

# Health Savings Accounts

A Guide for Missouri School Districts  
January, 2007



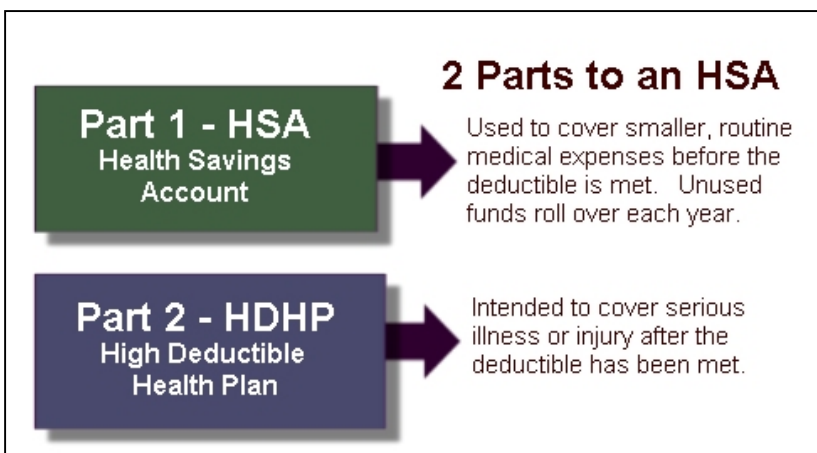
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## What is a Health Savings Account (HSA)?

Health Savings Accounts (HSAs) are essentially special savings accounts for medical expenses that are paired with high-deductible insurance coverage. Both employers and employees can invest money in the account. Employees can then withdraw funds, tax free, for eligible medical purposes.

You must be covered by a High Deductible Health Plan (HDHP) to be able to take advantage of HSAs. An HDHP generally costs less than what traditional health care coverage costs, so the money saved on insurance premiums can be put into the Health Savings Account.



Employees own and control the money in the HSA. Decisions on how to spend the money are made by the employee without relying on a third party or a health insurer. Employees also decide what types of investments to make with the money in the account in order to make it grow.

## What is a High Deductible Health Plan (HDHP)?

Sometimes referred to as a “catastrophic” health insurance plan, an HDHP is a lower cost health insurance plan that doesn't pay any expenses until the deductible is met. An HDHP may provide preventive care benefits without a deductible for services such as:

- Annual physicals
- Routine prenatal and well-child care
- Child and adult immunizations
- Tobacco cessation programs
- Obesity weight-loss programs

### 2007 HSA High Deductible Health Plan (HDHP) Requirements

	Individual	Family
Minimum Deductible	\$1,100	\$2,200
Maximum Deductible	\$2,850	\$5,650
Maximum Out-Of-Pocket Expenses	\$5,500	\$11,000

These numbers will be adjusted annually for inflation.

A High-Deductible Health Plan (HDHP) using a PPO network may apply higher deductibles and out-of-pocket expenses to covered health care services provided by non-PPO providers.

#### Who is eligible for a Health Savings Account?

To qualify for an HSA, you must meet the following requirements:

- You must have an HDHP
- You have no other health coverage (exceptions shown below)
- You must not be enrolled in Medicare
- You cannot be claimed as a dependent on someone else's tax return

Examples of other permitted coverages include policies which specifically cover:

- Accidents
- Cancer
- Disability
- Dental
- Vision
- Long-term care

#### What is the maximum an individual can contribute to an HSA?

For 2007, you'll be able to contribute the lesser of:

- Your insurance deductible, or
- \$2,850 for individuals; \$5,650 for families

#### What are the investment options for an HSA?

HSAs can be set up through banks, credit unions, insurance companies, or any other entity that meets the IRS standards for being an IRA trustee or custodian. HSAs can be invested in the same type of investments permitted for IRAs including stocks, bonds, mutual funds, CDs, etc. The individual decides whether they want to invest their funds in their account and what type of investments best suit their needs.

## WHAT DISTRICTS NEED TO KNOW

Health Savings Accounts are designed to provide employers an alternative to the high cost of health insurance by giving employees financial incentives to manage their own health expenses.

Many of the benefits of choosing a Health Savings Account over a traditional health insurance plan can directly affect the bottom line of the District's budget. Most importantly, Health Savings Accounts are dependent on a high deductible insurance policy, which lowers the premium. Additionally, the impact on utilization of the health plan should decrease resulting in lower premium increases compared to a traditional plan.

As an added benefit to employees or an incentive to elect an HSA over a traditional insurance plan, employers may contribute – either a one time contribution or ongoing through a Cafeteria Plan – to employees Health Savings Accounts.

### What are the pros and cons of offering an HSA Plan?

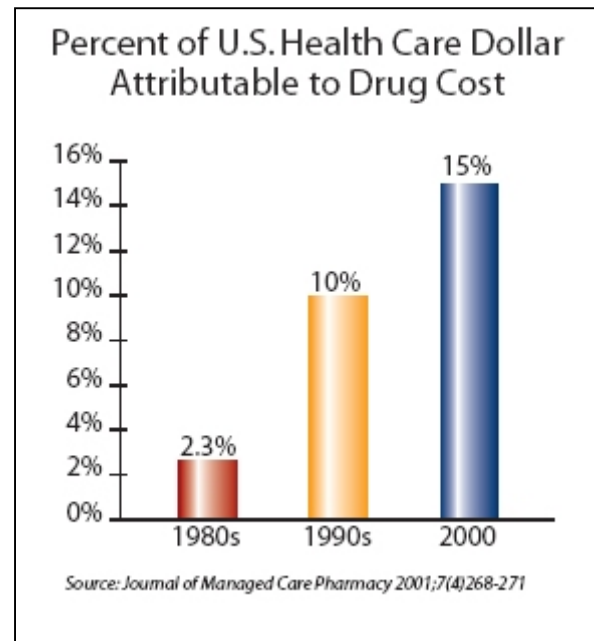
There are both risks and rewards associated with implementing an HSA.

Employees will be concerned about certain features, especially relating to out-of-pocket costs. Paying the full price of prescription drugs or office visits before meeting the high deductible will be extremely undesirable if employees are used to paying small copayments.

Additionally, giving more responsibility for making health care decisions can cause concern. While information regarding the costs and quality of health care providers is beginning to emerge, currently there is limited information available to help employees make informed decisions about their health care. As consumers demand more information, health care providers will respond by publicizing the prices for their fees and services.

Employees also will be responsible for handling more paperwork and record keeping to document expenses.

On the reward side, employees will begin to learn the true cost of health care services. With traditional insurance with low copays, employees have no incentive to learn what a drug, test, or office visit may really cost. While a typical consumer can accurately estimate the price of a new car, most have little idea what a three-day hospital stay will cost. As employees begin to ask questions and seek more information, they can start to take a more active role in health care decisions.



Employees also may be more inclined to participate in wellness programs or change lifestyle behaviors through diet and exercise to help reduce their own health care expenses.

The most beneficial reward for the employee will be the potential to accumulate a large fund of money – with tax-free money and interest earnings – to help pay health care expenses in later years.

### **What is the best way to implement an HSA Plan?**

Educating and involving employees will be critical to their success. Let the employees know why the decision was made to introduce an HSA. Show employees the annual amount the District spends on health insurance and how it affects other budget items such as compensation. For some smaller employers, offering an HSA is an affordable alternative to eliminating a health plan completely.

Share the savings from switching to a high deductible plan with the employee by making a one time contribution to the employee's HSA account. This can alleviate the concern of employees who may be faced with medical expenses early in the plan year – before they have had time to fund the account.

When you educate the employees, talk about the savings account first; the deductible second. Make sure the employees understand the HSA consists of two parts: a tax-free savings vehicle to pay health care expenses and a catastrophic medical plan to pay expenses beyond the deductible.



Key points to emphasize to your employees:

- It's your health, your money and your choice.
- HSAs empower you – instead of a third party – to take control of health care decisions.
- HSAs allow greater flexibility in investment options, contribution times and disbursements.
- Your HSA is 100% portable – wherever you go, your HSA goes with you.
- There is no "use it or lose it" rule. Savings roll over each year.
- The earnings potential is significant: For example, a working family begins at age 40 depositing the full amount into an HSA each year. The family could spend \$2,000 out of the account every year for the next 25 years to cover routine health costs, and still have more than \$125,000 saved by retirement at age 65.

If offering the HSA as a plan option, generally a small percentage of employees will participate – regardless of how well it is designed or communicated. The second year will generate greater participation through word of mouth.

**What type of premium savings will we see by moving to a HDHP?**

It depends on many factors including the size of the group, plan design, claims history, etc. In general, however, premiums for the HDHP will be less because of the larger deductible and the absence of copays for services other than preventative care.

However, if the employer funds the HSA in full, it is likely there will be no savings to the employer *in the first year*. The savings will be realized in years when the utilization of benefits drops because of greater employee awareness of how to use their benefits. HSA/HDHPs will show less utilization of benefits, which will equate to lower premium increases.

### What's the difference between the HSAs and FSAs?

The tax benefits of both plans are quite similar, but there are several differences as shown in the chart below. The biggest and most important difference is that HSA balances can roll over from year to year and continue to grow tax deferred.

	<b>HSA</b> Health Savings Account	<b>FSA</b> Flexible Spending Account
Who is eligible	Employees and Retirees (not enrolled in Medicare)	Employees
Max Annual Contribution (2007)	\$2,850 Individual \$5,650 Family	No IRS maximum – Employers can set maximum amount
Who owns	Employee	Employer
Who contributes	Employer or Employee	Employee Only
Can employee earn interest on money	Yes	No
Can money roll over	Yes	No
Is an HDHP required	Yes	No
Distributions		
Medical Expenses	Funds can be used for medical expenses for yourself, your spouse or your dependents	Funds can be used for medical expenses for yourself, your spouse or your dependents
Non-Medical Expenses under age 65	Withdrawal of funds for non-medical expenses will create a 10% tax penalty in addition to income tax	N/A – Distributions are only allowed for non-reimbursed qualified medical expenses
Non-Medical Expenses after age 65	Withdrawal of funds for non-medical expenses are subject to normal income tax without a penalty	N/A – Distributions are only allowed for non-reimbursed qualified medical expenses
Is it portable	Yes	No
Eligible for Cafeteria	Yes	Yes

### **Can we offer both a Flexible Spending Account and an HSA in our District?**

Yes. However, for an employee to be eligible to contribute to an HSA, he or she must not have other non-HDHP coverage, including health FSA coverage. A health FSA that reimburses all qualified medical expenses without other restrictions is a health plan that constitutes other coverage. Consequently, an individual who has health FSA coverage is not eligible to contribute to an HSA. This result is the same even if the individual is covered by a health FSA sponsored by a spouse's employer.

### **Is there any way an individual can contribute to both a health FSA and an HSA?**

Yes. You can amend your Health FSA plan to be "HSA compatible." There are a couple of different ways to do this.

1. **Limited-purpose health FSA** – This reimburses expenses only for preventive care and "permitted coverages" (examples include dental and vision care). Essentially, the limited purpose FSA will not cover any of the expenses provided by the HDHP. Typically dental and vision expenses are not covered by health insurance and therefore would be eligible for coverage under the FSA.
2. **Post deductible health FSA** – This reimburses preventive care expenses before the deductible. However, for all other qualified medical expenses, the FSA will reimburse expenses only after the minimum annual deductible for the HDHP is satisfied.

### **How does the new 2-½ month grace period for an FSA affect an employee's ability to contribute to an HSA?**

The IRS issued a clarification of the interaction of the 2-1/2 FSA grace period and eligibility to contribute to Health Savings Accounts. The guidance clarifies that coverage by the FSA grace period disqualifies an individual to contribute to an HSA during the grace period. However, the notice also provides guidance on how an FSA can be amended to enable a covered individual to contribute to an HSA during the grace period.

An individual who has his or her health FSA coverage extended by the grace period is not eligible to contribute to an HSA, even where the health FSA has reached its annual benefit limit. However, if the employer amends the FSA to be HSA-compatible during the grace period for all participants, individuals would not be disqualified from contributing to an HSA during the FSA grace period.

### **Do COBRA rules apply to the HSA?**

COBRA rules only apply to the High Deductible Health Plan – not to the HSA.

**Who determines if a high deductible health plan is a “qualified plan?”**

The insurers themselves determine whether their HDHP meets the federal requirements. The insurance companies are expected to inform their customers which plans are HSA qualified.

**What advantages are there to allowing employees to make HSA contributions through a Cafeteria Plan?**

First, contributions by an employer and employees through a Cafeteria Plan are pre-tax.

Second, it provides the employer with a convenient way to integrate the HSA into existing benefit options.

Third, if the district wants to use a method for establishing the level of HSA contributions that it will make (such as matching contributions), offering an HSA through the Cafeteria Plan will allow you to do so.

**What are the disadvantages?**

Most likely, your cafeteria plan document and the employee’s summary plan description will need to be amended. The district also may have to modify election forms and other communication materials.

**Any advantages to the employee in making contributions pre-tax?**

The non-certified employee also will be able to enjoy a greater tax benefit by avoiding additional taxes (such as FICA) by making contributions through the Cafeteria Plan rather than taking the allowable income tax deduction. Second, both certified and non-certified employees can enjoy the tax savings throughout the year rather than waiting until the end of the year to take an income tax deduction.

**Any disadvantages?**

Cafeteria Plan rules limit the circumstances under which the Cafeteria Plan election may be revoked or changed. However, the IRS has adopted a more flexible approach to HSA contributions than other benefits by taking the position that an HSA has a monthly election period rather than annual.

**Does the employer have to contribute the same amount to every employee's HSA?**

Employer contributions must be comparable, that is they must be in the same dollar amount or same percentage of the employee's deductible for all employees in the same class. You can vary the level of contributions for full-time vs. part-time employees, and employees with self-only coverage vs. family coverage. You do not need to consider employees who do not have HDHP coverage as they are not eligible for HSA contributions.

## **WHAT YOUR EMPLOYEES WILL ASK**

### **Let's say I go to the doctor's office...how does the HSA work?**

If you are covered by your HDHP and have not met your policy deductible, you will be responsible for 100% of the amount agreed to be paid by your insurance policy to the physician. Your physician may ask you to pay for the services provided before you leave the office.

With your HSA, you may have a checkbook or debit card to pay your physician directly from the account. If not, you can pay the physician with your own money and reimburse yourself for the expense from the account after your visit.

If your physician does not ask for payment at the time of service, the physician will probably submit a claim to your insurance company, and the insurance company will apply any discounts based on their contract with the physician. You should then receive an "Explanation of Benefits" from your insurance plan stating how much the negotiated payment amount is, and that you are responsible for 100% of this negotiated amount.



### **What happens after I have met the deductible?**

It depends on the HDHP plan design. Typically, there will be coinsurance with higher benefits for in network vs. out of network. There also may be additional copays for prescriptions, office visits or other services. The most you will be required to pay in any one year (out-of-pocket maximum) is \$5,500 for individuals and \$11,000 for families. This limit is set for 2007 and will be adjusted annually.

### **Who makes sure my expenses are eligible?**

You're responsible for complying with HSA spending regulations. The IRS may ask you to prove an expense is eligible, so always save itemized receipts when you spend HSA money.

### **How do I know which expenses are eligible?**

In general, you can spend your HSA funds tax-free for all medical, dental (including braces for your children), and vision expenses and even chiropractic visits. For a more detailed list, visit [www.irs.gov](http://www.irs.gov) and search for Publication 502.

### **Can I use the money in my HSA to pay for medical care for a family member?**

Yes, you may withdraw funds to pay for the qualified medical expenses of yourself, your spouse or a dependent without tax penalty. This is one of the great advantages of HSAs.

### **What if I don't use the HSA funds?**

If you fund your HSA regularly, stay healthy and do not use a lot of medical care, a substantial amount of wealth can accumulate in your account. Below is an example of an individual's potential savings based on a 4% and 10% interest rate. Your interest rate will, of course, vary depending on your investment and the market conditions.

<b>Example: Individual's Approximate Savings HSA Growth Over 30 Years. Based on a maximum yearly contribution of \$2,750</b>		
<b>Medical Expenses Per Year</b>	<b>4% Annual Return</b>	<b>10% Annual Return</b>
\$0	\$154,233	\$452,358
\$500	\$126,191	\$370,111

### **Can I use the money in my HSA to pay for insurance premiums?**

You can use tax-free funds from your HSA to pay for the following types of health coverage:

- COBRA continuation coverage
- Health coverage while you are receiving unemployment benefits
- Long-term care insurance
- When age 65 or older, premiums for Medicare Part B and Medicare Part D. You cannot, however, use HSA funds to pay for Medicare Supplement policies.

### **Can I get an HSA even if I have other insurance that pays medical bills?**

You are allowed to have certain other coverage such as dental, vision, cancer, accident disability and long-term care insurance at the same time as an HDHP. Wellness programs offered by your employer also are generally permitted.

### **Can I start an HSA for my child?**

No, you cannot establish separate accounts for your dependent children, including children who can legally be claimed as a dependent on your tax return.

### **Do my HSA contributions have to be made in equal amounts each month?**

No, you can contribute in a lump sum or in any amounts or frequency you wish. However, your account custodian can impose minimum deposit and balance requirements.

**Can I make contributions when I establish my HSA account or when my HDHP coverage begins?**

Your eligibility to contribute to an HSA is determined by the effective date of your HDHP coverage. Your annual contribution depends on the number of months of HDHP coverage you have during the year (technically, the months where you have HDHP coverage on the first day of the month).

**Can I claim both the "above-the-line" deduction for an HSA and the itemized deduction for medical expenses?**

You may be able to claim the medical expense deduction even if you contribute to an HSA. However, you cannot include any contribution to the HSA or any distribution from the HSA, including distributions taken for non-medical expenses, in the calculation for claiming the itemized deduction for medical expenses.

**Do the tax benefits phase out at certain income levels?**

No. Unlike many other tax breaks, there aren't any income limits.

**Can I roll over money from an IRA or 403(b) into an HSA?**

No. Funds in an IRA, 403(b) or other retirement account cannot be directly deposited or rolled over. An employee cannot transfer the balance of an FSA into an HSA.

**What happens if I withdraw the money for non-medical expenses?**

If you are under age 65 and use the money in your HSA for non-medical expenses, you will incur a 10% penalty in addition to paying income taxes on the money.

**Am I allowed to withdraw the money for non-medical expenses after age 65?**

Yes you are. You won't be hit with the 10% penalty if you use the money for non-medical expenses after age 65, but you would still have to pay income taxes on the money. Keep in mind that you can continue to withdraw money from the account tax free for qualified medical expenses after age 65.

**I'm over 55 and would like to make "catch-up" contributions to my HSA. Is that possible?**

Yes, individuals 55 and older who are covered by an HDHP can make additional "catch-up" contributions each year until they enroll in Medicare. The additional "catch-up" contributions to HSA allowed are as follows:

- 2006 – \$700
- 2007 – \$800
- 2008 – \$900
- 2009 and after – \$1,000

**How much can I contribute if my spouse also has insurance?**

It depends on the circumstances. The following examples describe how much can be contributed under a variety of situations.

**Example 1:** Steve and Mary Jones are married with three children. Steve has a low deductible family health plan that covers him and the Jones children. His plan does not qualify for an HSA. Mary, who is not covered under Steve's family plan, may have her own separate high deductible health plan (HDHP) that does qualify for an HSA.

**Example 2:** Steve has a family HDHP coverage with a \$5,000 deductible that covers Mary. Steve has no other coverage. Mary also has self-only coverage with a \$200 deductible. Mary, who has coverage under a low-deductible plan, is not eligible and cannot contribute to an HSA. Steve may contribute \$5,000 to an HSA.

**Example 3:** Steve has a family HDHP with a \$5,000 deductible that covers Mary. Steve has no other coverage. Mary also has *self-only* HDHP coverage with a \$2,200 deductible. Both Steve and Mary are treated as having family coverage. The combined HSA contribution by Steve and Mary cannot exceed \$5,000, to be divided between them by agreement.

**What happens to my HSA if I leave the District?**

HSAs are portable. You can keep the money in an HSA account even after you leave the district (similar to a 403(b)). Funds remain in the account indefinitely.

If your new employer also has an HSA option, you can continue to contribute to your account tax-free *and* withdraw your funds tax free for eligible medical expenses. On the other hand, if there were no HSA option, you would still be able to withdraw your funds tax free for eligible medical expenses but would not be able to contribute.

### **What happens to the money in a HSA after I turn age 65?**

You can continue to use your account tax free for out-of-pocket health expenses. If you have retiree health benefits through your former employer, you also can use your account to pay for your share of retiree medical insurance premiums

Once you turn age 65, you also can use your account to pay for things other than medical expenses. If used for other expenses, the amount withdrawn will be taxable as income but will not be subject to any other penalties.

### **What happens when I enroll in Medicare?**

When you enroll in Medicare, you can use your account to pay Medicare premiums, deductibles, copays, and coinsurance under any part of Medicare. You cannot, however, use HSA funds to pay for Medicare Supplement or Medigap policies. After you enroll in Medicare, you cannot continue to make contributions to an HSA.

### **What happens to the HSA when I die?**

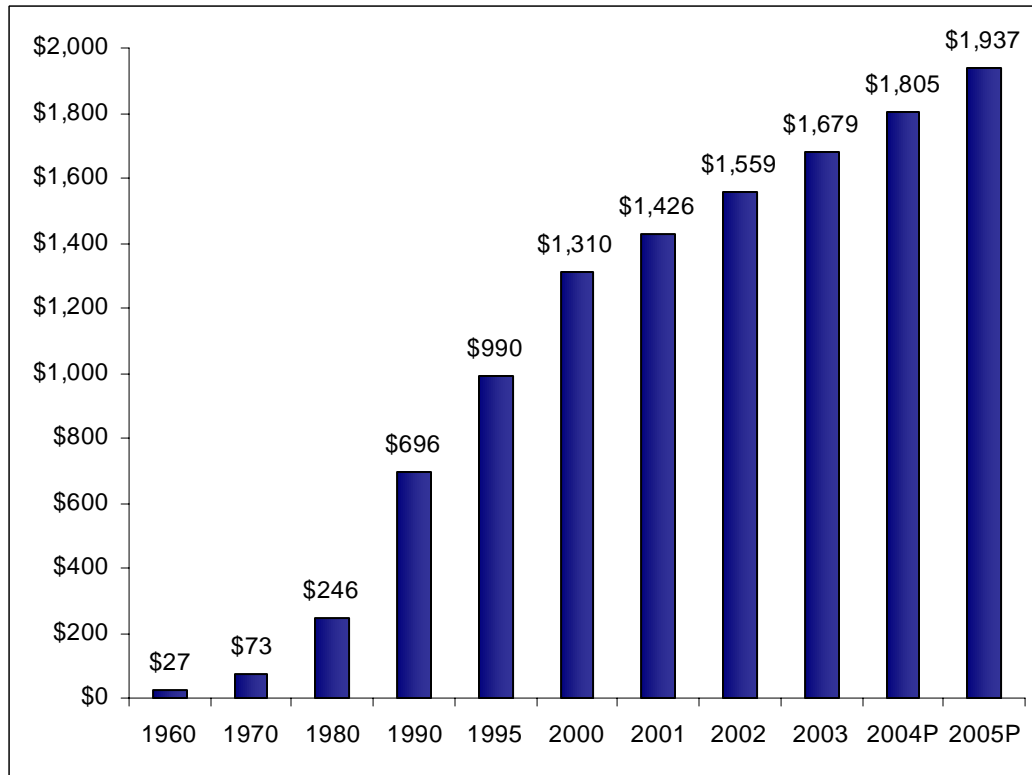
If you have named your spouse as your beneficiary, it will be treated as the spouse's HSA upon your death.

If someone other than a spouse is designated:

- The account stops being an HSA, and
- The fair market value of the HSA becomes taxable to the beneficiary in the year in which you die.

If your estate is the beneficiary, the value is included on your final income tax return.

## National Health Spending in Billions



**Source** Centers for Medicare and Medicaid Services 2004 and 2005 Projected

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