

2007 Planning: Health Savings Accounts

As you may be aware, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 permits eligible individuals to establish Health Savings Accounts (HSA). An HSA is a tax-exempt trust or custodial account used exclusively for paying the qualified medical expenses of an eligible account beneficiary.

An HSA is similar to an individual retirement account (IRA), but is designed to provide for the qualified medical expenses of an individual rather than for retirement. Contributions you make to an HSA are tax deductible and any earnings grow tax-free. In addition, any distributions you take to pay for qualified medical expenses are also tax-free. However, if you take a distribution and do not use the distribution to pay for qualified medical expenses, you will be subject to tax on the distribution in addition to a 10 percent penalty on the distribution amount.

In order to be eligible to establish an HSA, you must satisfy several conditions. First, you must be covered under a high-deductible health insurance plan (HDHP). If the coverage is only for yourself, the plan must have an annual deductible of at least \$1,100 and annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) not exceeding \$5,500. If the coverage is for your family, the plan must have an annual deductible of at least \$2,200 and annual out-of-pocket expenses not exceeding \$11,000.

Second, you may not be covered by any other health plan that is not a HDHP, including your spouse's plan, your parent's plan, or Medicare. However, you may still be covered under workers' compensation laws, home and auto insurance, insurance for specified diseases or illness, insurance that pays a fixed amount per day of hospitalization, and insurance covering accidents, disability, dental care, vision care, or long-term care. In addition, you may not be claimed as a dependent on another person's tax return.

Qualified medical expenses are those expenses that would generally qualify for the medical and dental expense deduction. These expenses may be for you, your spouse, or your dependents, but they cannot be covered by insurance. In addition, you cannot have your HSA pay your health insurance premiums because they are not qualified medical expenses. However, your HSA can pay for your qualified long-term care insurance, COBRA health care continuing coverage, and your spouse's or dependent's premiums for Medicare Part A or B coverage.

The maximum deductible contribution you can make to your HSA is the lesser of your annual deductible under the HDHP or \$2,850 for coverage for yourself. If the coverage is for your family, this amount increases to \$5,650. If you are age 55 or older, you may contribute an additional \$800 to your HSA in 2007. The extra contribution amount will increase \$100 annually until it reaches \$1,000 in 2009.

Along with contributing for yourself or your family, your employer may contribute to your HSA and can pay the premiums for your HDHP on a deductible basis. The contributions made by your employer on your behalf are not taxable to you. If you have any questions regarding HSAs, or if you would like assistance with setting up an HSA account, please contact our offices at your convenience.

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