What is an HSA?

brought to you by
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Defined

An HSA—it stands for "Health Savings Account"—is an account to which you and your employer contribute.

- You use it to meet your everyday health care needs, such as a doctor's visit or prescription medication. You spend it on the items that matter to you. It covers expenses not covered by another plan.
- But your HSA does not work alone. You also have traditional health care coverage—an insurance plan with a high deductible. Once you use up the funds in your HSA, you may have to pay out of pocket for any additional expenses, until you meet the deductible of your plan. Then, once you meet the deductible, your plan begins to pay its share of the costs. Your insurance plan gives you protection when you need it, for major items like surgery or childbirth.

Because you have an account full of cash to spend on your health care needs, you may be wondering: What's the best way to spend this money? How can I be sure I'm getting the most for my health care dollars? Not to worry. You will have online tools, worksheets, glossaries and other materials and services that will give you the answers you are looking for.

And, because it's in a savings account, you get to invest the money and save for future expenses.

Eligibility

You're eligible to sign up for an HSA if:

- You are enrolled in a high deductible health plan (also called an HDHP). What is a high deductible health plan? When used with an HSA, a high deductible health plan must meet the following criteria:

  • The minimum deductible is (for 2006):

    - $1,050 for individual coverage
    - $2,100 for family coverage

- The maximum out-of-pocket limit is (for 2006):
    - $5,250 for individual coverage
    - $10,500 for family coverage

Note that the deductible is always the “in-network” deductible for the plan.

- You are not enrolled in Medicare
- You are not a dependent on someone else’s tax return
- You have no other health care coverage (such as being covered under your spouse’s plan, or other individual coverage.) That also means you can’t be covered under a separate prescription drug plan. You can, however, be covered under dental, vision or long term care coverage, or coverage that pays a fixed dollar amount for a disease or for a period of hospitalization, and still enroll in an HSA.

There are no income limits for HSAs. So your income is never a determining factor in whether you can establish an HSA.

Contributions to the Account

The amount that can be contributed to an HSA is also subject to annual limits. For 2006, you are limited to the lesser of your health plan’s deductible or the HSA annual limit of:

- $2,700 for individual coverage, and
- $5,450 for family coverage.

In addition, if you are age 55 or older, you are eligible to make an additional “catch-up contribution”—for 2006, that amount is $700.

These are annual amounts. The contributions are prorated for any month in which you don’t participate in an HDHP.

Note: these limits represent the total that can be contributed in a single year—your contributions, and your employer’s contributions, combined.

Eligible Expenses

Which expenses can be covered by your HSA?

- Your HSA is designed to cover qualified medical expenses that are not covered by your high deductible health plan. It includes items like eyeglasses, doctor’s fees, prescription and certain over-the-counter medications. It also includes copayments, coinsurance and deductible amounts for these items.
- Remember that, to be reimbursed from your HSA, each expense must be considered a “qualified medical expense” by the IRS. Qualified expenses are the types of medical, dental and vision expenses that can be claimed as a tax deduction (generally, you can only deduct health care expenses if they equal at least 7.5% of your adjusted gross income).
- In addition to the items mentioned above, “qualified medical expenses” also include items such as dental treatment, long term care insurance premiums, and transportation to and from doctor’s visits. In general, you cannot use your HSA to pay for health insurance premiums.

Whose expenses can be covered? Your expenses are obviously eligible, since you are the holder of the account. But you can also claim expenses for your spouse and eligible dependents.

How it Works

- Enroll in a high deductible health plan
- Set up your HSA with a local bank or other financial institution that offers HSAs. Only institutions that meet specific IRS requirements may offer an HSA. Your company may already be working with a bank to make this easier for you. There are only a few forms to fill out; setup fees are minimal. You will also choose how to invest the funds in your HSA.
- Decide how much to contribute to the account. Remember that your contributions, plus your employer's contributions, cannot exceed the annual maximum.
- Receive care. You will generally use a debit card or special check to use the funds in your HSA. You have immediate access to healthcare dollars; you generally don't have to pay any coinsurance to receive treatment. Some HSAs are coupled with HDHPs that provide coverage for preventive care from day one.
- If you use up the funds in the account before you meet your plan deductible, then you have to pay out of pocket until you meet that deductible. However, your plan has an overall out of pocket maximum to protect you and limit the amount you have to pay. And once you meet the deductible, the high deductible plan begins to pay its share of costs.
- If you have money left in your account at the end of the year, it just rolls over into the following year, creating a bigger nest egg for future medical expenses.
- And if you leave your job—the account goes with you. You don't forfeit any of the funds.

Invest in Your Health

When you open an HSA, it's just like opening an IRA. You open the account at a financial institution that is authorized to open HSAs; they are also referred to as HSA Trustees or Custodians.

- You will generally have a choice of investment options for your HSA funds. Your permitted investment options may include stocks, certificates of deposit, bonds, savings accounts, or other types of investment vehicles. The money in your account earns investment return, and interest. Plus, you can change your investment selections according to your needs.
- The best part of the HSA is that any money you don't spend rolls over from year to year (unlike money in a flexible spending account). This way, you can start building up a reserve for future medical expenses that you and your family may incur.
- The next best part of the HSA is that everything is tax-free to you. If you pay via payroll deduction, your contributions are pre-tax. Your interest and investment earnings are tax-free. And your reimbursements are tax-free. But remember: if you use the money for anything other than qualified medical expenses, you will owe a 10% tax on the amount of the reimbursement. (Note that once you reach age 65, there is no 10% tax on funds you withdraw to pay non-qualified expenses.)