# Werba & Davis
## Advisory Services, LLC

May 2010


**Alan Werba, CPA, CFP®**
*Managing Member*

**Barbara Davis, EA, MS**
*Senior Advisor*

**Aaron Rubin, CPA/JD**
*Investment Advisor*

3055 Olin Ave., Suite 2000
San Jose, CA 95128

408 260-3109


## Using a Health Savings Account to Lower your Taxes

You may be surprised to learn that many of our clients do not enjoy paying income taxes. If you fall into this category, please consider the benefits of a Health Savings Account. While there are a variety of ways that we help people lower their tax bills, using a Health Savings Accounts (HSA) tends to be an under-utilized tax saving strategy.

An HSA allows for tax deductible contributions for payments of future qualified medical expenses. Unlike their more familiar Flexible Spending Account (FSA) counterpart, the HSA does not have a "use it or lose it" aspect. The taxpayer may keep the funds in the HSA account almost indefinitely.

Let's review some of the ground rules for establishing an HSA. First, the taxpayer must have a "high deductible health plan" (HDHP). The HDHP can be established either as an individual plan or as a family plan. Likewise, the HSA can be on an individual basis or for family coverage. For 2010 an HDHP is defined as a plan where the minimum deductible for self-only coverage is $1,200 and $2,400 for family coverage. The 2010 annual out-of-pocket expense limit for and HDHP is $5,950 for self-only coverage and $11,900 for family coverage. There can be no other health insurance besides the HDHP, except the following: specific disease coverage, drug discount cards, and eligibility of VA benefits (unless you have actually received such benefits in the last three months).

Not everyone is qualified to enroll in an HSA, even if they participate in an HDHP. Individuals enrolled in Medicare, or over age 65, may not contribute to an HSA. If one spouse is receiving Medicare, and the other is not, the couple cannot enroll in a family HSA, but the spouse not receiving Medicare benefits may contribute as if he/she were single. Also, dependents may not establish their own HSAs. There are no income limitations, and no requirement of earned income.

For 2010 an individual who is enrolled in an HDHP for 12 months may contribute up to $3,050 for self only coverage or $6,150 for family coverage and deduct the contribution on their tax return. Taxpayers over age 55 may contribute an extra $1,000 per year, but if spouses over the age of 55 have an HDHP, both spouses must have an HSA account in their own names in order to make two catch-up contributions.

Employers can contribute on a pre-tax basis directly to an HSA on an employee's behalf. Employer contributions will not only be tax deductible, they will also avoid payroll taxes. Employees may not deduct any of the contributions made by their employers. Funds deposited by the employer are aggregated with the funds contributed by the employee to determine the maximum contribution allowable each year.

Qualified medical expenses may be paid directly from the HSA or reimbursed to the HSA participant. Qualified expenses include not only the deductible that you must pay with the HDHP, but other medical expenses as well. Preventative care such as immunizations, tobacco cessation programs, cancer screening, and weight loss programs is covered. Generally, any medical expense that can be deducted as an itemized deduction is eligible for HSA reimbursement; even over-the-counter medicines can be purchased with HSA funds. However, premiums paid to the HDHP are not eligible for HSA reimbursement.

Each taxpayer is responsible for monitoring how their HSA funds are used. A form 8889 must be filed each year with your 1040 return to declare how much was contributed to the plan, how much was disbursed and whether the disbursements were for qualified expenses. Unqualified disbursements are subject to income tax plus a 10% penalty tax. The penalty tax will be waived if the account beneficiary died, becomes disabled, or turned age 65. When an HSA account holder passes away, a spousal beneficiary will be treated as the new account holder of the HSA. If the beneficiary is not a spouse, then they will be taxed on the contents of the HSA, but with no penalty.

There are some hidden pitfalls to consider. Creating an HSA means that a taxpayer needs to find an account provider. Banks are the predominant HSA providers, but there are also specialized companies that offer HSA accounts. Each HSA provider sets its own operating rules. Some offer debit cards for the account, some charge a maintenance fee, others assess transaction charges, and some allow participants to invest the proceeds in the stock market. Therefore, if you are seeking to open an account, you should research the best provider for your individual needs.

If the participant chooses to leave an HDHP, all of the funds inside of the HSA remain the property of the taxpayer, and so long as the money is used for qualified medical expenses, it is not taxed. However, once funds are placed inside an HSA, the taxpayer must be on an HDHP for one calendar year from the date of deposit. California taxpayers also need to be aware that HSA contributions are not deductible for the state return.

The HSA offers a taxpayer an additional means for deferral of income. This can be particularly helpful for those who have maxed out their IRA or 401(k) contributions. By using an HSA, the taxpayer will get a current year tax deduction, along with the possibility of never having to recognize the income, or the growth that occurs once the funds are invested.

---

For additional questions about HSAs please contact us at (408) 260-3138, or arubin@loringward.com.

Securities offered through Loring Ward Securities Inc., member FINRA/SIPC 10-116 (05/10)