

TAX TIPS
HEALTH SAVINGS ACCOUNTS
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Given the ever-escalating cost of insurance and health care benefits, Health Savings Accounts (HSA's) are becoming one of the most effective methods for reducing health care costs for both individuals and small business owners. HSA's offer a tax-favorable way for eligible individuals to set aside funds, or have their employer do so, to meet future medical needs. Here are the key tax-related elements:

- Contributions you make to an HSA are deductible, with limits,
- Contributions your employer makes aren't taxed to you,
- Earnings on the funds within the HSA are not taxed, and
- Distributions from the HSA to cover qualified medical expenses are not taxed.

Who is eligible? To be eligible for an HSA, you must be covered by a "high deductible health plan", as discussed below. Also, you must not be covered by a plan which (1) is not a high deductible health plan, and (2) provides coverage for any benefit covered by your high deductible plan. If an individual is enrolled in Medicare, he or she is no longer an eligible individual under the HSA rules, therefore contributions to an HSA can no longer be made.

For 2009, a "high deductible health plan" is a plan with an annual deductible of at least \$1,150 for self-only coverage, or at least \$2,300 for family coverage. For self-only coverage, the 2009 limit on deductible contributions is \$3,000. For family coverage, the 2009 limit on deductible contributions is \$5,950. Additionally, annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits cannot exceed \$5,800 for self-only coverage or \$11,600 for family coverage.

An individual (and the individual's covered spouse) who has reached age 55 before the close of the tax year, and is an eligible HSA contributor, may make additional "catch-up" contributions for 2009 of up to \$1,000.

Deduction limits. You can deduct contributions to an HSA for the year up to the total of your monthly limitations for the months you were eligible. For 2009, the monthly limitation on deductible contributions for a person with self-only coverage is 1/12 of \$3,000. For an individual with family coverage, the monthly limitation on deductible contributions is 1/12 of \$5,950.

Contributions may be made to an HSA by or on behalf of an eligible individual even if the individual has no compensation, or if the contributions exceed the individual's compensation. Contributions made by a family member on behalf of an eligible individual to an HSA (which are subject to the limits described above) are deductible by the eligible individual in computing adjusted gross income.

Rollovers from IRAs, FSAs, and HRAs. For a limited period beginning Dec. 20, 2006 and ending December 31, 2011, an eligible individual can make a one-time transfer of amounts from a health flexible spending arrangement (health FSA) or health reimbursement arrangement (HRA) to an HSA. The amount transferred is subject to statutory limits.

Similarly, on a once-only basis, taxpayers can withdraw funds from an IRA, and transfer them tax-free to an HSA. The amount transferred can be up to the maximum deductible HSA contribution for the type of coverage in effect at the time of the transfer. The amount so transferred is excluded from the taxpayer's gross income, and is not subject to the 10% early withdrawal penalty.

Employer contributions. If you are an eligible individual, and your employer contributes to your HSA, the employer's contribution is treated as employer-provided coverage for medical expenses under an accident or health plan and is excludable from your gross income up to the deduction limitation, as described above. Further, the employer contributions are not subject to withholding from wages for income tax or subject to FICA or FUTA. The eligible individual cannot deduct employer contributions on his federal income tax return as HSA contributions or as medical expense deductions.

An employer that decides to make contributions on its employees' behalf must make comparable contributions to the HSA's of all comparable participating employees for that calendar year. If the employer does not make comparable contributions, the employer is subject to a 35% tax on the aggregate amount contributed by the employer to HSA's for that period.

Earnings. If the HSA is set up properly, it is generally exempt from taxation, and there is no tax on earnings. However, taxes may apply if contribution limitations are exceeded, required reports are not provided, or prohibited transactions occur.

Distributions. Distributions from the HSA to cover an eligible individual's qualified medical expenses, or those of his spouse or dependents, are not taxed. Qualified medical expenses for these purposes generally mean those that would qualify for the medical expense itemized deduction. If funds are withdrawn from the HSA for other reasons, the withdrawal is taxable. Additionally, an extra 10% tax will apply to the withdrawal, unless it is made after reaching age 65, or in the event of death or disability.

And, finally, more good news about HSA's: any left-over money carries forward in your HSA account to future years and is not lost! It's yours to spend on future healthcare costs.

Please be sure to consult with your tax professional and your health insurance provider prior to setting up an HSA account.