



FINANCIAL PLANNING

<http://www.financial-planning.com>

[Back](#)

HSA Highlights

By Jeanne Lee

September 1, 2008

As healthcare costs continue to skyrocket, small business clients must arm themselves with strategies to help their employees save money on health benefits. A crucial arrow in this quiver is knowledge of health savings accounts (HSAs) and the various ways they can make benefits more affordable.

Showing how companies can use these accounts is an effective way to begin, solidify or broaden relationships with small business clients. "There's a real opportunity for planners to distinguish their practices by helping clients consider health benefit planning as part of overall financial planning," says Tracey Baker, vice president of CJM Wealth Advisors in Fairfax, Va., and co-author of *Navigating Your Health Benefits for Dummies*. "Health savings accounts are a terrific tool from a planner's perspective," adds Brad Rosley, president of Fortune Financial Group in Glen Ellyn, Ill.

How They Work

Legislation allowing HSAs, which must be linked to high-deductible health insurance policies, was passed in 2003. It enabled workers to put aside money for qualified health expenses on a tax-free basis. Employers and employees may contribute, and the funds can be used to pay for prescriptions, lab tests, X-rays, surgery and even alternative medicine treatments in some cases.

Since their introduction four years ago, HSAs have helped 6.1 million Americans save money on health insurance premiums while socking away pre-tax money toward anticipated medical expenses. "The average account balance has increased for [our] clients from \$800 in the first year to \$2,000 in the third year," with 4% holding more than \$15,000, says William West, M.D., president and CEO of First HSA, a health savings account administration company in southeast Pennsylvania.

Since HSAs are still relatively new, planners may need to begin by introducing the basics and their connection to high-deductible health plans. Here's how the HSA plans work: The business owner changes from a traditional health insurance plan to one with a deductible of at least \$1,100 for an individual or \$2,200 for a family (2008 levels), greatly reducing monthly premiums. The business owner can deposit some money saved in an HSA for each employee. The employer or employee contributes pre-tax money, so returns are tax-deferred. When the employee withdraws money, the funds are tax-free if used for qualified medical expenses. They cover medical expenses until annual deductibles are met—when insurance kicks in at 100%.

Business owners love the premium savings but worry that a high deductible will alienate their employees. To allay this concern, an owner can share some of the premium savings from executing the high-deductible/HSA changeover with employees by partially or fully funding their HSAs, offsetting the high deductible. Rosley showed one client, a business owner with 37 employees, that he could save \$50,000 a year by changing from a health plan with a \$500 deductible to one with a \$2,500 deductible, while depositing \$2,500 annually in each employee's account. "If he hadn't put anything in [employees' accounts], he'd have saved \$100,000 a year," Rosley says. "But their employees might object." Some business owners balk at asking employees—especially those with high medical expenses—to accept a health plan with a high deductible, so using them requires some soul-searching.

Planners can underscore their role as trusted advisors by helping clients weigh options. These might include whether to offer employees the choice of a traditionally structured health plan, a high-deductible plan with an HSA or having a larger portion of their HSAs funded.

Upcoming Legislation?

Planners should also be aware of pending legislation affecting these accounts. In April, the House Ways and Means Committee approved H.R. 5719, a bill that would require users to submit receipts for medical expenses for third-party review before claiming distributions from their accounts. Currently, no substantiation is required.

"With my HSA, I have a debit card and a checkbook. What's to stop [me] from using it to buy groceries or a flat-screen TV?" Rosley says. But he feels this proposal goes too far: "What they're talking about doing—monitoring every nickel-and-dime expense—would be cost-prohibitive." Others fear the additional administrative costs will hamper market growth. "HSA substantiation would be a significant step backward in moving healthcare into the electronic age," Ward says.

Fortunately, the bill's chances of becoming law now seem slim. "The Senate Finance Committee has stated its opposition to the bill, so most likely it won't make its way out of the Senate," says Paul Verberne, vice president and associate counsel for HSA Bank. President Bush has vowed to veto it. "But, we don't expect it will be the last attack by HSA opponents," Verberne adds.

Regardless, planners assisting clients with HSAs can benefit from monitoring the status of this legislation or any reincarnation that may develop after the November election. "Just because it dies this time doesn't mean the same issue won't come up with a change of administration," Verberne says.

Tax Questions

Whatever happens to the bill, some clients, particularly those approaching retirement, will focus mainly on HSA's tax advantages. If a client has maxed out 401(k) or IRA contributions, an HSA can be another piece of the retirement-planning puzzle. Assume John puts away the family contribution of \$5,800 each year from age 40 until retirement at 65. If he spends an average of \$1,000 per year on medical expenses, earns 3% interest and is within the 28% tax bracket, he will accumulate over \$175,000 and save nearly \$40,000 in taxes. With aggressive investments and a 5% return rate, that balance could grow to over \$229,000. Calculate the future value of a client's account online at www.hsabank.com.

If maximizing tax savings is the priority, some advise clients not to spend the money in their HSAs unless it's an emergency, Baker says. "If they want to sock money away and take maximum advantage of the tax-free growth, they may pay those deductibles out of pocket. If you don't need to take it out, let the maximum amount of money grow. It's similar to the planning we do with IRAs."

Money in an HSA is subject to income tax and a 10% penalty if used for anything other than qualified health-care expenses. But after age 65, the 10% penalty disappears. If clients' employees have built up an HSA nest egg of \$100,000 over decades and don't need all of it for health expenses, they can tap some of it for other purposes once they retire, paying only income tax.

Investing the HSA

For the first few years, most clients will be content to leave the funds liquid in a checking or money market account. But as balances build over time more aggressive investment options are available. Baker advises keeping the client's complete financial picture in mind. "Have in cash or in a money market account the money she will need in the next year or two, because you don't know if she's going to need to tap it. But as she begins to build a nice sum of money, then she will want to start to diversify."

HSA money is mostly subject to the same investment rules as IRA money. "Most quality administrators offer an investment option to clients when their accounts meet a certain threshold," Ward says. "Investment options include mutual funds, asset allocation models and brokerage accounts. Current law prohibits certain types of investments, including rare coins, art and real estate."

By counseling small business clients on such nuances, advisors can prepare them for internal discussions on health benefits programs. They will be able to decide whether to add an HSA program and if so, how to structure it.

Jeanne Lee is a business and health writer living in New York. Her work has appeared in Fortune and Money.