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Health Savings Accounts

Are they right for your organization?

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Health Savings Accounts (HSAs) are a new vehicle to offer your employees a high deductible health insurance plan in conjunction with a savings account that's funded by the employer, employee, or both. These plans can be great deals for both your employees and your organization. You may want to consider adding them as an option at your next renewal.

HSA's became available in 2004 and were created to encourage individuals to save for qualified medical expenses on a tax-free basis. They are in the same category of products as Health Reimbursement Accounts (HRA's) and Flexible Spending Accounts (FSA's), but have some important differences. Many organizations have been able to significantly reduce their benefits expenses while providing plans that better meet the needs of their employees. That's the best of both worlds!

Here's how they work:

- An employee must be covered under a qualifying high-deductible health plan (HDHP). *Because these plans have a high deductible, the premiums are generally significantly lower than traditional health plans.*
- An HSA is opened with an authorized financial organization in the name of the employee. Money that is deposited into the account is used to pay for expenses before the deductible is met. Because the account is in the employee's name, all funds belong to the employee (including employer contributions) and are taken with the employee if they leave your employment.
- Contributions are extremely flexible! The employer, the employee, or anyone on behalf of the employee can make them. They can be made monthly, annually, or up until April 15 for the previous year (just like an Individual Retirement Account—IRA).
- Distributions can be taken at any time, and many HSA custodians even provide debit-cards specifically for these expenses. As long as the distribution is for a "qualified medical expense" (see HSA Terms to Know on page 3), they can be taken tax-free. Funds may also be used for premiums paid during a leave of absence, while on COBRA, and while unemployed. *Because these accounts were created to encourage people to save, once you become 65, withdrawals can be taken for any reason and only taxed as regular income (like an IRA).*

So, why might you consider an HSA for your organization?

While HSA's may not be right for everyone, they may be attractive to your employees who don't have on-going health or prescription needs. Typically, these groups of people pay traditional premiums for years, and rarely use the coverage. With an HSA, the premiums will be lower and any funds deposited into the savings account continue to grow for future use! As an employer, you will be able to give your employees more benefit plan options and reduce your contribution expense with the lower premiums these plans carry!

A few last things:

As an employer, you are responsible for the following:

- determining whether or not an HSA option would be beneficial for your organization and employees (at the time of your renewal, contact your customer service representative for assistance!)
- reviewing your existing health plan to verify there will be no conflicts with HSA eligibility:
 - a) Do you offer a general Flexible Spending Account (FSA) that cannot be terminated mid-year? If so, you probably won't be able to offer an HSA until the following year (general FSAs are considered a health plan that is not a High Deductible Health Plan (HDHP) and disqualifies individuals from having an HSA).

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b) Are any of your employees also covered under a spouse's or parent's plan that's not HDHP?

- establish an HDHP option along with your traditional PPO and HMO plans
- determine how much and how often you will contribute to the employees' HSA
- decide whether to offer the HSA through a cafeteria plan (your choice)
- make sure you pass nondiscrimination testing (if using a cafeteria plan), or comparability testing (if not using a cafeteria plan)—see “HSA Terms to Know” to the right.
- set up or direct employees to a qualified HSA provider, such as a bank

Things the employee is responsible for:

- determining individual eligibility to participate in an HSA
- maintaining records to verify qualified medical expense distributions
- reporting account income (i.e. HSA interest earned) on CA state tax filing

Because HSA's require a lot of pre-planning, we strongly encourage you to contact your customer service representative for more details if you are considering this option for your next renewal. Additional information is available in IRS Publication 969 at: www.irs.gov.

This article is an overview of Health Savings Accounts (HSA's). We recommend, because of the complexity and potential liability of HSA's, legal advice or other expert assistance should be obtained. ■

HSA Terms to Know

Permitted coverage: an individual may have the following types of insurance and still qualify for an HSA: accident, disability, dental, vision, long term care, workers' compensation, another HDHP, and either a limited-purpose FSA (one that reimburses items only relating to the other types of permitted insurance) or post-deductible FSA (one that reimburses items only after the minimum annual deductible is met).

Qualified medical expenses: generally the same list that is used for FSA reimbursements, including some over-the-counter (OTC) medications (for the full list see IRS Publication 502 at www.irs.gov).

Nondiscrimination test: if the HSA is being offered through a cafeteria plan, the offering of and contributions to the HSA must not discriminate in favor of highly compensated employees (for detailed rules see IRS Publication 15b at www.irs.gov).

Comparability test: if the HSA is not being offered through a cafeteria plan, employer contributions must either be the same dollar amount or the same percentage of the annual deductible of the HDHP for:

- Employees covered under HDHP and eligible for HSA
- Employees covered as self-only or employees covered as family
- Employees who are full-time or employees who are part time

How the Employer Benefits

	TYPICAL HMO OR PPO	HDHP WITH HSA
Sample annual employer contribution	\$4000	<ul style="list-style-type: none"> • \$1800 toward premium for high deductible plan • \$1000 contribution into HSA
Employer savings	\$0	\$1200

- No FICA withholding
- May be offered under a cafeteria plan, but not required
- Employers are currently required to withhold CA state disability and income taxes from employee contributions

How the Employee Benefits

	TYPICAL HMO OR PPO	HDHP WITH HSA
Sample annual employee contribution	\$1000	\$500 toward premium for high deductible plan
Sample out-of-pocket expense	\$500	\$0 (the \$500 was deducted from the \$1000 the employer contributed to the HSA)
Employee cost	\$1500 cost	\$500 cost

- Eligible contributions made by employee or someone other than employer are deductible on federal tax returns (not CA however), or may be taken pre-tax thru payroll deductions
- Funds in the account roll over year to year (no use-it or lose-it)
- Funds in the account will pass to the beneficiary upon the individual's death (like an IRA)

HSA expenses Allowed...or not?

ALLOWED	NOT ALLOWED
Acupuncture	Cosmetic surgery
Artificial teeth	Teeth whitening
Birth control pills	Medicine from other countries
Co-payments	Hair transplants
Deductibles	Nutritional supplements
Eyeglasses	Health club dues
Eye surgery	
Lab fees	
Orthodontia	
Some over-the-counter drugs	
X-rays	

For a complete list of allowable expenses, please see IRS Publication 502 at www.irs.gov.