Health Savings Accounts, or HSAs, were created by Congress to combat rising medical costs by providing an incentive for more consumers to pay "first-dollar" medical expenses. An HSA, like an Archer medical savings account (MSA) is a type of IRA account that is designed exclusively for covering medical expenses incurred by the HSA account beneficiary (the person who establishes the account) and his or her dependents. However, there are some differences.

- HSAs are available to individuals covered by a high deductible health plan (HDHP) regardless of whether the person is self-employed or employed by a small employer and regardless of whether their employer maintains the HDHP
- An employer may offer HSAs through a cafeteria plan
- Employer contributions to an HSA reduce what an individual can contribute, but they do not eliminate an individual's ability to contribute.
- Non-qualifying use of HSA assets are subject to a potential 10 percent (rather than a 15 percent) penalty.
- HSA qualifying medical expenses include expenses to purchase certain health insurance after age 65.
- The law allows MSA assets to be rolled over to HSAs, which is one way a current MSA account holder can immediately take advantage of these more favorable HSA rules.

What are the Benefits to HSAs?

HSAs can provide significant tax benefits to eligible individuals. Not only can HSAs provide tax benefits related to paying qualified medical expenses, they may also provide benefits similar to many taxfavored retirement plans. A summary of the HSAs tax advantages is below.

Tax Benefits

- HSA contributions – by employer or employee – are excluded from income.
- HSA earnings are tax-deferred.
- If used for qualified medical expenses, HSA assets are never taxed.
- Unused HSA assets may be used for retirement; however, they will be subject to a 10 percent penalty until the HSA account beneficiary turn 65. If not used for medical expenses, they will be subject to income taxes.
- Upon death, HSA assets become the property of a named death beneficiary, or of the HSA account beneficiary's estate. A spouse may treat the assets as his or her own HSA, while nonspouse death beneficiaries must treat such assets as ordinary taxable income.

What are qualified medical expenses?

For HSA assets to retain their tax-free status, they may only be withdrawn and used for certain expenses.

- Actual medical expenses, including doctor visits, prescriptions, transportation to get medical care, and dental care
- Long-term care insurance
- Healthcare coverage when unemployed
- Certain continuation-of-benefit healthcare coverage
- Certain health insurance after age 65

Nonqualified uses of HSA assets are subject to taxation and a 10 percent penalty unless the HSA account beneficiary is age 65 or older, dies or is disabled.

Who is eligible to participate?

You are an eligible individual for any month if you

- Are covered under an HDHP on the first day of such month;
- Are not also covered by any other health plan that is not an HDHP (with limited exceptions);
- Are not enrolled for benefits under Medicare (generally not yet age 65); and
- Are not eligible to be claimed as a dependent on another person's tax return.

What is considered an HDHP?
An HDHP is an insurance policy that meets certain dollar limits as shown in the table below.

2006 HDHP Limits		
	Self Only	Family
Annual Deductible	$1,050 or more	$2,100 or more
Annual Deductible plus out-of-pocket expenses Cannot exceed…	$5,250	$10,500

Can self-employed individuals have an HSA?

Sole proprietors and others who are self-employed can have an HSA and are, in fact, often-ideal candidates for an HSA. In such situations, the business owner is both employer and employee. HSAs are often advantageous for the self-employed because:

- High-deductible heath insurance plans generally have modest premium costs, and may be an effective cost-containment mechanism for the employer

- The employer is protected against potentially catastrophic healthcare expenses.

- The HSA may serve the dual purpose of providing for both medical and retirement expenses.

What are the HSA contribution rules?

The total amount you or your employer may contribute to an HSA for any taxable year is dependent upon whether you have individual or family coverage under a high deductible health plan as shown in the table below.

2006 HSA Contribution Limits*		
	Self Only	Family
Annual Contribution Limit	Lesser of: - annual plan deductible, or -$2,700	Lesser of: - annual plan deductible, or -$5,450

*HDHP and contribution limitations are revised each year to reflect cost-of-living increases.

In addition to the standard HSA contribution limits shown in the previous table, if you have attained age 55 before the close of a taxable year, you may also contribute an additional amount known as a “catch-up” contribution. This catch-up contribution limit is $700 for 2006, and is scheduled to increase through 2009 as shown in the table below.

Catch-Up Contribution Limits	
Taxable Year	Maximum Catch-up
2005	$600
2006	$700
2007	$800
2008	$900
2009 and later	$1,000

Do HSAs require reporting?

- HSAs require the following government reporting:

- HSA holders must report all contributions and distributions on their individual income tax returns.

- An employer contribution is reported on a business tax return, as well as on the W-2 form of any employee receiving an employer contribution.

- The custodian or trustee also reports all contributions and distributions from an HSA account where the HSA is held.

For more information…
To learn more about how to take advantage of the many HSA benefits, ask one of our representatives for more details.