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HEALTH SAVINGS ACCOUNTS (HSAs)

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The following information is a brief description of health savings accounts (HSAs) and some of the benefits and rules regarding their use. Federal tax laws regulate HSAs; therefore, you are encouraged to access the most current and more detailed information at:

www.treas.gov

(Click on "Health Savings Accounts")

Email address:

HSAInfo@do.treas.gov

Voice mailbox:

202-622-4HSA (202-622-4472)

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The Basics

What is a Health Savings Account (HSA)?

An HSA is a special account owned by an individual where contributions to the account are to pay for current and future medical expenses. HSAs are used in conjunction with a "High Deductible Health Plan" (HDHP) offered on an individual basis or on a group basis through your employer. These accounts can be interest bearing or earn income on the invested money.

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What is a High Deductible Health Plan (HDHP)?

- A health insurance plan with minimum deductibles for 2006 of at least \$1,050 for an individual and \$2,100 for a family, and maximum annual out-of-pocket amounts (including deductibles and copays) that are indexed annually for inflation.
- If the HDHP covers more than one person, the entire "family" deductible must be satisfied before any benefits are paid.
- First-dollar coverage (no deductible) for certain preventive care services (copays are allowed).
- Higher out-of-pocket amounts (copays and coinsurance) for non-network services are allowed.
- The in-network deductible determines HSA contribution limit.

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Who Can Have a Health Savings Account?

Who can set-up an HSA?

Any individual that meets ***all*** of the following:

- Is covered by a High Deductible Health Plan (HDHP).
- Is not covered by any other insurance with first-dollar coverage. (Specific injury insurance or accident, disability, dental care, vision care, or long-term care insurance are permitted.)
- Is not enrolled in Medicare.
- Cannot be claimed as a dependent on someone else's tax return.

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Can a spouse establish his/her own HSA?

Yes, spouses can establish their own HSAs, if eligible.

Can a child establish his/her own HSA?

No, children cannot establish their own HSAs if they are claimed as a dependent on someone else's tax return.

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Are there income limits?

No, there are no income limits on who may contribute to an HSA.

Is it necessary to have earned income to contribute to an HSA?

No, there is no requirement of having earned income to contribute to an HSA.

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What other health coverage is allowed for an individual to still be eligible for an HSA?

- Specific disease or illness insurance, accident insurance, disability, dental care, vision care, and long-term care insurance.
- Employee Assistance Programs (EAP), disease management programs or wellness programs.
- Drug *discount* cards.
- Eligibility for VA benefits (unless you have actually received VA health benefits in the last 3 months).

What Does a High Deductible Health Plan Cover?

What plans qualify as HDHP plans?

Health Maintenance Organization (HMO), Preferred Provider Organization (PPO) or Indemnity plans qualify as HDHPs, as long as each meets the requirements.

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What "first-dollar" medical expenses are covered?

Except for certain preventive care services, first-dollar medical benefits are not allowed in an HSA-qualified HDHP.

What "first-dollar" medical benefits could make someone **ineligible** for an HSA?

- Medicare
- Tricare
- Flexible Spending Arrangements (FSA)
- Health Reimbursement Arrangements (HRA)

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What covered benefits must apply to the plan deductible?

All covered services, other than benefits for certain preventive care services, but including prescription drugs, must apply to the plan deductible.

What are some of the HDHP reasonable benefit designs that are not counted toward the out-of-pocket maximums?

- Lifetime limits on benefits.
- Limits to usual, customary and reasonable (UCR) amounts.
- Limits on specific benefits, such as:
 - Maximum number of days or visits covered.
 - Maximum dollar reimbursements.
- Pre-certification requirements.

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What about prescription drugs?

As of January 1, 2006, HDHPs must apply the cost of prescription drugs to the annual deductible. Therefore, there is no first-dollar prescription drug coverage or copays included in HDHPs that qualify for use with HSAs.

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What about preventive care?

- The HDHP can apply copays to certain preventive care services.
- Preventive care generally does not include any service or benefit intended to treat an existing illness, injury or condition.
- Certain drugs and medications can be considered preventive care, such as:
 - Drugs taken by a person who has developed risk factors for a disease that has not yet manifested itself or to prevent the reoccurrence of a disease. An example is: cholesterol-lowering medication for those with high cholesterol.

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What is the "safe harbor" list for preventive care?

The "safe harbor" list is a list of preventive care services that the HDHP can provide as first-dollar coverage before the minimum deductible is satisfied:

- Periodic health evaluations (e.g., annual physicals).
- Screening services. This includes screening services for the following:
 - Cancer (e.g. mammograms).
 - Heart and vascular diseases.
 - Infectious diseases.
 - Mental health conditions.
 - Substance abuse.
 - Metabolic, nutritional, and endocrine conditions.
 - Musculoskeletal disorders.
 - Obstetric and gynecological conditions.
 - Pediatric conditions.
 - Vision and hearing disorders.
- Child and adult immunizations.
- Tobacco cessation programs.
- Obesity/weight loss programs.
- Routine pre-natal and well-child care.

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How Do I Use a Health Savings Account?

HSA Distributions

Distributions are tax-free if taken for "qualified medical expenses", which now include over-the-counter drugs. Qualified medical expenses must be incurred on or after the date the HSA was established.

- If the HDHP coverage effective date is on the first day of the month, the HSA can be established as early as the first day of the same month.
- If the HDHP coverage effective date is any day other than the first day of the month, the HSA cannot be established until the first day of the following month.

Tax-free distributions can be taken for qualified medical expenses of:

- The individual covered by the HDHP.
- The spouse of the individual (even if not covered by the HDHP).
- Any dependent of the individual (even if not covered by the HDHP).

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What are qualified medical expenses?

Unfortunately, there is not a definitive list of “qualified medical expenses”. A partial list is provided in IRS Publication 502. To be an expense for medical care, the expense has to be primarily for the prevention or alleviation of a physical or mental defect or illness. However, HSA funds can pay for any qualified medical expense, even if the expense is not covered by your HDHP. For example, most health insurance plans do not cover the cost of over-the-counter medicines, but HSAs can. If the money from the HSA is used for qualified medical expenses, then the money spent is tax-free.

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Can HSA funds be used to pay other health insurance premiums?

No, qualified medical expenses do not include other health insurance premiums, including premiums for dental or vision care. However, there are exceptions:

- COBRA continuation coverage premiums.
- Health insurance premiums you must pay while receiving Federal or State unemployment benefits.
- For individuals who turn 65 and enroll in Medicare:
 - Medicare premiums and out-of-pocket expenses (Part A, Part B, Medicare HMOs, and Part D, the new prescription drug coverage).
 - Employee-share of premiums for employer-based coverage.
 - Funds cannot be used to pay for Medigap or Medicare supplement policy premiums.

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Are premiums for long-term care insurance considered to be a qualified medical expense?

Yes, if it is a *tax-qualified* long-term care insurance policy. However, the amount considered to be a qualified medical expense depends on the policyholder's age. IRS Publication 502 will provide these amounts.

How can I use funds from my HSA to pay my provider?

If you are still covered by your HDHP and have not met your policy deductible, you will be responsible for 100% of the amount agreed to be paid by your insurance policy to the provider. The provider may ask you to pay at the time of service. Some HSA custodians provide a checkbook or debit card so that you can pay the provider directly from your HSA account. If your custodian does not offer these features, you can pay the provider with your own money and reimburse yourself for the expense from your HSA.

If the provider does not ask for payment at the time of service, the provider will probably submit a claim to your insurance carrier, who will send you an explanation of benefits (EOB) after processing the charges. If you have not already made any payment to the provider for the services provided, the provider will then send you a bill for payment.

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Can I use my HSA to pay for medical services provided in other countries?

Yes.

What Records Do I Need to Keep?

Should the HSA account holder keep receipts or other records of medical expenses?

Yes! HSA funds can pay for any qualified medical expense, even if the expense is not covered by your HDHP. For example, most health insurance plans do not cover the cost of over-the-counter medicines, but HSAs can.

- There may be a need to prove to the IRS that distributions from your HSA were for medical expenses so keep copies of explanation of benefits (EOBs) and itemized provider billings.
- Receipts will probably be required by the insurance carrier to prove that your HDHP deductible was met. It is recommended that you keep copies of itemized provider billings for this purpose.

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Can distributions from an HSA be used to reimburse prior years' expenses?

Distributions from an HSA can be used to reimburse prior years' expenses, as long as the expenses were incurred on or after the date the HSA was established.

There is no time limit on when distributions must occur, but the individual must keep records sufficient to prove that:

- The expenses were incurred.
- The expenses were not paid for or reimbursed by another source or taken as an itemized deduction.

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What if I Lose My High Deductible Health Plan Coverage?

I have an HSA but no longer have HDHP coverage. Can I still use the money that is already in the HSA for medical expenses tax-free?

Once funds are deposited into the HSA, the account can be used to pay for qualified medical expenses tax-free, even if you no longer have HDHP coverage. The funds in your HSA account roll over automatically each year and remain, indefinitely, until used. There is no time limit on using the funds.

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What happens to the money in my HSA if I lose my HDHP coverage?

Funds deposited into your HSA remain in your account and will automatically roll over from one year to the next. You may continue to use the HSA funds for qualified medical expenses. You are no longer eligible to contribute to an HSA for the months that you are not an eligible individual because you are not covered by an HDHP.

If you have coverage by an HDHP for less than a year, the annual maximum contribution is reduced; if you made a contribution to your HSA for the year based on a full year's coverage by the HDHP, you will need to withdraw some of the contribution to avoid the tax on excess HSA contributions. If you regain HDHP coverage at a later date, you can begin making contributions to your HSA again.

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What are Health Savings Account Custodians or Trustees?

What does the HSA custodian or trustee do?

The HSA custodian/trustee will determine what you need to do, which may include completing and processing appropriate paperwork, and making a minimum deposit.

Who can be an HSA custodian or trustee?

- Banks and credit unions: contact your financial institution to determine if it provides this service.
- Insurance companies.
- Entities already approved by the IRS to be an IRA or Archer MSA custodian or trustee.
- Other entities can apply to the IRS to be approved as a non-bank custodian or trustee.

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Can the HSA custodian or trustee put reasonable limits on accessing money in the account?

Yes, the HSA custodian or trustee can put reasonable limits on accessing the money in the account, such as:

- Frequency of the distributions.
- Size of the distributions.

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What about HSA custodian or trustee fees?

- Fees can be paid from the assets in the HSA account without being subject to tax or penalty.
- Fees can be directly paid by the beneficiary without being counted toward the HSA contribution limits.

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General Questions About Health Savings Accounts

How much can I contribute to an HSA annually?

Annual contribution amounts are tied to the HDHP plan design and the minimum/maximum amounts indexed annually by the U.S. Treasury Department.

What happens to the money in an HSA after I turn age 65?

You can continue to use your HSA account tax-free for out-of-pocket health expenses. When you enroll in Medicare, you can use your account to pay Medicare premiums, deductibles, copays, and coinsurance under any part of Medicare. If you have retiree health benefits through your former employer, you can also use your account to pay for your share of retiree medical insurance premiums. The one expense you cannot use your account for is to purchase a Medicare supplemental insurance (Medigap) policy.

Once you turn age 65, you can also use your account to pay for things other than medical expenses. If used for other expenses, the amount withdrawn will be taxable as income but will not be subject to any other penalties. Individuals under age 65 who use their accounts for non-medical expenses must pay income tax and a 10% penalty on the amount withdrawn.

Can mistaken distributions from an HSA be returned to the HSA?

Mistaken distributions from an HSA can be returned to the HSA, but clear and convincing evidence must be shown that the distribution was a mistake of fact. This would include health claims incorrectly processed by the carrier. These distributions must be repaid by April 15 of the year following the year in which the individual knew or should have known the distribution was a mistake.

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Who owns/controls the HSA account?

The individual, not the employer, owns the HSA account. The individual decides:

- Whether he or she should contribute.
- How much to use for medical expenses.
- Which medical expenses to pay from the account.
- Whether to pay for medical expenses from the account, or save the account for future use.
- Which company will hold the account.
- What type of investments to grow the account.

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Do "use it or lose it" rules apply to HSA accounts?

No, there are no "use it or lose it" rules like those imposed on Flexible Spending Arrangements (FSAs).

- All amounts in the HSA account are fully vested.
- Unspent balances in accounts remain in the HSA account until spent.
- HSA account holders are encouraged to spend their funds more wisely on their medical care.
- HSA account holders are encouraged to shop around for the best value for their health care dollars.

Are all amounts in an HSA account fully vested?

Yes, all amounts in an HSA account are fully vested.

What happens to unspent HSA account balances?

Unspent balances in HSA accounts remain in the account until spent.

HSA account investment options and investment restrictions.

HSA accounts can grow through investment earnings, just like an IRA. The accounts have the same investment options and limitations as IRAs and the same investment restrictions on self-dealing as with IRAs.

Are rollovers from Archer MSAs and other HSAs permitted?

Yes, rollovers from Archer MSAs and other HSAs are permitted, with certain restrictions, such as:

- Only one rollover per year is permitted.
- The rollover to the new HSA must be completed within 60 days.

These restrictions follow the IRA rollover rules.

Where Can I Go for More Information?

How do I contact the U.S. Treasury Department?

The website is: www.treas.gov (Click on “Health Savings Accounts”)

The website contains:

- Guidance from the Department of the Treasury.
- Frequently asked questions.
- IRS forms and publications.
- HSA laws.
- Examples of tax savings from HSA contributions.

Still have questions?

Email address: HSAInfo@do.treas.gov
Voice mailbox: 202-622-4HSA (202-622-4472)

Additional information regarding HSAs can be found at:

www.healthdecisions.org

The America’s Health Insurance Plans (AHIP) website, under the “Health Savings Accounts” portal link, provides links to current news articles about HSAs.

www.nahu.org

The National Association of Health Underwriters (NAHU) website provides an HSA consumer brochure under the “Consumer Guides” link. It also offers a variety of information related to HSAs.