

Health Savings Accounts

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The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 created Internal Revenue Code Section 223 that has established Health Savings Accounts (HSA). Prior to HSAs, Congress created Medical Savings Accounts, subsequently renamed as the Archer Medical Savings Accounts (Archer MSA). An Archer MSA is a high-deductible health insurance plan combined with a side account for qualified medical expenses. The benefits of the Archer MSA, and subsequently the HSA, are contributions to the account are tax deductible, earnings on the account accumulate tax deferred, and qualified distributions are tax-free. The HSA replaced the Archer MSA that expired at the end of the 2003.

The purpose of the HSA is similar to the Archer MSA. An HSA is a tax-exempt trust or custodial account administered by a bank, insurance company or other approved entity for paying qualified medical expenses of an account owner covered by a high-deductible health insurance plan. Taxpayers may not establish an HSA if they have coverage under another health insurance plan that is not a high-deductible health plan nor may anyone eligible for Medicare establish an HSA. In addition, the tax deduction is not available for anyone claimed as a dependent of another taxpayer.

A high-deductible health insurance plan is an insurance plan that has an annual deductible of at least \$1,000 for individual coverage or \$2,000 for family coverage and a maximum annual out-of-pocket deductible of \$5,000 for individual coverage or \$10,000 for family coverage. A high deductible health insurance plan may include preventive care benefits. These benefits may be included in the plan without applying a deductible limit.

Annual tax-deductible contributions to an HSA are limited to the lesser of the deductible or \$2,600 for individual coverage or \$5,150 for family coverage. Taxpayers ages 55 to 64 are allowed to increase the contribution by \$500 for 2004. This catch up contribution increases annually until it reaches \$1,000 in 2009. Employers can make HSA contributions to the employee's account subject to the limitations. These contributions are treated as an employer-provided medical expense and are not included in the employee's income. Eligibility in the

HSA is determined monthly based upon participation in a high-deductible plan. Therefore, the annual limits are prorated monthly throughout the year based upon participation. Contributions should be made to the HSA prior to the due date of the account owner's income tax return, excluding extensions. HSA contributions may not be made once an individual becomes entitled to benefits under Medicare.

Account distributions are tax-free when used for qualified medical expenses of the account owner, the owner's spouse and dependents. Qualified medical expenses are those allowed for income tax purposes as a medical expense. The qualified medical expenses paid from HSA distributions may not be claimed as a medical expense on the IRS form Schedule A. In general, account distributions cannot pay health insurance premiums. However, distributions are allowed for COBRA health premium, health premiums while an individual is unemployed, long-term care premiums or Medicare coverage premiums once an individual reaches age 65. Any distribution made that is not used to pay for qualified medical expense is includable in income subject to tax as well as subject to a 10% penalty. Distributions made after the account owner's death, disability or attainment of age 65 are not subject to the penalty.

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The enactment of Health Savings Accounts provided individuals another option for paying the rising costs of medical expenses. Whether you are an individual or an employer, it may be well worth your efforts to review your current insurance plan costs and benefits and compare those with the costs and benefits of an HSA.

To learn more about how an HSA could benefit you, contact a **friendly Kemper professional** today! There are many options available, and we can help you determine which is most appropriate for you and your family. It's your money—we can help you keep more of it. **Contact us today!**