Making HSAs Easier!™

Health Savings Accounts For Dummies®

Amy O'Meara Chambers, JD

Confused by Health Savings accounts?

You’re not alone.

That’s why we offer this free booklet that makes HSAs simple to understand. It’s all part of our commitment to helping you have a good health care experience and save money.

Health Savings Accounts FOR DUMMIES®

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Health Savings Accounts For Dummies®

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Introduction

Welcome to the wonderful world of *health savings accounts* (HSAs), the tax-advantaged savings and investment vehicle you can use to pay for you and your family's qualified medical expenses.

About HSAs and This Book

This slim book packs a ton of information about how you can contribute, earn interest, and spend money on health expenses — all tax-free through an HSA.

Putting you in the driver's seat for your health care costs

Insurers and the government are encouraging greater participation in consumer-driven health plans. HSAs are one aspect of this effort to give you more control over and more responsibility for your spending on health care.

Why the emphasis on consumer-driven health plans? Because when you pay for the health care you access rather than having your insurer pick up the bulk of the bill, you're more careful about how you spend health care dollars. You pay closer attention to cost and quality and work harder at getting the right care, at the right price, at the right time.

Take the example of teenagers given a credit card. What they choose to buy with a credit card when they don't have to pay the bill is much different from the purchases they'd make if the money were coming straight out of their own pockets. Believe it or not, economists tell us that the same phenomenon comes into play with health care costs. When insurers step in and pay the bulk of patient bills (essentially, handing

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out no-limit credit cards in return for insurance premiums), those patients don't show the same level of prudence in accessing health care as they do when they pay on their own.

Consider another scenario: You've been coughing at your desk all day and are feeling crummy. You can:

- Take a trip to the ER at $300.
- Go to an urgent care center for $150.
- Visit your doctor's office when it opens tomorrow or pop in for their night walk-in clinic at a cost of $75.
- Stay home from work tomorrow (your co-workers will thank you), take some over-the-counter cold medicine, and see if you need to still see a medical professional after you get some rest.

Each choice helps you battle your cold, but each has a different impact on your wallet and your insurer's pay out.

When you start footing your own medical bills and stop paying nominal amounts in copayments, you lower your medical expenditures, cut down on marginally necessary visits, and help lower everyone's insurance costs.

The bottom line is that if you use your health care dollars more wisely, you help slow the speedy rise of health insurance premiums.

Opting for a high-deductible health plan

You're not really on your own with a consumer-driven health plan; you just have to stake more of your own money by meeting a higher deductible.

Joining a *high-deductible health plan,* known as an HDHP in the insurance biz and in this book, makes you eligible to save for your medical expenses tax-free by establishing a health savings account, known as an HSA in the biz and in this book. And HSAs are what this book is all about.

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Foolish Assumptions

The foolish assumptions I make about you as a reader of this book are few. I think either:

- You're interested in discovering whether an HSA is right for you.
- You have an HSA and want to know more about your options.

How This Book Is Organized

Four main chapters in this book give you the nuts-and-bolts (or should that be stethoscopes-and-tongue-depressors?) of HSAs:

- Chapter 1 fills you in on the basics of HSAs — what they are and who can have one.
- Chapter 2 talks about how to contribute to your HSA.
- Chapter 3 shares tips on keeping track of your HSA.
- Chapter 4 focuses on how you can and can't distribute your HSA funds.
- Chapters 5 and 6 give you lists of quick tips to make the most of your HSA and offer interesting items in the list of qualified medical expenses.

Conventions Used

I already mentioned a couple of abbreviations I use a lot in this book, namely HSA and HDHP, but I always spell out the whole term before I introduce acronyms and abbreviations. And, the first time a term is defined, it's in *italics* to draw your attention to it. The key word or term in a bulleted list gets the **boldface** treatment.

And, whether they're conventions or not, *For Dummies* books use cute little icons in the margins to point out particularly interesting, useful, or relevant text. The icons in this book are:

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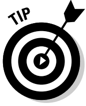

This targets useful information about HSAs.

Tidbits to keep in mind get the remember icon.

This points out not so much dangerous information but nuggets of information to keep an eye on.

You can access a lot about HSAs on the Internet and this icon highlights helpful Web sites.

Now, feel free to go forth and discover HSAs.

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Chapter 1

Examining HSAs

In This Chapter

- Going through the basics
- Querying your qualifications
- Opening an HSA

An *HSA,* or *Health Savings Account,* helps you do what you know you should do — save money — plus, an HSA also allows you to invest it and spend it tax-free! One catch is that you have to spend the money on qualified medical expenses, which isn't much of a catch when you consider the long list of qualified expenses and your family's total health care expenses. Face it, you're going to spend the money anyway, why not spend money you can earn some return on — tax-free!

This chapter tells you what an HSA is and how to find out whether you can invest in one.

Explaining HSAs

Basically, an HSA is a tax-free investment account whose proceeds are earmarked exclusively for medical expenses. You (or your employer — see Chapter 2) put pre-tax dollars into an investment account that grows your money tax-free, then you spend that money on qualified health care costs without paying tax on it — it's a tax-free triple treat!

HSAs are one tool in the ever-expanding toolbox of consumer-driven health care plans. Designed by the U.S. government, HSAs help you, the consumer, play a more informed and active role in controlling your family's health care costs. You start

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your own HSA, you contribute to it, you choose where to invest the money, and you decide when to spend it and on what — within the pretty broad parameters of what the Internal Revenue Service (IRS) considers a qualified medical expense.

From the IRS's Website at `www.irs.gov`, you can access IRS Pub. 502, which lists allowable medical expenses, most of which are qualified medical expenses for HSA purposes as well.

In other health care savings vehicles such as Flexible Spending Accounts (FSAs), if you don't use the money in the account by the end of the benefit year, you lose it — it goes to your employer. Not so with an HSA.

The money you accumulate in an HSA is yours for as long as you live. An HSA operates like a normal savings account or an Individual Retirement Account — the money you put in is yours until you take it out.

Checking Out Your Eligibility . . . for an HSA, Anyway

The opportunity to establish an HSA with all its tax preferences is the federal government's way of thanking you for participating in a high-deductible health plan, or HDHP. The sections here help you determine whether you're an *eligible individual* (entitled to start saving in an HSA) and under what circumstances you become ineligible.

When you talk about health care and health care policies, a couple of terms crop up again and again:

- **Deductible:** The amount you pay for covered health care expenses before you receive benefits. Your insurer doesn't cover costs for your medical services before you meet the deductible. Instead, you pay for those trips to the doctor for sore throats or to the pharmacy for antibiotics. Only after you spend enough to meet the deductible does your insurer start chipping in for covered medical and pharmacy costs.

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- **Out-of-pocket expense:** Appropriately enough, money that comes out of your pocket to pay medical costs. This category includes the money you pay towards your deductible, your copayments, and your coinsurance. Your health care plan sets this maximum limit on the amount of out-of-pocket costs you pay within a plan year.

Keep these terms in mind as I talk about the health plan requirements in the next sections.

Belonging to a health plan with a high deductible

Figuring out the basics of a *high-deductible health plan* is fairly straightforward — it's a health plan in which you pay for most of your health costs until you reach the deductible threshold, at which point the plan starts paying the major portion of your medical expenses.

Make sure that the plan you buy is, in fact, an HDHP. The paperwork you receive should highlight the fact that the health plan can accompany an HSA. If the material doesn't specifically say that it's an HSA plan or an HDHP, ask!

HDHPs generally have lower premiums than traditional health plans. Plus, when premiums go up for HDHPs, they're likely to go up less than premiums for other types of traditional medical plans.

If you're covered by an HDHP and no other non-HDHP plans, aren't enrolled in Medicare (which generally means that you're not 65 yet), and aren't claimed as a dependent on someone else's tax return, you're well on your way to being an eligible individual.

If your coverage changes to anything other than an HDHP plan, the deal is off. The HSA is still yours and you can continue to take distributions from it, but you can't make any new contributions to the HSA — that is, until you meet the eligibility requirements again.

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Mapping out the plan

IRS rules distinguish between *self-only policies* that cover a single individual and *family policies* that cover two or more people. So, if you're the only one covered under your HDHP, even if you're the proud parent of 12 darling children (and if you are, I'm in awe), you fall under the self-only rules, not the family rules.

Your high-deductible health plan can use any type of benefit platform. For example:

- **HMO (Health Maintenance Organization):** An HMO is a managed-care plan in which you select a primary care physician (PCP) from within a network of participating health providers. Your PCP provides the bulk of your primary care (which only makes sense, right?)
- **PPO (Preferred Provider Organization):** You pay less by choosing doctors, labs, and hospitals within a network. PPOs generally don't make it quite as costly as HMOs to go outside the network, though you still pay a larger share of the cost.
- **POS (Point-of-Service):** You choose to pay a fixed amount to a doctor affiliated with your plan or to pay a bigger proportion of the costs to an unaffiliated physician.

The IRS doesn't care what kind of plan you have; it only cares how high the deductible is, which leads me to the next section.

Dealing with deductibles

Obviously, the deductible level of an HDHP has to be high — otherwise there's no point in calling it high-deductible — and, as you'd expect, the IRS has some pretty clear ideas about how high is high.

If your plan's deductible doesn't meet or exceed the required minimum, you aren't eligible to open or contribute to an HSA.

At the birth of HSAs, way back in the dark ages of 2004, the minimum deductible for self-only policies was $1,000 and $2,000 for family policies. (The family coverage limits are always twice the self-only coverage limits.) However, the limits incrementally increased in subsequent years.

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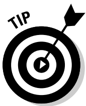
To see the current minimum annual deductibles for self-only and family policies, visit priorityhealth.com (keyword search: *hsa limit)*.

If you're on a family HDHP — two or more people on the policy — everyone's covered medical expenses help meet the deductible. So, the money spent on the baby's pediatric appointments, Sis's soccer sprain, and Mom's bout with the flu all get added together to help reach the deductible limit. Then again, Dad's emergency appendectomy can put the family over the limit in the time it takes to get the surgeon off the golf course.

The minimum deductibles for HDHPs change based on the Consumer Price Index. Visit the U.S. Treasury's website at www.treas.gov to learn more.



Insurers keep an eye on the federal minimums and maximums for both deductibles and out-of-pocket expenses (see the next section), so you don't have to.

Keeping some money in your pocket

The government wants to encourage you to take responsibility for managing your health care expenses, but the last thing it wants is to expose you to unlimited financial liability. So, the IRS sets limits on how much your total out-of-pocket costs can be under your health care plan. To see the current out-of-pocket maximums for self-only and family policies, visit priorityhealth.com (keyword search: *hsa limit)*.

If your HDHP doesn't meet or beat the IRS-established maximum for out-of-pocket expenses (or the *out-of-pocket maximum,* if you want to be official), you can't open or contribute to an HSA. Fortunately for your bank account, your plan's maximum may be much lower than the IRS's, so your financial liability may top out long before you spend the IRS mandated out-of-pocket maximum.

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Having prevention paid for

The federal government knew that health care would suffer, not improve, if folks in HDHPs skimped on all-important preventive care services because those services weren't covered until the plan's deductible was met. So, the IRS rules state that insurers can pay for preventive care before you reach your deductible. In fact, your health plan may be required to cover preventive care before the deductible is met.

Preventive care includes services such as periodic health exams, routine pre-natal and well-child care (immunizations for kids, for example); breast and colorectal cancer screenings, and so on. Some plans also include a handful of prescription drugs on their preventive care list.

Each health plan handles preventive care a little differently: Some cover it in full before the deductible; some apply a copayment; some apply a dollar limit. Review your benefit summary to see if and how your plan covers your preventive care — and what your plan defines as preventive care.

If you have an HDHP that has both in-network and out-of-network benefit levels, know that the IRS permits the out-of-network benefits to have higher out-of-pocket limits than the annual maximums.

The maximum out-of-pocket limits apply to services covered under your health plan, so make sure that you know what's covered and what's not under your policy.

Like the minimum deductible, the out-of-pocket maximum adjusts based on changes in the Consumer Price Index and those adjustments for the following year are announced by June 1.

What counts towards your health plan's out-of-pocket maximum? Almost everything you pay out of your own pocket towards covered health care expenses, including all your spending towards your deductible, copayments, coinsurance, and other paid amounts *except* premiums. Sometimes a few things — such as penalties for failing to preauthorize a service or amounts over a lifetime plan maximum — are excluded from the out-of-pocket totals, but these exceptions are highlighted in your health plan rules. Elective expenses such as cosmetic surgery and vision and dental expenses not covered under your health plan generally do *not* count toward the out-of-pocket maximum.

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After you meet your plan's out-of-pocket maximum, the plan pays in full for all covered medical and prescription drug services (assuming they're part of the plan) for the remainder of the plan year — it's the law. At this point, you put your wallet away and your insurer picks up the rest.

Making sure you're not in other plans

To be eligible for an HSA, you have to be covered by an HDHP and must not be covered by any other non-HDHP insurance. Remember, it's your duty as the HSA account holder to make sure that you're not covered under any other non-HDHP plans (meaning, plans that don't follow all the IRS HDHP rules).

There are specific exceptions. For example, you can belong to your employer's wellness program if it doesn't offer much in the way of actual medical benefits (most don't). And, certain types of insurance — auto, dental, vision, disability, insurance for a specific disease or illness (such as cancer), and long-term care insurance — don't disqualify you from contributing to an HSA.

Now, your spouse and dependents can have other insurance without invalidating your HSA eligibility. The IRS only looks for the account holder to satisfy the eligibility requirements. Ask yourself: Do I meet the eligibility rules? It doesn't matter if the spouse or dependents have other non-HDHP insurance.

Take special note if you're in an HDHP and also have an FSA (Flexible Spending Account) or HRA (Health Reimbursement Arrangement) — or are covered under your spouse's FSA or HRA — sad to say, you can lose your eligibility for an HSA.

Only if the FSA and/or HRA are considered *limited purpose* (meaning limited to reimbursing for vision, dental, or preventive care) or *post-deductible* (meaning limited to reimbursing medical expenses that occur after the plan deductible is met) can you benefit from having an HSA as well. The next section talks about how to have a limited FSA and an HSA, which is not quite as enjoyable as having your cake and eating it too.

Receiving Medicare disqualifies you from starting an HSA. If you started an account before you enrolled in Medicare, you

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still keep the account, you just can't contribute to it any longer — you can only make withdrawals. Likewise, if you received benefits from the Veterans Administration during the past three months, you can't contribute to an HSA.

Looking into a limited FSA

Designed to be used in conjunction with a high-deductible health plan and a health savings account, a *limited flexible spending account (FSA)* is a tax-free way to accumulate funds to pay for specific healthcare expenses. A limited FSA is a wholly separate account from your HSA and would need to be sponsored (meaning, offered by your employer).

If you're contributing to an HSA, you're not eligible to contribute to a traditional FSA — a limited FSA is your only option.

The health care expenses you can pay for from your limited FSA are restricted to dental, vision, and preventive care, plus any coinsurances, copayments, and other medical expenses you're liable for after you meet your HDHP's deductible. For example:

- Dental procedures such as cleanings, fillings, crowns, orthodontics
- Vision care and products such as contact lenses, eyeglasses, refractions, and vision correction procedures
- Over-the-counter drugs after you meet your HDHP's deductible (yes, only after)

As with your HSA, you can use funds from your limited FSA to pay allowable expenses for your spouse and children as well as yourself.

The funds you contribute toward a limited FSA are above and beyond the contribution limits of your HSA. This means that you can save more money for your health care costs tax free. Having a limited FSA gives you another way to pay some medical expenses while letting your HSA grow.

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FSAs (both traditional and limited) and HSAs are alike in that they both let you set aside money tax free that you can use to pay for qualified medical expenses for yourself and your family. However, Table 1-1 shows you several key differences that exist between the two.

Table 1-1 Differences between HSAs and FSAs

HSA	*FSA*
You own the money in your account.	Funds do not belong to the contributor.
Funds left over at the end of the year rollover automatically.	You lose any unused funds at the end of the plan year.
You decide when and how to use your funds.	The plan administrator has final say about every request for reimbursement.
You can be reimbursed from an extensive qualified medical expense list.	These plans have a shorter list of reimbursable expenses.

Establishing an Account

Eager to realize the benefits of opening an HSA? You can start one as soon as you're covered under an HDHP. In fact, you can get the paperwork in order ahead of time and even have your deposit at the ready; you just can't actually establish your account until your HDHP policy is in effect.

In order to establish an HSA, you don't have to be covered as an employee under the HDHP policy; you could be covered as a spouse under the plan. As long as you're covered under the HDHP (and meet the other eligibility requirements), you can establish an HSA.

One odd thing about establishing your account: When the IRS looks to see that you are enrolled in an HDHP as a prerequisite to opening your HSA, they look to see your enrollment status as of the first of the month. Yes, they take a snapshot of January 1, February 1, and so on to see when you first enrolled in an

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HDHP. Only on or after you're enrolled in an HDHP on the first of the month can you open your HSA. So, if your HDHP policy takes effect on Groundhog Day (that's February 2 for those of you who pay no attention to weather-predicting rodents), the earliest you can open an HSA is March 1. (Chapter 3 talks about who offers HSAs and how to manage them.)

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Chapter 2

Paying into Your HSA

In This Chapter

- Seeing who can add to your HSA
- Facing your limits
- Knowing when

An HSA works much like any other savings vehicle: You put money in, it earns a return, and you spend the proceeds. This chapter addresses that first part — the putting-money-in part.

Who Contributes?

In the natural scheme of things, you're likely to be the largest contributor to your HSA, which only makes sense as it *is* your HSA. But you don't have to be the only contributor — your employer can pay into your account as well as individuals including family members, your next-door neighbor, and the town philanthropist. You just have to make sure that the total dollar amount going in doesn't exceed the allowed contribution maximum for the year. (The "How Much" section later on talks about contribution limits.)

In the strange-but-true department: If Grandma (or anybody else) puts money into your HSA, you get the tax benefits. You can take an above-the-line deduction on your taxes — she can't, but you can.

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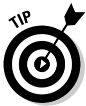
Kicking in your own money

You can make contributions to your HSA just like you make deposits into your regular savings account. Of course, you've probably already paid tax on the money you deposit in your regular savings account and you can put pre-tax dollars into your HSA if your employer has a cafeteria plan.

A *cafeteria plan* allows you to choose the benefits you want and to have the cost of those benefits deducted from your salary before payroll and income taxes are taken out (this has the added benefit of lowering your taxable income — a win-win for us working stiffs). So, you can send pre-tax contributions directly to your HSA.

If you don't have a cafeteria plan, your contributions most likely come from *after-tax funds,* meaning your take-home pay after it's already been taxed. In that case, you can take what's known as an *above-the-line deduction* when you file your taxes, which adjusts your gross income and has the effect of making your contribution income-tax-free.



You don't need to itemize your deductions at tax time to write off your HSA contributions. In practical terms, taking an above-the-line deduction means writing your contribution total on the designated line on your 1040 form and attaching a Form 8889 (available on the IRS website).

Accepting bucks from your boss

Your employer can show how much they value you by boosting the amount in your HSA through their own contributions that are not regarded as income for you, though they do count toward your contribution limit.

If you're self-employed (for example, a sole-proprietor, a partner in the company you work for, or a shareholder who owns more than two percent of the stock in an S-corporation), you're generally not considered an employee; and, as you're not an employee, you can't receive a contribution from an employer you don't have, right? Right — according to the IRS, anyway. You're stuck making after-tax contributions on your own and then taking an above-the-line deduction when you're doing your taxes.

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How Much?

The tax benefits of HSAs are so great you may want to deposit all your disposable income, forgetting that you can spend the money only on medical expenses. But don't try it. The government wants you to contribute to your health savings account, but Uncle Sam doesn't want you to over contribute and sets strict limits on how well you can fund your HSA each year.

Looking at limits

The bottom line on how much you can put into your health savings account each year is that you cannot put in more than the annual maximum contribution. The current annual maximum contribution can be found at `priorityhealth.com` (keyword search: *hsa limit*).

HSA contribution limits apply to the total of all contributions from every source into every HSA you own. So when I say "you" and "your" in this section, I really mean you and all the wonderful people who put money into all the HSAs you have.

Like the health plan limits, the maximum annual HSA contribution adjusts based on changes in the Consumer Price Index and those adjustments for the following year are announced by June 1.

Increases in contribution limits in future years are linked to inflation. Check the Treasury department's website at `www.treas.gov` for current limits.

Making changes and prorating

If you make contributions through a cafeteria plan (refer to the preceding section), your employer must allow you to make changes to your contribution at least once monthly.

Some other conventional wisdom about HSA contribution limits follows:

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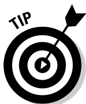
- Total contributions from all sources — you, your employer, your mother, whomever — must not exceed your limit.
- If you have more than one HSA (and you can, just as you can have more than one IRA), the total contributions to all your accounts can't exceed your limit.
- If you're covered by an HDHP for only part of a year, your contribution limits are prorated according to the number of months you're covered by an HDHP on the first day of the month.

  For example, if you're enrolled in a family HDHP for the first six months of the year (meaning you're in an HDHP as of January 1, February 1, and so on through June 1), then you leave the HDHP on June 30, you're allowed to contribute six-twelfths (one half) of the annual maximum (because you were covered for 6 months out of the 12 months in a year). To see the most up-to date annual maximum limits, visit `priorityhealth.com` (keyword search: *hsa limit*s).



Newcomers play by special rules. If you're new in an HDHP (congrats!), and your first day in the HDHP is other than January 1, the IRS still allows you to contribute all the way up to the annual maximum contribution for that year. However, you must still be covered under the HDHP on December 1st of that same calendar year, as well as all 12 months of the following calendar year. If you're not, the IRS makes you pay tax on any extra contributions you made based upon the months you weren't enrolled in the HDHP, plus a ten percent penalty on those excess contributions. Ouch!

Going over

It's up to you to keep track of how much you — and every one else — puts into your HSA. If Aunt Beulah slips an extra hundred into your account and that is a hundred more than your yearly contribution limit, you need to take that hundred as well as any income it earned out of your account by tax time.

Overages include contributions over the limit as well as contributions made when you're not eligible — when you don't belong to an HDHP, for example.

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If you don't remove excess contributions for any given year before the last day for filing your tax return (generally, April 15 of the next year), you pay a six percent excise tax for each year that goes by and are liable for taxes owed on the amount that should have been part of your gross income instead of invested in your HSA. Don't forget that you also need to take out any earnings associated with the excess contributions.

Topping off

You have until you file your taxes for the year to add to your HSA. So, if you haven't reached your contribution limit by the end of the year, you can consider making a lump-sum payment to your account.

Catching up

Ah, the benefits of growing older — the excuse of creaky joints to prevent having to roll around in dirt with the grandkids, the opportunity to find some really snazzy reading glasses, and the ability to play catch-up with your HSA.

If you're 55 or older and not enrolled in *Medicare* (the federal program that provides basic health benefits to people aged 65 or older and to some disabled folks), you can contribute up to an additional $1,000 to your HSA. These additional contributions are a way to help your HSA keep pace with your advancing years. (Alright, we're done with the "old" jokes. After all, they say 50 is the new 40, and we're too old to fight about it.)

If you're enrolled in an HDHP for the whole year, you can add the entire catch-up amount regardless of where your birthday falls within the year. If you had HDHP coverage for only part of the year, you have to prorate the catch-up amount. However — special rule here — if you are covered under the HDHP on December 1, you are considered an eligible individual for that entire year and can make the full catch-up contribution.

When you reach age 65 and enroll in Medicare, you're no longer eligible to make any contributions to an HSA.

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When?

You can make your annual HSA contribution in one lump sum or in a series of payments throughout the year. If your employer makes HSA deposits for you with your pre-tax dollars, you just have to let them know where to deposit the money and how much to put in.

You can't make deposits to your HSA for any given tax year before the first day of the year, but you can make them up until the day you file your federal income tax return for that year (without extensions) — similar to rules for adding to your IRA. For example, for the current tax year, you can make contributions to your HSA starting January 1 all the way through to April 15. Just make sure that the financial institution or insurance company your HSA is invested with knows to record your April 15 deposit as a prior-year contribution.

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Chapter 3

Managing Your HSA

In This Chapter

- Earning a return
- Watching your investment
- Paying attention to the right things
- Noting changes when you reach 65

As the owner of your very own HSA, you have sole control to manage and track your investments — and sole responsibility. This chapter explains the can's and can'ts; the do's and don'ts of managing your HSA.

Investing Your HSA Funds

Just as you can invest the money you put into an IRA in stocks, bonds, mutual funds, and certificates of deposit, you can use these same investment vehicles to help grow your health savings account.

Choosing a custodian or trustee

In legal and IRS terms, the institution that holds your HSA investment is either a custodian or a trustee. The difference between the two is fairly minor: You can place your HSA in a *trust,* a legal arrangement in which the funds are owned and held on behalf of a beneficiary — you! The trustee can invest the funds — the trustee has what's called *fiduciary authority* by people who talk like that — but must do so with your best interests in mind. A *custodian,* on the other hand, simply holds the funds for your benefit — if you want changes made, you have to direct the custodian to make them. Laws in individual states determine what constitutes a trust or custodial arrangement.

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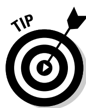
Now that the legalese is out of the way, we can move on to what kinds of people can be trustees and custodians. You'll be relieved to hear that the same people you entrust your IRA to, have your checking account with, and open little Gabriel's first savings account with are the people you invest your HSA with, namely:

- A federally insured bank
- A federally insured credit union
- A qualified insurance company

Basically, any institution that the IRS says is qualified to manage IRAs and Archer Medical Savings Accounts (Archer MSAs, which are a previous version of HSAs) also gets the okay to handle HSAs.



Your custodian or trustee is responsible for sending you Form 1099 SA, which reports the distributions from your HSA at the end of the year. You then take this information and file a Form 8889 with your taxes. Form 8889 reports all your HSA contributions and distributions for the year and is fairly simple to fill out.

As you can tell, being a trustee or custodian carries some responsibility. And, it's not that Uncle Sam doesn't trust you, he just doesn't want you to be overwhelmed, so he doesn't allow you to be your own custodian; you have to place your HSA with an approved institution.

To compensate for some of the duties of managing your HSA, the custodian or trustee can place some restrictions on how often and how much you can withdraw from your funds. They are also able to limit the investment menu they offer through the HSA. Ask before you invest!

Need help finding an HSA bank? Look online or at your local bank or credit union. Almost all financial institutions offer HSAs these days.

Establishing your account

Your account trustee/custodian lets you know what you need to do to establish your HSA. As with opening any account,

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you have to do some paperwork and often make an initial deposit — which may need to meet a minimum threshold set by the institution.

Paying fees

Just as with any other investment, your HSA may be subject to fees the financial institution levies for overseeing your investment. Some HSAs have set-up fees, some have monthly fees that vary with your account balance, some have both, and some have none.

You can pay the trustee or custodian of your account directly from your HSA or you can pay the fees yourself.

Keeping Track of Your Money

Notice the "Your" in this heading. The funds in your HSA are yours — not your employer's or the trustee's, but yours. You get to say how they're invested (within the HSA's investment menu), you get to spend them, and you get to keep track of them. You're already the chief cook and bottle-washer at home, aren't you, so it's no big thing to be your own bookkeeper for your HSA as well.

Some institutions offer separate checkbooks or debit cards for your HSA so that you can write a check at your doctor's office or use the debit card to pay for your prescription. Just make sure you use these payment tools for qualified medical expenses only if you want those payments to be tax free! Chapter 4 talks about qualified medical expenses and the upcoming "Saving receipts" section reminds you of the importance of being able to justify your expenditures.

Balancing statements

Pay attention to the statements you get regarding your HSA, just as you monitor your checking and savings account statements. Make sure the amounts going in are what you signed on for and that the funds you withdraw are recorded accurately.

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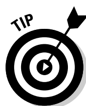
The custodian or trustee of your HSA isn't responsible for making sure you don't exceed your contribution limits — you are! (Refer to Chapter 2 for information on contribution limits.)

Saving receipts

In the normal course of things, it makes sense to save receipts for health care expenses if only because it may be worth your while to itemize deductions on your tax return.

More importantly, if you have an HSA, your receipts can help show the IRS that you spent funds from your account on qualified medical expenses. (Check Chapter 4 for help in determining appropriate expenses.)

Probably the best kinds of receipts to keep are the EOBs (Explanation of Benefits) from your insurance company. An EOB explains what the health plan paid and how much you owe toward your qualified medical expense.



If you misplace your EOBs, you can often print them from your insurance company's website or call the insurance company's number and ask them to send duplicates.

You're the one who decides what to spend your HSA funds on, so you're the one responsible for making sure that you spend them on medical expenses.

Controlling Your Funds

As the sole owner of your HSA, you decide

- How much to put into your account.
- Where to invest your funds — or whether to invest them at all.
- How much to spend from your account.
- What to spend the money on, which means being familiar with what constitutes a qualified medical expense. For help with that, turn to Chapter 4.
- Whether to spend the money now or save it for future expenses.

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Rolling over

HSAs and IRAs are similar in many ways, but they're not very much like each other when it comes to your ability to roll over funds. You can roll money from other accounts into an IRA fairly easily and with few financial repercussions. But it wasn't the same for HSAs. Until January 1, 2007, the only straight rollover you could make to an HSA was from an Archer MSA or from another HSA. With regard to that transaction, you must transfer the funds within 60 days of taking them out of the first account. And, you can make just one rollover per year. The exception — there's always an exception, isn't there — is that trustee-to-trustee rollovers are unrestricted, though trustees are not required to make transfers at all.

You cannot make a direct rollover from an HSA to an IRA or from any retirement account including 401(k), 403(b), and 457 plans to an HSA, except for the new one-time IRA to HSA exception: Beginning in 2007, Uncle Sam allows a one-time-only tax-free rollover (trustee to trustee) from an IRA (but not a SEP or a SIMPLE) to an HSA. The rollover is limited to the amount of your maximum annual HSA contribution, based on the type of HDHP coverage (single or family) at the time of the rollover. You can adjust the maximum if you change from single to family HDHP coverage during the year. The rollover amount offsets (dollar for dollar) the amount that can otherwise be contributed to the HSA for that year, and you can't take a tax deduction for the IRA rollover.

If you don't remain HSA-eligible for 12 months after the rollover (except for death or disability), you're taxed on the rollover *and* you pay a ten percent penalty, so make sure your situation fits before you take advantage of this rollover.

All the money in your HSA is yours — no matter who contributed it — and it stays yours whether you change jobs, move across the country, retire to your own private island, or otherwise live your life as you see fit. Even contributing to your HSA doesn't give your employer any say in how you spend the money in it.

One thing you can't do with your HSA is borrow against it or pledge the funds in it. Section 4975 of the IRS Code covers prohibited activities.

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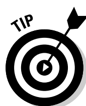
Surveying the Scene from 65

Turning 65 initiates several changes in your relationship with your HSA, just as turning 65 sparks changes in many areas of your life. For one thing, you generally are enrolled in Medicare, which means that though you can no longer start an HSA, you can use the funds in an existing account to pay for a wider range of services than your maturity-challenged brethren:

- You can pay any Medicare premiums, deductibles, copayments, and coinsurance costs, though you cannot spend HSA money on premiums for Medicare supplemental insurance — so-called Medigap coverage.
- If you're retired and have retiree health benefits through your old company, you can pay those premiums with your HSA funds.

Don't forget that you can always use HSA funds to pay for a long-term care policy — even before you reach 65.

Strange rule: You can also pay for your spouse's Medicare premium, but only if you (as the account holder) have reached age 65.



Your HSA can even become another source of retirement income! Being 65 frees you to spend your HSA money on anything you like; you're no longer bound by the qualified-medical-expenses-only rule. The amount you use for non-medical purposes is subject to income tax, but you're not subject to that nasty 20 percent penalty that under-65s would be charged.

Death and your HSA

If you have money in your HSA when you die, the balance becomes the property of the beneficiary you name to your account. If your surviving spouse is the beneficiary, the HSA becomes his or her HSA and they can treat it as their own.

If you designate anyone other than your spouse as the beneficiary, the account ceases to be an HSA and the funds become part of your estate and may be subject to tax. However, your beneficiary has a year to use the remaining funds to pay for any qualified medical expenses you incurred before your death and deduct those costs from the taxable portion of your estate.

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Chapter 4

Spending Your HSA Funds

In This Chapter

- Coming to terms with qualified medical expenses
- Abiding by the rules
- Spending on loved ones
- Letting your funds languish

I have lots of good news when it comes to spending the money in your HSA without ever paying tax on it! Chapter 2 explains how you can invest tax-free money in your HSA, Chapter 3 shows that you can grow your investment tax free, and this chapter sets out the rules you can follow to spend your HSA tax free as well.

Exploring What Makes for a Qualified Medical Expense

To keep the money in your HSA tax free (remember, to this point, your investment has never been taxed, and you can keep it that way), all you need to do is spend it solely on what the IRS calls qualified medical expenses. Basically, a *qualified medical expense* is money you pay primarily to prevent or treat a physical or mental illness. *Primarily* becomes the key word in determining whether certain expenditures are qualified, but the list is long — so long I can't hope to include it

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here. But I can already tell you this: I'm sorry, even if you bought those concert tickets primarily to prevent the mental anguish you'd experience if you didn't get to hear John Mayer live, you can't use your HSA funds to pay for them.

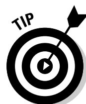
IRS Publication 502 provides a partial list of eligible expenses. Check it out at `www.irs.gov`.

Spending on expenses

Paying for medical expenses is the reason you started an HSA in the first place (if not, you need to recheck your investment strategy), and the range of medical expenses you can cover tax-free is long and varied.

What you can pay for with funds from your HSA — and keep in mind that this is by no means a comprehensive list — includes:

- Medical care and services (duh!) like office visits, hospitalizations, and lab tests. Whether you're paying a deductible, a copayment, a coinsurance, or the whole enchilada — it can come out of your HSA.

  If you fall ill in another country — and I sincerely hope you don't — you can pay your medical expenses from your HSA funds.

- Prescription — This does not include drugs illegally imported from other countries, such as Canada.
- Vision and dental care — you can get LASIK surgery and give away your glasses or get that dental implant you've always wanted.

  You can't pay for cosmetic procedures with your HSA funds, so bringing your HSA debit card to the botox party or to get your teeth nuked snow white is a definite no-no.

- Hearing aids, crutches, and guide dogs are also on the list. As I said, it's a long and winding list — or was that the Beatles? Chapter 6 lists more of the unusual qualified medical expenses.

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Your HSA can pay for expenses your health plan doesn't cover. Be careful about over-the-counter remedies. You must have a prescription from your doctor for OTC medication in order for them to qualify as qualified expenses.

Paying for specific premiums

It would be nice if you could pay the premiums for your high-deductible health plan with funds from your HSA, but that's not how things work down at the Treasury Department.

However, although you can't pay for your regular, everyday health insurance premiums under regular, everyday circumstances, unusual situations call for unusual exceptions. So the circumstances under which you *can* pay your health insurance premiums from your HSA include the following:

- You're receiving federal or state unemployment benefits.
- You're paying for COBRA continuation coverage, for example, after leaving a job (voluntarily or involuntarily), or losing a spouse.
- You're paying Medicare premiums.

Remember, you cannot use your HSA money to pay for your spouse's Medicare premium until you (the account holder) have reached age 65.

The one type of insurance premium you *can* pay from your HSA is for a qualified long-term care insurance policy. *Long-term care insurance* pays the expenses of nursing homes, assisted-living centers, and in-home caretakers.

Age matters when it comes to IRS rules for determining how much of a long-term care premium is a qualified medical expense.To see eligible amounts for the the latest tax year for which figures are available, check for Publication 502 on the IRS website at `www.irs.gov`.

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Paying the piper . . . er, physician

How you pay your physician depends on where you are in relation to meeting your deductible, what out-of-pocket costs remain after you reach your deductible, and how your physician's office runs its collections.

If you haven't reached your deductible yet, you're responsible for the full amount due the doctor under his or her agreement with your insurance company (except maybe for preventive care services). After you've reached your deductible, you're only responsible for any copayments and coinsurance required by your plan. And, if you've hit your plan's out-of-pocket maximum, you owe nothing for covered services with your insurer paying 100 percent.

In most physician offices these days, it is difficult for the front desk to determine what you might owe at the point of sale, mainly because of the structure of these new plans. What most offices do is send the claim to the insurer, allow the insurer to process the claim to figure out how much you owe, send notice of this back to the physician, and then have the physician bill you at home. This way, everyone has an accurate assessment of your liability.

From there, you can use a checkbook or debit card tied to your HSA if you have one, or you can fork over your own money and pay yourself back later with funds from your HSA.

Know that technology and office procedures are quickly catching up to these plans, so soon your physician — just like your pharmacy — will know exactly what to charge you at the point of sale. So be ready for the question: Check, Cash or Charge?

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Surveying other spending situations

The money in your HSA is yours to spend as you see fit. Of course, there are big advantages to seeing fit the same way the IRS does and big disadvantages to spending HSA funds the non-IRS way — the next section covers some of those repercussions. In this section, I cover some of the issues that arise even in a mundane medical existence.

Exiting an HDHP

You're in a high-deductible health plan and seize the opportunity to start an HSA. But a couple years later, you opt for a more traditional plan without a high deductible. You can no longer contribute to your HSA because belonging to an HDHP is the prime qualification. However, you still own your HSA, and you can still spend the funds in it on qualified medical expenses tax free.

Even if you decide to go back to a non-HDHP or turn 65 and are enrolled in Medicare, you can still spend the money in your HSA.

Reimbursing yourself

You can use HSA funds to reimburse yourself for a previous year's expenses as long as your HSA was established on or before the date you incurred the qualified medical expense. So, if you start your HSA in May this year, have a root canal in June, you can reimburse yourself for your qualified out-of-pocket costs when you've built up enough in your HSA next April.

You can go back any number of years — there's no time limit — just make sure you keep good records so that you can prove that

- You actually incurred the expenses.
- You weren't reimbursed for the costs.
- The bill wasn't paid by someone else (your insurance company, for example).
- You didn't itemize and deduct the expenses on your tax return.

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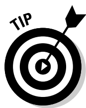
Avoiding Spending Outside the Rules

Your tax life is so much easier if you play by Uncle Sam's rules, and he has a few rules about HSAs that it pays to keep in mind.

The primary directive when it comes to HSAs is not to spend the funds on anything other than a qualified medical expense.

You may be wondering who's to know whether you bought something that isn't a qualified medical expense: Your employer doesn't check, your insurance company doesn't check, your HSA trustee or custodian doesn't check. However, the IRS will check if they audit you.



I know that I emphasize how important it is to spend your HSA dollars on qualified medical expenses. However, if you're really in a financial jam, the nice thing about HSAs is that access to your money is only a check or debit card swipe away. You'll pay tax and probably a penalty, as the next section talks about, but it's good to know that the money's there if you need it.

Paying the penalties

If you spend money from your HSA on anything other than a qualified medical expense, Uncle Sam gets a piece of the action:

- You have to claim the amount you spent as income on your tax form. That's Form 8889 (refer to Chapter 3).
- You pay income tax on it.
- You pay a 20 percent penalty on top of that.

  Note: Only if you're 65 or older, disabled, or dead are you not liable for the penalty.

You can't pay for health expenses that occurred before you started your HSA. So, starting an HSA in March and trying to pay yourself back for the eyeglasses you bought in February doesn't work.

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Auditing must-haves

If you're audited and the IRS looks at your HSA expenditures, you need to be able to prove that

- The distributions you took were exclusively to pay for or to reimburse yourself for qualified medical expenses.
- The expenses were not previously paid or reimbursed from another source.
- The expenses were not taken as an itemized deduction in any prior tax year.

So, keep your receipts in a safe place and, of course, keep copies of your tax files.

Making things right with the IRS

If you make a mistake and use money from your HSA to pay for something that isn't allowed, you can make it right. Of course, a casual "Oops, my goof" doesn't cut it.

You have to be able to prove that you didn't mean to make the mistake — buying skis with your HSA funds is pretty intentional, so don't try that excuse — and you have to put the money back into your HSA by April 15 of the year after the one in which you made the mistake.

Sharing the Wealth: Paying Your Family's Health Care Expenses as Well as Your Own

One of the advantages of having an HSA is that you can share the wealth. You can use money from your HSA to pay the qualified medical expenses of your spouse and any dependents (you may refer to them as your dearly cherished blessings or annoying rug rats . . . or some combination thereof). Typically, they're

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anyone you can claim as an exemption on your tax return. And, you can spend your HSA money on them even if they're not covered by the HDHP that makes you eligible to contribute to your HSA.

The same expenditure rules apply, so check the previous section, "Exploring what Makes for a Qualified Medical Expense."

Deferring Distribution: Growing Your Account Tax-Free

Your HSA is yours to spend or save as you choose. There's no time limit on spending your HSA funds. The funds automatically roll over every year and keep on doing their thing until you withdraw them to pay for your medical expenses. The money is always there, always yours, and always growing (assuming that you invested it).

If you can cover all your medical expenses now, but think doing so may be more difficult in later years, nothing's stopping you from stockpiling your HSA money until you really need it. Consider saving your HSA money until you hit Medicare age, particularly as all the financial advisors out there report that medical care during retirement will be the wildcard in the retirement savings game.

Rules governing HSAs may well change in the future, so keep on top of things either through your benefits provider or the Treasury Department website at `www.treas.gov`.

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Chapter 5

Ten (Okay, Seven) Tips to Keep Your HSA Healthy

In This Chapter

- Making the most of your deposits
- Spending smartly

You have so many ways to maximize your HSA. This chapter offers a few ways to make the most of your tax-advantages.

Making Tax-Free Deposits

If you can make deposits into your HSA through your employer's cafeteria plan before taxes are taken out, you definitely want to take advantage of that. If putting in pre-tax dollars isn't an option, you can deduct your HSA contributions when you file your taxes.

Contributing as Much as You Can

If you're serious about saving for your medical expenses, put as much as you're allowed into your HSA. You can contribute all the way up to the annual maximums. It's a great way to save for your future or that rainy day. Contribution information is in Chapter 2.

Investing Wisely

The money in your HSA grows tax-free, so you have a chance to make some smart investments and increase your medical

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nest egg. Chapter 3 explains your options for choosing a trustee or custodian for your account.

Paying Premiums

You can't use your HSA funds to pay the premiums on your regular health insurance policy except in extraordinary circumstances (explained in Chapter 4), but you can pay for your Medicare premiums (no Medicare supplements), your COBRA premiums, your retiree health care premiums (if you're 65+), premiums for health insurance if you're receiving unemployment, or long-term care insurance, which can be a savvy investment all on its own.

Spending Only on Qualified Expenses

So many health care costs register as qualified medical expenses that it's more than foolish to risk the penalties that come with using HSA funds to pay for other things. Chapter 4 talks about what you can and can't use your funds for and what happens if you stray into the can't category.

Saving Your Receipts

In case you ever have to prove that you spent money from your HSA only on approved expenses, it pays to save all your health care receipts. They can come in handy at tax time as well, though remember you can't double-dip and deduct for expenses you paid for with HSA funds.

Topping Off If You Undercontribute

You can add to your HSA right up until you file your taxes for the year, so if you haven't reached your contribution limit, you can make a last-minute deposit and lessen your tax burden. Don't forget to file Form 8889 (refer to Chapter 3). Chapter 2 has more on contribution rules and regulations.

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Chapter 6

Nine Interesting Qualified Medical Expenses

In This Chapter

- Paying for everyday items
- Spending on special expenses

The key to making the best use of your HSA is making sure you spend your HSA funds only on what the IRS deems qualified medical expenses. Chapter 4 goes into these in depth, but this chapter lists some of the more unexpected allowable expenditures.

Publication 502 at the U.S. Department of Treasury website `www.irs.gov` gives you a more complete look at qualified medical expenses.

Alternative Treatments

You can stick your HSA with the bill from your acupuncturist, get straight with your chiropractor with money from your account, and pay your Christian Science practitioner from your tax-free funds.

Trips

If you need to go out of town to receive medical care, some of the cost of your trip is an allowable expense. You can pay for up to $50 a night for lodging, plus some of the planes, trains, and automobile costs.

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Emergency Transport and Treatment

If you have to head to the emergency room, you can pay for the ambulance and any other charges from your HSA funds.

Ear Gear

Hearing aids are an allowable expense; as most health plans don't consider them a covered benefit or only cover them minimally, this is a great bonus.

Eye Gear

If it improves your vision, you can use your HSA to pay for it. You can pay for eyeglasses, contact lenses, even laser surgery with your HSA money.

And, should you need one, you can purchase a guide dog with funds from your account.

Tooth Gear

Your choppers are crucial to maintaining good health and you can pay for dental work including implants and dentures from your account — but not cosmetic dentistry such as teeth whitening.

Mobility Aids

Need crutches for a while? Pay for them from your HSA. Likewise, if a wheelchair is what you need, it's a qualified expense, as is what the IRS calls an *autolette,* otherwise known as those handy self-drive carts advertised on late-night TV.

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Reproductive Resources

Yes, you can use your account to pay medical expenses for your children, but you can also use it to prevent having them either through birth control, vasectomy, or sterilization. And you can boost your chances of conceiving through fertility treatments and fund those with your HSA as well.

Health-Improvement Programs

No, you can't use HSA money to pay for the manicure that makes you feel like a million bucks, but if you have a drug or alcohol dependency, you can use your funds to pay for treatment programs.

Likewise, certain smoking cessation and weight-loss regimens qualify as allowable expenditures.

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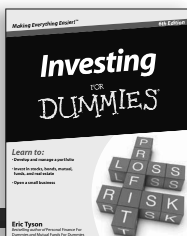

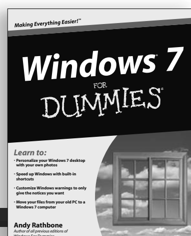

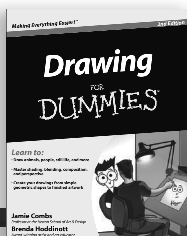

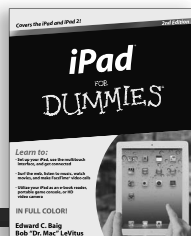

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