

Health Savings Accounts

A Tax Advantage to Offset
Health Care Expenses



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Health savings accounts (HSAs), were created by Congress to combat rising medical costs by providing an incentive for more consumers to pay “first-dollar” medical expenses. HSAs, first available in 2004, are tax-favored accounts designed to help individuals who are covered by high deductible health plans pay medical expenses for themselves, their spouses, and their dependents. Congress again addressed the issue of health care costs in 2006 and simplified some of the HSA requirements through the Tax Relief and Health Care Act of 2006.

Who is eligible for an HSA?

HSAs are available to individuals covered by a high deductible health plan (HDHP) regardless of whether they are self-employed or employed by a small employer, and regardless of whether their employer maintains the HDHP.

You are an eligible individual for any month if you

- are covered under an HDHP on the first day of such month,
- are not also covered by any other health plan that is not an HDHP (with limited exceptions),
- are not enrolled in Medicare, and
- are not eligible to be claimed as a dependent on another person’s tax return.

An employer may offer HSAs through a cafeteria plan. Employer contributions to an HSA reduce what an individual can contribute, but they do not eliminate an individual’s ability to contribute.

What are the benefits of an HSA?

HSAs can provide significant tax benefits. Not only can they provide tax benefits related to paying qualified medical expenses, they may also serve as additional income for retirement.

Tax Benefits

- HSA contributions made by employer or employee are excluded from income.
- HSA earnings are tax-deferred.
- If used for qualified medical expenses, HSA assets are never taxed.
- Unused HSA assets may be used for retirement. These distributed amounts, however, will be subject to income taxes. They will also be subject to a 10 percent penalty until the HSA owner turns age 65.
- Upon death, HSA assets become the property of a named beneficiary or of the HSA owner’s estate. A spouse beneficiary may treat the HSA as his or her own, while nonspouse beneficiaries must treat such inherited assets as ordinary taxable income.

What is an HDHP?

An HDHP is an insurance policy that meets certain dollar limits as shown in the table below.

2007 HDHP Limits*		
	Self-Only Coverage	Family Coverage
Annual deductible	\$1,100 or more (\$1,050 for 2006)	\$2,200 or more (\$2,100 for 2006)
Out-of-pocket expense	\$5,500 or less (\$5,250 for 2006)	\$11,000 or less (\$10,500 for 2006)

If the plan does not meet both the deductible and out-of-pocket expense restrictions, it is not considered an HDHP.

What are qualified medical expenses?

For HSA assets to retain their tax-free status, they must be withdrawn and used for certain qualified medical expenses. Qualified medical expenses are generally expenses that qualify for the medical and dental income tax deductions as defined in IRS Publication 502. Expenses paid with HSA assets cannot also be claimed as a deduction on your income taxes. Here are some examples.

- Medical expenses, including doctor visits, prescriptions, transportation to get medical care, and certain dental and vision care
- Qualified long-term care insurance
- Health plan premiums when unemployed
- Health plan premiums during COBRA (continuation-of-benefit) coverage
- Certain health insurance after age 65

Nonqualified uses of HSA assets are subject to taxation and a 10 percent penalty unless the HSA owner is age 65 or older, dies, or is disabled.

Can self-employed individuals have an HSA?

Sole proprietors and others who are self-employed can have an HSA and are, in fact, often ideal candidates for an HSA. HSAs are often advantageous for self-employed individuals because

- HDHPs generally have modest premium costs, and may be an effective cost-containment mechanism,
- the employer is protected against potentially catastrophic health care expenses, and
- the HSA may serve the dual purpose of providing for both medical and retirement expenses.

How much can I contribute to an HSA?

The total amount you or your employer may contribute to an HSA is dependent upon whether you have individual or family coverage under an HDHP as shown in the table below.

2006 HSA Contribution Limits	
Self-Only Coverage	Family Coverage
Lesser of: – annual plan deductible, or – \$2,700*	Lesser of: – annual plan deductible, or – \$5,450*

*Subject to potential cost-of-living increases.

The Tax Relief and Health Care Act of 2006 provides that the contribution limit for 2007 and beyond is no longer dependent on the HDHP's deductible amount, but rather, only on the annual statutory limit.

2007 HSA Contribution Limits*	
Self-Only Coverage	Family Coverage
\$2,850	\$5,650

*Subject to potential cost-of-living increases.

In addition to the standard HSA contribution limit, if you have attained age 55 before the close of a taxable year, you may also contribute an additional amount known as a "catch-up" contribution, as shown in the table below.

Catch-Up Contribution Limits	
Taxable Year	Maximum Catch-Up
2006	\$700
2007	\$800

Are cash contributions the only way to fund an HSA?

There are a few additional options to fund an HSA. If you have money in an Archer medical savings account, you can roll that money to an HSA.

The Tax Relief and Health Care Act of 2006 allows certain individuals to move money from health flexible spending accounts (FSAs) or employer-sponsored health reimbursement arrangements (HRAs) to HSAs. Also, individuals are allowed a one-time rollover of money from an IRA to an HSA. This IRA rollover, however, counts toward the HSA contribution limit. Since certain restrictions apply to these options, you should seek competent tax advice to help analyze the options available to you.

Do HSAs require reporting?

HSAs require the following government reporting.

- HSA holders report contributions and distributions on their income tax returns.
- An employer contribution is reported on a business tax return, as well as on employees' Form W-2s.
- Contributions and distributions are also reported to the IRS by the trustee or custodian where the HSA is held.

For more information...

To learn more about how to take advantage of the many HSA benefits, ask one of our representatives for more details.

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