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Health Savings Account (HSA)

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A **health savings account** (HSA), is a tax-advantaged medical savings account available to taxpayers in the United States who are enrolled in a High Deductible Health Plan (HDHP). The funds contributed to the account are not subject to federal income tax at the time of deposit. Unlike a flexible spending account (FSA), funds roll over and accumulate year over year if not spent. HSAs are owned by the individual, which differentiates them from the company-owned Health Reimbursement Arrangement (HRA) that is an alternate tax-deductible source of funds paired with HDHPs. Funds may be used to pay for qualified medical expenses at any time without federal tax liability. Withdrawals for non-medical expenses are treated very similarly to those in an IRA in that they may provide tax advantages if taken after retirement age, and they incur penalties if taken earlier. These accounts are a component of consumer driven health care.

Proponents of HSAs believe that they are an important reform that will help reduce the growth of health care costs and increase the efficiency of the health care system. According to proponents, HSAs encourage saving for future health care expenses, allow the patient to receive needed care without a gate keeper to determine what benefits are allowed and make consumers more responsible for their own health care choices through the required High-Deductible Health Plan.

Opponents of HSAs say they worsen, rather than improve, the U.S. health system's problems because people who are healthy will leave insurance plans while people who have health problems will avoid HSAs. There is also debate about consumer satisfaction with these plans.

History

HSAs were established as part of the Medicare Prescription Drug, Improvement, and Modernization Act which was signed into law by President George W. Bush on December 8, 2003. They were developed to replace the Medical Savings Account system.

A survey of employers published by the Kaiser Family Foundation in September 2008 found that 8% of covered workers were enrolled in a consumer-driven health plan (including both HSAs and Health Reimbursement Accounts), up from 4% in 2006. The study found that roughly 10 percent of firms offered such plans to their workers. Large firms were more likely to offer a high-deductible plan (18%), but enrollment was higher in small firms (8% of covered workers, versus 4% in larger firms).[1]

A survey of health insurers performed by America’s Health Insurance Plans (AHIP) found that 4.5 million Americans were covered by HSA-qualified health plans as of January 2007. Of those, 3.4 million were covered through employer sponsored plans, and 1.1 million were covered by individually purchased HSA-qualified plans. This represented an increase of 1.3 million since January 2006. In the individual market, 25% of new purchasers bought HSA-qualified plans. HSA-qualified plans represented 17% of new policies sold in the small group market and 8% of new policies sold in the large group market.[2] A follow-up survey by AHIP reported that the

number of Americans covered by HSA qualified plans had grown to 6.1 million as of January 2008 (4.6 million through employer sponsored plans and 1.5 million covered by individually purchased HSA-qualified plans). HSA-qualified plans represented 27% of new purchases in the individual market, 31% of new enrollment in the small group market and 6% of new enrollment in the large group market.[3]

In January 2008, market research firm Celent moderated its earlier projections, citing the HSA market's "disappointing early showing", and projected 12.5 million accounts by 2012.[4]

The Government Accountability Office (GAO) reported in April 2008 that many individuals enrolled in HSA-qualified health plans did not open tax-qualified HSA accounts, and individuals that had HSA accounts had higher incomes than others. According to the report, nationally representative surveys conducted by Blue Cross Blue Shield Association in 2005 to 2007 found that 42 to 49 percent of HSA-eligible plan enrollees did not open HSAs in those years. Based on an examination of Internal Revenue Service (IRS) data, GAO found that tax filers who reported HSA account activity had higher average incomes than other tax filers. Contributions into HSA accounts ($754 million in 2005) were roughly double withdrawals from the accounts ($366 million). Average contributions were also roughly twice average withdrawals ($2,100 versus $1,000). 41% of tax filers who made an HSA contribution did not make any withdrawals; 22% withdrew more than they contributed during the year. [5]

How they work

Deposits

Deposits to an HSA may be made by any policyholder of an HSA-eligible high-deductible health plan or by their employer, or any other person. If an employer makes deposits to such a plan on behalf of its employees, non-discrimination rules still apply — that is, all employees must be treated equally. However, if contributions are made through a Section 125 plan, non-discrimination rules do not apply. Employers may treat full-time and part-time employees differently, and employers may treat individual and family participants differently. (The treatment of employees who are not enrolled in a HSA-eligible high-deductible plan is not considered for non-discrimination purposes.) Also, for 2007, employers may contribute more for non-highly compensated employees than highly compensated employees.

Contributions from an employer or employee may be made on a pre-tax basis through an employer. If this option is not available through the employer, contributions may be made on a post-tax basis and then used to decrease gross taxable income on the following year's Form 1040. The main advantage of making pre-tax contributions is the FICA and Medicare Tax deduction, which amounts to a savings of 7.65% to the employer and employee. The self-employed must pay self-employment tax on their contributions. Regardless of the method or tax savings associated with the deposit, the deposits may only be made for persons covered under an HSA-eligible high-deductible plan, with no other coverage beyond certain qualified additional coverage.

Initially, the annual maximum deposit to an HSA was the lesser of the actual deductible or specified IRS limits. Congress later abolished the limit based on the deductible and set statutory limits for maximum contributions. For example, the 2008 statutory limits are $2,900 individual and $5,800 family.[6] All contributions to an HSA, regardless of source, count toward the annual maximum. A catch-up provision also applies for plan participants who are age 55 or over, allowing the IRS limit to be increased.[7] Contribution limits for 2009 are $5950 for Family, $3,000 for individual, and $1,000 for catch-up contributions.[8]

All deposits to an HSA become the property of the policyholder, regardless of the source of the deposit. Funds deposited but not withdrawn each year will carry over into the next year. If the policyholder ends their HSA-eligible insurance coverage, he or she loses eligibility to deposit further funds, but funds already in the HSA remain available for use.

The Tax Relief and Health Care Act of 2006 signed into law on December 20, 2006, added a provision allowing a one-time rollover of IRA assets to be used to fund up to one year's maximum HSA contribution.

State tax treatment of HSAs varies. Depending upon the state, HSA contributions and earnings may or may not be subject to state taxes.

Investments

Funds in an HSA can be invested in a manner similar to investments in an Individual Retirement Account (IRA). Investment earnings are sheltered from taxation until the money is withdrawn (and can be sheltered even then, as discussed in the section below).

While HSAs can be "rolled over" from fund to fund, an HSA cannot be rolled into an IRA or a 401(k), and funds from these types of investment vehicles cannot be rolled into an HSA, except for the one time IRA transfer allowed above. Unlike some employer contributions to a 401(k) plan, *all* HSA contributions belong to the participant immediately, regardless of the deposit source. A person contributing to an HSA is under no obligation to contribute to his or her employer-sponsored HSA, although employers may require that payroll contributions be made only to the sponsored HSA plan.

Withdrawals

HSA participants do not have to obtain advance approval from their HSA trustee or their medical insurer to withdraw funds, and the funds are not subject to income taxation if made for qualified medical expenses. These include costs for services and items covered by the health plan but subject to cost sharing such as a deductible and coinsurance, or co-payments, as well as many other expenses not covered under medical plans, such as dental, vision and chiropractic care; durable medical equipment such as eyeglasses and hearing aids; and transportation expenses related to medical care. Non-prescription, over-the-counter medications are also eligible.[9] [10]

There are several ways that funds in an HSA can be withdrawn. Some HSAs include a debit card, some supply checks for account holder use, and some allow for a reimbursement process

similar to medical insurance. Most HSAs have more than one possible method for withdrawal. The exact method of withdrawal varies from HSA to HSA and can be considered a marketing design issue. Checks and debits do not have to be made payable to the provider. Funds can be withdrawn for any reason, but withdrawals that are not for documented qualified medical expenses are subject to income taxes and a 10% penalty. The 10% tax penalty is waived for persons who have reached the age of 65 or have become disabled at the time of the withdrawal. Then, only income tax is paid on the withdrawal, and in effect the account has grown tax **deferred** (similar to an IRA). Medical expenses continue to be tax free.

Account holders are required to retain documentation for their qualified medical expenses. Failure to retain and provide documentation could cause the IRS to rule withdrawals were not for qualified medical expenses and subject the taxpayer to additional penalties.[11]

When a person dies, the funds in their HSA are transferred to the beneficiary named for the account. If the beneficiary is a surviving spouse, the transfer is tax-free.

HSAs vs. other types of medical savings plans

Health Savings Account are similar to medical savings account (Archer MSA) plans that were authorized by the federal government before HSA plans. HSAs can be used with some high deductible health plans. HSAs came into being after legislation was signed by George W. Bush on December 8, 2003. The law went into effect on January 1, 2004.

HSAs differ in several ways from MSAs. Perhaps the most significant difference is that employers of all sizes can offer an HSA account and insurance plan to employees. MSAs were limited to the self-employed and employers of 50 or fewer people.

Benefits

The premium for an HDHP generally is less than the premium for traditional health insurance. A higher deductible lowers the premium because the insurance company no longer pays for non-preventative healthcare, and insurance underwriters believe that, if Americans see a relationship between medical cost and their bank accounts, they will consume less medical care, shop for bargains, and be more vigilant against excess and fraud in the health care industry. Introducing consumer-driven supply and demand and controlling inflation in health care and health insurance were among the government's goals in establishing these plans.

With HSAs, in catastrophic situations the maximum out-of-pocket expense liability can be less than that of a traditional health plan. This is because a qualified HDHP can cover 100% after the deductible, involving no coinsurance.

HSAs also give the flexibility not available in some traditional health plans to pay on a pretax basis for qualified medical expense not covered in standard or HSA insurance plans. This may include dental, orthodontics, vision, and non-prescription medications such as aspirin. [12] [13]

HSA accounts also have an advantage over Flexible Spending Accounts since deposits are not necessarily tied to expenses in a particular plan or calendar year. They are automatically rolled over for future medical expenses, or may be used to reimburse qualified expenses from prior years as long as the expense was qualified under an HSA plan at the time incurred. [14]

Over a period of time, if medical expenses are low and contributions are made regularly to the HSA, the account can accumulate significant assets that can be used for health care tax free or used for retirement on a tax-deferred basis.

A recent industry survey found that in July 2007 over 80% of HSA plans provided first-dollar coverage for preventive care. This was true of virtually all HSA plans offered by large employers and over 95% of the plans offered by small employers. It was also true of over half (59%) of the plans which were purchased by individuals. All of the plans offering first-dollar preventive care benefits included annual physicals, immunizations, well-baby and well-child care, mammograms and Pap tests; 90% included prostate cancer screenings and 80% included colon cancer screenings.[15]

Criticisms

Some consumer organizations, such as Consumers Union, and many medical organizations, such as the American Public Health Association, have rejected HSAs because, in their opinion, they benefit only healthy, younger people and make the health care system more expensive for everyone else. According to Stanford economist Victor Fuchs, "The main effect of putting more of it on the consumer is to reduce the social redistributive element of insurance."[16]

Critics contend that low-income people who are more likely to be uninsured, do not earn enough to benefit from the tax-breaks offered by HSAs. These tax breaks are too modest—when compared to the actual cost of insurance—to persuade significant numbers to buy this coverage.[17] There is also concern that the lower premiums of HSA-qualified high-deductible health plans might attract lower-income individuals who cannot afford to fund an HSA account, and may therefore forego necessary health care services under the high-deductible.

In testimony before the U.S. Senate Finance Committee's Subcommittee on Health in 2006, Commonwealth Fund Assistant Vice President Sara R. Collins, Ph.D., said that all evidence to date shows that health savings accounts and high-deductible health plans worsen, rather than improve, the U.S. health system's problems.[18]

Consumer satisfaction

Consumer satisfaction results have been mixed. While a 2005 survey by the Blue Cross and Blue Shield Association found widespread satisfaction among HSA customers[19], a survey published in 2007 by employee benefits consultants Towers Perrin came to the opposite conclusion; it found that employees currently enrolled in such plans were significantly less satisfied with many elements of the health benefit plan compared to those enrolled in traditional health benefit plans.[20]

In 2006, a Government Accountability Office report concluded: "HSA-eligible plan enrollees who participated in GAO's focus groups generally reported positive experiences, but most would not recommend the plans to all consumers. Few participants reported researching cost before obtaining health care services, although many researched the cost of prescription drugs. Most participants were satisfied with their HSA-eligible plans and would recommend them to healthy consumers, but not to those who use maintenance medication, have a chronic condition, have children, or may not have the funds to meet the high deductible." [21]

According to the Commonwealth Fund, early experience with HSA-eligible high-deductible health plans reveals low satisfaction, high out-of-pocket costs, and cost-related access problems.[18] A survey conducted with the Employee Benefits Research Institute found that people enrolled in HSA-eligible high-deductible health plans were much less satisfied with many aspects of their health care than adults in more comprehensive plans:

- People in these plans allocate substantial amounts of income to their health care, especially those who have poorer health or lower incomes.

- Adults in high-deductible health plans are far more likely to delay or avoid getting needed care, or to skip medications, because of the cost. Problems are particularly pronounced among those with poorer health or lower incomes.

- Few Americans in any health plan have the information they need to make decisions. Just 12 to 16 percent of insured adults have information from their health plan about the quality or cost of care provided by their doctors and hospitals.

Some policy analysts say that consumer satisfaction doesn't reflect quality of health care. Researchers at Rand Corp. and Department of Veterans Affairs asked 236 elderly patients at 2 managed care plans to rate their care, then examined care in medical records, as reported in Annals of Internal Medicine. There was no correlation. "Patient ratings of health care are easy to obtain and report, but do not accurately measure the technical quality of medical care," said John T. Chan, UCLA, lead author.[22][23][24].

HSAs and health policy

According to a 2006 Zogby poll, seven in ten voters back Congressional action to allow HSA participants to pay for their insurance premiums using money in their savings plans.[25]

See also

- Consumer driven health care (CDHC)
- High Deductible Health Plan (HDHP)
- Flexible spending account (FSA)
- Health care in the United States
- Health reimbursement arrangement (HRA)
- Medical savings account (MSA)

- Direct primary care

[edit] Notes and references

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20. ^ Towers Perrin (2007-05-22). *Without the Correct Approach and Implementation, Long-Term Effectiveness of Account-Based Health Plans Could Be Undermined, Towers Perrin Research Shows*. Press release. http://www.towersperrin.com/tp/jsp/hrservices_webcache_html.jsp?webc=HR_Services/United_States/Press_Releases/2007/20070522/2007_05_22.htm&selected=press&language_code=global. Retrieved on 2007-07-10. "As compared to traditional health benefit plan participants, ABHP members are less comfortable with the level of financial risk their plan exposes them to, less likely to understand how the plan works, less favorable

about how easy it is to use the plan, less favorable about the clarity of communication around benefit change and less satisfied with the basic elements of their plans."

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[edit] External links

- U.S. Treasury site on HSAs
- HSA Contribution limits for 2007
- HSA Contribution limits for 2008
- HSA Contribution limits for 2009
- List of Eligible Medical Expenses
- The HSA Coalition
- List of Over-the-Counter Drugs considered Eligible Expenses
- Federal Tax Savings from HSA contributions made in 2007
- IRS Forms for HSAs
- Council for Affordable Health Insurance
- A Guide to Health Care Spending Accounts from America's Health Insurance Plans (July 2005)
- Health Plan calculator from American Institute for Economic Research (AIER)
- State Tax treatment of HSAs
- FAQs on HSAs: Frequently Asked Questions on Health Savings Accounts from the American Academy of Actuaries (October 2007)

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