Health Savings Accounts (HSAs)

Tax Considerations Regarding Individual Health Insurance

DECODING HEALTH INSURANCE

Who Can Benefit

Health savings accounts (HSAs) are an important option for those with individual health insurance that fits the federal definition of a high-deductible plan, and a growing number of people with employer-sponsored insurance have these special types of accounts as well. HSAs can save you a lot of money on healthcare costs by saving income taxes and thus stretching your healthcare budget, so it's worth it to understand how they work.

Triple Tax Advantages

The great thing about HSAs is that money you put into them is tax-free going in and tax-free coming out, as long as it's used for qualifying medical expenses. This means that the contributions to the account are pre-tax, so that amount of money is subtracted out of your income when you file your federal income taxes and you don't have to pay taxes on it. You also don't have to pay taxes on it when you take it out to use for medical expenses, so it doesn't add to your income and you are getting to use the full value of your money. The money in HSAs grows tax-free as well, so you don't pay taxes on any interest/dividends the account earns each year. This is why HSAs are sometimes called "triple-tax-advantaged" (though a few states have different state laws for the tax advantages). Your bank will send you a statement after the end of the year that show your contributions and withdrawals for the year, so you can use them when preparing your income taxes to make sure you get the appropriate tax benefits.

Timing of Contributions

You have a choice on when to put money into an HSA. You can make contributions monthly, a few times during the year to equal the annual total, or in a lump sum at the beginning of the year so it accrues more interest over a longer period of time. You can also wait until the beginning of the following year—similar to a retirement account, you have until the federal income tax filing deadline (usually on April 15th, but April 18th in 2022), to contribute to an HSA for the previous calendar year.

Amount of Contributions

The maximum amount you can contribute for calendar year 2021 is $3,600 for self-only coverage and $7,200 if you have a family insurance policy. For 2022, this increases by $50 for self-only or $100 for family coverage. Starting the year you turn 55, you can contribute an extra $1,000 per year (each spouse will need separate HSAs if they each want to contribute this amount). You can't contribute to HSAs after age 65, assuming you are on Medicare like most older people are, because Medicare is not high-deductible health insurance, but you can continue to take money out of HSAs. In fact, this is a good reason for putting money into an HSA —so it can grow tax-free and you can use it later in life when you are likely to have higher medical expenses.

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Qualified Medical Expenses

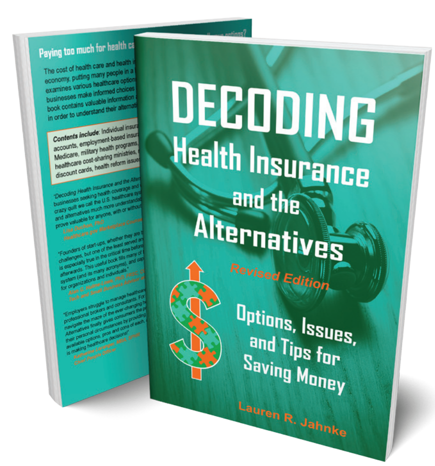
If you take money out of your HSA for any reason other than to pay for qualified medical expenses, you must pay a penalty of 20 percent of the amount, plus must pay income taxes on it. After you turn 65, you will not have a penalty no matter why you take a withdrawal, but you will still have to pay income taxes on it if the money was not used for medical expenses. HSAs can be used to pay for any out-of-pocket costs you and anyone else on your health insurance have for medical services covered under insurance (the essential health benefits like doctors' visits and hospitalization), but another nice benefit of HSAs is that they can be used for certain healthcare costs not covered by your health insurance as well, such as dental work, hearing aids, and contact lenses. All of these eligible expenses are called "qualified medical expenses." There are also certain expenses that don't qualify, such as cosmetic surgery, gym memberships, and nonprescription drugs. (See IRS Publication 969 on HSAs and Publication 502 on what medical expenses qualify.)

No time limit

There is no time limit to use HSA funds, and no age where you have to start taking required distributions from the account like there is for a retirement account. If you are saving money in an HSA to reimburse yourself with, especially in future years, just remember to save all of your qualifying medical receipts to make sure you can prove you don't have to pay taxes on it. Due to the three types of tax advantages that save you money (as allowed in your state), if you are eligible to open an HSA due to having the right type of high-deductible plan, you should seriously consider opening one, even if you aren't sure you can afford to contribute much each year!

If you are saving money in an HSA, remember to save all of your qualifying medical receipts so that you can prove you don't have to pay taxes on it. You can find more info and tips on these topics in our book *Decoding Health Insurance and the Alternatives: Options, Issues, and Tips for Saving Money*, mainly in Chapters 5 and 6.

This is not to be taken as tax advice, so please consult an accountant, tax lawyer, or the IRS for issues, questions, and details.



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