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Health saving accounts can save tax dollars

Karin Price Mueller | NJ Advance Media for NJ.com on March 23, 2017

Health savings accounts can reduce you medical bills and your taxes at the same time.

If you've been unhappy with your employer's health plan offerings, you're not alone. But if you have a high deductible plan, your employer probably offers a chance for you to save on taxes. We're talking about health savings accounts, or HSAs.

HSAs are tax-advantaged medical savings accounts used to pay for qualified medical expenses -- tax-free, says Michael Green, a certified financial planner with Wechter Feldman Wealth Management in Parsippany.

"Qualified withdrawals can be used for out-of-pocket medical, vision and dental expenses," Green says. "However, an HSA cannot be used to pay for health insurance premiums," until age 65.

You can use the money in the account to pay for qualified health care expenses throughout your life."
The contributions you make to an HSA are pre-tax, Green says, which reduces your taxable income today.

The contributions grow tax-deferred and when you take the money out, the funds will be tax-free as long as you use it to pay for qualified medical expenses.

You must have a high deductible health plan (HDHP) in order to be eligible for an HSA.

The big bonus to HSAs is that they're not "use it or lose it" plans, like other pre-tax savings accounts your employer may offer.

"If you have unused funds in your (HSA), they carry over into the next year. If you change jobs, the account stays with you," says **Bernie Kiely**, a certified financial planner and

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Q | What's the difference between an HSA and an FSA?

A | Each of these accounts allows you to save pre-tax money, but they're used for different reasons. A flexible savings arrangement (FSA) is an employer-provided benefit program. "There are FSAs for medical costs, dependent care costs and adoption expenses," says Laurie Wolfe, a certified public accountant with Lassus Wherley in New Providence. Because you're asking about the FSA vs. an HSA, we'll stick to the medical costs here. Contributions to an FSA can be used to reimburse yourself for medical, dental and vision costs, Wolfe says. "These include any cost that would be deductible on your tax return as an itemized deduction," she says. "Any expense that is reimbursed by the FSA is not allowed to be taken as a deduction -- no double dipping." For 2017, you can save $2,600 to an FSA, and if you're married, each spouse can have their own FSA, if offered by an employer. Excess contributions are subject to taxation, Wolfe says. Your FSA balances must be used for qualified expenses incurred during that year, unless your boss has made other arrangements. It's a "use it or lose it" plan. A health savings account (HSA), on the other hand, doesn't force you to spend what you save in one year, but instead, allows your savings to grow over time. "The benefit of these accounts is the ability to put away tax-free dollars with which to pay the deductible and co-pays of these types of plans," Wolfe says. "Contributions made via your paycheck are done so on a pre-tax basis." Your savings are deductible, even if you do not itemize your deductions and even if someone other than yourself makes the contribution, she says. To have an HSA, you must be covered under a high deductible health plan (HDHP). The maximum annual deductible and other out-of-pocket expenses, such as co-pays, must not exceed $6,550 for self-only coverage and $13,100 for family coverage, Wolfe says. "The big plus to these type of plans is that these accounts have no risk of forfeiture if not used within a certain time frame," Wolfe says. "Earnings on the accounts grow tax-free if ultimately used for qualified purposes." There are even more rules to follow, so speak to your benefits department to fully understand these plans.

certified public accountant with **Kiely Capital Management in Morristown**. "You can use the money in the account to pay for qualified health care expenses throughout your life, including in your retirement."

This is a huge opportunity, if you can find extra cash in your budget to fund it.

Kiely says the amount you can contribute to your HSA depends on the type of HDHP coverage you have, your age and other factors. If you have self-only HDHP coverage, you can contribute up to $3,350. If you have family HDHP coverage, you can contribute up to $6,750.

Just be sure that when you withdraw the money, you're only using it for qualified medical expenses. That's what makes it tax-free.

"If you receive distributions for other reasons, the amount you withdraw will be subject to income tax and may be subject to an additional 20 percent tax," he says.

It's also essential that you make sure to properly report your contributions and withdrawals at tax time.

Kiely says that when the calendar year ends, the HSA custodian will send you a form, 1099-SA -- Distributions From an HSA, Archer MSA, or Medicare Advantage MSA -- indicating the amount you withdrew.

If you're thinking you don't have to report this to the IRS because the withdrawals were tax-free, you're wrong.

If you don't report it on your tax return, the IRS will send you a bill for additional taxes, interest and penalties, Kiely says.

"The IRS does not know you used the distribution for the appropriate medical reasons. It assumes they were not used appropriately unless you tell them so. You do this by completing Form 8853, Archer MSAs and Long-Term-Care Insurance Contracts," he says. "You report the distribution on this form and you indicate the amount of qualified medical expenses you paid. From this, the IRS will realize that the distributions are not taxable."

So, be sure to keep accurate records of how you spend the money during the year.

Once you're eligible for Medicare, you have to make some choices.

Green says you can no longer contribute to your HSA, but you can continue to use the funds for future qualified medical expenses tax-free.

"You are permitted to pay for some health insurance premiums with your HSA upon reaching age 65," Green says. "HSA funds cannot be used to pay for Medigap insurance premiums, but may be used to pay for Medicare Parts A, B, D and Medicare HMO premiums tax-free and penalty-free."

Or you may distribute funds from your HSA for nonmedical expenses, penalty-free, after age 65. But if you do that, you'll have to pay taxes on nonqualified distributions, he says.

Another option is to roll your HSA plan into a retirement account, such as an IRA, Green says.