Insurance

Open a Health Savings Account; reduce your taxable income

By Peter MacDonald, CIC, LIA

Since 2003 — when Federal Law transitioned Medical Savings Accounts into Health Savings Accounts — millions of Americans have opened up HSAs, reduced billions on health care premiums, and saved the difference in the tax-advantaged bank account. The most disciplined among them have an extra source of investable, tax advantaged medical expense funds now and forever, and extra income in retirement. For this reason, some consider an HSA better than a 401k.

FSA, HRA, HSA?

A Flexible Spending Account is a use-it-or-lose-it, employee owned account to pay for health costs throughout the year. A Health Reimbursement Account is an employer-owned promise to share health expenses with the employee. An HSA is an employee-owned bank account of tax advantaged dollars designed to pay for health expenses such as your deductible, prescriptions, glasses (and a generous host of other health related expenses itemized in IRS Publication 502).They each serve a purpose, but the HSA offers unparalleled benefits.

Who can open a HSA?

Anyone can open a HSA. However, to save on taxes you must be enrolled in a federally qualified "High Deductible Health Plan" (qHDHP), with a 2013 threshold deductible of $1,250 for individual coverage and $2,500 for family coverage. You may not be entitled to Medicare benefits and you may not be claimed on another person's tax return.

What is different?

With qHDHPs, all health insurance benefits are subject to you first meeting your deductible, which is a large paradigm switch for many Massachusetts employers. Traditionally, most employees are used to simply paying a copayment when they see the doctor (for example, $20). With qHDHPs, employees pay the rate their health insurance company negotiated with the healthcare provider until they meet their deductible. However, qHDHPs pay from dollar one for routine preventative care to encourage employees to have regular checkups and a healthy lifestyle. Nonetheless, if the plan design isn't carefully considered, and this paradigm switch isn't communicated effectively, changing to a HSA health plan will frustrate your employees.

The critical piece in a smooth transition is done with effective design and communication.

Plan design

Effective design begins with a cost benefit analysis: Calculate how much both the employer and employee pay per month for premiums and how much the health plan is used. If you switch to a qHDHP, how much will the employer and employee save per month? Once calculated, use any offset in premiums to prefund employee HSAs. Then consider, how much will employees contribute into the HSA to pay for anticipated medical expenses? The IRS set a 2013 maximum contribution of $3,250/individual and $6,450/family, with a "catch-up" allowance of $1,000 per year for those over 55. (So for example a 57-year-old on a family qHDHP could lower his taxable income by contributing up to $7,450 of earnings in 2013 to his HSA.) Prefunding accounts isn't required, but helps a successful transition.

Communication

Similar to a matching 401k, HSAs must be communicated effectively to be appreciated. The message varies depending on the audience. The key points I stress follow:

(1) everyone pays health expenses every year, whether you know how much you spend or not;

(2) everyone pays income tax;

(3) income tax lowers your purchasing power for all goods by your tax bracket. For example, if you pay 30 percent income tax and you buy a prescription for $70, it actually costs you $100 worth of pre-tax income;

(4) if you regularly save a little bit of money in your HSA, the net effect is (for example) 30 percent savings on all health related costs;

(5) the money you don't use this year will roll over to next year with no taxes, penalties, or fees. If you don't use it, it will be there next year through retirement.

Why change? You can't keep increasing your deductible

In the face of steep costs, many businesses have already changed to a "high" deductible, but the plan isn't an HSA qualified plan so everyone is missing out on the HSA tax savings.

Furthermore, you can only increase your deductible so far until you are no longer in compliance with Massachusetts Minimum Credible Coverage. The maximum deductible is $2,000 individual, $4,000 family. With an HSA, you can increase your deductible to $3,000 individual / $6,000 family and still be in compliance with MCC.

Why change? Healthcare is changing

The traditional model has been a no-strings-attached health insurance "credit card" or "monopoly money." Disconnected from the true costs of services, we spend without discretion.

Ultimately, there is no such thing as "free" care, though some politicians and news articles use that language. We all pay. In the past nine years nationwide, the average premium and deductible have both doubled, and premium increases outpace income increases, notes the Commonwealth Fund. Health insurance now costs nearly 20 percent of a family's average income. John Torinus, CEO of Serigraph and Author of *The Company That Solved Healthcare* concisely explains: "in ten or fifteen years, at present trends, health costs will exceed base pay for employees." Most employees cannot afford credible coverage without employer contributions.

Meanwhile employers have quietly been paying more than they can afford with uncontrollable annual 7 percent increases for the past decade. Business owners often tell me that health insurance is their single largest expense after payroll. It is no wonder: Massachusetts has the most expensive premium in the country, costing $16,953 in 2011 for the average family plan.

John Torinus controlled his company's costs to a 2.8 percent annual renewal increase over eight years for his 1200 employee company. But many of their techniques are out of reach for small businesses.

The HSA is an innovative solution that any determined business owner can implement. It is part of a shift called "consumer driven health." When designed effectively, HSAs put employees back in control of their medical decisions and purchases. When employees have more skin in the game and know the true costs of care, the consumer wins. Consumers will shop and ask "how much?" And costs will become transparent.

What is next?

qHDHPs and HSAs are just a few of the recent changes. The Patient Protection and Affordable Care Act presents compliance challenges. I advise my clients to work through a Health Care Reform Toolkit. Beginning in 2014, Insurance Exchanges will change the way people and companies buy health insurance. It is important to have the right advisors on your team to navigate through the complex changes ahead while protecting your balance sheet. CPB

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