A Premium Savings

Health savings accounts help offset health insurance costs

By Connie Myers

CONGRESS MODERNIZED more than Medicare with the November passage of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, signed into law by President Bush on December 8. The act also creates Health Savings Accounts (HSAs), a pre-tax savings account employees can use to offset the rising costs of healthcare.

HSAs offer distinct advantages over the more familiar Flexible Spending Accounts (FSAs), says Robert K. Lake of the Salt Lake City accounting firm Lake Hill & Myers. Both accounts allow employees to contribute pre-tax dollars to a savings account for reimbursement of medical expenditures not covered by health insurance. But under FSA rules, any balance left over at the end of a calendar year is forfeited. "The new HSAs allow an unused balance to be rolled over to future years," Lake says. The account balance may also accrue interest with no tax on the earnings as long as the funds are only used to pay for qualified medical expenses. In fact, according to a CCH Tax Briefing Special Report, HSAs have "the potential of creating quite a nest egg for a healthy worker and family. Moreover, funds can be withdrawn after retirement for non-medical purposes penalty-free (although not tax free)."

Limitations

Companies that want to offer HSAs must have or change their employee health insurance plan to a high-deductible plan. For an individual, that means at least a $1,000 annual deductible with a maximum annual out-of-pocket limit of $5,000; for a family, the deductible must be at least $2,000 with a maximum annual out-of-pocket limit of $10,000.

For companies with low healthcare deductibles, participation in an HSA plan would require significant increases in employee deductible rates, Lake says. For example, one local small business offers its employees an IHC plan with deductibles of $500 per employee and $1,000 per family. In order to offer an HSA plan, the company would have to double employee deductibles. While the increase would cut the cost of insurance premiums for both the company and the employee, employees would see an increase in out-of-pocket expenses. Employees may pay the higher costs

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with pre-tax dollars saved in an HSA, but their total expenses would still increase. Also, lower-income employees often have a lower rate of participation in savings plans and therefore may be less likely to participate in an HSA. If an employee chooses not to participate in the HSA plan, the higher deductible will not be offset and will have to be paid with after-tax dollars. Employers may choose to help employees with these higher costs by using the savings from lower insurance premiums to make contributions to the HSA for the employees. This could benefit the employer by helping to control insurance premium costs and benefit employees by giving them potential additional savings as they manage their healthcare expenses.

While HSAs would benefit employees with high deductibles on their healthcare plans, high-income earners and the self-employed may benefit most from HSA provisions. HSAs give these individuals an incentive to reduce healthcare spending because HSA money left unspent remains in their account, earning tax-free interest. HSAs also provide a safety net against the expenses of catastrophic illness.

Annual contributions to an HSA are limited to either the annual deductible amount or a specified annual maximum, whichever is smaller. For 2004, the maximum allowable contribution is $2,600 for individual coverage and $5,150 for family coverage. Individuals over the age of 55 by the end of 2004 can make an additional $500 annual contribution to the plan; this amount will increase each year to $1,000 by 2009. Contributions can no longer be made to an HSA once an employee retires.

Applying the Act

Because HSAs are so new, employers and benefits administrators are still exploring their potential applications. Michael Oliphant owns BenefitsManager.net, a company operated out of Layton with offices in Texas and Arizona, and manages health insurance benefits for employers. "We help maintain affordable benefits," Oliphant says.

Oliphant sees HSAs as a way to slow the rise in medical costs. "Congress is aware of the problem with double-digit healthcare cost increases," he says. Oliphant sees employers as a key component in using HSAs to meet that goal. "[Congress] has come up with a mechanism that will allow the employer to lower the overall cost of healthcare," he says. "This is a program that is suited for employers that have to get their [health insurance] rates down but are tired of raising their deductible and their out-of-pocket expense to make their rates affordable."

As an example, Oliphant cites the stituation at Aerographics, an aerial survey and photography company based in Salt Lake City. "IHC wanted to increase their premium by 20 percent," Oliphant says. "The employer wanted to continue to fund 100 percent of their premium at no cost to the employee." Aerographics employees had a $1,000 employee deductible, Oliphant says. " IHC gave them a $2,000 deductible option to meet their increase." That increase was a little too steep. Aerographics asked Oliphant to find another way.

Oliphant set up an HSA for Aerographics employees. Second, he set up a corresponding HRA (Health Reimbursement Arrangement), a system that allows employers to contribute to employee healthcare costs. Third, he arranged for a third-party benefits manager to oversee payments in the place of IHC, lowering the cost of IHC health plan administration. Aerographics' overall cost savings were significant. The IHC insurance increase dropped from 20 percent to four percent without shrinking employee benefits. "Aerographics should have a $12,000 savings this year in premiums," Oliphant says.

HSAs are worth investigation, Oliphant says, noting "some employers are just dropping health coverage altogether" because of high healthcare costs. "The government is making this available to help alleviate premium burdens."

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