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Health Savings Accounts: A Tax-Free Way to Save for Future Medical Expenses

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What is a Health Savings Account (HSA)?

A Health Savings Account (HSA), is a special savings account you can set up at a bank if you participate in a high deductible health insurance plan. The account can then be used to pay for typical medical and dental expenses not covered by insurance like your deductibles and copayments for trips to the doctor and hospital. It can also be used for other expenses such as prescriptions, artificial limbs, wheelchairs, vaccines, drug addiction treatment, physical therapy, ambulance rides, and even laboratory fees.

What is so special about this type of account?

Two words…. tax free.

In order to qualify for the tax savings, the bank account must be a designated qualified HSA.

First, you begin to save money through tax savings as soon as you contribute money into your HSA, which could happen in one of the following three ways:

1. Allow some of your paycheck to go directly into your HSA account instead of your regular bank account. Don't worry, it is still your money, only you have the rights to utilize these funds. Instead of being deposited into your major bank account, you're just having a portion go into another bank account, which you own. When doing this, the money going in the HSA is never subject to income OR payroll taxes (such as social security).
2. You could contribute other available funds to your HSA. This allows you to take a tax deduction on your personal return for the amount you have put into the account lowering your taxable income. Unlike some other deductions, you can take this deduction even if you are using the standard deduction.
3. Your employer can deposit money directly into your account. By doing so, you are essentially being paid by your employer with money that avoids both income tax as well as payroll tax.

Second, just like any bank account, the HSA can earn income on the money you have in the account. Unlike other bank accounts, the income earned by your HSA account will not be taxed. For example, the HSA could be invested in a mutual fund that pays dividends. Those dividends are tax free when normally they would be subject to tax.

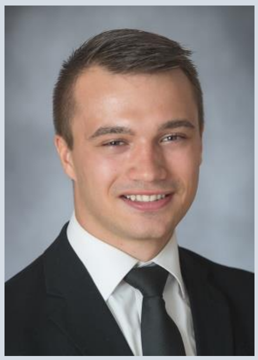
Finally, distributions from the account to pay for your qualified medical expenses are also exempt from taxation. This means that, as long as the money is used to pay qualified medical expenses, the money that is put in, held in, earned by, and distributed out of an HSA will not be subject to tax.

This sounds similar to a flexible spending account (FSA), why shouldn't I just use one of those?

A common phrase that is associated with an FSA is "Use it or lose it". This means if you don't use the money put into the FSA during the year by the end of the year, you lose the money. It will not rollover into the next year. This is not the case with an HSA. Any money that is in the HSA is yours to keep. You can never lose it. It doesn't matter if you retire, changed positions, or change your job, the HSA is your account to use for unreimbursed medical expenses whenever you want.

So, if you want a simple and easy way to save taxes while also saving money for your future medical expenses, an HSA might be the perfect solution for you.

For more information, please contact John Allan at jallan@dopkins.com.



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