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## How a health savings account (HSA) works

Health coverage plan combines tax-advantaged personal savings with high-deductible health insurance policy (HDHP)

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### At a glance: health savings accounts

An HSA allows you to pay lower federal income taxes by making tax-free deposits each year.

Deposits to your HSA are yours to withdraw at any time to pay for medical expenses not paid by your HDHP.

You can also use the account to pay for the medical expenses of a spouse or other family members – even if they aren't covered by your HDHP.

Funds roll over from year to year – and your account continues to grow.

When you reach age 65, you're allowed to draw from any unspent HSA funds.

**HSA contributions are pre-tax** — regardless of your income.

**No tax on investment gains or interest** while the money is in your HSA.

**Withdrawal from your HSA and it's still tax-free** — if you use the funds to pay for qualified medical expenses.

When you take your money out, you can **find a plan**

**A long-term care fund?**  
Your HSA could be a long-term investment that continues to grow — even after you retire.

**HEALTH SAVINGS ACCOUNTS**

**+ The 'Swiss Army knife' of tax-advantaged accounts?**

**"Use it or lose it?"**  
**Nope.**  
Prefer to wait to use your HSA funds? They'll remain in your account for future withdrawal.

**Can an HSA help you qualify for a subsidy?**  
Maybe. Contributing to an HSA reduces your modified adjusted gross income, which determines ACA subsidy eligibility.

**You can decide how your HSA grows.**  
Keep your funds in interest-bearing accounts OR invest them in stocks, bonds, or mutual funds.  
(Your options depend on whether your HSA is through your employer.)

health insurance .org  
hio.news/hsa

Infographic: The HSA: 'Swiss-Army knife' of tax-advantaged accounts?

Would you like the ability to pay for medical expenses with pre-tax money? What about the option to build retirement savings that can be used at any time — without taxes or penalties — to pay medical expenses that arise along the way? Do you prefer coverage that comes with a higher deductible and lower premiums?

A health savings account (HSA) could be just what the doctor ordered. Used wisely, this innovative approach to health coverage may provide major advantages that could keep both your personal and financial life healthy.

A health savings account is a tax-advantaged personal savings account that works in combination with an HSA-qualified high-deductible health insurance



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need to use it — is an interest-bearing nest egg that grows until you need it. HDHP, meanwhile, is your safety net should you need catastrophic or major medical expenses.

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## How an HSA works

Opening an HSA allows you to pay lower federal income taxes by making tax-free deposits into your account each year. Most states (all but California, Alabama, and New Jersey) also offer tax breaks on funds deposited in these accounts. The 2019 contribution limit is \$3,500 if you have individual coverage under your HDHP, and \$7,000 if you have family HDHP coverage. You can deduct your contributions even if you take the standard deduction and don't itemize. If you're 55 or older, you can contribute an extra \$1,000 a year.

For 2018, the contribution limit was \$3,450 if you had self-only HDHP coverage, and \$6,900 if your HDHP provided family coverage [Note that the family contribution limit was initially set at \$6,900 for 2018. A March 2018 IRS bulletin reduced it to \$6,850, as a result of changes to the inflation adjustment procedure that were implemented by the Tax Cuts and Jobs Act, but the IRS opted in April 2018 to set the contribution limit back to \$6,900, due to the administrative challenges associated with a mid-year change in the contribution limit.]

If you had HDHP coverage in 2018 (even if it was just in December), you have until April 15, 2019 to contribute to your HSA for 2018. And when you're filing your 2018 taxes, note that while you'll still use Form 8889 to report your HSA contributions and withdrawals, the HSA deduction (if you're eligible for it) on Form 1040 now shows up on Schedule 1. This is because the IRS has shortened the main 1040 and moved things that used to be on the main form onto a series of schedules instead. But nothing has changed about eligibility for the deduction itself. Assuming you made after-tax HSA contributions for 2018, you'll still get to deduct them on your 1040 and avoid paying income taxes on the amount you contributed.

The money you deposit into your HSA is yours to withdraw at any time to pay for medical expenses that aren't paid by your high-deductible individual health insurance policy or reimbursed by anyone else (so if you have a dental policy that pays part of your dental costs, for example, you can only use your HSA funds to pay the portion of your dental bill that you have to pay out-of-pocket). HSAs are considered part of consumer-driven health care (CDHC), meaning that you control the plan, deciding how to spend and invest those dollars.



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qualify is broad: You can use your HSA to pay for acupuncture, chiropractic services, or even traditional Chinese medicine (everything you can find a plan outlined in IRS Publication 502). Since 2011, however, individuals have not been able to use tax-advantaged money from an HSA for over-the-counter drugs that are not prescribed by a doctor.

You can also use the account to pay for the medical expenses of a spouse or other family members (dependent children or qualifying relatives; in other words, anyone who is a part of your tax household), even if they aren't covered by your HDHP.

If you're fortunate enough to not need to withdraw from the account to pay for medical expenses, your funds roll over from year to year and your account continues to grow (including investment returns or interest, depending on where you deposit your HSA funds).

When you reach age 65, you're allowed to draw from any unspent HSA funds. You can still spend the funds tax-free for medical expenses, or you can withdraw them without penalty to use them for non-medical expenses (though you will pay income tax on the withdrawals if you don't use them for medical purposes, just as you would if the funds were in a traditional IRA). If you withdraw the funds prior to age 65 for purposes other than paying medical expenses, you'll owe a 20 percent penalty on the withdrawal, in addition to income taxes.

Sounds too good to be true? Well, remember that you're paying a lower premium for your insurance coverage because it's a high-deductible plan that doesn't cover anything other than preventive care before the deductible. If you need to see the doctor, you'll pay the entire bill (reduced according to the negotiated rates your health plan has with the doctor) if you haven't yet met your deductible.

## **2018: Higher contribution limits, deductibles, and out-of-pocket maximums**

HSA-qualified plans have deductibles starting at \$1,350 for singles and \$2,700 for families in 2019.

But HSA-qualified plans have also always had limits on how high the maximum out-of-pocket can be — unlike the rest of the market, which didn't have limitations like that until 2014 when the bulk of the ACA was implemented. In



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all plans under the ACA. For HSA-qualified plans in 2019, it's \$6,750 for individuals and \$13,500 for families, as opposed to the general market limit out-of-pocket spending to \$7,900 for individuals and \$15,800 for families.

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The 2019 contribution limits for HSAs are \$3,500 if you have individual coverage, and \$7,000 if you have family coverage under an HDHP (family coverage means that your plan covers at least one other family member, in addition to yourself; you don't have to have your entire family on the plan in order to qualify for the family HSA contribution limit).

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**Ready to try out a Health Savings Account?**

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## Health savings accounts get mixed reviews

The country is largely split over the question of whether health savings accounts are a wise coverage solution on a large scale – and whether HSAs help or hurt the nation's health care system.

Proponents of HSAs argue that people tend to be more careful with their own health care costs when they're paying part of the bills themselves. So instead of going to a doctor for every cough, cut or cramp, HSA users would have an incentive to be less wasteful with their health care spending, and maybe even take the time to shop around.

They say that the cumulative effect will be a nation of health consumers whose behavior would lower health care costs, while injecting price and quality competition into the medical marketplace. And tax advantages, they say, could lure the uninsured into lower-cost, high-deductible plans, reducing the ranks of the uninsured and possibly even nudging them into healthier lifestyles.

Critics of HSAs argue that health savings accounts benefit the young and healthy, while those with regular medical problems or who are older may end up paying more if they select an HDHP/HSA combination, because they tend to drain their savings with more frequent up-front medical expenses. But this would be true of any comparison between higher-deductible plans (generally favored by healthier people) and lower-deductible plans. And it's also worth noting that people with very high-cost medical needs sometimes end up better off with an HDHP/HSA combination, because the tax savings from the HSA and the lower premiums for the HDHP are enough to more than offset the higher



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Another argument is that the tax-advantaged option constitutes a **find a plan** the rich, and that low-income families don't earn enough to benefit from the tax breaks. Further, skeptics warn that many people with HSA plans — and especially the poor — might be reluctant to spend money from their savings account, even on necessary healthcare expenses. Although a reduction in spending on unnecessary care would be beneficial, it's often hard for a consumer to know what care is necessary and what's unnecessary, and skimping on the former could lead to higher-cost problems later.

But it's worth noting that the ACA requires all plans — including HSA-qualified plans — to cover preventive care with no cost-sharing. So all HSA-qualified plans effective January 2014 or later, cover the full range of recommended preventive care before the deductible.

## Accounts are becoming mainstream

Enrollment in HSA-qualified HDHPs has soared to 21.8 million people by 2017, up from 10 million people in 2010 (more than three-quarters had HDHP coverage provided by a large employer as of 2017). According to data from America's Health Insurance Plans (AHIP), enrollment has been growing at a rate of about 15 percent per year since 2011. AHIP's data indicates that 8 million individuals were enrolled in HSAs in 2009 and just 3.2 million in 2006. Not all of those enrollees contribute funds to an HSA, but they're eligible to do so if they want.

Many businesses, large and small, offer these HDHP policies to their employees, but you can also purchase them on your own through the exchange in your state or directly from a health insurance carrier. For people who buy their own insurance, HDHPs are available in nearly every county in the US.

HealthCare.gov introduced optional standardized plans for 2017, and for 2018, they expanded the standardized plan selection to include an HSA-qualified HDHP. But in the Benefit and Payment Parameters for 2019, HHS eliminated the standardized plan designs for 2019, and has instead encouraged insurers to offer HDHPs. The agency also wants to pursue adjustments to the plan display information on HealthCare.gov in order to “promote the availability of HDHPs,” although nothing was included in the final regulation about how that would be accomplished (HHS noted that they “will take [the comments they received on this issue] under consideration.”) But clearly, HDHPs and HSAs are a focus for the current Administration.



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to select any HSA custodian they like. A long list of banks, credit unions and brokerage firms offer accounts for saving and growing HSA funds, so shop around before you select an HSA custodian. The saving accounts include a dizzying array of options. And brokerages offer countless stocks, bonds and funds to invest in with low trading fees, while others may have limited choices, are more expensive, and have hidden fees (HSA Search is a useful tool showing fees charged by hundreds of HSA custodians, but it is by no means an exhaustive list of all the available HSA custodians; check with your bank, credit union, or brokerage firm to see what they offer as far as HSAs, and what fees they charge).

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*Louise Norris is an individual health insurance broker who has been writing about health insurance and health reform since 2006. She has written dozens of opinions and educational pieces about the Affordable Care Act for healthinsurance.org. Her state health exchange updates are regularly cited by media who cover health reform and by other health insurance experts.*