SHOULD YOU CONSIDER A HEALTH SAVINGS ACCOUNT?

Often described as an individual retirement account for medical expenses, health savings accounts (HSAs) are billed as the elixir to rising health care costs, according to the *Journal of Financial Planning*.

But what are HSAs? Simply put, a HSA is a special account owned by an individual in which contributions to the account are used to pay for current and future medical expenses. Created in Medicare legislation signed into law by President Bush on Dec. 8, 2003, and modeled after Archer MSAs, HSAs are used in conjunction with a "high deductible health plan (HDHP). With the exception of preventive care, a HDHP is insurance that does not cover "first-dollar" medical expenses. For those who contribute to a HSA in 2005, the annual deductible is at least $1,000 with a $5,100 limit on out-of-pocket expenses. For families the annual deductible is a minimum of $2,000 with a $10,200 limit on out-of-pocket expenses. (These amounts are indexed annually for inflation.) The insurance can be a health maintenance organization (HMO), PPO or indemnity plan, as long as it meets the requirements.

In short, the HSA provides triple tax savings, including tax deductions when you contribute to your account; tax-free earnings through investments, and tax-free withdrawals for qualified medical expenses.

Who is eligible for HSAs? According to the Department of Treasury, any individual who is covered by a HDHP and; 1) is not covered by other health insurance that is not a HDHP, i.e. a low-deductible insurance; 2) is not enrolled in Medicare; and 3) can't be claimed as a dependent on someone else's tax return. Children, for instance, cannot establish their own HSAs. Eligibility to contribute to a HSA does not depend on:

1) your income. There is no income phase out as with IRAs, for instance;

2 earned income. You don't have to be working, for instance.

3) who is the primary policyholder? Spouses, for instance, can establish their own HSAs, if eligible.

4) Insurance coverage of your children.

Those that have the following type of "first dollar" medical benefits would be ineligible to establish a HSA: Medicare, Medicaid, Tricare, Flexible Spending Arrangements (FSAs); Health Reimbursement Arrangements (HRAs); and coverage under a spouse's plan, including a low-deductible insurance plan or a FSA or HRA through the spouse's employer.

Administered by a financial institution or insurance company, contributions to the HSA are tax deductible and can be made by the employee, employer, or both, according to the *Journal of Financial Planning.* You may fund up to 100 percent of the policy's deductible but may not exceed in 2005 $2,650 (individual) or $5,250 (family). As with IRAs, individuals who are age 55 and older can make additional catch-up contributions to a HSA. In 2005, for instance, the catch-up contribution is $500. Contributions must stop once a person is enrolled in Medicare. Money that is contributed to the HSA and not used may be rolled over to next year or future years. Typically, the money in a HSA is invested in instruments that provide safety of principal, such as money market deposit accounts and short-term certificates of deposit. As with an IRA, the money

grows tax free and distributions taken to pay for qualified medical expenses are tax free, too. According to the Department of Treasury, qualified medical expenses include

- over-the-counter drugs,
- specific health insurance premiums, including COBRA continuation coverage, health insurance coverage while receiving federal or state unemployment compensation, qualified long-term care insurance; and for individuals enrolled in Medicare: Medicare premiums and out-of-pocket expenses (Part A and Part B, Medicare HMOs, and the new prescription drug coverage). The HSA cannot, however, pay for Medigap insurance premiums.

HSA distributions not used for qualified medical expense (such as cosmetic surgery) are subject to ordinary incomes taxes and a 10 percent penalty unless the individual dies, is disabled, or is 65 years of age. Money left in a HSA account after age 65 withdrawn for a purpose other than health care is taxed at the account holder's ordinary income tax rate.

Also of note, there is no time limit on distributions. There is not "use it or lose it" rules as there are with FSAs. Distributions from a HSA can even be used to reimburse prior years' expenses as long as the expenses were incurred on or after the date the HSA was established.

As with IRAs, it's important that individuals keep good records to prove that the expenses were incurred and they were not paid for or reimbursed by another source or taken as an itemized deduction. The Department of Treasury also notes that mistaken distributions from an HSA can be returned to the HSA. Also noteworthy, rollovers from Archer MSAs and other HSAs are permitted.
Check with your state's insurance department to locate a company that offers HDHP plans.

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