

# TAX BULLETIN

## Health Savings Accounts SAVE MONEY through:

- Lower premium payments
- Tax deductible Health Savings Account contributions
- Converting "Schedule A" medical deductions subject to 7.5% of AGI limitations to fully deductible expenses

## HEALTH SAVINGS ACCOUNTS

Taxpayers have watched health care costs soar over the last decade. 2004 marked the fifth year in a row of double digit increases according to a recent Wall Street Journal article. Workers are being asked to pay more. Doctors feel they are receiving less compensation and are paying skyrocketing liability insurance. More and more individuals are becoming uninsured. The Center for Studying Health System Change is expecting 56 million uninsured by 2006. Congress has gotten involved. In 1996, the MSA (medical savings account) was established. It never attained a popular following. In 2003, the IRS opened the door for the Health Reimbursement Arrangements HRA, by issuing some favorable Revenue Rulings. Finally, in Decem-



### Rising Health Care Costs

ber, 2003, Congress has enacted what should be a favorable and popular plan called HSA (health savings account).

## HOW IT WORKS

Health savings accounts use inexpensive "high-deductible health plans". The IRS has defined a high-deductible health plan (HDHP) as one where the minimum deductible for an individual is at least \$1,000 and for a family is at least \$2,000 and the maximum out-of-pocket cost for the deductible and any co-payments cannot exceed \$5,000 for individuals and \$10,000 for families. Qualified medical expenses (discussed in detail below) can then be

paid out of a health savings account. Contributions to this account can earn interest, are 100% tax deductible for adjusted gross income (up to applicable limits) and roll over each year it goes unused. Qualifying distributions are not reported as income and non-qualifying distributions for age 65 and over are subject to tax but no penalty (much like an IRA). Non-qualifying distributions before age 65 are subject to tax and a 10% penalty.

# HOW IT SAVES MONEY

## EXAMPLE #1:

Heidi Ductable is an employee of Cost Containment, Inc. (CCI). CCI pays 75% of Heidi's family plan which has a \$100 deductible. CCI has decided to implement a HDHP plan with a \$5,150 deductible in 2004. CCI has decided to pay the same overall amount under the new plan and will pay 100% of the premium.

NOTE: Savings becomes much greater for Heidi if she does not use the deductible – it carries over for future expenses.

|   | <u>Old</u>     | <u>HSA</u>     |
|---|----------------|----------------|
| Premium Cost                              | \$9,100        | \$2,808        |
| Employer pays                             | 6,825          | 2,808          |
| Employee pays                             | <u>\$2,275</u> | <u>\$ 0</u>    |
| Employer HSA Contribution (\$6,825-2,808) | N/A            | \$4,017        |
| Employee HSA contribution (\$5,150-4,017) | N/A            | <u>1,133</u>   |
| HSA Maximum Contribution                  | N/A            | <u>\$5,150</u> |
| Savings to Employee (\$2,275-1,133)       |                | \$1,142        |

## EXAMPLE #2:

Scrooge and Marley offer a health insurance plan but do not pay any portion of the employees' premiums. After Scrooge sees the ghost of Christmas future, he takes pity on his employees and implements a high deductible health plan (\$5,000 deductible for a family) though he still can't bring himself to pay the premiums.

NOTE: Again, savings become much greater if the employee does not use the deductible each year.

|                                      | <u>Old</u>      | <u>HSA</u>     |
|--------------------------------------|-----------------|----------------|
| Premium Cost                         | \$10,000        | \$3,500        |
| Employer pays                        | 0               | 0              |
| Employee pays                        | <u>\$10,000</u> | <u>\$3,500</u> |
| Employer HSA Contribution            | N/A             | \$ 0           |
| Employee HSA Contribution            | N/A             | <u>5,000</u>   |
| HSA Maximum Contribution             | N/A             | <u>\$5,000</u> |
| Savings to Employee (\$10,000-8,500) |                 | \$1,500        |

*“Contributions to a health savings account can earn interest, are 100% tax deductible for adjusted gross income and roll over each year they go unused.”*

## WHAT QUALIFIES?



- ◆ Amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, and for the treatments affecting any part or function of the body.
- ◆ Amounts paid for certain over-the-counter items if purchased in reasonable quantities (ex. allergy medicine, nasal strips, pain reliever, reading glasses, etc.)
- ◆ Amounts paid for certain over-the-counter drugs reimbursed with a medical practitioner's note (ex. dietary supplements, glucosamine, sunscreen, weight-loss drugs)
- ◆ Essentially, everything except for toiletries! (ex. chap stick, shampoo and suntan lotion are not qualified)