

HEALTH SAVINGS ACCOUNT (HSA) FREQUENTLY ASKED QUESTIONS

Who Qualifies for an HSA?

You, if you're:

- under the age of 65,
- not listed as someone else's dependent for income tax purposes,
- not receiving Medicare or Social Security benefits,
- covered by a high-deductible health plan, and
- *not* covered by any other type of health insurance plan, *except for*:
 - Separate dental and/or vision care insurance, or flexible spending accounts (FSAs) covering only dental and/or vision care
 - Discount cards for health care services or products (for example, prescription drugs)
 - Disease management and wellness programs, as long as they do not "provide significant benefits in the nature of medical care"
 - Employee assistance plans, again if they do not "provide significant benefits" (short-term counseling is okay)
 - FSAs or HRAs that pay or reimburse for medical expenses after a high deductible has been met*
 - Separate long-term care insurance
 - Worker's compensation insurance (through employers)
 - Disability insurance (individual or through unions or employment)
 - Automobile insurance (including coverage for medical care in accidents and emergencies)
 - Business liability insurance
 - Insurance that pays for fixed amount of hospitalization
 - Freestanding health insurance for travel (such as flight insurance or automatic travel coverage when transport is booked on a credit card).

* Employers may offer HSAs or FSAs that pay or reimburse additional fees for coinsurance or out-of-pocket costs, provided that you have already satisfied your in-network deductible. Retirement HRAs funded by employers, accounts that will only pay for or reimburse medical expenses incurred after retirement, are permitted.

If your spouse or dependents are covered by other insurance, they may not be able to participate. However, you may still be able to use your HSA to pay for their qualifying medical expenses tax-free.

Who Will Not Qualify?

HSAs are not available to persons who are both eligible for and enrolled in Medicare. Most Americans qualify for Medicare at age 65; however, if an individual continues to work past that age, remains enrolled in a high-deductible health plan, and does not apply for Medicare benefits, he or she may qualify to contribute to an HSA.

If you're claimed as a dependent on someone else's tax forms — regardless of whether that someone is a spouse, a domestic partner, or a parent — you cannot open your own HSA.

Children not of working age cannot open their own HSAs with money given by their parents. Children who work but are claimed as dependents on their parents' tax return cannot open their own HSAs.

Similarly, a non-working spouse or any other relative who is claimed as a dependent on another person's tax return cannot open his or her own HSA either.

Individuals and families covered under traditional, full-coverage insurance plans (including Health Maintenance Organizations, Preferred Provider Options, Point-of-Service plans, Medicare and Medicaid) that do not meet the deductible minimum are *not* eligible for HSAs.

How do I establish an HSA account?

The HSA account is established with the assistance of an HSA Administrator. Funds are held in an account in your name by a financial institution (such as a bank or stock brokerage firm).

The Administrator's duties/responsibilities include the establishment and monitoring of the account, processing of claims and ongoing reporting to you, the account holder.

Administrator's charge a fee for their services, provide you with a debit card for accessing to your funds and are available to discuss the status of your account and claims processing procedures.

The Financial Institution provides the services of holding your funds, investing them at your direction and reporting your fund's investment performance (to you).

How do I select an HSA administrator and Financial Institution?

There are many choices available. You might search the internet using Google or similar service. When selecting an HSA Administrator, you might review their services, their fees, their track record, the Financial Institution they are affiliated with, the investment options available through the Financial Institution.

At your request, we will provide a list of several HSA administrators for your review and selection.

HSAs: Catch-Up Contribution - Special Rules for Those Over 55

To allow older taxpayers to "catch up," the current law allows HSA participants to stretch their contribution limit by an additional \$700 in 2006. This means that if you are over 55 and have a \$1,050 deductible, your legal contribution may be \$1,750 for the tax year. Under current law, the

“catch-up” amount will increase \$100 per year (the catch-up amount will be \$800 in 2006) until it reaches an additional \$1,000 per tax year by 2009 and there after.

These additional amounts must also be pro-rated, in the same way any other contribution would be, if you participate in the HSA program for only part of the year.

HSA: Excess Contributions & Rollovers - Penalties on Excess Contributions

Current law mandates a penalty if you, or your employer, contribute in excess of your limit for the tax year. You will be penalized with a 6% excise tax on the entire amount that is over the limit.

The IRS will also treat amounts in excess as income. The tax responsibility will be yours, even if your employer made that excess contribution.

The 6% penalty tax will be waived if a distribution of the excess (including its earnings) is made to the account holder in a timely manner. The easiest way to do this is to write an HSA check to yourself, in the amount of the excess, before December 31 of the relevant tax year. The earnings on the excess will be taxable on distribution.

If you can prove the check to yourself is a reimbursement for out-of-pocket qualified medical expenses in the second year, you may not have to pay any tax on that amount. You'll need receipts to back this up, naturally.

Avoid a Tax Penalty

It's up to you to monitor your HSA contributions and make sure they don't exceed your legal limit. Use the Contribution Calculator and make sure you know what your limit is. Then pay attention. A monthly number-check, at the same time you balance your checkbook, ought to be enough — it will take only an additional minute or two.

What About Rollovers from Other Accounts?

If you had an MSA (the ancestor of the HSA, which was available only to the self-employed), you can **roll over** accumulated funds from that account into your HSA, without paying a tax or penalty. Rollovers do not count towards your contribution limit, but you do not get an additional deduction for them in the current tax year.

An HSA may accept only one rollover per year.

Under current law, rollovers from an IRA, HRA, or other health reimbursement plan from an employer or flexible spending arrangement are permitted on a one time only basis and only to the maximum amount allowed by the HSA regulations.

Using Your Account

How do you spend HSA Funds?

HSA money must be used for qualified medical expenses to remain tax-free. You can make tax-free withdrawals from your HSA to pay for these expenses as soon as

- your account is activated, and
- you have an opening balance.

There are two reasons why you would pay for qualifying medical expenses with funds outside the HSA account. The first is because you do not have enough money in the account to pay for the procedure. In that case, you may use other funds and take the deduction later as long as you have supporting documents to show the tax authorities. The second reason is that you prefer to leave the funds in the HSA and continue to earn dividends and profits that are not taxable until you retire or use later for qualifying expenses.

What Can You Use Your HSA For?

You can spend your HSA dollars on medical expenses for yourself, or anyone you claim as a spouse or dependent on your personal income tax — even if that person is not covered by your HDHP. In general, HSA withdrawals for qualifying medical expenses are excluded from your gross income — that is, they are not taxed — even if you're not currently eligible to contribute to the HSA.

Only distributions provable as qualifying medical expenses will be tax-free. If you pay for procedures that do not qualify, the monies used are considered to be "income" for your tax year and will be subject to both federal and state income taxes, as well as an additional penalty tax of 10% of the amount that was spent.

What's a Qualifying Medical Expense?

The IRS definition of "qualifying medical expenses" is broad, and you can use your HSA to pay for many things your health insurance won't cover. However, regulations do change. You can always find the most up-to-date list of qualifying expenses online, in Publication 502 on the [IRS website](#).

Here's just a sampling:

- Professional care
- Medical doctors
- Dentists
- Optometrists
- Nursing services
- Emergency care
- Christian Science practitioners
- Chiropractors
- Psychiatrists
- Psychologists
- Acupuncturists (but not herbalists)
- Therapists (certain certifications may be required)
- Treatments not often covered by health insurance:
- Alcoholism or drug addiction treatment
- Fertility enhancement
- Laser eye surgery
- Prescribed weight-loss or stop-smoking programs
- Special schools and homes for the mentally retarded

- Medical equipment, appliances and other personal items:
 - Artificial limbs and prosthetics
 - Dentures and other artificial teeth
 - Contact lenses and eyeglasses
 - Braille books and magazines
 - Crutches and wheelchairs
 - Hearing aids
 - Guide dogs and other helper animals
 - Birth control pills
 - Costs that may be incurred when seeking treatment
 - Trips and travel exclusively for the purpose of a treatment
 - Meals and lodging associated with such trips
- Qualifying treatment-related expenses:
 - Telephone or television modifications for disability
 - Legal fees related to treatments
 - Medical conferences (must be related to a condition)

Over-the-Counter Items

The law provides that these small items, such as aspirin, sunscreen, vitamins, “aromatherapy” candles, acne creams, Epsom salts and Ace bandages, qualify *only* if they have been *prescribed*.

What Does NOT Qualify?

These expenses are just a sampling of expenses you can’t pay for with your HSA. (If you do pay for these with a withdrawal from your HSA, you’ll either have to reimburse the account by April 15th of the year following the tax year or pay income tax — plus a 10% penalty tax — on the withdrawal amount.)

- Cosmetic surgery (unless the surgery is related to a medical condition, as in the case of a birth defect or a mastectomy)
- Teeth whitening
- Maternity clothes
- Diaper services
- Health club dues
- Electrolysis for hair removal
- Hair transplants
- Household help or babysitting
- Marijuana for glaucoma (or other controlled substances)
- Nonprescription drugs and medicines (over-the-counter drugs can be qualifying expenses, but you must have a doctor’s written recommendation)
- Food supplements not prescribed by a doctor (e.g., Ensure TM.)
- Over-the-counter vitamins or diet drinks (e.g., Slimfast)
- Swimming lessons
- Weight-loss programs *not prescribed*
- Funeral expenses

Some borderline expenses must wait for further guidance in the form of future IRS notices.

IRS Qualifying Medical Expenses

- Abortion
- Acupuncture
- Alcoholism Treatment
- Ambulance
- Artificial Limb
- Artificial Teeth
- Bandages
- Birth Control Pills
- Braille Books and Magazines
- Breast Reconstruction Surgery (post-mastectomy only)
- Capital Expenses (see note)
- Car Modifications (for disabilities)
- Chiropractor
- Christian Science Practitioner
- COBRA Payments
- Contact Lenses & Solutions
- Crutches
- Dental Treatment
- Diagnostic Devices (i.e. blood sugar test kits for diabetics)
- Drug Addiction Treatment
- Eyeglasses
- Eye Examinations
- Eye Surgery
- Fertility Enhancement (some treatments excluded)
- Guide Dog or Guide Animal
- Hearing Aids
- Hospital Service
- Laboratory Fees
- Laser Eye Surgery
- Lead Paint Removal In Home
- Learning Disability
- Legal Fees (with restrictions)
- Lodging (treatment-related only, and with restrictions, up to \$50 per person)
- Long Term Care Insurance
- Long Term Care (Some)
- Meals (treatment related, with restrictions)
- Medical Conference Fees (relating to chronic illness; no lodging or meals)
- Medical Information Plan
- Medicare Parts A and B
- Medicines (prescribed)
- Mileage (12 cents per mile)
- Nursing Home
- Nursing Services
- Operations
- Optometrist
- Organ Donors
- Osteopath
- Oxygen

- Prosthesis
- Psychiatric Care (including costs for residential care)
- Psychoanalysis
- Psychologist
- Special Education
- Sterilization
- Stop-Smoking Programs
- Surgery
- Telephone modifications (for disability)
- Television modifications (for disability)
- Therapy
- Transplants
- Transportation (treatment related)
- Trips (for treatment)
- Tuition (special education only)
- Vasectomy
- Vision Correction
- Weight-loss programs (only if prescribed)
- Weight-loss foods (only if prescribed)
- Wheelchair
- Wheelchair maintenance
- Wigs
- X-Rays

Note: Deductions for capital improvements that relate to modifications of a home to make it more accessible to handicapped family members are calculated by taking into account the resale value of your home before and after the modifications.

For more details on what's qualified and how to calculate deductions, see IRS Publication 502 (<http://www.irs.gov/pub/irs-pdf/p502.pdf>) or contact a qualified tax advisor.

Payments & Tracking

How Do You Pay?

Using an HSA is pretty much like using any checking account. Typically, you'll have a checkbook with about 25 checks, plus a debit card. Some account custodians charge you for the checks (anywhere from \$10 to \$25) and will charge you for additional check orders as well.

Besides debit cards and checks, other ways to pay include certain types of credit cards issued by the account custodian and stored-value cards in specific dollar amounts. Stored-value cards for HSAs are similar to store gift cards or phone cards. The starting balance is debited every time the card is used, until the amount is used up.

As a practical matter, the amount of money you spend depends on the balance in your account. Although your deposits in the first few years may be small, your accumulated savings can provide a cushion of tax-free dollars over time.

What If You Need Your HSA Money for Something Else?

In the event of severe financial difficulties, money saved in an HSA account may be immediately withdrawn to meet a crisis. All you have to do is write yourself a check. You will have to report this distribution as potentially taxable income, as you would if you “cashed out” your IRA or Keogh. But you don’t have to withdraw the entire amount, just what’s really needed for this important, non-medical need.

Remember, though, that the amount you withdraw for non-medical expenses loses value as soon as you withdraw it — you could forfeit over 30% of the amount in taxes. Plus, whatever’s left in the account will accumulate less interest for the future. Unless you’re facing a true financial crisis, such as a foreclosure or eviction, you’re probably better off leaving the money in your account.

How Do You Keep Track of HSA Spending?

Your HSA custodian is required to report all distributions from your HSA account to the IRS. You get a copy of the report from your custodian vendor at the end of the year. It’s up to you to tell the IRS how much of the distribution total was for qualifying medical expenses, and what part of the total does not qualify.

You must include any unqualified amount in your taxable income for the year (when you file your income taxes). The qualified amount is noted on a special form. You *don’t* have to file your medical receipts with the IRS, though you should save them, along with copies of your tax forms, in case of an audit.

What Do You Do At Tax Time?

You don’t have to itemize your HSA contributions to get the tax write-off for medical expenses. It comes right off the top — above the line — and gets deducted from your gross income.

On your personal income tax return, the amount of your HSA should ideally equal the limit of your allowable deduction under your insurance plan. To make up any difference, the law allows you to contribute to your HSA as late as April 15 of the year after the current tax year. Use the [Contribution Calculator](#) to determine the maximum amount you can contribute and still get the tax advantage. Amounts over this maximum may incur tax penalties.

All eligible contributions into an individual or family HSA are exempted from personal income tax. It doesn’t matter whether or not you spend all the money in the HSA in that tax year.

Rules for Reporting Premium Costs and HSA Contributions

Contributions into an HSA can be made either by an individual or by an employer. If you make the contribution, the amount is DEDUCTIBLE from your TOTAL INCOME. In 2006 this deduction is on line 28 of Form 1040. The line may change for 2005, but it will be in the section for “Adjustments to Gross Income.” Similar deductions are reported in this “AGI” section — Lines 23 to 34 on your 2004 tax form. A rundown of your contributions and disbursements may be noted on a separate schedule (Form 8889) to be attached to the 1040.

If your employer contributes to your HSA, the amount is EXCLUDABLE from your WAGES (Line 7 on the 2004 Form 1040). The excluded amount is supposed to be noted on your W-2 paperwork, but you should check to make sure your wage figure, which is minus your employer’s

contribution, is correct on your W-2, so you can enter a correct amount on Line 7 on the Form 1040.

If your employer paid for all of your health insurance premiums, only that employer is entitled to deduct this sum as a business expense. You can't deduct the premium costs.

If you paid part of the premium out of your salary, your costs for the premium will be noted on the W-2, but this sum is not excludable from your wages.

Your Retirement & Beyond

Can I Retire on Funds from My HSA?

To retire comfortably, you'll probably need more income than an HSA alone can provide. For most Americans, that income will probably come from a combination of sources: Social Security, employer-sponsored pension plans, and personal savings in accounts like 401(k)s and IRAs. Your HSA can be a part of that — even a big part. *But HSAs aren't designed to be your primary retirement savings vehicle.* Use a 401(k), SEP, IRA, or Keogh plan to provide for your retirement income. Use an HSA to give that income a hefty supplement.

After you reach age 65, you can use your accumulated HSA funds (which can include interest or dividends from stock funds, bonds, or other high-yield instruments) for other things besides health care. After retirement, money you withdraw and use for non-qualifying expenses is taxed at the normal rate for investment income. However, money you use for qualifying expenses later in life — such as nursing home costs — can still be withdrawn with no tax paid. It is entirely tax-free.

Death Benefits

The money saved in an HSA is considered an "inheritable asset" subject to estate tax. Taxes may be paid by your heirs or **assigns** in the year the funds are released from your estate, at the same rate as other inherited, previously untaxed income. Under the current law, the entire amount may pass to a surviving spouse without estate tax.

Annual Medical Expenses

Medical Expenses are low for most of us. This chart shows Annual Medical Expenses for the United States population by percentage:

Money Spent on Medical Care Annually	Percentage of U.S. Population
No Medical Expenses \$0	33%
\$1 - \$500	40%
\$501 - \$1,000	9%
\$1,001 - \$2,000	7%
\$2,001 - \$5,000	6%
\$5,001 - \$10,000	3%
\$10,001 - \$25,000	3%
\$25,001 - \$50,000	.5%
\$50,001 - \$100,000	.2%
\$100,001 - And Up	.05%

Seventy-three percent of the population spends \$500 or less on Medical Expenses per year. Most people will not spend all of their HSA funds in a year. What is not spent is yours to keep and earn interest.