Decreasing The Cost Of Health Insurance

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No, your eyes are not playing tricks on you; the title of this article does say "Decreasing."

The Medicare bill that was signed into law on December 8, 2003 established a new and innovative insurance program for employers and employees called an "HSA," otherwise known as a Health Savings Account. This revolutionary vehicle will help many employers, big and small, save taxes and save money on health insurance premiums.

An HSA is a tax-exempt account that is created for the purpose of paying qualified medical expenses. The HSA can be funded by the employers and/or the employee. To be eligible to create an HSA, you must be an individual who has a high-deductible health plan (HDHP). An HDHP is one in which a single individual has a yearly deductible of no less than $1,000, or if you have family coverage, the deductible can be no less than $2,000. In addition, if you have individual coverage, the out-of-pocket expenses required to be paid cannot exceed $5,000, and for

family coverage, this amount cannot exceed $10,000.

Further requirements are as follows:

- You must not be covered under an insurance plan that is not an HDHP.
- You must not be entitled to Medicare benefits.
- You cannot be claimed as a dependent on another person's return.

If you meet all of the above requirements, you are an "eligible individual" for an HSA.

Employee Benefits of an HSA

An HSA has many benefits for employees. The first benefit is that an HSA can have up to 100% of the annual deductible for the individual or family contributed to it. However, this amount cannot exceed $2,600 for an individual, and $5,150 for family coverage. People ages 55 to 64 can make additional contributions of $500 to "catch up" in 2004. This amount will gradually increase to $1,000 in 2009.

The contribution to the HSA is tax-free to the employee. The employee can take a deduction for any amounts they contributed to the HSA. This deduction is an "above-the-line-deduction," and therefore directly reduces an employee's taxable income.

An HSA is held in an account for the benefit of the individual, their spouse or children. This account is invested and any gain on the investment is also tax-free. In addition, if an employee changes jobs, the account goes with them. The employee is allowed to transfer the entire fund balance in the account to a new employer if they were to terminate their employment with their current employer.

Finally, it should not be forgotten that if the deductible increases to $1,000 per person or $2,000 per family, the cost of the health insurance premiums will be less, resulting in cash savings.

Employer Benefits

There are also benefits to the employer. An employer is not taxed on the amounts they contribute to the account, and these amounts are also not subject to withholding from wages for income tax, FICA or FUTA. Therefore, an employer obtains a direct write off for the amounts paid not only for the health insurance premiums, but for the HSA as well.

In addition, most employers will see a reduction in the monthly premiums they pay for the employees due to the increase in deductibles (if the employer does not already have an HDHP).

The reduction in the premiums and the tax deduction will help to offset the cost of the employer funding a portion of the HSA, if they so wish to assist their employees with funding the HSA.

Employee Disadvantages

The disadvantages of an HSA are few and far between. First of all, once you reach the age of 65, you can no longer contribute to an HSA. If you do contribute, all amounts will be taxable to you in addition to a penalty of 6%. This also occurs if you are considered an "eligible individual" and exceed the allowable amounts that can be contributed if you are under 65 years of age.

If you do not use the funds for "qualified medical expenses," the funds that are used are included in your gross income, and a penalty of 10% is imposed. The 10% penalty is eliminated in the case of a distribution after the account beneficiary's death, disability or once you have attained the age of 65.

An HSA can be transferred to a spouse tax-free, but when an HSA is transferred to a person other than your spouse, it ceases to exist as an HSA. It is then included in the person's taxable income. This amount, however, is reduced by any amount paid by the HSA for the decedent's qualified medical expenses paid up to one year after their death.

Employer Disadvantage

One disadvantage for an employer is that a "comparability" rule applies. An employer must make comparable contributions to each individual's HSA. They must be either the same amount or same percentage of the deductible of an HDHP for each employee. No discrimination is allowed as to employees.

A second disadvantage is that the employee is deemed the owner of the HSA, and therefore, if they were to quit or be terminated from employment, all employer-funded amounts remain the property of the employee. The employee is free to transfer their HSA to another employer, including all payments made by their former employer and all interest accumulated on those payments.

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The Practical Effect

The practical effect for both an employer and an employee is a reduction in the overall cost of qualified medical expenses. The following example identifies the savings that are created by setting up an HSA:

- Facts: An employer pays the premium for a single individual with a deductible of $500. This premium equals $250 per month.

The employer then increases the deductible to $1,000 in order to set up a qualified HSA. The premium is now reduced to $200 per month.

- The Results: An immediate savings occurs to the employer of $50 per month, or $600 per year. The employer then contributes $500 during the year to the HSA and obtains a tax deduction. The employee contributes $500 during the year and has this amount deducted from his gross payroll. The employer saved $600 and contributed $500 to the HSA tax-free (thereby realizing a net savings of $100 + all payroll taxes on the $600). The employee contributed $500 to the HSA before taxes.

The greatest benefit for the employee is that normally the $500 deductible would be paid with after-tax income. Now the $500 deductible can be paid with pre-tax income. In addition, the employee can contribute his $500 at any time, and therefore would not have to contribute the money if he did not incur any expenses. Funds can be contributed as needed during the year, subject to the maximum amount allowed.

Remember, the employee also reaps the investment income from the entire amount, and can take this account with him as his employment may change from year to year.

The employer can contribute throughout the year as they pay the medical premiums for their employees. Thus, an employer can save on the cost of the premiums, spread the payment amount over the year and save payroll taxes on the money contributed. This is in addition to making the employee happy.

HSA Administration

An HSA must be administered by a qualified HSA trustee or custodian. This includes an insurance company, bank or a person approved by the IRS (approval may be difficult to obtain.) It is important to check the cost of administration or approval and add that cost into the example above to determine the net savings to the parties involved. The trustee can be different than the company that provides the HDHP, but you should first check with your insurance carrier to determine if they carry HSAs, and the cost of such plans.

Health Savings Accounts are as good as they are sound. Decreasing the cost of health insurance is a refreshing option in today's rising inflationary economy.

Small and large employers alike can now benefit from a quality health program. It is not often that we have the ability to reduce our health insurance costs. Therefore, it is imperative to reassess your employer-sponsored health insurance plan and determine if an HSA is appropriate for your company.

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