Health Savings Accounts: Innovative Health Care Financing

Would you be interested in a health insurance program that puts you in control of your own health care dollars, while protecting you and your family against the cost of a serious illness or injury?

Prepared for:

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MRW FINANCIAL BROKERAGE

Life Insurance, Annuities and Long-Term Care

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The Problems

In attempting to provide health care benefits, individuals face several problems:

Cost Due to the high cost of traditional health insurance coverage, it is difficult (if not impossible) for many people to purchase adequate health insurance protection at an affordable cost. Without this protection, however, the financial impact of a serious injury or illness can be devastating!

Choice While managed care has produced cost savings, people enrolled in managed care plans generally find their choice of doctors restricted. There is also increasing concern about the interference of bureaucracies in the doctor-patient relationship.

Control Individuals who need little or no health care receive no financial reward under traditional or managed care plans, nor is there any financial incentive under these plans for individuals to exercise control over their health care expenditures.

A Potential Health Savings Account Solution

By combining tax-advantaged personal savings with a high-deductible health insurance plan, the Health Savings Account (HSA) puts you in control of your own health care dollars, while protecting you and your family against the cost of a serious illness or injury:

Cost High-deductible health insurance is more affordable, while still protecting individuals and their families against the costs of serious illness or injury. Personal savings accumulated in an HSA can be used to pay smaller expenses covering routine services until the health plan's deductible is met. **NOTE:** If there are not sufficient funds in the HSA to cover the entire deductible, you must pay the difference out of pocket.

Choice Tax-free HSA funds can be used to see any doctor, enter any hospital or pay any qualified medical expense, even those not covered under the high-deductible health plan. These decisions belong to you, not to a medical bureaucracy.

Control An HSA puts you in charge of how your health care dollars are spent. If little or no health care is needed, the money in the HSA accumulates tax-free until funds are needed…even after retirement. In fact, subject to income tax and, if under age 65 a penalty tax, HSA funds can be withdrawn for any reason. With a Health Savings Account, you control when and how your health care dollars are spent.

What Is a Health Savings Account?

A Health Savings Account (HSA) is a tax-advantaged personal savings account designed to provide funds to pay qualified medical expenses, including health insurance deductibles and co-payments. An HSA is available to eligible individuals only in conjunction with a high-deductible health plan provided by an employer or purchased by an individual.

The tax benefits of an HSA are significant. **Your contributions to a Health Savings Account are tax deductible on an "above the line" basis,** resulting in a dollar-for-dollar reduction in adjusted gross income. What might this mean to you? For example:

Annual HSA Contribution	$3,000
Marginal Federal Income Tax Rate	24%
Tax Savings per Year	$720
Net Cost to You	$2,280

If your employer contributes to your HSA, those contributions are not taxable income to you and are not subject to withholding.

Funds in an HSA can be invested, with earnings not subject to income tax so long as they remain in the HSA.

Distributions from an HSA may be made at any time. If used to pay for qualified medical expenses, the distributions are not subject to federal income tax. If used for non-medical expenses, HSA distributions are considered taxable income to you and are subject to a 20% penalty tax if you are under age 65 when the distribution is taken.

How Does a Health Savings Account Work?

Health Savings Account + **High-Deductible Health Insurance Plan**

Health Savings Account

You establish a Health Savings Account, into which you make tax-free contributions up to specified maximums each year.

If an illness or injury strikes, funds can be withdrawn tax free from the HSA to pay for qualified medical expenses.

Funds not withdrawn to pay for qualified medical expenses remain in the HSA and grow from year to year in an investment account whose earnings grow free of tax.

HSA funds may be withdrawn for purposes other than paying qualified medical expenses, but are subject to income tax plus a 20% penalty tax. Beginning at age 65, HSA funds may be withdrawn for any reason, subject to regular income tax without penalty, or can continue to be used to pay qualified medical expenses without tax.

High-Deductible Health Insurance Plan

You purchase a qualifying high-deductible health plan.

Once the health insurance deductible is satisfied, insurance benefits become available to pay for covered expenses.

Advantages of a Health Savings Account

By combining a high-deductible health plan with tax-advantaged personal savings, a Health Savings Account offers you these advantages:

- The high-deductible health plan provides protection against the financial impact of a serious illness or injury.
- Tax-deductible savings are set aside today in a Health Savings Account to pay for future health care expenses, including the high-deductible health plan's deductible and out-of-pocket expenses.
- You own your Health Savings Account and you decide how to invest your HSA contributions.
- You control when and how HSA funds are spent.
- As needed, tax-free HSA distributions can be used to pay for qualified medical expenses not covered by the high-deductible health plan.

- If you need little or no health care, the unspent funds remain in your HSA and accumulate tax free.
- You can spend the funds in your HSA as you choose. In fact, if not needed to pay future medical expenses, HSA funds can be withdrawn and used for any purpose (subject to income tax and a 20% penalty tax if under age 65).
- Funds may be rolled over (transferred) tax free from one HSA to another HSA.
- You may be able to roll over funds from an IRA into an HSA, making additional funds available on a tax-advantaged basis to pay the plan's deductible or qualified medical expenses not covered by the high-deductible health plan.

Questions and Answers…HSA Eligibility

Who is eligible to establish an HSA?

A Health Savings Account can be established by an "eligible individual"…someone who:

- is covered under a qualified high-deductible health plan;
- is not also covered by any other health plan that is not a high-deductible health plan;
- is not entitled to benefits under Medicare (generally under age 65); and
- may not be claimed as a dependent on another person's tax return.

What is a high-deductible health plan (HDHP)?

A high-deductible health plan, or HDHP, is a health plan that satisfies certain requirements with respect to deductibles and out-of-pocket expenses, which are adjusted annually for inflation:

Type of Coverage	Minimum Annual Deductible		Maximum Annual Out-of-Pocket Expenses	
	2020	*2021*	*2020*	*2021*
Individual	$1,400	$1,400	$6,900	$7,000
Family	$2,800	$2,800	$13,800	$14,000

Except for preventative care, the high-deductible health plan may not provide benefits for any year until the deductible for that year is met.

What other health coverage can I have and still qualify for an HSA?

You can maintain certain types of "permitted insurance" in addition to the high-deductible health plan and still remain eligible for an HSA. Types of "permitted insurance" include workers' compensation, auto insurance, insurance for a specified disease or illness that pays a fixed amount per day (or other period) of hospitalization, accident and disability insurance, dental and vision care and long-term care insurance.

Questions and Answers…HSA Contributions

How much can I contribute to an HSA?

Contributions must be made in cash to an HSA that you establish with a qualified HSA trustee or custodian, such as an insurance company or bank, and cannot exceed a maximum annual limit, which is indexed annually for inflation:

Type of Coverage	Maximum Annual HSA Contribution	
	2020	***2021***
Individual	$3,550	$3,600
Family	$7,100	$7,200

Up to the maximum annual HSA contribution can be made for the current tax year so long as an individual becomes eligible for an HSA by December 1. If, however, coverage begins during the year, the high-deductible health plan must be maintained until the end of the following tax year (generally December 31) or tax must be paid on the HSA contribution attributable to the months during which the employee was not eligible for an HSA. This amount is also subject to an additional 10% tax.

In addition, individuals between ages 55 and 65 can make an additional "catch-up" contribution of up to $1,000 each year.

Who can make contributions to an HSA?

Contributions to an HSA can be made by an eligible individual, directly or through a cafeteria plan, by a family member on behalf of an eligible individual or by the eligible individual's employer. In addition, you may be able to roll over (transfer) unused funds from an IRA to an HSA on a tax-free basis. Regardless of who makes the contributions, you own the HSA.

How am I taxed on HSA contributions?

You deduct your HSA contributions on an "above the line" basis, resulting in a dollar-for-dollar reduction in your adjusted gross income. Any contributions made by an employer to an HSA are not included in your gross income for tax purposes and are not subject to withholding.

When must HSA contributions be made?

Contributions may be made at any time of the year in one or more payments, but must be made no later than April 15 of the year following the year for which the deduction is taken.

Must I contribute the maximum to an HSA?

While there is no requirement that you contribute the maximum to your HSA each year, doing so will enable you to take full advantage of the powerful tax benefits provided by an HSA.

Questions and Answers… Additional HSA Funding Sources

What sources other than annual contributions are available to fund an HSA?

If you have immediate health care needs, there may be insufficient funds in an HSA, especially in its initial phase, to pay for the health insurance policy deductible and/or any qualified medical expenses not covered by the health insurance policy. To help compensate for this potential problem, funds may be rolled over from an IRA into an HSA on a tax-free basis.

What are the requirements to fund an HSA with funds from an IRA?

A one-time tax-free transfer of funds from an IRA to an HSA may be made. The amount rolled over cannot exceed the annual HSA statutory maximum contribution for the year ($3,550 for individual coverage or $7,100 for family coverage in 2020; $3,600 for individual coverage or $7,200 for family coverage in 2021). The transfer of funds from an IRA to an HSA can be done only once during your lifetime and, once rolled over to the HSA, the funds cannot be transferred back to the IRA.

Questions and Answers… HSA Distributions

When can funds from an HSA be withdrawn tax free?

HSA funds can be withdrawn tax free at any time to pay for the qualifying medical expenses of yourself, your spouse and dependents. These expenses include:

- Prescribed and over-the-counter medications, as well as feminine care products
- Doctors visits, lab, x-ray and other diagnostic and treatment services
- Dental, vision and psychiatric care services
- Qualifying long-term care services and long-term care insurance premiums
- Medicare Parts A, B and D premiums, Medicare HMO or Medicare Advantage premiums (but not Medicare supplemental policy premiums)
- COBRA health continuation coverage premiums and health insurance premiums for those on unemployment compensation

It is your responsibility to ensure that expenses paid from the HSA are qualifying medical expenses and to keep adequate records concerning the use of HSA funds.

Can HSA funds be withdrawn to pay for non-medical expenses?

Yes, but such withdrawals are subject to income tax plus a penalty tax of 20% of the amount withdrawn. Any such withdrawals made after you reach age 65, die or become disabled are not subject to the 20% penalty tax.

What happens if I become ineligible for an HSA?

In this event, no additional contributions can be made to your HSA. The funds in the HSA, however, can still be used as described above. If used solely to pay for qualifying medical expenses, the distributions will be free of income tax.

What happens if I die?

If the beneficiary listed on the HSA is your surviving spouse, she/he becomes the new account owner and can use the HSA subject to the normal rules that apply to all HSAs. If the beneficiary is other than your surviving spouse, the funds in the HSA are taxable income to your beneficiary in the year of death, except for any of your qualifying medical expenses paid from the HSA within one year of death.

Health Savings Account Action Checklist

- ☐ Become covered under a qualifying high-deductible health plan.
- ☐ Establish a Health Savings Account with a qualified HSA trustee or custodian.
- ☐ Arrange for payment of HSA contributions, subject to the maximum annual contribution amount ($3,550 for individual coverage or $7,100 for family coverage in 2020 and $3,600 for individual coverage or $7,200 for family coverage in 2021).
- ☐ An HSA typically provides a debit card to use when paying for qualified medical expenses. An HSA debit card can only be used for qualified healthcare expenses at specific healthcare-related merchants that accept debit cards.

Important Information

The information, general principles and conclusions presented in this report are subject to local, state and federal laws and regulations, court cases and any revisions of same. While every care has been taken in the preparation of this report, VSA, L.P. is not engaged in providing legal, accounting, financial or other professional services. This report should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professional.

This discussion of Health Savings Accounts reflects federal income tax law. State or local law, however, may differ from federal law. As a result, a professional advisor familiar with your state and local law should be consulted before establishing a Health Savings Account.

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