HEALTH SAVINGS ACCOUNTS (HSA)

DEFINITION

These tax-favored savings accounts are utilized for those enrolled in a high-deductible health plan (HDHP). Contributions to this account are not subject to federal income tax, earnings grow tax-deferred, and tax-free distributions can be made for qualified health-related expenses.

They were first introduced in December 2003 to replace Medical Savings Accounts (MSA) and unlike an MSA, the balance in your HSA is portable and at 65 and over, the HSA may be withdrawn tax-free, for any reason.

HOW THEY WORK

Contributions are made into an HSA by the individual or the individual's employer and are limited to a maximum amount each year. Unlike employer matching contributions to a 401(k) plan which may have a vesting schedule, all HSA contributions are immediately vested even if it was made by the employer. 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.

If HSA funds go unused in one year, they roll over into the next year and continue to accumulate, unlike a flexible spending account (FSA), where there is a “use it or lose it” provision.

ELIGIBILITY

In years where an individual and/or family have an HSA-compatible high deductible health plan (HDHP), they are eligible to contribute to an HSA. For 2015, an HDHP must have a minimum deductible amount of $1,300 for individual coverage and $2,600 for family coverage.

If an individual no longer has an HDHP, the HSA funds remain in the account and can continue to be used for qualified medical expenses. The individual cannot make additional contributions since they are no longer covered by an HDHP.

Those enrolled in Medicare are not eligible to contribute to an HSA.

CONTRIBUTION LIMITS

For this year, the maximum contribution to an HSA is $3,350 for individual coverage and $6,650 for family coverage. For individuals ages 55 and over, an additional catch-up contribution of $1,000 per individual is allowed.

ALLOCATION OF CONTRIBUTIONS

Funds in an HSA can usually be invested once the account is over a minimum balance as most HSA providers require a certain amount to remain in cash. Investment earnings are sheltered from taxation until the money is withdrawn. Individuals can choose to rollover their HSA from one provider to another with no tax liability, but they cannot be rolled over to an IRA or 401(k) plan.

DISTRIBUTIONS

HSA funds may currently be used to pay for qualified medical expenses at any time without federal tax liability or penalty. Most HSA providers give their accountholders a debit card or checkbook so they access their HSA funds.

Beginning in 2011, over-the-counter (OTC) medications cannot be paid with HSA dollars without a prescription. Withdrawals for non-medical expenses before age 65 are taxed as ordinary income and assessed a 10% penalty.