PROS AND CONS
Health Savings Accounts

The Health Savings Account (HSA) is a growing trend in health care. They have been embraced by over 10 million Americans since first established by law in 2003.

ADVANTAGES

Health Savings Accounts offer a way to save for – and pay for – healthcare (medical, prescription, dental, vision) expenses. There are many advantages to having a Health Savings Account, including:

OTHERS CAN CONTRIBUTE TO YOUR HSA. Contributions can come from various sources, including you, your employer, a relative and anyone else who wants to add to your HSA.

PRE-TAX CONTRIBUTIONS. Contributions made through payroll deposits (through your employer) are typically made with pre-tax dollars, which means they are not subject to federal income taxes. In most states (including KS and MO), contributions are not subject to state income taxes either. Your employer can also make contributions on your behalf, and the contribution is not included in your gross income.

TAX DEDUCTIBLE CONTRIBUTIONS. Contributions made with after-tax dollars can be deducted from your gross income on your tax return, which means you may owe less tax at the end of the year. Contributions to your HSA can be made any time during the calendar year and up to April 15 of the following tax year. You can make regular contributions throughout the year, or make one lump-sum contribution whenever it's convenient.

TAX-FREE WITHDRAWALS. Withdrawals from your HSA are not subject to federal (or in most cases, state) income taxes if they are used for qualified expenses (medical, prescription, dental and vision).

TAX-FREE EARNINGS AND INTEREST. Any interest or other earnings on the assets in the account are tax free.

FUNDS ROLL OVER. If you have money left in your HSA at the end of the year, it rolls over to the next year (unlike an FSA which is subject to the "use-it-or-lose-it" rule). The funds in the account continue to build over time, with no maximum.

YOU CAN BUDGET HOW MUCH TO CONTRIBUTE. The IRS permits you to change, start and stop the amount of your pre-tax payroll contributions as often as monthly.

PORTABLE. The money in your HSA remains available for future qualified healthcare expenses even if you change health insurance plans, change employers or retire. Funds left in your account continue to grow tax fee.

CONVENIENT. Most HSAs issue a debit card, so you can pay for your prescription medication and other expenses right away. If you wait for a bill to come in the mail, you can call the billing center and make a payment over the phone using your debit card. And, you can use the card at an ATM to access cash.

REDUCED PREMIUMS. HSAs go hand-in-hand with HDHPs, so monthly premiums are generally significantly less than if you have a low deductible health plan.

OWNERSHIP. The employee owns the account and has full control over how the account is used and invested.

FLEXIBILITY. You can use the funds in your account to pay for the expenses (medical, prescription, dental and vision) of yours, your spouse and your tax-dependent children even if they are not enrolled on your insurance plans.

DISADVANTAGES

HSAs also have a few disadvantages, including:

HIGH DEDUCTIBLE REQUIREMENT. You must be enrolled in a qualifying High Deductible Health Plan (HDHP) before you can open and establish an HSA. Even though you are paying less in premiums each month, it can be difficult – even with money in an HSA – to come up with the cash to meet a high deductible.

UNEXPECTED HEALTHCARE COSTS. Your healthcare costs could exceed what you had planned for, and you may not have enough money saved in your HSA to cover expenses.

PRESSURE TO SAVE. You may be reluctant to seek healthcare when you need it because you don't want to use the money in your HSA account.

TAXES AND PENALTIES. If you withdraw funds for non-qualified expenses before you turn 65, you'll owe taxes on the money plus a 20% penalty. After age 65 (or if you become disabled), you'll owe taxes but not the penalty.

RECORDKEEPING. You have to keep your receipts to prove that withdrawals were used for qualified health expenses.

ADDITIONAL TAX FORMS. Your HSA bank will provide you two tax forms you will need to file your taxes and save with your tax return. IRS form 8889 is filed with your income taxes to report year-to-date contributions and distributions from your HSA. IRS form 1099-SA provides you with the total distributions that were made from your HSA. IRS form 5498-SA reports the contributions made to your HSA in that particular tax year.

FEES. Some HSAs charge a monthly maintenance fee or a per-transaction fee, which varies by institution. While typically not very high, the fees do cut into your bottom line. Sometimes these fees are waived if you maintain a certain minimum balance. Oftentimes, the employer will cover the cost of the monthly fees for their full-time employees.

CONTRIBUTION LIMITS. The IRS sets contribution limits that determine how much you and/or your employer can contribute to your HSA each year. For 2017, the maximum contribution amounts are $3,400 for self-only coverage and $6,750 for family coverage. You can add up to $1,000 more as a "catch-up" contribution if you are age 55 or older at the end of your tax year.

RESPONSIBILITY. You as the accountholder are required to be knowledgeable of the IRS rules regarding HSA eligibility, contributions and distributions.

A Health Savings Account can be a great choice for people who wish to limit their upfront healthcare costs while saving for future expenses. For additional information, please see IRS Publication 502 for a listing of hundreds of qualified medical, prescription, dental and vision expenses. Also, IRS Publication 969 goes into more detail on the eligibility, contribution and distribution rules associated with HSAs.