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Health Savings Accounts

Health savings accounts (HSA's) are apparently a little understood, underfunded and underutilized perk of high deductible health insurance policies. As the cost of health care insurance has increased in the past few years, more and more employers and individuals are switching to high deductible insurance policies. But, not many people are apparently taking advantage of HSA's.

While there can be a cost savings on the annual insurance premiums, a high deductible insurance policy could have more significant out-of-pocket costs for someone needing health care. HSA's were created to help patients pay for their out-of-pocket expenses. Each year, people enrolled in a qualified high deductible health insurance plan may contribute to an HSA account. The contribution maximum is $3,000 for an individual policy and $5,950 for a family policy for 2009, assuming the high deductible insurance plan is in-force for the entire calendar year. The contributions limits adjust each calendar year. There is also a $1,000 extra contribution allowed for people aged 55 and older. If you are enrolled in an HSA for part of the calendar year, there is a formula to prorate the contribution.

One benefit of the annual contributions to the HSA account is that the contributions are tax-deductible. And, you don't need to itemize in order to obtain the tax benefit because the deduction is taken right on page one of the IRS Form 1040 in the adjusted gross income section. So, if you are in a 25% tax bracket and you make a $5,950 contribution to your HSA account, you could save almost $1,500 in federal income taxes. And, there could be an additional tax benefit for people who also pay state income taxes.

If you have out-of-pocket health care costs, you could make a contribution to your HSA to get the tax benefit and then turn around and withdraw the funds for qualified medical expenses. Or, you could take advantage of another tax benefit of HSA's and that is that your contributions grow tax free as long as they are eventually used for qualified medical expenses. So, if you are really motivated, go ahead and contribute the maximum allowed to your HSA. Then, use other, after-tax dollars to pay your medical expenses. This allows the HSA account to hopefully grow and compound over time.

You have essentially two investment options for the HSA account. You may invest it in a savings account at a bank. Almost all banks offer HSA accounts, even if they are not prominently advertising the fact so you may want to inquire at your local bank. Or, you may invest your HSA account in mutual funds thru a special HSA account. The third option is to do a bit of both – put the amount you think you will need in the short term in a savings account or money market account and then invest the rest in a mix of mutual funds for long term future benefit.

You can easily find companies that offer HSA accounts through an on-line search. You do not need to go with the firm suggested by your insurance company or employer. The keys to shopping around for an HSA account are comparing the mutual fund investments and the fees. The fees are sometimes difficult to ascertain as they can be hidden in the fine print on the web site so look carefully and call the company and ask them a lot of questions. And, be sure to look for a plan that offers a variety of good, low cost mutual funds.

If you are already maximizing your IRA and 401(k) contribution, then maximizing your HSA contribution would probably be the next logical step. If you don't quite have the resources to fund the IRA, the 401(k) and the HSA, then you will have a difficult question to answer of how best to balance the three accounts as all three have certain benefits and drawbacks. If you are definitely going to have medical bills to pay, then it might make sense to contribute to the HSA and then take the money right back out because at least this way, you will get the tax benefit of the contribution.

HSA withdrawals can be used for "qualified medical expenses" and there are tax penalties if the funds are used for non-qualified purposes. The IRS definition of qualified is rather liberal because you can use HSA dollars to pay for long term care insurance, Cobra health insurance and Medicare premiums (although people who are enrolled in Medicare are not eligible to contribute to HSA accounts).

For more information about HSA's, I'd suggest you read IRS Publication 969, which can be found on the IRS web site. And then, I would urge you, if you have a high deductible health insurance plan to seriously consider contributing to a low cost HSA account. You may find that the future rewards well worth the effort and a bit of sacrifice today.