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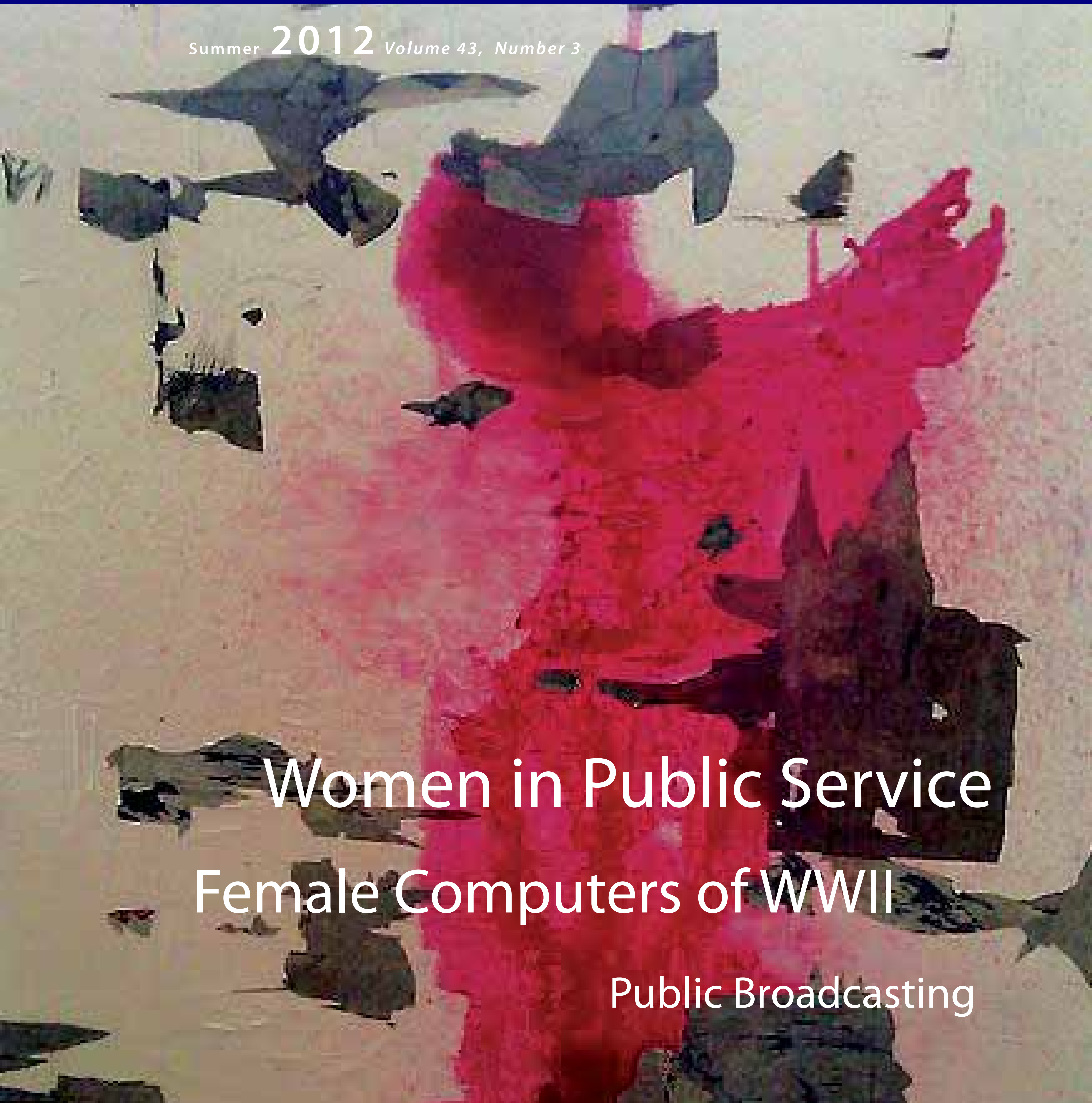

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In Every Issue

Healthcare Savings Accounts– a Life-Long Saving Habit

By Edi Alvarez

There are tools to help you manage cash flow and tools to maintain a diversified rebalanced investment portfolio. Some financial tools are written right into the tax code. Most of us are familiar, for example, with IRAs, 401Ks, 403bs or the less common 457 plans, all designed to encourage saving through tax deferral for retirement. A lesser known part of the tax code allows for tax-advantaged savings for medical expenses that can be used today and in retirement (1).

You should, in fact, think of medical savings accounts not as a retirement "tool," but as one of those healthy "financial habits" you just can't do without, like brushing your teeth.

You may have heard of Healthcare Savings Accounts, but there are actually four tax advantaged medical savings accounts that go under the acronyms FSA, HSA, MSA, HRA (see the table for a summary of each). Each type of account was created to defray the cost of a trend in healthcare plans that increased the amount of out-of-pocket expenses for the participants. I will focus on Healthcare Savings Accounts (HSAs) for two reasons. One, they are the most portable tax-advantaged medical savings account. And, two, because individuals who don't have employer sponsored insurance or are self employed will encounter HSAs as an option when they purchase high deductible healthcare insurance.

Acronym	F.S.A.	H.S.A.	M.S.A.	H.R.A.
Tool name(s)	Flexible Spending Arrangements	Health Savings Account	Medical Savings Account, Archer MSA, Medicare Advantage MSA	Health Reimbursement Arrangements
Qualifying	Part of cafeteria plan benefit only in employer benefit plan	Individual participates in HDHP** by Dec. 1st of year to qualify for that year	Employee and spouse participating in a HDHP*	Employer benefit for employees
Who can make contributions	Employee & employer	Employer, employee, spouse or other can all make contributions	Employer or employee NOT both	Employer only
Contributions	At beginning of year you decide on the amount to a maximum stated in your plan	Up to mid April of following year. Maximum limits posted annually can rollover money from an M.S.A.	Up to mid April of following year. Limits apply based on % of annual deductible and income.	No limit but solely at discretion of employer
Distributions	Tax Free for qualifying expenses can distribute more than you contributed as long as it is within the amount you set at the beginning of the year	Tax Free for qualifying expenses	Tax Free for qualifying expenses	Expense must be incurred on or after date enrolled in HRA
Individual Tax Reporting	None	1040 Form 8889	1040 Form 8853	None
Portability	Available during the same year or early the following. Not available once leave employer	Account is employee owned and portable	Account moves with you but can only be rolled to an HSA	Not portable once you leave employer it is no longer available
Balance	'Use-it-or-lose-it' at year end but can have a grace period till the March 15th	Your contributions can be spent any year – contributions remain in your account until used	Your contributions can be spent any year – contributions remain in your account until used	Carried over from year to year but can't take it with you when you leave.

Okay. How Do They Work?

Annually, you deposit tax deductible dollars into an account ($3,100 in 2012 for single, or $6,250 for family) as long as you have high deductible healthcare insurance that qualifies (2). Contributions must be made by April 15th of the following year. This contribution is an "above the line" tax deduction, which means that your contribution lowers your adjusted gross income and your tax liability. If you draw on your HSA account to pay for an eligible medical expense it is tax free, but use it to buy your favorite toy and you will incur a 20% penalty.

What Are Your Choices?

One option is to save the money in an HSA, leaving it to grow for future use. The other is to spend it on current qualified medical expenses not itemized on your tax return. The choice you make depends on your current situation and your plans for the future.

If putting it aside for retirement is your objective, then you might invest it along with other retirement assets in an HSA brokerage account. If your intent is to save it for a rainy day, then placing it in a HSA guaranteed interest bearing account (at a bank or other institution) may be the best option.

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For those with more pressing need, the best option is to keep it in a bank account that can be accessed regularly to cover on-going expenses such as prescriptions, co-pays, dental and other medical expenses. It is important to note that in this scenario, the individual is using their healthcare savings account to cover their out-of-pocket expenses. They can't then deduct these same expenses as part of the Schedule A tax deductions, which lowers taxable income.

If you have a high deductible healthcare plan (HDHP) that allows HSAs, then you should save the maximum you can each year (up to the allowable limit). Deduct the contribution "above the line" and then decide how to best deploy this tool.

HSAs and Retirement

The average life expectancy of a 65-year-old women is 20 years (as compared to 18 years for males) (3). In fact, twenty-five percent of 65-year-old females are expected to live to 94 years (4)! It is during that period of our lives that HSAs can play a particularly important role by providing a tax-free way to pay for medical expenses at a time when we most need it.

Down the Road

It is impossible to predict the impact that the new healthcare act will have on HSAs. While some healthcare costs that were previously not eligible will be covered under the Act (for example, certain pre-existing conditions), there is certainly no guarantee that healthcare costs will roll back. For the present, HSAs remain an unparalleled hedge against inflation of uncovered expenses. This "financial tool" remains one of the preeminent and undervalued ways to secure your quality of life going forward and especially into retirement. Don't just think about your "nest egg" in terms of traditional investment accounts. Think about quality of life and how you will realistically support your future healthcare needs. Regular contributions to an HSA now and appropriately invested, can mean piece of mind later.

* HDHP is a 'high deductible healthcare plan' with no other health or Medicare coverage that can reimburse your expenses. Rules are strictly followed on minimum and maximum annual deductibles and maximum annual out-of-pocket expenses for a HDHP (1). ■

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4. Northwestern Mutual Life Insurance "best risk" for individuals in good health (2009). Quoted from Life expectancy at Age 65 table http://www.choosetosave.org/calculators/index.cfm?fa=retireeCalc

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Edi Alvarez, MS CFP® reminds us that finances can support or derail professional and family life. Reach for your dreams and build finances to support them. Edi is a Registered Investment Advisor in California and Certified Financial Planner TM empowering women through building solid financial decisions. She will continue to serve on the AWIS Finance Committee and was past-president and treasurer of AWIS, San Francisco. While she begun the Money Matters column in 2008, this is her last planned Money Matters column. Edi can be contacted at edi@aikapa.com