

**The Common Sense Guide to  
HEALTH SAVINGS ACCOUNTS**

*What You Need to Know  
About High Deductible Health Plans  
and Health Savings Accounts*

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## How To Use This Guide

This guide is intended to help individuals and families better understand Health Savings Accounts, how the health plans that make people eligible for Health Savings Accounts compare to traditional health insurance, and how to determine whether a Health Savings Account is right for you or your family. A worksheet is included to help you compare the financial features of the Health Savings Account to a traditional policy. In addition, a detailed comparison of a traditional PPO policy and an HSA plan prepared by the *Washington Post* is re-printed in Appendix 3.

The guide examines the finer details of HSA accounts and the health insurance policies that accompany them. In each section, a “Buyer’s Guide” provides advice, reminders, and things to consider when examining a Health Savings Account. The “Buyer’s Guide” is intended to provide additional insight into the finer details of Health Savings Accounts and how they work.

Additional help is provided through answers to frequently asked questions, definitions of terms that are commonly used with Health Savings Accounts, and a description of additional resources available through the Internet.

Every attempt will be made to keep this guide current with any changes in the laws, regulations or operational details of HSAs. In addition, the section “Frequently Asked Questions” will be updated as additional clarification is needed and further questions arise.

## **INTRODUCTION**

Increasingly, individuals and families are considering health insurance policies with higher deductibles than traditional policies. Sometimes, employers are asking their employees to enroll in these plans, either as an option or the only health insurance plan available to employees. Individuals and families purchasing health insurance on their own may sometimes only find affordable health insurance if they choose a policy with a high deductible.

Some, but not all, of the newer health insurance policies with high deductibles may qualify individuals and families for a new type of trust or custodial account that has certain tax advantages, called a “Health Savings Account” or “HSA.” An HSA offers a way to put aside money to pay for your routine medical expenses and help you save money on taxes. HSAs are designed to fill in the gaps for “catastrophic” insurance policies that cover larger medical bills.

Most of us know that we can lower our premiums on our auto or homeowners insurance by raising our policy deductible. But few of us actually put the savings into a “rainy day” fund in case we actually have to pay our deductible when we have a claim. HSAs offer a way of putting money into that “rainy day” fund for health care. The tax benefits that come with the HSA make the opportunity that much better.

This guide will provide useful information about: (1) which types of high deductible health insurance policies qualify for HSAs and which do not; (2) how to set up and use an HSA; and, (3) tips on how to help you find good resources to answer your questions.

Health Savings Accounts do not solve some or all of the problems with obtaining health insurance. However, for many individuals and families, HSAs may make health insurance more affordable while providing an alternative way of financing their medical coverage.

## **HISTORICAL BACKGROUND**

In 1996, federal legislation included a demonstration project which created Archer Medical Savings Accounts (MSAs). MSAs have many similarities to HSAs, including their coordination with high deductible health insurance policies and tax advantages. However, these accounts were limited in scope and available only to self-employed individuals and employees of small businesses.

In 2003, federal legislation removed the limitations on MSAs and re-named them “Health Savings Accounts.” HSAs are now available to any individual or family with HSA-qualified insurance. There are no limitations on who may have an HSA based on income or employment status. However, dependent children may not have their own HSA accounts but may be covered by the HSAs of their parents. In December, 2006, additional changes were made to the HSA program that improved account funding opportunities.

## “HSA-QUALIFIED” HEALTH INSURANCE

The term “HSA-qualified” insurance refers to health insurance policies with deductibles higher than traditional policies. HSA-qualified plans generally have lower premiums, higher deductibles and higher out-of-pocket spending limits, but in other ways resemble traditional health insurance plans. HSA-qualified plans can be licensed as an HMO, a PPO, or other type of insurance plan.

However, not all policies with high deductibles make individuals eligible to contribute to an HSA. In order for a high deductible policy to be an “HSA-qualified” policy, the policy must meet certain requirements relating to deductibles, out-of-pocket expenses, covered benefits, and preventive care. Plans that meet these requirements are also called “high deductible health plans” or “HDHPs.”

### ➤ **Deductibles**

In order for a high deductible health insurance policy to be “HSA-qualified,” the policy must have an annual deductible that is at least \$1,150 for self-only coverage or \$2,300 for family coverage beginning in 2009. The policy can have an annual deductible as high as \$5,950 for self-only coverage or \$11,600 for family coverage in 2009. If a high deductible policy has an annual deductible below or above these amounts beginning in 2009, it is not an HSA-qualified policy.

*NOTE: The amounts are adjusted annually for inflation and may increase from one year to the next. For 2010, the minimum deductible will increase to \$1,200 for self-only coverage and \$2,400 for family coverage. The maximum annual deductible will increase to \$5,950 for self-only coverage and \$11,900 for family coverage in 2010.*

Policies offering “family coverage” may apply a single “umbrella deductible” to the entire family. For example, a family has a policy that has a deductible of \$4,000 that applies to all medical expenses incurred by the family members. This means that one family member could incur all \$4,000 of medical expenses before the deductible is satisfied. Other policies have “embedded deductibles” for individual family members. For example, a family has policy that has an “umbrella deductible” of \$5,000 but has “embedded deductibles” of \$2,500 for each family member. This means that when any family member has incurred \$2,500 of medical expenses, that family member will have satisfied their individual deductible. However, a \$2,500 deductible could still apply to other family members until \$5,000 in medical expenses has been incurred by all the family members combined.

*NOTE: Family policies must have “embedded deductibles” for individual family members that are at least \$2,300 per person or the policy is not “HSA-qualified” for 2009.*

**Buyer’s Guide:** Make sure your policy has deductible that meets the requirements, especially as the required amounts change over time. The level of deductible you choose

will impact your premium and savings opportunity. Higher deductibles may lower your premium significantly and provide savings that you may put into your HSA account each year. However, you may not want to choose policies with the highest deductibles, at least initially, because the amount you may contribute to your HSA account to cover the deductible is limited each year. Over time, you may accumulate enough funds in your HSA to lessen the impact of higher deductibles. In addition, individuals age 55 or older may make additional contributions to their HSA accounts each year, which may allow them to accept policies with higher deductibles.

Based on a 2008 survey by America’s Health Insurance Plans (AHIP), annual premiums for best-selling HSA-qualified plans in the individual market averaged about \$2,300 for individual coverage and \$5,100 for families (see Table 1 below). Premiums for large employer-based HSA-qualified plans averaged about \$3,200 for single coverage and \$8,200 for family coverage. By contrast, premiums for all employer-based plans overall averaged \$4,704 and \$12,680 respectively, based on data from the Kaiser Family Foundation/HRET’s 2008 survey of employer sponsored health benefits.

**Table 1. Features of Individual Market Best-Selling HDHPs (AHIP Survey)**

|                       | <b>Single</b> | <b>Family</b> |
|-----------------------|---------------|---------------|
| Premium (Age 30-54)   | \$2,278       | \$5,125       |
| Deductible            | \$2,600       | \$4,846       |
| Out of pocket maximum | \$3,661       | \$7,057       |
| Lifetime maximum      | \$3.9 million | \$3.9 million |

➤ **Limits on Out-of-Pocket Expenses**

“HSA-qualified” policies must also limit annual out-of-pocket expenses paid by the individual or family for covered benefits under the plan. After the individual or family reaches this out-of-pocket limit, the plan must pay 100% of the cost of benefits covered under the plan for the remainder of the plan year. For 2009, the out-of-pocket limit may not be any higher than \$5,950 for self-only coverage or \$11,600 for family coverage. Out-of-pocket limits can be as low as \$1,150 for self-only coverage or \$2,300 for family coverage beginning. If a high deductible policy has an out-of-pocket limit above or below these amounts beginning in 2009, it is not an HSA-qualified policy.

*NOTE: The amounts are adjusted annually for inflation and may increase from one year to the next. For 2010, the limit on out-of-pocket expenses will increase to \$5,950 for self-only coverage and \$11,900 for family coverage.*

It is possible for the out-of-pocket limit to be as low as the policy deductible, in which case the plan pays 100% of covered benefits after the deductible is met. Other policies charge coinsurance (e.g., 20%) for covered benefits received after the deductible is met, up to a higher limit on total out-of-pocket expenses. Under HSA-qualified policies, the

deductible, copays, and coinsurance amounts paid under the plan must count towards meeting the out-of-pocket limit on expenses.

**Buyer's Guide:** Make sure your policy has a limit on out-of-pocket expenses that meets the requirements. The out-of-pocket limits for HSA-qualified plans offers two significant benefits to individuals and families when compared to traditional policies, especially for those with high medical expenses. First, some traditional policies do not have a limit on out-of-pocket expenses, leaving individuals and families exposed to unlimited and unpredictable expenses each year. Second, the deductible, copays, and coinsurance amounts paid under an HSA-qualified plan must count towards meeting the out-of-pocket limit on expenses. Under some traditional policies, the deductible and copays do not count towards meeting the out-of-pocket limit.

The level of out-of-pocket limit you choose will impact your premium. Some policies offer out-of-pocket limits as low as the deductible, meaning after you have met your deductible, the plan pays 100% of covered benefits. However, policies with higher limits may have lower premiums. Over time, you may accumulate enough funds in your HSA to lessen the impact of higher out-of-pocket limits. In addition, individuals age 55 or older may make additional contributions to their HSA accounts each year, which may allow them to accept policies with higher out-of-pocket limits.

#### ➤ **Covered Benefits**

There is a common misperception that HSA-qualified policies are “bare bones” insurance policies. This is generally not the case. Typically, the covered benefits under HSA-qualified are identical to traditional policies. The major difference is the amount of the deductible and the limit on out-of-pocket expenses.

High deductible insurance policies are subject to the same insurance laws and regulations as other policies (HMOs, PPOs, indemnity policies, etc.). This means that the same benefit mandates, premium regulations, and consumer protections prescribed by each state (and the federal government) apply to these high deductible policies. As with traditional policies, HSA-qualified policies must be approved for sale by the state insurance department.

The only exceptions to this are policies offered by companies (typically larger companies) that self-insure their company benefits. However, these policies are regulated by a federal law known as “ERISA” which allows companies to offer policies to their workers providing the same benefits regardless of which state the employees work.

One key difference between traditional plans and HSA-qualified plans is that the deductible must apply to all covered benefits under an HSA-qualified plan, including the cost of prescription drugs. This means that an individual or family could meet their deductible solely through prescription drug expenses. If you take a lot of prescription medicines, you may pay more out of your own pocket (or use HSA funds) than the \$15 or

\$20 copays you are used to paying, but you may also hit your deductible faster and reach higher levels of insurance coverage more quickly (e.g., 80% or 100% coverage).

As with traditional policies, HSA-qualified policies may have different levels of covered benefits depending on whether they are provided by “in-network” or “out-of-network” physicians, hospitals, and other medical providers. The limits on deductibles and out-of-pocket expenses described above apply only to covered benefits from “in-network” providers.

Just like traditional policies, HSA-qualified policies may put limits on covered benefits, such as the number of visits, limit payments to “usual, customary, and reasonable” (UCR) amounts, use formularies or preferred lists for prescription drugs, and require prior authorization before services are provided. These limitations should be described in any insurance policy contract. Be sure to read the policy contract and determine if the coverage is what you and your family need based on your family’s history of medical care use.

All consumers should learn as much as possible about the scope of coverage under the plan. In particular, you should not assume that once the plan’s deductible or out-of-pocket limit is met, all remaining medical expenses will be paid by the plan. While individuals who expect to rely on the plan’s coverage because they have high medical bills should understand how the plan will handle their particular expenses, everyone should understand what the plan will and will not cover once their deductible and out-of-pocket limits are met. As is the case with any type of health insurance, benefits are subject to the definitions, limitations, and exclusions described in the policy and are payable only if determined by the plan that they are medically necessary. However, such decisions may be subject to plan reconsideration and external appeal.

**Buyer’s Guide:** As with any insurance contract, the amount of covered benefits affects your premium. Pay close attention to the details of what is covered and under what circumstances, what is not covered (or “excluded”) and under what circumstances, and the types of medical providers from which covered benefits are available. Make sure you understand what expenses count towards satisfying your policy deductible and out-of-pocket limits.

If you are chronically ill and take several prescription medications, you may satisfy your HSA-qualified policy deductible with your drug expenses alone. Although this means that you pay the total cost of your prescriptions while your deductible is in effect, you will pay only the negotiated cost of your medicines, not the full retail price. This is one of the benefits of your HSA-qualified policy. Another benefit is that since these prescription expenses count towards meeting your deductible, you may hit your deductible and out-of-pocket limits faster than under a traditional policy, which means your policy could pay 100% of covered benefits sooner than a traditional policy.

## ➤ Preventive Care

HSA-qualified plans may provide coverage for preventive care on a first dollar coverage basis (i.e., without having to apply these expense to the policy deductible). HSA-qualified plans are not required to cover preventive care services, but most policies do offer at least some coverage for preventive care. Plans may cover 100% of preventive benefits or charge copays for the benefits. Plans may cover a limited or unlimited amount of preventive care benefits.

Each qualified plan determines what services are considered “preventive care” under the plan. Federal regulations allow plans to cover services such as the following:

- Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals.
- Routine prenatal and well-child care.
- Child and adult immunizations.
- Tobacco cessation programs.
- Obesity weight-loss programs.
- Screening services (see attached Appendix 1)

Some, but not very many, prescription drugs can be covered as “preventive care” under your policy. Two examples of types of drugs that may be covered as “preventive care” are drugs known as:

1. **Statins** that lower your cholesterol levels to prevent heart disease (e.g., Lipitor, Crestor, Mevacor, Zocor, Cholestin, Pravachol, etc.).
2. **Angiotensin-converting Enzyme (ACE) inhibitors** that may help prevent (or prevent reoccurrence of) a heart attack or stroke (e.g., Capoten, Lotensin, Vasotec, Altace, Zestril, Accupril, etc.).

*NOTE: Birth control pills and devices are not considered “preventive care” for HSA-qualified plans.*

**Buyer’s Guide:** Look for a policy that provides coverage of preventive care services that you will (or should) use. This will save you money in the long run and will help you maintain and improve your health. Make sure you understand the details of the preventive care services covered by your plan. Some services that are considered “preventive care” may not be covered by your plan.

Some plans may charge copays for certain preventive services. Of course, you may use your HSA funds to pay these copays. Pay special attention to whether any prescription drugs are covered as “preventive care” and under what circumstances. If you are unsure, ask your insurance plan for a more detailed explanation. If you are chronically ill, it is unlikely that your medications will be considered “preventive care.”

➤ **Is Your Policy HSA-Qualified?**

If your policy does not meet the requirements described above regarding deductibles, out-of-pocket limits, and covered benefits (including preventive care), it cannot be HSA-qualified. You must generally rely on your health insurance carrier to determine whether your policy meets the requirements and be “HSA-qualified.” HSA-qualified policies generally include a statement that they meet the requirements for HSAs or are determined to be a “High Deductible Health Plan” (HDHP). Although unlikely, some older insurance policies may meet the requirements to be “HSA-qualified.”

**Buyer’s Guide:** If you believe your current policy meets the HSA requirements, you should ask your insurance carrier to tell you in writing whether your policy is HSA-qualified. If the carrier is unwilling or unable to do so, you should not make your own determination. It is recommended that you contact your state insurance department and/or seek legal advice from a qualified professional who can help you make a determination. If you obtain your HSA-qualified policy through your employer, you can generally rely on the company’s determination.

➤ **How to Find an HSA-Qualified Policy**

Companies are increasingly offering HSA-qualified policies to their workers. If your employer does not offer an HSA-qualified policy or you do not currently have an HSA-qualified policy but would like to obtain one, contact a local insurance agent or ask your current insurance company about switching to an HSA-qualified policy. You may also want to contact the state insurance department for assistance, if needed. There are also many resources available on the Internet if you search on terms like “health savings account” or “HSA.”

**Buyer’s Guide:** Almost every health insurance company sells HSA-qualified policies. Ask any sales representative, agent, or broker about their experience selling HSA-qualified policies. Choose one that sells a lot of HSA-qualified policies, not just a few. Ask for references of companies or individuals to whom they have sold HSAs. If you do not currently have health insurance coverage or have a medical condition, you may be subject to medical underwriting and exclusions for pre-existing conditions when purchasing an HSA-qualified policy. HSA-qualified policies offer no greater protection against medical underwriting and/or pre-existing medical exclusions than traditional policies.

➤ **Other Coverage**

To be eligible to contribute to a Health Savings Account, not only must you have HSA-qualified insurance, but you must also not have any other first dollar coverage that could disqualify you. Other types of coverage that might disqualify you include:

- a traditional HMO, PPO, or indemnity policy, including coverage under a spouse’s policy

- a Flexible Spending Account (FSA) or Health Reimbursement Arrangement (HRA), including a spouse's FSA or HRA
- Medicare
- Medicaid
- Tricare
- VA benefits (if received within the past three months)

General purpose HRAs and health care FSAs are not HSA-qualified plans. However, certain types of FSAs or HRAs can be compatible with an HSA. For example, if your employer offers a "limited purpose" FSA or HRA that only reimburses dental, vision, and/or preventive care expenses, you may still be eligible for an HSA. These types of plans are desirable because it offers another tax-preferred way of paying for these expenses without using your HSA funds.

Certain types of insurance will not jeopardize your eligibility for an HSA. The following types of insurance may offer medical benefits but generally will not disqualify you if they are in place along with the HSA-qualified plan:

- Auto
- Accident
- Dental only
- Vision only
- Insurance for a specific disease or illness, as long as it pays a specific dollar amount when the policy is triggered
- Hospital indemnity, as long as it pays a specific dollar amount when the policy is triggered
- Long Term Care
- Disability
- Wellness programs offered by your employer, if they do not pay for significant medical benefits
- Worksite employee assistance programs (EAP), if they do not pay for significant medical benefits

**Buyer's Guide:** It is possible for you to be eligible for an HSA even though the rest of your family is not. This is possible even if you have "family coverage" that covers the rest of your family members. However, you should be particularly careful when a family member (except dependent children) has "other coverage" because it could jeopardize your ability to have and contribute to an HSA. Although HSA-qualified policies can be used as "secondary insurance," your primary insurance may eliminate your ability to contribute to an HSA account.

Be especially careful when your spouse has other insurance coverage or an FSA or HRA through his/her employer. It is not good enough to say you will never use their coverage or account to pay for your medical expenses – your spouse's plan/account must not allow your expenses to be paid (and should state this in writing). It is acceptable for your spouse's coverage/account to cover your children's medical expenses. Since

dependent children may not establish their own HSA accounts, any other coverage they may have is not relevant.

It may be worthwhile considering purchasing a supplemental “hospital indemnity” or “accident” policy. They may be relatively inexpensive but will help you pay your medical bills if you have to pay your entire deductible all at once because you are hospitalized. This will help keep the funds already deposited in your HSA for other medical expenses.

## HEALTH SAVINGS ACCOUNTS

Individuals that have HSA-qualified insurance policies (and no other first dollar coverage that disqualifies them) are eligible to establish health savings accounts and make contributions each year. Contributions provide certain tax advantages as described below. Funds deposited in the account roll over automatically each year and may be invested without paying taxes on earnings. Account funds may be used tax-free to pay for qualified medical expenses. Accounts may be established with qualified institutions such as banks and credit unions.

➤ **Making Contributions to Your HSA Account**

Contributions to HSA accounts may be made by individuals, employers, and other individuals (including family members). Employers may make fixed dollar or “matching” contributions. Contributions made by employers and employees through payroll deduction are treated the same way as payment of health insurance premiums for tax purposes – these contributions are not counted as “income” when determining income and employment taxes. This means that HSA contributions made through your job may reduce both you and your employer’s income and FICA taxes.

| Source of HSA Contribution                  | Tax Status                                |
|---|---|
| Employer                                    | No income or payroll taxes (FICA) applied |
| Employee, through payroll deduction         | No income or payroll taxes (FICA) applied |
| Employee, but not through payroll deduction | Deductible on employee’s income taxes     |
| Family member or friend                     | Deductible on recipient’s income taxes    |

Contributions may also be made outside of your employment. In this case, you pay no income taxes on your contributions. In addition, the amount you contribute to your HSA reduces your taxable income. For example, if your income is \$42,000 and you make a \$2,000 contribution to your HSA account, the amount of your income that is taxed is only \$40,000. You are not required to itemize deductions to take the deduction for your HSA

contributions. However, you do have to complete the standard Form 1040 (you may not file the form 1040-EZ).

*NOTE: HSA contributions are also deductible from state income taxes in all states except<sup>1</sup> Alabama, California, New Jersey, and Wisconsin. The following states have no state income tax: Alaska, Florida, New Hampshire, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming.*

Contributions may also be made by other individuals, such as family members. For example, parents may want to help their children that have recently graduated from college and are now on their own to fund their HSA accounts. In these situations, the person receiving the funds (i.e., the son or daughter) receives the tax deduction on their income taxes. These contributions may also be exempt from gift taxes for the person making the contribution (e.g., the parents).

The amount that may be deposited into an HSA account each year is set by the U.S. Treasury Department using a formula specified in law. For 2009, the amount you may deposit is limited to:

- \$3,000 for individuals with self-only coverage
- \$5,950 for those with family coverage

*NOTE: The amounts are adjusted annually for inflation and may increase from one year to the next. For 2010, the annual contribution limit will increase to \$3,050 for individuals and \$6,150 for families.*

Individuals age 55 or older may make additional “catch-up” contributions of \$1,000 each year.

If your employer makes contributions to your account, the company decides how frequently to make the contributions (e.g., every payday, monthly, quarterly, etc.). If you make contributions through payroll deduction, the contributions will probably be deposited in your account with every paycheck, or at least monthly. Once the money is deposited in your account, it belongs to you. Your employer may not tell you what to do with the funds after that point.

If the amount of contributions being made by your employer and/or by you through payroll deduction do not add up to the maximum amount you are allowed to contribute for the year (including catch-up contributions), you may deposit the difference into your HSA account and deduct this amount on your income tax return. For example, if you have self-only coverage and your employer agrees to contribute \$1,000 to your HSA account and you have another \$1,000 deposited to your account through payroll deduction, you may make an additional deposit of \$1,000 to your HSA account (i.e., \$3,000 total). If you are age 55 or older, you could also make a catch-up contribution for the year (i.e., \$4,000 total).

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<sup>1</sup> As of December 31, 2008.

You do not have to wait to incur medical expenses before you make this contribution (e.g., \$500 in the example above) to your account. Contributions may be made at any time of the year and as late as the income tax filing deadline (usually April 15) in the following year. However, funds must be deposited into your HSA account before they may be used to pay for or reimburse your medical expenses. If you do not deposit the funds first, you will not receive credit for the deposits and therefore not qualify for the income tax deduction for HSA contributions.

Your HSA eligibility is determined by the effective date of your HSA-qualified insurance coverage. You must be enrolled in an HSA-qualified plan as of the first day of the month to be “eligible” for that month. If your enrollment is effective on any day other than the first day of the month, you are not considered “eligible” for an HSA until the following month.

If your HSA-qualified coverage begins in any month other than January, you may still be able to make the full HSA contribution for the calendar year. For example, if your coverage under an HSA-qualified policy does not begin until July, you may still contribute the full \$3,000 (assuming you have self-only coverage) for 2009. However, you must keep your HSA-qualified coverage through at least the end of the following calendar year or you may have to pay back some of the contribution (and maybe interest and penalties).

For any year that you drop or lose your HSA-qualified coverage before the end of the year, you will not be able to make the full contribution to your HSA. You will need to pro-rate your contribution for that year. Count only those months for which you had HSA-qualified coverage on the first day of the month. For example, if you drop your HSA-qualified coverage at the end of June, you would only be able to contribute 50% of your allowed contribution for that year.

In the year you turn age 55, you are eligible to make the full catch-up contribution regardless of when your birthday falls during the year, if you have HSA-qualified coverage for the entire year. However, if your coverage begins on any day other than January 1, your catch-up contributions must be pro-rated for the number of months for which you have HSA-qualified coverage.

For families with married couples, the family may open one or two HSA accounts, if both spouses are eligible. However, the total contribution to the two accounts cannot exceed the maximum allowed for the year (including pro-rated amounts). If both spouses are age 55 or older, each spouse must open an account in their own name to allow them both to make catch-up contributions. As with IRAs, joint accounts are not permitted.

You may transfer funds from an IRA, but only once in your lifetime, to help fund your HSA account without paying a tax penalty for early withdrawal from your IRA. However, the amount you transfer may not exceed your annual HSA contribution for the year plus your allowed catch-up contribution for the year (i.e., \$4,000 if you have self-only coverage and are age 55 or older).

**Buyer's Guide:** Funds may not be used for medical expenses until they are deposited into the account, so it is important to make your contributions as early in the year as you can afford to do so. If you are opening an HSA account for the first time, you should open your HSA account and make an initial deposit as soon as possible because only those expenses incurred on or after the date your account is opened are eligible to be paid or reimbursed from your HSA account. After your account is opened and you have at least some funds on deposit, you may wait as late as April 15 to make the remaining contribution to maximize your account deposits for the previous calendar year. If you have medical expenses but not enough funds in your account, make sure to deposit to your HSA first (if you haven't already exceeded the maximum contribution for the year) and then reimburse yourself for the expenses so you get the tax savings that HSAs offer.

*NOTE: If you make contributions to a family member's (non-dependent) HSA account or transferring funds from your IRA to an HSA, consult your tax advisor before making contributions.*

### ➤ **Establishing HSA Accounts**

HSA accounts may be opened at any willing bank, credit union, or other qualified institution. The institution is the “custodian” or “trustee” of your account. By agreeing to offer HSA accounts, the custodian/trustee agrees to abide by banking laws, offer federal deposit insurance to protect your account, and report necessary tax information to you and the Internal Revenue Service.

The general process for establishing your HSA account is very similar to the way you open an Individual Retirement Account (IRA). You do not need permission from your employer or anyone else to establish your HSA account. The specific process varies from bank to bank. Generally, most trustees and custodians require that you complete an application form in writing, sign it, and return it by mail or fax. Some trustees and custodians have developed account opening processes that allow some aspects to be handled electronically.

Banks and credit unions are not required to open HSA accounts so don't be surprised that your local bank or credit union does not offer HSA accounts. Insurance companies are also approved to open your account. Many insurance companies offer HSA account services through a partnership with a bank. This often makes it easy to get your account started. You always have the flexibility to transfer your funds to another institution of your choosing at a later date.

It is important that you open your HSA account as soon as you enroll in an HSA-qualified plan (if not before) because your HSA may only be used to pay for or reimburse you for qualified medical expenses that you incur after your account is “established.” This is an important and subtle rule -- one that may surprise you when you enroll in an HSA-qualified plan for the first time. Typically you enroll in the HSA-qualified plan first, then open the HSA account. Many trustees and custodians allow you to complete the necessary account opening forms or other processes shortly before the date your

HSA-qualified coverage becomes effective, so your account is considered “established” on your coverage effective date. As a result, any medical expenses you incur during the first few days of coverage may be paid for or reimbursed from your account.

If your employer makes contributions to your account or allows you to make contributions through payroll deduction, your employer may choose a financial institution at which to deposit the funds. This makes it easier for your employer to deposit the funds into your HSA account. However, you may transfer the funds to another bank or credit union if you want your account held at a different institution.

Custodians and trustees may set administrative fees and other requirements for HSA accounts. These include things like minimum deposit requirements, minimum balance requirements, account set-up fees, account maintenance fees, etc. A 2007 survey of HSA custodians and trustees indicated the following ranges for HSA account fees:

- Account set-up fees – \$0 - \$50 (average = \$14.36)
- Monthly maintenance fees -- \$0 - \$10 (average = \$2.06)
- Transaction fees -- \$0 - \$5 (average = \$0.27)
- Account closing fees -- \$0 - \$30 (average = \$10.17)

You should consider these costs when deciding where to open your HSA account(s).

Most custodians and trustees pay interest on your account funds, just like they do for savings and checking accounts. The average interest rate paid is around two percent. The highest rate being paid is around 5 percent. Generally, higher interest rates are offered for larger account balances.

Your HSA account custodian/trustee may also offer investment options for your HSA funds. This may be an important consideration as your account balance grows over time. Your funds may be invested in the same types of investments permitted for Individual Retirement Accounts (IRAs), including stocks, bonds, mutual funds, CDs, etc. However, each institution may decide how many and what types of investment options it offers.

You may open and maintain more than one HSA account at different financial institutions. You may deposit as much as you wish into each account as long as your total contribution to all the accounts combined does not exceed the limits for the calendar year. However, because each account custodian/trustee may charge fees, etc., it may not be wise to open too many HSA accounts.

**Buyer’s Guide:** Be sure to shop around for banks or credit unions that offer you good value for your HSA account funds. Some charge high fees that may offset the growth you realize through interest payments or investments. Open your HSA account before your coverage begins, or as soon as possible after it starts. Doing so will ensure that you have your account opened on the first day of your HSA-qualified insurance coverage, which for many people begins on a holiday (January 1). That will guarantee that any expenses you might incur on January 1 (or later) will be eligible for reimbursement from the account.

## ➤ Using Your HSA Account

Once funds are deposited in your HSA account, you may withdraw funds from the account to pay for qualified medical expenses tax-free. The types of expenses that qualify for tax-free reimbursement from an HSA include more than just what your insurance covers. In fact, HSA funds may be used to cover many items and services that insurance often does not cover, including over-the-counter medications, vision care expenses (including laser eye surgery), dental care expenses (including orthodontia), chiropractic care, and much more (see Appendix 2).

In most instances, you may not pay for health insurance premiums tax-free with HSA funds. However, the funds may help you pay for your health insurance premiums during periods when you are between jobs. For example, you may use your funds to pay premiums for COBRA continuation coverage from a former employer. You may also use your funds to pay health insurance premiums if you are receiving federal or state unemployment compensation. In either case (COBRA or unemployment), you may pay premiums for health insurance even if it is not HSA-qualified insurance.

Looking towards retirement, HSA funds may be saved and used later to pay for long-term care expenses and insurance, and Medicare out-of-pocket expenses (deductibles, co-pays, and coinsurance) and monthly premiums for Part A (inpatient hospital), Part B (physician and outpatient), Part D (prescription drugs), and Medicare Advantage plans. The only thing funds may not be used tax-free to pay is premiums for Medicare Supplement (i.e., Medigap) insurance.

Your HSA account funds may be used to pay for not only your qualified medical expenses, but also the qualified expenses incurred by your spouse and dependents. Your spouse and dependents do not need to be covered by your HSA-qualified plan.

Many banks and credit unions offer checks or debit cards that you may use to pay for expenses at the time the services are provided. These features offer easy access to your account funds, including reimbursing yourself for expenses you have already incurred. Be aware that some of these features have associated fees, especially when using a debit card to withdraw “cash” from your HSA account, even if you are reimbursing yourself for a qualified medical expense.

**Buyer’s Guide:** You have great flexibility when determining how to use your account funds. This is one of the great advantages that HSAs offer. You alone may determine whether to use your account to pay for current medical expenses or save the funds in your account to pay for expenses in retirement. However, be aware of fees associated with different ways of accessing your account funds.

## ➤ How Your Health Savings Account Works

HSAs and HSA-qualified insurance work very similar to traditional insurance. Some medical providers prefer to submit a claim for the services provided to the insurance

company first and bill you after the insurance company applies their discount and your policy deductible. This ensures that your claim is for a covered service, that you get the benefit of the insurance company's negotiated fee with the provider, and that your expenses are counted towards satisfying your policy deductible. Your insurance company will then likely send you an "explanation of benefits" (EOB) showing the services provided, the charges submitted, and discount(s) applied. The EOB will also let you know how much you owe the medical provider.

The medical provider will also likely send you a bill for the amount you owe. If you have a debit card or checks to access your HSA account funds, you could use either form of payment the provider is willing to accept. You could also pay the provider in cash (or personal check or credit card) and reimburse yourself from your HSA account later.

Your account custodian/trustee and your employer do not have any responsibility to review or approve the expenses for which you use your account funds. If your tax return is audited by the IRS, you will need to prove that your medical expenses were "qualified." You will have to pay income taxes and a tax penalty (10%) on the amount that was not "qualified." Once you reach age 65 (or become disabled), you no longer have to pay the 10% penalty, just income taxes on amounts used for non-qualified expenses.

After the end of the year, you will be sent tax forms that indicate how much you contributed to your HSA account for the calendar year, how much you withdrew from the account during the year, and your ending balance on December 31. You do not need to itemize your deductions to take the deduction on your income taxes for the amount you contributed for the year. You will need to file a tax form (Form 8889) with your tax return which documents your HSA account funds and tax deductions.

**Buyer's Guide:** When you go to your medical provider, you should let them know that you have an insurance policy with a high deductible and that you may end up paying the entire amount for the services provided. You may want to offer to pay something before you leave the provider's office, as you would do when you have to pay a co-pay under a traditional policy. Some medical providers are concerned that they will have a harder time collecting from you if you don't pay something before you leave. These concerns may make your medical providers less willing to accept your HSA-qualified insurance in the future.

If you incur medical expenses early in the year, you may not have enough funds in your account to pay or reimburse yourself for the expenses you incur. If you will not be making the maximum contribution to your account through your employer and/or by payroll deduction, you could deposit the remaining funds you are allowed to contribute into your account at any time. If you can work out a payment plan with the provider, this may give you more time to deposit funds into your account. Your employer may also be willing to loan you the money which you could pay back over time (NOTE: Employers are not required to do this.) Over time, this may not be as much of a problem if you have unused funds that roll over to the next year.

Keep track of all your EOBs and receipts. This is the only proof you have that your expenses were “qualified medical expenses.” You are responsible for using your account funds appropriately. You need to keep good records to indicate that you used your HSA account funds exclusively to pay for or reimburse qualified medical expenses. These medical expenses may not be claimed as a “medical expense” if you itemize your deductions in the same year.

You may wait to reimburse yourself from your HSA account for many years into the future. There is no time limit on when you must use your HSA funds. However, if you receipts are no longer legible, you will have no proof that you incurred qualified expenses.

### ➤ **Beneficiaries & Estate Consequences**

You may name anyone you want (including your estate) the beneficiary of your HSA account. If your surviving spouse is the named beneficiary, he/she takes over ownership of the account and it becomes their HSA account. If he/she has HSA-qualified insurance, he/she may continue to contribute to the account as if it were their own. If the surviving spouse does not have a qualifying plan, he/she may not contribute to the account but may continue to use the account as his/her own HSA for qualified medical expenses with no tax consequence.

If you designate anyone other than a surviving spouse as the beneficiary, the funds in the account are no longer treated as an HSA upon your death. If the beneficiary is your estate, the fair market value of the account (as of the date of your death) is taxable on your final tax return. Qualified medical expenses incurred by you prior to your death may be reimbursed from the account before determining the “fair market value” of the account.

If the beneficiary is another individual, the account will become taxable to the recipient of it. The amount that is taxable will be reduced by any qualified medical expenses incurred by you prior to your death and paid by the recipient of the HSA. The taxable amount will also be reduced by the amount of estate tax paid due to inclusion of the HSA into your estate.

**Buyer’s Guide:** Consult your tax advisor or financial planner if you have questions about the estate tax consequences of your account. Be sure to designate a beneficiary for your account, especially if you are married. If you do not designate a beneficiary, your spouse may have to go through probate after your death to claim ownership of your HSA (depending on the laws of your state) even though the tax rules allow the transfer of ownership to occur tax-free.

## Advantages and Disadvantages of Health Savings Accounts

| Advantages   | Disadvantages  |
|--|--|
| <ul style="list-style-type: none"> <li>➤ <b>Security</b> – High deductible insurance and the HSA account provide protection against high or unexpected medical bills. Most policies also cover preventive care services to help you maintain your health and avoid illness and disease.</li> <li>➤ <b>Affordability</b> – HSAs make health insurance more affordable by lowering your health insurance premiums. The savings may be substantial, which may help you fund your HSA account.</li> <li>➤ <b>Flexibility</b> – HSA funds may pay for current medical expenses, including expenses that insurance may not cover. Funds may also be saved for future needs, such as:               <ul style="list-style-type: none"> <li>• Health insurance or medical expenses if no longer working (unemployed or retired but not yet on Medicare)</li> <li>• Out-of-pocket expenses and premiums when covered by Medicare</li> <li>• Long-term care expenses and insurance</li> </ul> </li> <li>➤ <b>Control</b> – You make all the decisions about your HSA account. You may make choices that are best for you, and physicians may be more effective patient advocates, with less intrusion from insurance companies.</li> </ul> | <ul style="list-style-type: none"> <li>➤ <b>Change</b> – You must switch to high deductible insurance from traditional insurance. Sometimes this means you must change insurance carriers as well.</li> <li>➤ <b>Insecurity</b> – Switching from traditional first-dollar coverage makes many people uncomfortable. High deductible plans are relatively new to many people.</li> <li>➤ <b>Other Coverage</b> – If you or a family member has other insurance coverage that is not HSA-qualified, or has an FSA or HRA through their employment, this may make you ineligible to contribute to an HSA.</li> <li>➤ <b>Control</b> – Some people prefer to have a third party (e.g., employer, insurance company) manage their health coverage for them. Employers and insurance companies are able to negotiate discounts for services and help us navigate the health care system in unique ways.</li> </ul> |

## Advantages and Disadvantages of Health Savings Accounts

(cont.)

| Advantages   | Disadvantages  |
|--|--|
| <p>➤ <b>Portability</b> – HSA accounts are completely portable. You may keep and take your account with you even if you:</p> <ul style="list-style-type: none"> <li>• Change jobs or become unemployed</li> <li>• Change your medical coverage or marital status</li> <li>• Move to another state</li> </ul> <p>➤ <b>Ownership</b> – You own the funds in your account. The funds in the account remain permanently and roll over from year to year, just like an IRA. There are no “use it or lose it” rules for HSAs.</p> <p>➤ <b>Tax Savings</b> – HSAs provide triple tax savings:</p> <ol style="list-style-type: none"> <li>(1) tax deductions when you contribute</li> <li>(2) tax-free earnings through investment</li> <li>(3) tax-free withdrawals for qualified medical expenses</li> </ol> | <p>➤ <b>Emergencies</b> – When you have an urgent situation or emergency, it is inconvenient and sometimes impractical to consider “comparison shopping.” Thankfully, most health care is provided in non-emergency situations.</p> <p>➤ <b>Information</b> – Sometimes it is difficult to get good information on health care prices and quality of services so you can comparison shop for good value in health care.</p> <p>➤ <b>Tax Filing</b> – You must file an income tax return to take advantage of all the benefits HSAs offer. Lower income individuals and families may not realize all the savings of HSAs if they pay no income taxes.</p> |

## HSA Worksheet

|  | HSA-Qualified Plan | Current/Other Plan |
|--|--------------------|--------------------|
| <b>Annual Premium</b>  |                    |                    |
| <b>Difference</b>  |                    |                    |
| <b>Annual Deductible</b>                                       |                    |                    |
| • Medical  |                    |                    |
| • Prescriptions  | (included above)   |                    |
| <b>Difference</b>  |                    |                    |
| <b>Annual Out-of-Pocket Limit</b>                              |                    |                    |
| <b>Difference</b>  |                    |                    |
| <b>HSA Contributions</b>                                       |                    |                    |
| • By your employer   |                    | N/A                |
| • By you   |                    | N/A                |
| • By others  |                    | N/A                |
| • “Catch-up” contribution <sup>2</sup>                         |                    | N/A                |
| <b>Total Contributions</b>                                     |                    | N/A                |
| <b>Tax Savings from Personal HSA Contributions<sup>3</sup></b> |                    | N/A                |
| <b>Sources for HSA Contributions</b>                           |                    |                    |
| • Premium Savings  |                    |                    |
| • Company HSA Contributions                                    |                    |                    |
| • HSA Contributions by others                                  |                    |                    |
| • Tax savings  |                    |                    |
| <b>Total Savings</b>   |                    |                    |
| <b>Increase in Out-of-Pocket Costs</b>                         |                    |                    |
| • Net increase in deductible                                   |                    |                    |
| • Net increase in out-of-pocket limit                          |                    |                    |
| <b>Total Increase</b>  |                    |                    |

<sup>2</sup> Per person age 55 or older. Maximum is \$1,000 per person.

<sup>3</sup> Add contributions made by you (if not made through your job), by others, and any catch-up contribution. Multiply total amount by applicable tax rate for your income (e.g., 15%). This is your tax savings.

## HSA Worksheet Example

|  | HSA-Qualified Plan | Current/Other Plan |
|--|--------------------|--------------------|
| <b>Annual Premium</b>  | \$5,600            | \$8,400            |
| <b>Difference</b>  | \$2,800            |                    |
| <b>Annual Deductible</b>   |                    |                    |
| • Medical  | \$5,000            | \$500              |
| • Prescriptions  | (included above)   | \$100              |
| <b>Difference</b>  |                    |                    |
| <b>Annual Out-of-Pocket Limit</b>                                | \$8,000            | None               |
| <b>Difference</b>  |                    |                    |
| <b>HSA Contributions</b>   |                    |                    |
| • By your employer   | \$1,200            | N/A                |
| • By you   | \$3,800            | N/A                |
| • By others  | \$0                | N/A                |
| • “Catch-up” contribution  | \$0                | N/A                |
| <b>Total Contributions</b>                                       |                    | N/A                |
| <b>Tax Savings from Personal HSA Contributions (assumes 15%)</b> | \$570              | N/A                |
| <b>Sources for HSA Contributions</b>                             |                    |                    |
| • Premium Savings  | \$2,800            |                    |
| • Company HSA Contributions                                      | \$1,200            |                    |
| • HSA Contributions by others                                    | \$0                |                    |
| • Tax savings  | \$570              |                    |
| <b>Total Savings</b>   | \$4,570            |                    |
| <b>Increase in Out-of-Pocket Costs</b>                           |                    |                    |
| • Net increase in deductible                                     | \$4,400            |                    |
| • Net increase in out-of-pocket limit                            |                    |                    |
| <b>Total Increase</b>  | \$4,400            |                    |

## Frequently Asked Questions

### *Why should I consider a Health Saving Account for me or my family?*

If you or your employer are tired of sending hundreds and hundreds of dollars each month to your health insurance company, and would prefer to keep a big chunk of that money for yourself to spend on health expenses or save it for the future, then you need to look into a Health Savings Account.

### *Why would some one who is less healthy want a Health Savings Account?*

You should also look at a health savings account if you have high medical expenses because the catastrophic protection against very high medical expenses may be superior to your current plan. There are two key reasons the less healthy should choose a Health Savings Account. The first reason is to have control over their own health care decisions and treatments, including their prescription drugs. With an HMO, the sick must face the rationing regime in place by HMOs to contain costs, which may include a frustrating waiting list to see a specialist or obtain a treatment, or prescription drug formularies that may not have the most up-to-date treatments or brand name drugs that would make them feel the best. Furthermore, in virtually all HSA qualified plans sold, prescription drug cost count towards your deductible.

The second reason is a financial incentive. Assuming the less healthy would rather not be in an HMO or other managed care plan, then they would likely choose a fee-for-service plan. The standard fee-for-service plan has a \$500 deductible, with a 20% co-pay of the next \$5,000. This means the person would pay \$500 for the deductible, and \$1,000 for 20% of \$5,000, before being covered 100%. That is \$1,500 in after-tax income to be insured 100% for someone who is less healthy in a traditional, low deductible, fee-for-service health insurance plan. Plus, the premium for a traditional low deductible plan is much higher, which adds more cost.

|  | <b>Traditional Plan</b>                                    | <b>HSA Plan</b>           |
|--|--|---------------------------|
| Deductible   | \$500  | \$2,500                   |
| Coinsurance above deductible                         | 20%  | 0% (100% coverage)        |
| Total patient medical expenses before plan pays 100% | \$5,500  | \$2,500                   |
| Out-of-pocket limit                                  | \$1,500  | \$2,500                   |
| Contribution to HSA                                  | N/A  | \$2,000                   |
| Amount and tax status of out-of-pocket expenses      | \$1,500<br>After-tax (not deductible unless > 7.5% income) | \$2,000<br>Tax deductible |

With a Health Savings Account, the same individual could pay a much smaller premium, and in most cases, use the savings to fund a majority of the deductible in their Health Savings Account. With a \$2,500 deductible with 100% coverage thereafter, and, say \$2,000 deposited tax-free in the Health Savings Account, the less healthy individual with an HSA would have to come up with \$500 to be covered 100% (\$2,500 deductible minus \$2,000 from the Health Savings Account equals \$500 to meet the deductible). The \$500 may be deposited

in the account to retain the tax advantage of whatever your specific tax situation is. So the choice for a less healthy individual in a traditional health plan is: (1) pay \$1,500 in after-tax funds to pay to be covered 100% by their insurance (\$500 deductible and 20% of the next \$5,000), or in this example, with an HSA, get a tax break on the extra \$500 they would need to be covered 100%. The less healthy, therefore, have a financial incentive to choose a Health Savings Account.

***For an employee, spouse and child coverage, does each individual open their own HSA account or is there one account for all? If there is one for all on the plan, what happens to the account if the spouses divorce?***

Each spouse may have their own account, and need to if you are making catch up contributions. Either spouse may use their account for any medical expenses for any member of the family, even if they are not covered by the HSA-qualified plan. If the couple divorce, the divorce settlement will decide the fate of the funds.

***If I get an HSA through my employer, how is it funded?***

The first step is to find out what your employer is currently paying for your health insurance. Then find out what an HSA would cost instead. Once you have that information, you may talk to your employer and a tax adviser about ways to fund your account. It may be cheaper for your employer to provide you with a partially or fully funded HSA compared to what he is currently paying for employee health care. Employer contributions to an HSA are excluded from employees' income. An employer may also choose to match the monthly HSA contributions made by employees. When you start a new job, find out if your new employer will contribute to your HSA each month. Employers are not obligated to contribute to your HSA, but you may also realize premium savings which may help you fund your account.

***If I use the catastrophic insurance, who pays the deductible?***

You pay the deductible with cash from your HSA. It generally it takes about a year to build up enough money in the account to pay the annual insurance deductible. In the event you need to pay the deductible early, you may use a loan, other savings or a credit card to make the payment first, and then repay yourself from your HSA a few months later when enough money has accumulated in the account. As long as you keep a record of the amount you first paid and when you paid yourself back, all these transactions are tax-free.

***If I use an out-of-network provider, will that count towards my deductible? May I pay for these out-of-network expenses from my Health Savings Account?***

Plans that cover out-of-network providers generally have a separate (higher) deductible for medical care received from out-of-network providers. These expenses do not count towards satisfying the deductible for medical care received from in-network providers. However, your Health Savings Account may be used to pay for medical care received from out-of-network providers if the care is a qualified medical expense.

***May I use my Health Savings Account for non-medical expenses?***

You may spend money out of your Health Savings Account for non-medical expenses, but you have to pay income tax and a 10% penalty for a non-medical withdrawal prior to age 65. At age 65, you only pay income tax on the amount of the non-medical withdrawal.

***Once I enroll in Medicare (age 65 yrs. old) may I get a Medicare Health Savings Account?***

Yes, there are Medicare Medical Savings Accounts (similar to HSAs) available starting in 2007. As with other private plans providing Medicare coverage (also known as “Medicare Advantage” plans), the federal government pays your plan premium and makes a contribution to your account. More information on these Medicare plans is available in the Medicare Handbook and on the Internet at [www.medicare.gov](http://www.medicare.gov).

***Is there a list of over-the-counter (OTC) drugs that are always/never/sometimes covered under an HSA?***

Most OTC drugs are qualified expenses under an HSA. Unfortunately, there is no definitive list available. Every day drugs are newly available over-the-counter.

***Currently my wife and I are uninsured and generally healthy but do have some pre-existing conditions. Will an HSA help us?***

HSA-qualified plans may be more affordable but medical underwriting practices may make it difficult for you to find an insurance carrier that will offer your coverage. Some states have “high risk pools” that have HSA qualified plans. Check your state insurance department to determine whether your state has a high risk pool.

***If the insured's expenses exceed the pre-tax contributions early in the plan year, will the insured have to pay the deductible with after tax dollars?***

No. You may deposit the funds later in the year and reimburse your expenses after the deposits are made. The deposits will qualify for the income tax deduction regardless of when they were made. Some employers will help their employees if there is a large expense early in the year. Another option is to purchase a supplemental policy such as a hospital indemnity policy that pays a certain amount if you are hospitalized and have to meet your deductible all at once. These policies may be relatively inexpensive. Ask your insurance carrier or agent where to find these types of policies in your area.

***Are HSAs considered “employer-sponsored benefit plans” that are governed by ERISA if my employer contributes to my account?***

The U.S. Department of Labor has ruled that HSAs are generally not “employer-sponsored benefit plans” governed by ERISA, even when the employer contributes to their HSA accounts, if:

- The employee’s participation in the HSA is voluntary
- The employer allows the employee to move his or her HSA to another custodian or trustee from where the employer deposits its contributions
- The employer does not place limits on employees’ withdrawals from their HSA accounts
- The employer does not make investment decisions for employees or influence the employees’ investment decisions

***How does making HSA contributions through my company save me money?***

If your employer offers a Section 125 plan (also known as a “cafeteria plan”) that allows you to make contributions to your HSA account through payroll deduction, you will save money by:

- Avoiding paying the employee share of the federal FICA tax on the amount you contribute, which results in greater tax savings than when you contribute after-tax amounts to the HSA. The employee share of federal FICA tax is 7.65 percent.
- Your tax liability and payments are reduced throughout the year when each contribution is made with each paycheck, and you do not need to wait until the end of the year to reduce your income taxes.
- Your interest or investment earnings accumulate faster if you make your contributions earlier in the year rather than waiting until the year ends.

***Who may be considered by “spouse” or “dependent”? May I use my HSA to pay for expenses of a domestic partner?***

Your HSA-qualified policy should specify who is considered a “spouse” or “dependent” for purposes of your insurance coverage. In many cases, domestic partners can be considered part of the “family” for policies providing family coverage. However, the rules for using your HSA funds are more rigid and specific:

1. Your spouse must be a person of the opposite sex to whom you are legally married as permitted under applicable state law.
2. “Dependents” generally must be either:
  - a. A child (son, daughter, stepchild, etc.) who lives with you more than half of the year and who is 18 years or younger for the entire calendar year (or under age 24 and a student for the entire year) or is permanently and totally disabled, or
  - b. A “qualifying relative” (consult an attorney or your tax advisor for details).

If a domestic partner meets the definition of a “qualifying relative,” you may use your HSA to pay for his or her qualified medical expenses tax-free. If the domestic partner is not a “qualifying relative,” you must pay income taxes on the amount of your HSA that you use to pay for his or her medical expenses, and an additional 10% tax penalty.

*NOTE: More frequently asked questions can be found at [www.hsaed.com](http://www.hsaed.com).*

## **GLOSSARY OF TERMS**

**Catch-Up Contribution** – These are additional contributions allowed for individuals age 55 or older. These contributions are allowed in addition to the annual amounts that generally match the deductible under an HSA-qualified policy. As with all contributions, these contributions must stop once an individual becomes eligible for Medicare.

**Coinsurance** – The percentage (e.g., 20%) of the cost of covered benefits you must pay. Generally, coinsurance is applied after you meet your policy deductible.

**Contributions** – Deposits to an HSA account. Contributions must be made in cash.

**Copay** – A fixed dollar amount (e.g., \$20) you must pay directly to the medical provider at the time you receive health care services.

**Custodian** – The bank, credit union, or other financial institution that holds your HSA account funds. In some states, the institution is considered a “trustee” of your account.

**Deductible** – A fixed dollar amount (e.g., \$1,500) you must pay each year before the plan pays for covered benefits.

**Distributions** – amounts paid from an HSA for qualified health care services.

**Embedded Deductible** – The amount any one individual family member may have to meet before the policy pays for covered benefits. This amount is generally lower than an “umbrella deductible.” Also known as an “individual deductible.”

**ERISA** – A federal law (the Employee Retirement Income Security Act of 1974) that regulates the administration of employee benefit plans provided by employers.

**Explanation of Benefits (EOB)** – A document prepared by your insurance carrier that indicates what services were provided by a medical provider, the amount the medical provider charged for the services, the negotiated rate at which the benefits were payable under your insurance policy, and the amount you owe the provider for the services provided. The document also may show the amounts you have paid year-to-date towards meeting your deductible and/or out-of-pocket limit.

**Family coverage** – For HSA purposes, any coverage that is not “self-only” coverage. “Family coverage” includes self + spouse only, self + dependent children, and self + spouse and children.

**Flexible Spending Account (FSA)** – A health care spending account offered through an employer to which employees make contributions through payroll deduction. The account may be used to pay for medical expenses approved by the employer. Unused funds do not roll over but revert back to the employer.

High Deductible Health Plan (HDHP) – A health plan that meets federal requirements regarding minimum deductibles, maximum out-of-pocket expenses, covered benefits and preventive care and makes in individual that has coverage under this type of plan eligible to contribute to a Health Savings Account. Also known as an “HSA-qualified plan.” Sometimes referred to as “catastrophic health insurance plan.”

Health Reimbursement Arrangement (HRA) – A health care spending account funded by employers that may be used for medical expenses or premiums approved by the employer. Unspent funds usually may be carried over to the next year, but cannot be taken with you if you leave the company.

Health Savings Account – An account established by an individual that has “HSA-qualified” health insurance coverage for payment of out-of-pocket expenses tax-free.

HSA-Qualified Plan – A health plan that meets federal requirements regarding minimum deductibles, maximum out-of-pocket expenses, covered benefits and preventive care and makes in individual that has coverage under this type of plan eligible to contribute to a Health Savings Account. Also known as a “High Deductible Health Plan” (HDHP).

In-Network – Care provided by health care professionals and facilities that have entered into an agreement with your insurance carrier to provide services to you and accept a negotiated fee for the services provided.

Out-of-Network -- Care provided by health care professionals and facilities that have not entered into an agreement with your insurance carrier to provide services to you and have not accept a negotiated fee for the services provided. Medical providers may charge their full amount (no discount) for these services. Your health insurance carrier may not pay these full charges. Some insurance contracts do not include out-of-network care as a covered benefit.

Out-of-Pocket Expenses – Expenses you pay for health care services you receive. Includes deductibles, copays and co-insurance. Does not include insurance premiums.

Out-of-Pocket Limit (or Maximum) – A fixed dollar amount of total out-of-pocket expenses you pay, above which your health plan pays 100% of covered benefits.

Qualified Medical Expense – A medical expense that is allowed to be paid tax-free from an HSA, HRA, or FSA. Section 213(d) of the federal Internal Revenue Code governs what can be a qualified medical expense. IRS Publication 502 (available at [www.irs.gov](http://www.irs.gov)) provides more information about the types of expenses considered “qualified.”

Trustee – The bank, credit union, or other financial institution that holds your HSA account funds. In some states, the institution is considered a “custodian” of your account.

Umbrella Deductible – The total amount of out-of-pocket expenses that a family must meet before the plan pays for covered benefits. The umbrella deductible may be met by one or any combination of family members’ out-of-pocket expenses, depending on the policy design.

## ADDITIONAL RESOURCES

The following resources and websites may be helpful to you in searching for HSA-qualified plans, financial institutions offering HSA accounts, and learning more about Health Savings Accounts.

### **U.S. Treasury Department**

[www.treas.gov/offices/public-affairs/hsa/](http://www.treas.gov/offices/public-affairs/hsa/)

This site is the definitive site for technical information about Health Savings Accounts.

### **National Association of Insurance Commissioners**

[www.naic.org](http://www.naic.org)

This site can help you quickly find your state insurance department's website for help with insurance matters.

### **National Association of Health Underwriters**

[www.nahu.org/consumer/HSAGuide.cfm](http://www.nahu.org/consumer/HSAGuide.cfm)

This is the site of the professional trade association for health insurance agents. The site includes a consumer-friendly HSA Guide.

### **Association of Health Insurance Advisors**

[http://www.ahia.net/consumer/guide\\_hsa.html](http://www.ahia.net/consumer/guide_hsa.html)

This professional advisor association site provides a consumer guide on HSAs.

### **eHealthInsurance**

[www.ehealthinsurance.com](http://www.ehealthinsurance.com)

This site is a good source for people not covered by an employer health plan and who need to buy their own insurance. On this site you'll find a large selection of health plans and the ability to compare costs.

### **GoHealth Insurance**

[www.gohealthinsurance.com](http://www.gohealthinsurance.com)

This is another good source for people not covered by an employer health plan and who need to buy their own insurance. On this site you'll find a large selection of health plans and the ability to compare costs.

## **Council for Affordable Health Insurance HSA Information Center**

[www.cahi.org/cahi\\_contents/consumerinfo/hsa.asp](http://www.cahi.org/cahi_contents/consumerinfo/hsa.asp)

This site has helpful information about HSAs. CAHI is a Washington, DC-based think tank.

## **HSA Decisions**

[www.healthdecisions.org/hsa](http://www.healthdecisions.org/hsa)

This site is operated by America's Health Insurance Plans, the trade association for the insurance companies. This site will give you information on 1,300 health plans and tens of thousands of agents and brokers nationwide.

## **HSA Finder**

[www.hsafinder.com](http://www.hsafinder.com)

This site can help you find HSA account custodians and trustees.

## **Other Helpful Sites**

The following resources and websites may be helpful to you in searching for information about the price and quality of health care products and services. There's no question that figuring out what your medical care costs and what health care provider offers the best quality care won't be easy. It's definitely not as easy as pricing out a Honda Accord, fully loaded. But when it comes to your health care, spend at least the same amount of time calculating the costs as you do pricing out your new ride.

## **HealthWise**

[www.healthwise.org](http://www.healthwise.org)

Healthwise develops consumer health information to help people make better informed health decisions.

## **Family Health Budget**

[www.familyhealthbudget.com](http://www.familyhealthbudget.com)

Humana Inc., in partnership with advocacy group Consumer Action, has created a free website that includes a family health budget planner. On the site you will find a number of tools to help you choose the best health care plan and benefits. The planner takes you through a step-by-step questionnaire asking for information such as your current insurance status, how many times members of your family go to the doctor, how often prescription medicines are purchased and how often the family visits the dentist, eye doctor or other specialists. Once you've added the information, you get a calculation of how much you need to set aside for health expenses for the year.

**WageWorks Inc.**

[www.wageworks.com](http://www.wageworks.com)

Wage Works is a provider of consumer-driven tax-advantaged spending accounts for health and dependent care. The site has a contribution and savings calculator for HSAs.

**HealthGrades Inc.**

[www.healthgrades.com](http://www.healthgrades.com)

HealthGrades is a health care ratings company based in Golden, Colorado that sells reports on the cost of 55 medical procedures, based on regional averages of payments made by health plans. One report costs \$7.95, but if you are facing a high deductible, it's worth the price to get detailed price information. You can also get physician reports, which include the amount that individual physicians are paid by Medicare for more than 100 types of procedures and visits. HealthGrades also offers hospital ratings of 28 procedures and diagnoses at more than 5,000 non-federal hospitals free. If you know you'll need to be hospitalized, for \$17.95 (\$2.95 for subsequent reports) you can get a more detailed hospital report that looks at the price of nearly 100 procedures. Before you buy a report, check with your employer because 125 major corporations provide them free as a benefit.

**Diagnostic Testing Web Sites**

[www.directlabs.com](http://www.directlabs.com)

[www.healthcheckusa.com/tests.asp](http://www.healthcheckusa.com/tests.asp)

[www.medlabusa.com](http://www.medlabusa.com)

[www.mymedlab.com](http://www.mymedlab.com)

There are several web sites that now offer consumers the opportunity to order the same diagnostic tests that they might get through traditional health care means – such as labs, hospitals and clinics. What makes these web sites unique is that consumers do not need a prescription from their doctor to have the test. Consumers pay upfront for the tests they want and receive a receipt to submit for reimbursement from their insurer, flexible spending account or HSA.

**HealingWell**

[www.healingwell.com](http://www.healingwell.com)

This web site is 10 years old and has more than 30,000 members. It provides access to information for nearly 40 chronic illnesses.

**Blue Cross and Blue Shield Association “Blue Distinction”**

[www.bcbsa.com/bluedistinction](http://www.bcbsa.com/bluedistinction)

The Association has launched “Blue Distinction,” an online-based program that includes a price transparency demonstration for medical services for 17 Blue Cross and Blue Shield plans around the country.

# APPENDIX 1

## Preventive Care Screening Services

### **Cancer Screening**

- Breast Cancer (e.g., Mammogram)
- Cervical Cancer (e.g., Pap Smear)
- Colorectal Cancer
- Prostate Cancer (e.g., PSA Test)
- Skin Cancer
- Oral Cancer
- Ovarian Cancer
- Testicular Cancer
- Thyroid Cancer

### **Heart and Vascular Diseases Screening**

- Abdominal Aortic Aneurysm
- Carotid Artery Stenosis
- Coronary Heart Disease
- Hemoglobinopathies
- Hypertension
- Lipid Disorders

### **Infectious Diseases Screening**

- Bacteriuria
- Chlamydial Infection
- Gonorrhea
- Hepatitis B Virus Infection
- Hepatitis C
- Human Immunodeficiency Virus (HIV) Infection
- Syphilis
- Tuberculosis Infection

### **Mental Health Conditions and Substance Abuse Screening**

- Dementia
- Depression
- Drug Abuse
- Problem Drinking
- Suicide Risk
- Family Violence

## **APPENDIX 1 (cont.)**

### **Metabolic, Nutritional, and Endocrine Conditions Screening**

- Anemia, Iron Deficiency
- Dental and Periodontal Disease
- Diabetes Mellitus
- Obesity in Adults
- Thyroid Disease

### **Musculoskeletal Disorders Screening**

- Osteoporosis

### **Obstetric and Gynecologic Conditions Screening**

- Bacterial Vaginosis in Pregnancy
- Gestational Diabetes Mellitus
- Home Uterine Activity Monitoring
- Neural Tube Defects
- Preeclampsia
- Rh Incompatibility
- Rubella
- Ultrasonography in Pregnancy

### **Pediatric Conditions Screening**

- Child Developmental Delay
- Congenital Hypothyroidism
- Lead Levels in Childhood and Pregnancy
- Phenylketonuria
- Scoliosis, Adolescent Idiopathic

### **Vision and Hearing Disorders Screening**

- Glaucoma
- Hearing Impairment in Older Adults
- Newborn Hearing

## APPENDIX 2

### Allowable<sup>4</sup> (Tax-Free) Expenditures from Your Health Savings Account

#### Examples of Allowable Expenditures from Your Health Savings Account

Acupuncture  
Alcoholism treatment  
Ambulance services  
Artificial limbs and teeth  
Bandages  
Birth control pills (by prescription only)  
Breast reconstruction surgery (mastectomy)  
Childbirth, labor and delivery services  
Chiropractic services  
Christian Science Practitioner services  
Contact lenses  
Cosmetic surgery, but only if due to trauma or disease  
Crutches  
Dental care  
Dermatology services  
Diagnostic devices  
Drug addiction treatment (inpatient)  
Eyeglasses  
Fertility treatments  
Gynecology services  
Hearing aids  
Home care  
Hospice care  
Hospital services (inpatient and outpatient)  
Laboratory services  
Laser eye surgery (e.g., LASIK)  
Long-term care (does not include custodial care)  
Maternity care  
Medicare deductibles, copays, coinsurance, premiums  
Nursing services

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<sup>4</sup> NOTE: This list is illustrative and is not meant to be an exhaustive list. There have been thousands of cases involving the many nuances of what constitutes “medical care” under the Internal Revenue Code, which governs Health Savings Accounts. A determination of whether an expense is qualified as “medical care” is based on all the relevant facts and circumstances. To be an expense for medical care, the expense has to be primarily for the diagnosis, cure mitigation, treatment, or prevention or alleviation of a physical or mental defect or illness. The determination often hangs on the word “primarily.” Additional information is available from IRS Publication 502 (available through [www.irs.gov](http://www.irs.gov)). Consult your physician and tax advisor, if you have questions.

## **APPENDIX 2 (cont.)**

### **Examples of Allowable Expenditures from Your Health Savings Account (cont.)**

Nursing home care  
Ophthalmology services  
Organ transplants (including donor's expenses)  
Orthodontia  
Orthopedic services, including orthopedic shoes  
Osteopathic services  
Over-the-counter medicines  
Oxygen and equipment  
Pediatric services  
Personal care services for chronically ill persons  
Podiatry services  
Pre-natal and post-natal care  
Prescription medicines  
Prosthetics  
PSA tests  
Psychiatric care  
Psychology services  
Radiology services  
Smoking cessation programs  
Splints  
Surgical services  
Transportation expenses for health care  
Vaccines  
Vision services  
Vitamins (only if prescribed by a licensed practitioner)  
Wheelchairs  
X-Rays

## **APPENDIX 2 (cont.)**

### **Non-Allowable (Not Tax-Free) Expenditures from Your Health Savings Account**

#### **Examples of Non-Allowable Expenses**

Advance payment for future medical expenses  
Athletic club membership  
Automobile insurance premiums  
Babysitting (for healthy children)  
Boarding school fees  
Bottled water  
Cosmetics and personal hygiene products  
Dancing lessons  
Diaper service  
Domestic help  
Electrolysis or hair removal  
Funeral expenses  
Hair transplants  
Health programs at resorts, health clubs, & gyms  
Household help  
Illegal operations and treatments  
Illegally procured drugs  
Maternity clothes  
Nutritional supplements  
Premiums for life, disability, other accident insurance  
Scientology counseling  
Social activities  
Special foods/beverages  
Swimming lessons  
Teeth whitening  
Travel for general health improvement

## Appendix 3

The following comparison appeared in the *Washington Post* on October 26, 2004. The article compares how families might fare under a traditional PPO plan versus an HSA plan if they have low, medium, or high medical expenses in a given year. This article compares plans available only to federal employees for calendar year 2005 (the first year HSA plans were offered to federal employees). While this example may not be an appropriate comparison for every family, it illustrates how one could determine whether they would be better off financially under a traditional plan or an HSA.

### Health Savings Accounts: Three Scenarios

*This chart compares consumer costs for the Aetna HealthFund, a new health savings account (HSA) plan being offered to federal employees in the Washington area, with costs for a popular traditional health plan—a preferred provider organization (PPO). Family-coverage costs for the PPO appear in column two; family-coverage Aetna HSA costs*

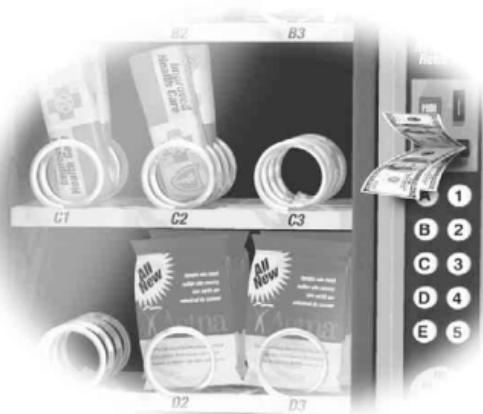


ILLUSTRATION BY RAMSEY MAPS FOR THE WASHINGTON POST

*appear in column three. All figures and estimates are provided by Aetna. The notes in the last column are our own.*

*Example 1 shows estimated costs for a family with low annual medical expenses of \$1,500. Example 2 shows estimated costs for a family with significant medical expenses of \$20,000. Example 3 shows estimated yearly costs for a family with catastrophic medical expenses of \$100,000.*

*The HSA calculations make several assumptions: The policyholder has made*

*voluntary deposits to his HSA account that may be larger than your family could afford. All medical treatments were considered eligible for coverage by the plan. Also, the family's income tax bracket is 28 percent. The calculations do not show interest earned on HSA fund deposits, expected to be around 2 percent per year. Costs for a person with a health savings account can vary, not just with individual health circumstances but with the amount of money deposited and the spending decisions made.*

#### EXAMPLE 1: Low family medical costs of \$1,500 per year

|   | <b>Traditional PPO Plan</b><br>Deductible: \$500<br>Coinsurance: 90/10<br>in network, 75/25<br>out of network | <b>Aetna HSA Plan</b><br>Deductible: \$5,000<br>Coinsurance: 90/10<br>in network, 70/30<br>out of network |   |
|---|---|---|---|
| Employee premium contribution   | \$3,070 (\$255.79/mo.)  | \$2,298 (\$191.53/mo.)  | This scenario assumes routine care for all family members. Your HSA plan deductible may be lower. HSA coinsurance applies after deductible, up to an \$8,000 out-of-pocket spending cap. PPO deductible is \$100 more for in-patient hospital care. |
| Annual automatic deposit to HSA by plan   | N/A   | \$2,500   | Automatic HSA deposit is from insurer. Not all insurers or employers will contribute to policyholders' HSAs.  |
| Voluntary HSA deposit   | N/A   | \$1,000 (\$83.33/mo.)   | You may choose to deposit less or more into your HSA account than the amount shown here—up to \$2,500 for the year in this example.   |
| Tax savings on voluntary deposit at 28%   | N/A   | \$280   | Your HSA deposit is not subject to federal tax. If your tax bracket is lower or higher, your HSA tax savings will differ from estimate shown here.  |
| Medical expenses/<br>deductible   | \$1,500/\$500   | \$1,500/\$5,000   | The family's medical costs are \$1,500 for the year. Note that the HSA plan's deductible is 10 times higher than the PPO's deductible.  |
| Expenses remaining after deductible, and amount of coinsurance paid by employee (10%) | \$1,000<br>\$100  | \$0<br>\$0  | Because expenses total only \$1,500, the family would pay no coinsurance under the HSA option.  |
| Expenses paid out of HSA at employee discretion                                       | N/A   | \$1,500   | Do you really need a name-brand drug instead of a generic? That kind of decision will impact how far your HSA dollars stretch.  |
| Actual employee-paid costs for year   | \$3,670   | \$3,018   | For HSA plan, payments include premiums and contribution to HSA, minus tax savings. For PPO, payments include premiums, deductible and coinsurance.   |
| <b>After-tax advantage compared with PPO</b>  | <b>N/A</b>  | <b>\$652</b>  | —   |
| Money left in portable employee-owned HSA   | \$0   | \$2,000   | This amount can be rolled over into next year's account. If the employee had funded his HSA fully, this total would be \$3,500.   |

## Appendix 3 (cont.)

| <b>EXAMPLE 2:<br/>Significant family medical<br/>cost of \$20,000 per year</b>        | <b>PPO</b>             | <b>Aetna HSA Plan</b>  |  |
|---|------------------------|------------------------|--|
| Employee premium  | \$3,070 (\$255.79/mo.) | \$2,298 (\$191.53/mo.) | —  |
| Annual automatic deposit to HSA by plan   | N/A                    | \$2,500                | —  |
| Voluntary HSA deposit   | N/A                    | \$2,500 (\$208.33/mo.) | In this HSA example, the family exposed to unexpected expenses somehow knew to put \$2,500 into the account. Everyone may not be so prescient. |
| Tax savings on voluntary deposit at 28%   | N/A                    | \$700                  | —  |
| Medical Expenses/<br>deductible   | \$20,000/\$600         | \$20,000/\$5,000       | PPO deductible includes \$100 for hospital stay.   |
| Expenses remaining after deductible, and amount of coinsurance paid by employee (10%) | \$19,400<br>\$1,940    | \$15,000<br>\$1,500    | 10% coinsurance rate in both cases is for network providers only. Coinsurance will be higher for other providers.                              |
| Expenses paid out of HSA at employee discretion                                       | N/A                    | \$5,000                | Employee paid for routine care as well as broken leg. To lower costs: use network doctors or negotiate fees before care delivery.              |
| Actual employee-paid costs for year   | \$5,610                | \$5,598                | Includes premiums, deductibles, coinsurance and out of pocket costs. In HSA example, money paid toward health care came from HSA account.      |
| <b>After-tax advantage compared with PPO</b>  | <b>N/A</b>             | <b>\$12</b>            | Out-of-pocket HSA limit of \$8,000 not reached. If the employee had deposited only \$1,000 into his HSA, he would have realized no savings.    |
| Money left in portable employee-owned HSA   | N/A                    | \$0                    | —  |

| <b>EXAMPLE 3:<br/>Catastrophic family medical<br/>cost year of \$100,000 per year</b> | <b>PPO</b>             | <b>Aetna HSA Plan</b>  |  |
|---|------------------------|------------------------|--|
| Employee premium contribution   | \$3,070 (\$255.79/mo.) | \$2,298 (\$191.53/mo.) | —  |
| Annual automatic deposit to HSA by plan   | N/A                    | \$2,500                | —  |
| Voluntary HSA deposit   | N/A                    | \$2,500 (\$208.33/mo.) | Again, the assumption here is that there was full funding of HSA, something every employee may not choose to do.   |
| Tax savings on voluntary deposit at 28%   | N/A                    | \$700                  | —  |
| Medical expenses/<br>deductible   | \$100,000/\$600        | \$100,000/\$5,000      | To lower costs: use network doctors or negotiate fees before care delivery. PPO deductible is \$100 higher because of hospital stay.   |
| Expenses remaining after deductible, and amount of coinsurance paid by employee (10%) | \$34,000<br>\$3,400    | \$30,000<br>\$3,000    | 10% coinsurance rate is for network providers only. Once you pay your HSA deductible, you're liable for a maximum of \$3,000 in coinsurance. The maximum PPO coinsurance is \$3,400. |
| Expenses paid out of HSA at employee discretion                                       | N/A                    | \$5,000                | To stretch HSA dollars: use network doctors or negotiate fees before care delivery; choose generic medications.  |
| Actual employee paid costs for year   | \$7,070                | \$7,098                | For HSA plan, payments include premiums, voluntary contribution to HSA and coinsurance minus tax savings. For PPO, payments include premiums, deductible and coinsurance.            |
| <b>After-tax advantage compared with HSA</b>  | <b>\$28</b>            | <b>N/A</b>             | —  |
| Money left in portable employee-owned HSA   | N/A                    | \$0                    | —  |