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Health Savings Accounts (HSA's) – Going Beyond Medical Insurance

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Are you kidding me? Tax-deductible contributions, tax-deferred growth, and tax-free distributions for Medical, Dental and Vision (M.D.V.) related costs for the rest of my life? The ultimate savings account vehicle has finally arrived! This unique triple-tax feature of the new Health Savings Account or H.S.A. separates it from other financial planning vehicles, like the Roth IRA. Baby boomers are now realizing that a large chunk of their presumed “retirement” nest egg is going towards sky-rocketing medical costs due to illnesses and long term care. To combat this problem, the U.S. government has given us a vehicle designed to encourage everyone under age 65 to start saving for those inevitable M.D.V. related costs and release some of the burden on Medicare. The new H.S.A. laws passed in Dec. 03', enhanced the former Medical Savings Account (M.S.A.), allowing everyone between age 18 and 65 to be a candidate. (Go to www.irs.gov publication 969 for more details)

Since then, thousands are signing up monthly across the country because of its affordability and tax savings. Early statistics show that up to 40% of new H.S.A. policy owners were previously un-insured due to the high cost barriers of other insurance plans. Most are saving thousands of dollars per year with lower premiums and more tax deductions. Prime candidates for individual H.S.A. policies tend to be self-employed entrepreneurs, families, pre-retirees, spouse or children on their spouse's expensive employer group medical insurance plan, or anyone paying for their own health insurance. Group H.S.A. plans are also available with larger employers considering it as a replacement to their existing plan.

But before we can discuss any H.S.A. strategies, we must begin with an overview of the Health Savings Account (H.S.A.). The H.S.A. requires two components: (1) a low cost, high-deductible major-medical insurance plan with NO co-payments or first dollar benefits and (2) a tax-advantaged savings account with the triple-tax features listed above. But, to open the savings account, you must first own an eligible H.S.A. high-deductible medical insurance policy with a minimum \$1000 deductible for individuals (max. \$5000) or a one-family deductible of \$2000 for families (maximum \$10,000). This one-family deductible is a key feature vs. per-person deductibles on most other plans, and provides a solution to larger families. In most plans, you're covered 100% after the deductible up to \$3-8 million.

Once the insurance policy is in force, the individual can contribute and tax deduct up to 100% of their insurance deductible per year to the savings account (Up to a maximum \$2650 for individuals and \$5250 for families of 2 or more). The amount is pro-rated according to the number of full months you own the health policy. If you're over age 55, you can contribute an additional \$600 a year. Any money left over in the account, is yours for life! The account is NOT a “use it or lose it” scenario like the Flexible Spending Accounts (F.S.A.) that most know well. The accounts grow tax-deferred, and can be spent tax-free for any medical, dental or vision expense. A full list of expenses can be found in publication 502 at www.irs.gov. If you review the list, you'll notice a number of items that present additional opportunities to tax deduct large M.D.V. related expenses. Items like braces, lasik eye surgery, maternity, fertilization, acupuncture, chiropractor, Medicare part B premiums, long-term care insurance premiums (up to

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a limit), home nursing needs, dental care, eyeglasses, contact lenses, over the counter drugs, and even band-aids are considered eligible expenses.

Once people realize that they are “pre-paying” for their doctor and prescription “co-pays”, utilized or not, it makes financial sense to take on the responsibility of being a better consumer with access to network discounts through the insurance company and the tax code at your disposal. For example, a normal doctor visit in network that may cost \$100 is discounted to \$80. With the H.S.A, this \$80 cost is fully tax deductible, bringing your real after-tax cost down to \$60 (25% tax bracket). Compare this cost to paying an extra \$100 a month in premiums, to have the “right” to pay an additional \$25 co-payment to the doctor for a total of \$125. Most can’t tax deduct out-of-pocket M.D.V. expenses because they don’t reach the 7.5% of adjusted gross income requirement on schedule A. As you can see, the government is giving you an incentive to take control of your own health care, with the hope that consumers will start asking questions about the real costs for hospital, doctor and prescriptions and ultimately create a more competitive pricing environment in the health care industry.

The savings component of the H.S.A. has no income phase-out limits when determining contribution eligibility, and delivers up to \$5250 in tax deductions each year in addition to other retirement plan contributions. Some use it as an additional tax shelter since few vehicles are available for those making higher incomes. This is an “above the line” deduction available to all taxpayers and transfers your out-of-pocket M.D.V. expenses to the front page of your Form 1040 on line 28. Individuals retain control of the assets and have portability rights for the rest of their lives. A penalty of 10% and income taxes are due if used for non-M.D.V. expenses before age 65. After age 65, distributions can be treated like an I.R.A as taxable income and penalty-free when spent on non-M.D.V. expenses. Since your H.S.A. can be used like an I.R.A. later in life, contributions to the account will not be looked upon later as a mistake. A variety of medical insurance companies, asset custodians, and investment choices like mutual funds and money markets are available. Checks and debit cards come with the account for easy tax-free access to the funds. (Go to www.hsainsider.com or www.hsadecisions.org for a list of approved providers).

Like any insurance vehicle, health insurance is one of the many tools that should be integrated into your financial plan. Its’ purpose is to protect your net worth from catastrophic situations and transfer that risk to an insurance company for the lowest cost possible. Planning ahead for your future M.D.V. related costs is becoming a required financial strategy and an inevitable expense for the majority. As with any insurance or investment product, please discuss your personal situation with a qualified professional to determine suitability. The Health Savings Account could be your solution to health insurance, as it has been for many others.

For more information from an H.S.A. specialist, you can reach William Steffen of Steffen Financial, Inc. at 928-252-2493.

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