

Health Savings Account (HSA)

FREQUENTLY ASKED QUESTIONS

1) What is an HSA (Health Savings Account)?

An HSA has two (2) components:

- 1) Qualified High Deductible Health Plan (that meets IRS requirements, refer to Publication 969)
- 2) A trust or custodial account that is managed by a qualified trustee/bank/insurance company

A health savings account (HSA) is a tax-exempt trust or custodial account that is set up with a qualified HSA trustee to pay or reimburse certain medical expenses incurred, (excluding health insurance premiums unless COBRA or while on unemployment). When setting up the account the individual must work with a qualified HSA trustee such as a bank, insurance company or other approved trustee.

2) What is a qualified HDHP?

A high deductible health plan (HDHP) is a health insurance policy that typically has a higher annual deductible and a maximum limit on out-of-pocket medical expenses set by the federal government. The policy may also have some first dollar coverage. *(for detailed qualifications refer to IRS Publication 969, page 3)*

3) Who Qualifies?

To be an eligible individual and qualify for an HSA, coverage must be under a qualifying high deductible health plan (HDHP), on the first day of the month, have no other health coverage except what is permitted, not be enrolled in Medicare, and the individual cannot be claimed as a dependent on someone else's tax return.

4) How are HSA funds used?

Once an account has been funded, the individual will typically receive a checkbook/debit card and then are responsible for paying providers as billed. Individuals will be responsible for retaining records for medical expenses that are reimbursed/paid through their HSA funds.

5) Are there limits for contributing to an HSA?

For 2010, an individual with a qualifying HDHP (according to IRS Publication 969) can contribute 100% of the deductible or a maximum of \$3,050. For a family HDHP the maximum is \$6,150.

6) Are Self-employed individuals (including sole proprietors, partners in a partnership, and more-than-2% shareholders in S Corp) eligible?

Yes, but they are not eligible to participate in a cafeteria plan used to fund HSAs in the workplace. They would be treated similarly to individuals making HSA contributions on their own. Sole proprietors must qualify for the self-employed insurance deduction on their 1040 to deduct their HDHP premiums. These premiums will not be deductible through their business.

7) Can an HSA be used with an HRA?

A traditional HRA will make an individual ineligible for an HSA. A post-deductible, limited-purpose, suspended or retirement HRA will not prevent eligibility.

8) Can HSA funds be used for health insurance premiums?

The only time an individual is allowed to pay health insurance premium with HSA funds is when the individual is collecting Federal or State unemployment or is on COBRA.

9) Can a qualified High Deductible Health Plan (HDHP) be used in conjunction with an HRA?

Yes. An HRA does not discriminate among the type of health insurance plan that may be eligible under the HRA. If the individual does not actually fund the trust account even though they purchased the qualified HDHP, an HRA may be used allowing for it to be taken as a business deduction.



Why would an HRA be preferred over an HSA?

The HSA must be pre-funded in order to take funds/reimbursements for medical expenses. HRA does not.

HRA has fewer restrictions on the type of health plan.

The HRA does not have funding maximums annually based on government restrictions. The HRA is based on employee involvement.

The HRA is an employer sponsored benefit plan.

Employer reimbursements are deducted through the business – saving in federal, state and self-employment taxes. Self-employed individuals are not eligible to deduct their own HSA funds except as a personal income tax deduction resulting in federal and state tax savings only.

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Base

Health Reimbursement Arrangement vs. Health Savings Account

CASE STUDY

Your client is a sole proprietor who is married with children. You sold them an HSA qualified health insurance policy; monthly premium is \$400.

Should they establish and fund an HSA or use an HRA?

If they choose to use an HSA, the client will need to go to an approved financial institution (bank, credit union, savings and loan, etc.) and open an account. Next, they will need to fund the HSA. This account typically is assessed a fee of \$2 to \$4 per month, plus additional charges for check writing and possibly other fees supporting the account. Interest rates, if any, are usually so low that they won't cover the account charges. The good thing is that all deposits in the account up to the federal limits are tax deductible as a personal deduction on their 1040 federal tax return and state tax return. It is important to remember deposits must be made to the account to be deductible and then withdrawn to cover eligible non-insured medical expenses.

The premiums for the qualifying health insurance policy are not deductible unless your client is self-employed and meets the federal guidelines. Even then, it is only deductible as a personal expense.

If the client qualifies and chooses to use an HRA the qualified health insurance policy can be placed in the HRA and will now be deductible on the business tax return. In addition, all of the non-insured medical expenses will also become business deductions up to the limit of the plan. All expenses should be paid by the personal account and reimbursed by the business account. There are no federal guidelines for the health insurance deductions on the business return as there are on the personal return for the HSA.

Tax Savings Comparison

	HSA		HRA
Premiums*	\$4,800	Premiums*	\$4,800
HSA Contribution	\$6,150	Non-insured expenses (including over-the-counter)	\$6,150
1040 Deduction (15% federal + 5% state)	\$10,950 x20%	Schedule C Deduction (15% federal + 5% state + 15.3% self-employment)	x 35.3%
Total tax savings	\$2,190	Total tax savings	\$3,865.35

*Insurance regulations may prohibit the reimbursement of health insurance premiums in your state. For additional details, please contact a BASE® Benefit Specialist.

ADVANTAGE – HRA provides \$1,675.35 additional in tax savings

Using the HRA your client saves an additional \$1675 over the HSA, or about \$140 per month.

HRA savings in the above example are \$322 per month, which could be used towards the health insurance premiums. Wouldn't it be easier to sell a policy that will only cost an additional \$78 per month when utilizing the HRA? Or \$218 using the HSA?

Other points to consider...

- Will the bank or credit union that your client chooses to set up their HSA sell health care? If so, will they replace your coverage?
- What about the client that can't qualify or won't change to your health care? If they qualify for the HRA, do you have other products that you could sell by showing them how to deduct their current premiums and expenses? How about life insurance, long term care (deductible under the HRA), an annuity (funded by the tax savings) to help them build for retirement? What about ancillary products and an Association membership that will multiply your income and bonus opportunity?

The HRA sets you apart from your competition by showing them that you care and are knowledgeable about tax savings opportunities for the self-employed.

BASE® does all of the work for you and your clients, leaving you more time to sell your products and services. Call 1-877-342-5105 for more information.

