if your spouse has non-HDHP family coverage, provided your spouse's coverage does not cover you.

If another taxpayer is entitled to claim an exemption for you, you cannot claim a deduction for an HSA contribution. This is true even if the other person does not actually claim your exemption. Each spouse who is an eligible individual who wants an HSA must open a separate HSA. You cannot have a joint HSA.

Contributions to an HSA

Any eligible individual can contribute to an HSA. For an employee's HSA, the employee, the employee's employer, or both may contribute to the employee's HSA in the same year. For an HSA established by a self-employed (or unemployed) individual, the individual can contribute. Family members or any other person may also make contributions on behalf of an eligible individual.

Contributions to an HSA must be made in cash. Contributions of stock or property are not allowed.

There are basically three different strategies you can take when deciding how to fund your health savings account.

- Put no money in the account (or the minimum amount required to open the account), except when you incur a medical expense. In other words, by depositing money into your HSA, then immediately withdrawing it to reimburse yourself for medical expenses, you are making your medical expenses all tax-deductible. You may want to use this strategy if you are on a tight budget and want to keep your cash outlay as low as possible.

- Fully fund the account, or at least put in as much as possible based on your budget. Take money out of the account any time medical expenses are incurred, and let the rest grow tax-deferred. This strategy will maximize your tax deduction, while making your HSA funds available to pay any non-covered medical expenses before your deductible is met.

- Fully fund the account, but pay all medical expenses from a non-HSA account. Reimburse yourself for medical expenses at a later date. This strategy will allow you to maximize your tax deduction, and will also allow you to maximize the tax-deferred growth of your HSA. You can then reimburse yourself, tax-free, at any time in the future for medical expenses incurred over the ensuing years.

Once you get your health insurance plan established, you may want to set up a Health Reimbursement Arrangement so that your business can cover the cost of your health insurance and other medical expenses, further reducing your taxes.

Limit on Contributions

The amount you or any other person can contribute to your HSA depends on the type of HDHP coverage you have, your age, the date you become an eligible individual, and the date you cease to be an eligible individual. For 2013, if you have self-only HDHP coverage, you can contribute up to $3,250. If you have family HDHP coverage you can contribute up to $6,450.

Benefits Of The HSA Strategy

An HSA is tax-favored savings account that is used in conjunction with a high-deductible HSA-eligible health insurance plan to make healthcare more affordable and to save for retirement. HSAs allow consumers to pay for qualified medical expenses with pre-tax dollars – meaning income-tax free – and save for retirement on a tax-deferred basis.

Basically with an HSA you get:
- Tax-deductible deposits
- Tax-deferred growth, and
- Tax free distributions for medical care

An HSA is comprised of two parts:

1. The first part is a high-deductible health plan (HDHP) insurance policy that covers regular medical and hospital bills.

2. The second part of the HSA allows you to make tax-free contributions to an investment account, retirement account, or HSA bank account

from which you can withdraw money tax-free for medical care. Otherwise, the money accumulates with tax-free interest until retirement, when you can withdraw it for any qualified medical expense.

HSA plans are personally owned by each participant or employee. Therefore they go with an employee when they leave one job and assume employment elsewhere.

HSAs are similar to individual retirement accounts (IRAs), but even better:

- Pre-tax money is deposited each year into an HSA and can be easily withdrawn at any time with no penalty or taxes to pay for qualified medical expenses.

- Any HSA funds not used each year remain in the account, and earn interest tax-free to supplement medical expenses at any time in the future.

- Like an IRA, the account belongs to you, not your employer. But unlike an IRA, your employer CAN contribute to your HSA.

Note: Some HSAs charge a small monthly maintenance fee.

Combining the HSA Strategy with the HRA (Section 105) Strategy

Tax Savings Involving The HSA Strategy

HSAs allow you to legally avoid federal income tax by saving up to $3,250 for singles or $6,450 for families, into your HSA account.

There is no minimum deposit (it can be $0 if you want), but whatever you deposit into your account by April 15 is an "above the line" tax deduction for the previous year's income taxes. This means that you get a federal income tax deduction for money you put in even if you take the standard deduction and don't itemize deductions. This tax deduction is available to everyone, with no limitations on the amount or source of income.

You may save money in the short and long term by:

- Deducting 100% of your HSA contributions from your taxable income

- Having the money in your HSA accrue interest and/or gains on a tax-free basis

- Paying no penalties or taxes when you use your HSA to pay for qualified medical expenses

- Having a high-deductible HSA-eligible health insurance plan, which typically has a lower premium than a plan with a lower deductible

- Helps pay your health insurance deductibles and co-pays plus all other incidental non-deductible medical costs.

For the participant who will write-off their HSA savings amount from their annual tax return, tax-free means they only avoid paying federal income tax, depending on their tax bracket. Participants are still responsible for paying their Medicare and Social Security taxes.

Example Of The HSA Strategy

Tom is a self-employed business owner. Tom's wife, Mary, is on his high deductible health plan. Three years ago, Tom decided to open up an HSA account and has contributed the maximum amount over those three years of $18,850 (2011 - $6,150, 2012 - $6,250, and 2013 – 6,450). These funds grew tax-deferred over these three years to a total of $22,000.

Then in the 2013, Tom and Mary had the following qualified medical expenses, which they paid for out-of-pocket and were reimbursed for these expenses from their HSA:

Reimbursement for family health deductible:	$ 5,000
Reimbursement for family health co-pays	$ 2,000
Reimbursement for uninsured medical expenses:	$ 3,000
TOTAL	$10,000

Based on federal (25%), and state (6%) tax rates, Tom received $3,100 ($10,000 x 31%) in actual tax savings over those three years by taking advantage of the HSA plan. Furthermore, Tom did not have to pay taxes on the $10,000 withdrawn from the HSA for the qualified medical expenses, and the balance remaining in the HSA account of $12,000 will continue to grow tax-deferred until used again.

Implementing The HSA Strategy

❑ Step 1: To establish a health savings account, you must first own an HSA-qualified high deductible health insurance plan.

❑ Step 2: Once you have applied for a high deductible health insurance plan, you'll want to go ahead and set up your Health Savings Account. You are not required to immediately establish an HSA, but by funding the account as soon as possible you'll be able to take advantage of the tax-deductions and tax-deferred growth that the HSA offers.

❑ Step 3: To establish your HSA, you will need to choose the bank or trustee that you would like to administer your HSA. While some insurance companies offer to administer your account (only if you have their insurance plan), you may also choose to work with an outside, third party administrator.

❑ Step 4: Once you have chosen your administrator, you will need to obtain (download) their enrollment form.

❑ Step 5: After downloading the proper enrollment form, you will need to send it, along with your opening deposit, to the address listed on the enrollment form. You will receive your introductory packet, including complete instructions on how to make future deposits and the options you have for withdrawing your funds.

Using funds in your Health Savings Account is usually simple:

Typically an HSA will provide you with a checkbook or debit card. Then when you pay for qualified medical expenses, you can use the debit card or check to make the payment.

You do not need to get approval from the HSA administrator when you use funds in your account.

You do not need to submit receipts to the HSA administrator, although you should save them just as you keep receipts for other items that are deducted from your taxes. You should also not send these records with your tax return. Just keep them with your tax records.

Note: You must establish the HSA before you incur medical expenses otherwise the expenses will not qualify.

❑ Step 6: Report all contributions to your HSA on Form 8889 and file it with your Form 1040 or Form 1040NR. You should include all contributions made for 2013, including those contributions made by April 15, 2014 that are designated for 2013. Contributions made by your employer and qualified HSA funding distributions are also shown on the form. You must file the form even if only your employer or your spouse's employer made contributions to the HSA.

You must also file Form 8889 with your Form 1040 or Form 1040NR if you (or your spouse, if married filing a joint return) had any distributions from your HSA during the year.

If you are the beneficiary of two or more HSAs, or you are a beneficiary of an HSA and you have your own HSA, you must complete a separate Form 8889 for each HSA. Enter “statement” at the top of each Form 8889 and complete the form as instructed. Next, complete a controlling Form 8889 combining the amounts shown on each of the statement Forms 8889. Attach the statements to your tax return after the controlling Form 8889.

❑ Step 7: You should receive Form 5498-SA, from the trustee showing the amount contributed to your HSA during the year. Your employer's contributions also will be shown in Box 12 of Form W-2, Wage and Tax Statement, with code W. Follow the instructions for Form 8889. Report your HSA deduction on Form 1040 or Form 1040NR, line 25.

❑ Step 8: The trustee will report any distribution to you and the IRS on Form 1099-SA, Distributions From an HSA.

Documents Used To Implement The HSA

These are the forms you will need to implement a Health Savings Account:

- Form 8889 and Instructions for Form 8889
- Form 1099-SA and Instructions for Form 1099-SA
- File Form 1040

IRS Publications & Forms References

IRS Publications

Employer's Tax Guide to Fringe Benefits
Publication 15-B – Health Savings Accounts
http://www.irs.gov/publications/p15b/ix01.html

Tax Favored Health Plans
Publication 969 Tax-Favored Health Plans
http://www.irs.gov/publications/p969/ix01.html

Qualified Medical & Dental Expenses
Publication 502, Medical and Dental Expenses
http://www.irs.gov/publications/p502/ar01.html

IRS Forms 8889, 1099-SA
http://www.irs.gov/app/picklist/list/formsInstructions.html