

Health Savings Accounts

Health Savings Accounts (HSA) are relatively new tax-exempt savings tools designed to help people save for current or future medical and retiree health care expenses. Account holders enjoy these three tax advantages:

- Contributions are usually tax-deductible
- Earnings accumulate tax-deferred
- Withdrawals for qualified medical expenses, including earnings, are tax-free as determined by the IRS

HSAs also provide several key improvements over other Medical Savings Accounts (MSA) that benefit both employers and employees.

KEY BENEFITS FOR EMPLOYEES

- There is no “use it or lose it” rule — year end balances carry forward to be used in the future
- For accounts established by an employer, the account belongs to the employee, it is non-forfeitable and it is completely portable
- Provided the expense occurs after the account is opened, there is no time limit for submitting claims
- First dollar coverage for IRS-allowed preventive care (if permitted by first dollar coverage requirements of state where the account holder lives)

KEY BENEFITS FOR EMPLOYERS

- HSAs are non-ERISA plans
- Switching to High Deductible Health Plan (HDHP) can help reduce employer medical coverage costs an average of 25-50%

- Employer contributions are tax deductible
- Employer contributions are not subject to FICA or FUTA

HOW IT WORKS

HSAs are available to anyone who has a HDHP. Accounts typically provide options to invest in mutual funds, stocks and bonds, similar to an IRA (a minimum money market balance is often recommended). The HDHP must have a minimum deductible and out-of-pocket maximum to be used with an HSA.

The HSA begins paying benefits for qualified medical expenses in essence to cover the account holder’s annual minimum deductible for the HDHP. As of 2010, to qualify as an HDHP, the annual minimum deductible must be at least \$1,200 for single coverage and \$2,400 for family coverage, and the out-of-pocket deductible must not exceed \$5,950 for single coverage and \$11,900 for family coverage.

HSAs are not available in states that do not permit HDHPs.

WHO USES IT?

HSAs support the Consumer Driven Health Care (CDHC) approach that is gaining popularity. CDHC increases patient involvement in decisions about how their health care dollars are spent, which is helping hold down rising medical costs for the employer, the employee, and individuals who have an HDHP.



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HSAs are ideal for:

- Family-owned businesses
- Small businesses
- Highly compensated plans
- Employee premium sharing plans
- Partners or shareholders in S-corporations
- Companies with a variety of employee health care needs
- Savvy insurance buyers
- Federal government employees
- Individuals who purchase a HDHP

ELIGIBILITY

Unlike other tax-advantaged savings plans, you do not need to meet any income standards or have earned income to participate. Contributions can be made to a HSA any month you are:

- Not covered by Medicare (and generally under age 65)
- Covered by a HDHP
- Not covered by any other health plan that is not a HDHP
- Not claimed as a dependent on another person's tax return

For estate purposes, accounts may be transferred to a spouse, after death of original account holder, without penalty and spouse may take distributions for qualified expenses tax-free. Accounts must be distributed to other beneficiaries without penalty

(however, distributions must be distributed and will be taxable in the year of the participant's death).

Before opening a HSA, insurance professionals recommend verifying the HDHP meets the minimum requirements, because there are penalties (in the form of excise tax) for opening accounts without appropriate insurance.

CONTRIBUTIONS

HSAs may be funded in one or more payments and contributions must be made before the account holder's federal tax filing date (April 15). Anyone can contribute to a HSA. An employer can fund an HSA on behalf of an employee (in which case the employer gets the tax deduction, not the employee), however the employer must also make comparable contributions for all participants. Rollovers or transfers from other HSAs or MSAs are acceptable.

The maximum annual contribution must meet a couple requirements.

First, as of 2010, the IRS tax code limits the maximum annual contribution to \$3,050 for single coverage and \$6,150 for family coverage. (These amounts will be increased for inflation in future years.)

Second, please note that beginning in 2007, the maximum HSA contribution will not be limited to the annual deductible amount under the high deductible health insurance plan. Prior to 2007, the annual HSA contribution could never exceed the insurance plan's deductible, unless the participant is age 55 or older and making "catch-up" contributions into the HSA.



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In addition, and also beginning 2007, as long as the participant is enrolled in an HSA-qualified HDHP for at least the last full month of the year, the participant is eligible to make a full HSA contribution for that year, provided the participant remains enrolled in an eligible HDHP for the full calendar year following the year in question. If the participant does not have HDHP coverage through the end of the following year and, consequently, does not maintain HSA eligibility, then the maximum contribution amount will be pro-rated based on the number of full months the participant had the HDHP.

By way of illustration, if the participant becomes eligible on December 1, 2010, even though the participant did not have HDHP coverage for the first eleven (11) months of the year, the participant will still be eligible to make a full-year HSA contribution of \$3,050 provided that HDHP coverage and HSA eligibility is maintained for a period beginning December 1, 2010 and ending December 31, 2011.

Again, remember that an exception to these contribution requirements is the additional “catch up” contribution people age 55 and older are permitted to make annually. In 2010, the maximum catch up amount is \$1,000 per year. The catch up amount increased \$100 per year until reaching a maximum catch up contribution of \$1,000 per year in 2009 and it remains at \$1,000 in 2010.

DISTRIBUTIONS

HSA funds may be used for any purpose at any time. Withdrawals for qualified medical expenses for the account holder, his or her spouse, or his or her dependents are tax-free. Non-qualified withdrawals prior to age 65 are taxable, and a 10% penalty applies. Non-qualified withdrawals after age 65 are taxable, but no penalty applies.

Provided qualified medical expenses occur after the HSA is established, there is no time limit on when distributions must occur. For example, if a HSA account were opened in 2010, it would be perfectly acceptable for the account holder to submit a claim in 2012 for a qualified medical expense that occurred in 2011. Otherwise, the maximum annual HSA distribution may not exceed the HDHP participant’s maximum annual contribution (see above).

Accounts may also have a check writing option to pay for expenses.

Receipts for all expenses covered by distributions must be retained in case of audit.



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QUALIFIED MEDICAL EXPENSES

Qualified medical expenses may include a broad range of items currently being paid for with post-tax dollars (for example, routine dental examinations or non-prescription medicines). Allowable reimbursements include:

- Diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure of the body
- Transportation for the essential medical care listed above
- Over the counter drugs
- Qualified long-term care insurance
- COBRA health care continuation coverage
- Health care while a person is receiving unemployment compensation

All receipts for these medical expenses must be maintained by you the account holder and it is recommended that they be kept with your tax records for the year the disbursements occur.

IS A HEALTH SAVINGS ACCOUNT RIGHT FOR YOU?

HSAs offer three important tax advantages — tax-deductible contributions, tax-free accumulation of earnings and tax-free distribution for qualified medical expenses — in addition to providing several key improvements over other MSAs. Once you understand some of the details, they are easy to use for employer, employee and individual alike. If you have questions, your Financial Consultant can help you decide if a Health Savings Account is right for you.

RBC Wealth Management does not provide tax or legal advice. All decisions regarding the tax or legal implications of your investments should be made in connection with your independent tax advisor.

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