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Frequently Asked Questions about Health Savings Accounts (HSAs)

What is an HSA?

An HSA is a tax-advantaged savings account, similar to a traditional Individual Retirement Account (IRA), but designated for qualified medical expenses. An HSA allows members to pay for current qualified medical expenses and save for future qualified medical expenses on a tax-favored basis.

HSAs provide triple-tax advantages: contributions, investment earnings, and qualified distributions-are all exempt from federal income tax, FICA (Social Security and Medicare) tax and state income tax (for most states).

Unused HSA dollars roll over from year to year, making HSAs an easy way to save and invest for future qualified medical expenses. Members own their HSA and can take it with them when they change medical plans, change jobs, or retire. This means the funds in a member's account, contributed by the member and employer, are non-forfeitable and portable.

Funds in the account not needed for short-term expenses may be invested, providing the opportunity for funds to grow. Investment options include money market accounts and mutual funds.

To be eligible to set up and contribute to an HSA, members must be covered by a qualified HDHP and not have other coverage (e.g., Medicare).

Who is eligible to open an HSA?

Members are eligible to open an HSA if they are:

- Covered by a qualified HDHP;
- Not covered by another health care plan, such as a health plan sponsored by a spouse's employer, including a general purpose FSA, Medicare or TRICARE; and
- Not claimed as a dependent on another individual's tax return.

Members are still eligible if they:

- Have certain limited coverage approved by the IRS, (e.g., dental, vision and long-term care insurance) or
- Are entitled to benefits under an Employee Assistance Plan (EAP), disease management or wellness program or have a discount card for prescriptions.

What is an HDHP?

An HDHP provides comprehensive health care coverage like a traditional health plan and like a traditional plan; members are responsible for paying for their medical expenses before the deductible is satisfied. However, the deductible is higher than a traditional plan and must meet or exceed the amount determined annually by the IRS.

After the annual deductible is met, members are responsible for a portion of their medical expenses through coinsurance or co-payments, just as with a traditional health plan.

- For 2012, the HDHP Deductible must be at least $1,200 for individuals and $2,400 for families.
- For 2013, the HDHP Deductible must be at least $1,250 for individuals and $2,500 for families.
- For 2012, the maximum out-of-pocket expenses (including deductible and co-payments, but not including premiums) cannot exceed $6,050 for individuals and $12,100 for families.
- For 2013, the maximum out-of-pocket expenses (including deductible and co-payments, but not including premiums) cannot exceed $6,250 for individuals and $12,500 for families.

The deductible and maximum out-of-pocket expenses are indexed annually for inflation.

What are consumer-directed health care plans?

Consumer-directed (consumer-driven) health care plans give employees more incentives and tools to control both health care decisions and the costs associated with them. A typical consumer-directed plan might include:

- A Health Reimbursement Account (HRA) or an HSA, paired with a High Deductible Health Plan design;
- Web-based tools that support the decisions employees make regarding their plan choices, health savings amounts, etc.; and
- Other support features, such as nurse telephone lines, care coaches and disease management programs.

How does an HSA work?

If a member enrolls in a qualified HDHP and meet other IRS criteria, they may open and contribute to an HSA. All of the money deposited into an HSA, up to the maximum annual contribution limit determined by the IRS each year, is 100% tax-deductible for federal income tax, FICA (Social Security and Medicare) tax, and state income tax (for most states).

If the member chooses, they may use their HSA funds, to pay for expenses under their HDHP, incurred before meeting he deductible, for coinsurance or copayments the member owes after meeting their deductible or for any other qualified medical expenses.

The funds in their account can be used for other, non-medical expenses, but distributions used for non-medical expenses are subject to ordinary income taxes, plus a 20% penalty if the member is under age 65. The 20% penalty does not apply if the distribution occurs after reaching age 65, become disabled or die; however, ordinary income tax may still apply.

Funds remaining in an account at the end of the year roll over and accumulate for future qualified medical expenses. The member may choose not to spend their HSA dollars and instead use after-tax dollars for ther qualified medical expenses, leaving HSA dollars to grow for the future. Choosing which expenses to pay with out-of-pocket after-tax dollars and which to pay with HSA dollars is entirely up to the member.

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How is money deposited to an HSA?

Money may be deposited to an HSA through payroll deduction, if the employer participates in such a program, or funds may be deposited directly to their account. Deposits may be made periodically or in one lump sum.

Payroll deductions: If the employer offers the option, the member may specify a regular contribution to be deducted from the member's paycheck. This contribution is made before Social Security, federal income tax and state income tax (for most states) are deducted.

Deductible contributions: The member may choose to make all or part of their annual account contributions to an HSA by writing a personal check or completing an electronic transfer and deducting the contribution on their income tax return, using IRS Form 1040 and Form 8889.

Please note, the member must file IRS Form 1040 to take a deduction for their HSA contributions, not the short form 1040A or 1040EZ. This deduction is taken "above the line" and the member does not need to itemize contributions on Schedule A in order to claim the deduction for HSA contributions.

A tip: members can contribute up to the maximum annual contribution at any time until the deadline for filing income tax returns (generally, April 15 of the following year for calendar year tax payers). Employers may contribute to members' account as well; while members do not take a deduction for these contributions, they are excluded from gross income. Employer contributions are counted toward the maximum annual contribution.

How are HSAs different from other health accounts?

Highlights of MSAs, HRAs and FSAs are described below:

Medical Savings Accounts (MSAs), precursors to HSAs and sometimes known as Archer MSAs, were made available in 1996 to self-employed individuals and employees of smaller businesses. Most employers that offered MSAs are converting them to HSAs.

- Health Reimbursement Accounts A Health Reimbursement Account (HRA) is an account established by an employer to reimburse employees for qualified medical expenses. Unlike an HSA, which requires an individual to be covered under a qualified HDHP to be eligible to make or receive contributions, HRAs do not require any specific type of health plan coverage as a condition of eligibility. Only an employer can contribute to an HRA and there is no limit on the amount the employer can contribute. Upon termination of employment, an employer is not required to pay unused HRA funds to the employee. By comparison, HSAs are owned by the employee and any funds in the account belong to the employee regardless of employment status.
- Flexible Spending Accounts Both HSAs and FSAs allow the member to pay for qualified medical expenses with pre-tax dollars. One key difference is that HSA balances can accumulate and roll over from year to year, while FSA money left unspent at the end of the year or after a designated grace period, is forfeited.
- Caution: Health care FSAs also are referred to as "tax-free spending accounts," "medical reimbursement accounts (MRAs)," and even "health care spending accounts (HCSAs or HSAs)." Don't be confused by the inconsistent terminology.

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What are the differences between FSAs, HRAs and HSAs?

	Flexible Spending Account (FSA)	Health Reimbursement Account (HRA)	Health Savings Account (HSA)
Eligibility			
High Deductible Health Plan (HDHP)	Not Required	Customary	Required
Portability	No	Optional	Yes
Contributions			
Employee	Permitted	Not Permitted	Permitted
Employer	Permitted	Permitted	Permitted
Investment earnings	No	No	Yes
Tax-favored funding rate	Annual	Annual	Monthly
Distributions			
For out-of-pocket medical expenses	Permitted	Permitted	Permitted
For insurance premiums	Not Permitted	Optional	Permitted*
For non-medical expenses	Not Permitted	Not Permitted	Permitted
Annual forfeitures	Required	Not Customary	Not Permitted
Claims substantiation	Employer	Employer	Individual
Compliance			
IRS Code Section	125	105	223
Subject to ERISA and COBRA	Yes	Yes	No
Nondiscrimination requirements	Yes	Yes	Yes

*At age 65, HSA funds can be used to pay premiums for Medicare Parts A and B, Medicare HMO coverage and retiree medical insurance.

How do employees benefit from HSA?

HSAs provide employees with multiple benefits and generally are an improvement over earlier health accounts earmarked for medical expenses.
Specifically, HSAs are:

- Tax-advantaged: Neither contributions, earnings nor withdrawals for qualified medical expenses are subject to federal or state tax (for most states).
- More flexible than HRAs: Money accumulates and remains with the employee (is non-forfeitable). The funds in the account can be used for nonmedical expenses, but are then subject to ordinary tax, plus a 20 percent penalty if the employee is under age 65. (However, this 20 percent penalty does not apply if the distribution occurs after the individual becomes disabled, or if payment is made to the spouse of a deceased participant.)
- Portable: Accounts move with the employee when he or she changes employers or retires.
- Savings mechanism for future health needs: Unused contributions accumulate and can be "banked" for future medical expenses.
- Contributions can come from multiple sources: Employers, employees and family members can all contribute to HSAs. (As an alternative to pre-tax payroll deductions, after-tax contributions to HSAs can be made through personal checks. Contributions are then deducted when filing income taxes.)

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Why should an employer offer our product?

Employers can enjoy the following benefits from offering BenefitWallet™

- HSAs increase the likelihood that employees will choose high deductible consumer directed health care plans — which cost less for employers to provide — because they offer a vehicle to contribute, save and pay for health care on a tax-free basis.
- HSAs allow employers to offer employees a valuable tax-sheltered form of compensation at a low cost. Both employee and employer contributions are immediately translatable into cash — a benefit to all employees covered by High Deductible Health Plans, whether or not they have medical expenditures.
- BenefitWallet is the premier product in the market because it offers a solution that integrates top insurance, banking, communications and customer support processes.
- BenefitWallet handles all administration, processing, investments, recordkeeping and customer service related to the HSA.
- The Bank of New York Mellon (BNY Mellon) will prepare and send annual tax reporting (Forms 1099 and 5498) to account holders and the IRS.

What should an employer consider when deciding to offer an HSA?

While HSAs promise a significant opportunity for employers and employees alike, there are some important decision points for an employer's consideration.

Employers who answer "yes" to the following questions should seriously consider offering an HSA:

- Do you have fairly low turnover among your work force?
- Do you have a large number of highly compensated employees?
- Are you looking for less expensive health care plan options?
- Do you want to design a health care plan with maximum flexibility for employees?
- Are you trying to incent your employees to take a more active role in health care decision-making and funding?
- Are you willing to help educate employees about HSAs and consumer-directed health care in general?
- Do you have a High Deductible Health Plan in place, or are you considering implementing an HDHP?
- Are you looking for ways to help fund retiree medical coverage?

Employers who answer "yes" to the following questions may find it more difficult to implement — or may not receive the maximum value from an HSA:

- Do you have high employee turnover?
- Do you have a large number of lower-paid workers?
- Do you pay for all or most employee health care costs and plan to continue doing so?
- If you already offer HRAs, do you have a sizeable number of employees with large unused account balances?
- Do your employees expect your company to fund their health care — even in retirement — and to make most benefit decisions for them?

Note: Some of the above issues could be positive or negative for a given employer's organizational readiness for HSAs.

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Because HSAs include vehicles for investing surplus funds, do producers need a Series 7 license or a Certified Financial Planner designation to sell them?

No, a producer does not need any special licenses or designations to sell HSAs. When producers "sell" HSAs, they are simply helping participants establish bank accounts. Except in cases of some MSA rollovers into HSAs, the beginning balances on these accounts will not be large enough to invest. Once an account grows to the point where it has a surplus balance, the investment management firm will contact the participant regarding his or her investment options.

Note: This is not intended to be a complete summary of all provisions relating to Health Savings Accounts (HSAs).

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