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Health Savings Accounts: Save Now and Save for Later

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Health savings accounts (HSAs) recently became law as part of President Bush's Medicare Prescription Drug, Improvement and Modernization Act of 2003.

The purpose of HSAs is twofold: First, they promote savings for future health care expenses; second, they represent another attempt by the government to gently nudge the insured public into consumer-driven health products by offering tax incentive programs to those enrolled in qualified plans.

Why would a tax proposal tied to health insurance be included in a Medicare reform package? By the time the Medicare rolls consist primarily of Baby Boomers, Medicare will be in serious financial trouble; and the cost of health care will have grown to a level we can only imagine now. HSAs are designed to retrain a new generation toward more personal responsibility through high-deductible health plans and tax-advantaged savings plans aimed at saving for future health care costs. The success or failure of HSAs could have a significant impact on the Medicare prognosis.

What is an HSA? An HSA is a tax-advantaged account created by an individual who is covered under a high-deductible health plan. HSAs have limits on how much you may deposit, as well as what constitutes a qualified withdrawal. The tax advantages of the HSA are what set them apart from other tax-advantaged programs. Not only is the money deposited into the account tax-deductible, but the interest earned and any qualified withdrawals are also all tax-free.

Who can have an HSA? In order to qualify for an HSA, you must own an HSA qualified health insurance policy. A qualified policy includes the following:

1. Plan must have a minimum deductible of $1,000 ($2,000 for families).
2. No first dollar benefits. Copayments for office visits and prescriptions prior to satisfaction of the deductible are not allowed.
3. A maximum out-of-pocket liability of no more than $5,000 ($10,0000 for families).
4. Preventive benefits are allowed without deductible.
5. The policy must be in effect at the time of any qualified contribution. A policy does not need to be in effect in order to make a withdrawal from the account.

In addition to owning a qualified policy, the individual cannot be covered by another health plan that is not a high-deductible health plan (for example, their spouse's employer coverage). Individuals eligible for Medicare do not qualify for HSAs.

How much money can you contribute to your HSA? Contributions are limited to the lesser of the deductible or $2,600 for singles and $5,150 for families (amount increases annually based on consumer price index). Individual over age 55 can make "catch-up" contributions (limited to $500, rising by $100 increments until reaching $1,000 for 2009 and later years). Rollovers from existing Medicare savings accounts (MSAs) are allowed and not counted toward the annual contribution.

The following presents a few scenarios to help you better understand how the contribution limits work in different situations:

Deductible of Policy Owned	Type of Policy	Maximum Annual HSA Contribution
$1,000	Individual	$1,000
$5,000	Individual	$2,600
$2,000	Family	$2,000
$7,500	Family	$5,150

Note: The contribution limit is calculated on a monthly basis; i.e., if a person bought a policy in January but opened the HSA in June, the contribution limit would be based on seven months vs. an entire year. (1/12 of annual limit times the number of months the account is open).

Remember, setting up the HSA account is as easy as walking into the bank and opening a savings account or IRA. The only requirement is that you must be covered under a qualified high-deductible policy at the time. Several insurers have set up turnkey applications for both the insurance policy and the HSA.

Once you've acquired the high-deductible policy and set up the HSA, how do you get your money out? Third-party administrators and banks will administer accounts on a fee basis. The actual process of making withdrawals will be specific to each administrator. Money may be withdrawn on a tax-free basis as long as it is for a qualified medical expense. A qualified medical expense is any health care cost paid on behalf of the individual or his or her spouse or dependents for medical care, as defined in the Internal Revenue Code [IRC 213(d)]. These expenses include certain over-the-counter drugs that were recently authorized by the IRS (Revenue Ruling 2003-102). Funds from the HSA may not be used for health insurance premiums, except for:

1. COBRA health care continuation premiums;
2. health care coverage premiums while receiving unemployment compensation;
3. qualified long-term care insurance; or
4. health insurance premiums for individuals over age 65, other than Medicare supplement (approved plans would include Medicare Part A & B, Medicare+Choice and employer retiree coverage).

These withdrawals may be made at any time. You may recall that section 125 "cafeteria plans" require that you "use it or lose it" on a plan-year basis. This encourages individuals to run out and spend everything in their account each year. The HSA encourages you to save your money by allowing the amounts to roll over and accrue tax-free over time. Ultimately, the best scenario would result in a bankroll to fund your health care expenses later in life. For this reason, HSAs should be added to all current section 125 plans when a high-deductible plan is available.

Who will sign up for HSAs? Some suggest that only the healthy and wealthy will sign up - but this doesn't hold up against actual experience. Older workers and those who may need more health services see greater value in the control they get over their health choices. Experience shows that high-deductible policyholders use the preventive benefits and generic drugs, and make wiser choices on discretionary expenses. These habits reduce annual health care expenditures through a reduced rate in the use of the emergency-room and outpatient visits. The Galen Institute did some research with six insurers who have had two years of experience with health reimbursement arrangements (HRAs) and discovered the following:

1. Enrollees in these new plans are more likely to be older and sicker (usually already holding a qualified medical plan).
2. Plans do lower costs.
3. Preventive service utilization increases up to 60%.
4. Generic drugs are chosen 50% more often.
5. Satisfaction and re-enrollment rates are up to 98%.

The Galen Institute also reported some interesting findings regarding the income level of those who find the HSA idea attractive. Lower income workers are more likely to see the value of the savings opportunity than higher income employees, since a savings of $1,000 a year is more valuable for someone making $25,000 a year than for someone making $100,000.

HSAs are getting more attention from the insurance industry than the MSA and HRA plans of the past few years. This renewed enthusiasm will bring more consumer-friendly programs to entice the public. Bankcards attached to your HSA will make using your HSA at the pharmacy or health care provider hassle-free. Unlike the claims forms required to receive reimbursement from section 125 plans, the bankcard will act just like your ATM card. This competition will help the consumer by driving premiums, benefits and provider networks to their favor.

With over 20 years in the insurance industry, I have seen the slow migration of individuals and employer groups to higher-deductible, consumer-driven health plans. These plans made sense before the passage of health savings accounts. This new tax advantage is the "icing on the cake" the industry needed to convince more individuals to take a second look. Saving on premiums now and depositing these savings on a tax-advantaged basis for future medical expenses is the best of both worlds.

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