

## HSA: managing the high cost of providing health care benefits

A recent report from the National Coalition on Health Care probably did not come as a surprise to business owners who offer health care benefits to their employees. In 2007 employer health insurance premiums increased by 6.1%, twice the rate of inflation. And since 2000 the increase in the cost of premiums has been explosive—100%, compared to a cumulative inflation of 24%—making health insurance the fastest-growing expense for business owners.

Health savings accounts (HSAs), first introduced in 2004, were created to help individuals and businesses play a part in keeping health care costs down. According to Information Strategies, Inc., an independent information and advisory website for HSAs: “By making the healthcare consumer a part of the medical services decision process, HSAs help to manage medical expenses and reduce the continuing growth of health care costs.”

### **The insurance component**

HSAs have two components: a *high-deductible health plan* and a *health savings account* that will pay or reimburse certain medical expenses.

High-deductible health plans are just what their name says. The plan pays medical costs only when out-of-pocket expenses (deductibles and co-pays) exceed at least \$1,150 for individuals or \$2,300 for families. The caps on out-of-pocket expenses may not be more than \$5,800 for individual coverage and \$11,600 for family coverage. (These caps are for 2009 and are adjusted annually for inflation.)

A high-deductible health plan may provide preventive care benefits (for example, health evaluations, diagnostic procedures and certain screening tests) either without a deductible or with a deductible below the annual deductible.

### **The savings component**

The health savings account works like this: Contributions may be made by an individual to an HSA that he or she sets up, by a business owner, or even by someone else (a spouse, for example). Contributions can be made through regular payroll deductions, in a lump sum, periodically or even sporadically.

The maximum allowable contribution to an HSA for 2009 is \$3,000 for individual coverage and \$5,950 for family coverage and are inflation-adjusted annually. Participants in HSAs who are age 55 and over may be entitled to contribute an extra \$1,000 “catch-up” contribution in 2009.

The health savings account part of the HSA requires a qualified trustee—generally, a financial institution such as ours — to manage the investments of the amounts contributed to an HSA.

### **Why establish an HSA?**

- Contributions to an HSA are excluded from income and, therefore, are not subject to tax.
- Income earned from the account’s investments grows tax-free.
- Withdrawals are tax-free when used for “qualified” medical expenses (more on that below). But when withdrawals are used for other purposes, they are taxed as ordinary income and may be subject to a 10% penalty as well.
- Unlike an IRA, withdrawals never become mandatory, nor will they ever be taxed as long as they are used to pay medical expenses.
- HSAs are portable, meaning that they can travel from one employer’s HSA plan to another’s.
- A recent change in the law permits a **one-time transfer** from an IRA to an HSA without tax consequences as long as the transfer travels directly from the IRA trustee to the HSA trustee. The rollover amount cannot exceed the maximum HSA contribution for the year.

## **Benefits for your business**

In addition to the benefits to a business owner personally as a participant in an HSA, there are advantages for the business itself as well. Premiums for high deductible health plans generally cost less than traditional health insurance plan premiums. Plus, contributions to the employees' HSAs are tax deductible (as are the cost of premiums paid).

## **Is an HSA right for you?**

You may want to consider an HSA if:

- You are self-insured or self-employed and want a cost-effective health insurance solution that also helps you to build financial security.
- You are a business owner and want to offer an alternative to your employees, while lowering your overall health insurance costs.

## **Paying medical expenses with an HSA**

Once the deductible is met, the insurance policy element of the HSA covers a participant's qualified medical expenses for the remainder of the year.

What qualifies as a medical expense for HSA purposes is fairly broad. They are, for the most part, expenses that are deductible as a medical expense on an income tax return. They also may include some expenses not typically paid by regular health care insurance—contact lenses, hearing aids, weight-loss and stop-smoking programs, dental treatment, and even some over-the-counter drugs. (Refer to IRS Publication 502 for a complete list of eligible expenses.)

## **Limits on participation and coverage**

Not everyone can have an HSA. They include those:

- with health insurance coverage other than a high deductible health plan. (If only one spouse is covered by a health plan, the other spouse is eligible for an HSA);
- who are age 65 or older;
- who are enrolled in Medicare;
- who are claimed as a dependent on someone else's income tax return.

## **A final note: the HSA as an income source in retirement**

A recent article in *The Wall Street Journal* suggests a way for investors to supplement their funds for retirement. Any unused amounts in an HSA "roll over" and can be used in subsequent years—while the income from the investments in the HSA continues to grow tax free. When an HSA owner remains relatively healthy during his or her working years—or chooses to let the funds grow by not taking any withdrawals and paying medical expenses out of pocket—an HSA may accumulate a substantial amount by retirement.

During retirement an HSA provides a completely tax-free source to pay medical expenses (including, in many instances, skilled nursing facility costs incurred for medical purposes and for at-home nursing care). And the HSA can be tapped for other expenses as well. Although withdrawals will be taxed at ordinary income rates (but without penalty as long as the HSA owner is at least age 65), he or she may be in a lower tax bracket than during his or her working years.

Of course, when the participant dies, the HSA will become an asset in his or her estate and could be subject to income or estate tax. But if a spouse is named the beneficiary of the HSA, he or she will be considered the owner of the HSA and can continue to take withdrawals from the HSA tax free to pay his or her medical expenses or make taxable withdrawals for other expenses.

(April 2008)  
© 2008 M.A. Co. All rights reserved.

This information is provided for informational purposes only. Opinions expressed herein are subject to change at any time without notice. Information has been obtained from sources believed to be reliable, but its accuracy and interpretations are not guaranteed.

Member FDIC

## **Salisbury Bank and Trust Company**

5 Bissell Street  
Post Office Box 1868

Lakeville, Connecticut  
06039-1868

t: 860.435.9801  
t: 800.222.9801

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