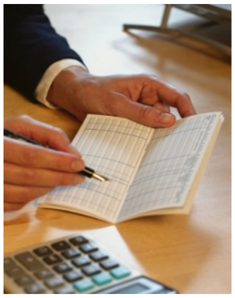
Saving for Health & Medical Expenses
Flexible Spending Accounts and Health Savings Accounts



Health care can be costly. From doctor visits and medicine to braces and glasses, there are many things you have to pay for beyond the monthly insurance premium. Setting money aside to manage these expenses helps reduce your reliance on credit to cover these costs and reduces your concerns regarding your ability to cover a bill.

You can save money in your emergency fund or you can use a special type of savings accounts that provide tax saving benefits. The two most common are health Flexible Spending Accounts (FSAs) and Health Savings Accounts (HSAs).

Both of these accounts help you save for out-of-pocket expenses each pay period by allowing you to set aside money before taxes are taken out. This is called using **pre-tax dollars**. The biggest benefit of using pre-tax dollars to fund these accounts is that you reduce your income tax bill allowing you put more money in your pocket to pay for health care and other expenses.

Though the Flexible Spending Accounts (FSAs) and Health Savings Accounts (HSAs) are similar in their benefits there are some key differences. This fact sheet helps to explain the difference between the two, what they can pay for and tips on figuring out how much to save.

Important Words to Know

Pre-tax dollars - sometimes described as pre-tax income, this is your gross income before income taxes are withheld. Any contributions you make to a flexible spending account or health savings account comes out of your pre-tax income.

The contribution reduces your current income, thus reducing the amount of taxes you owe because you don't pay taxes on the money set aside.

Qualified Medical Expenses - amount paid for the diagnosis, cure, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body. There are many different types of medical expenses that would qualify.

Qualified expenses are defined by IRS code. You can find out what these are by going to: http://www.irs. gov/pub/irs-prior/p502--2013.pdf

Health Flexible Spending Account

1. **What is it?**

A health flexible spending account (or health FSA) is an account you contribute money using pre-tax dollars. You can then be reimbursed for **qualified medical expenses**. FSA accounts are available as part of your employer's benefits plan package; you cannot open one as an individual consumer. The amount you choose to save is automatically deducted from your paycheck and is placed in an account managed by a third party agency.

For 2014-15, the IRS will let you set aside up to $2,500 each year.

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Your employer determines how money that is unspent by the end of the year is managed. The IRS allows two ways unspent money can be treated. First, your employer can provide a "grace period" of up to 2 ½ extra months to use the money in your FSA account. The second option is new under IRS rules and allows employees to carry over up to $500 per year to use in the following year. Your employer can offer either one of these options but not both. Note that they are not required to offer either one. The best way to figure out the rules for your FSA is to contact your employer's benefits office.

At the end of the year or grace period, you may lose any money left over in your FSA. So it's important to plan carefully and not put more money in your FSA than you think you'll spend within a year on things like copayments, coinsurance, drugs, and other allowed health care costs.

2. **How do I Enroll in a Health Flexible Savings Account?**

FSAs are offered by employers, typically during an open enrollment season. Once a year, the employer allows employees to decide the amount they would like to save. If offered, you can sign up for a FSA. For specific plan details, contact or visit your employer's benefits office.

Health Savings Account

1. **What is it?**

A health savings account (HSA) is a medical savings account available to you if you have a HSA-qualified, high-deductible health insurance plan (HDHP). The best way to figure if your plan qualifies is to ask your benefits office or insurance provider. If the plan is HDHP, you are able to open an HSA. This account allows you to save **pre-tax dollars** for **qualified medical expenses**. Contributions can be made by you and/or your employer, but you are the account owner.

Two key advantages to HSAs are you can build savings to help pay for future health care costs and earn interest on your contributions. The IRS limits the amount you can save each year. For 2014 and 2015, this amount is $3,300 for an individual and $6,550 for a family, with a special rule allowing people over age 50 to contribute up to $1,000 extra each   Don't worry; any money in the HSA you don't spend carries over year to year.

If you no longer have HSA-eligible insurance coverage, you will lose the ability to deposit further funds, but funds already in the HSA remain available for use.

Because you are using **pre-tax dollars**, any withdrawals for expenses that are not qualified will be taxed as income and a 20% penalty will be charged. This penalty is waived if you're over age 65 (1).

2. How do I set up an HSA?

If your health insurance plan meets the rules for a health savings account, you set up the account with a trustee. A qualified HSA trustee can be a bank, an insurance company, or any organization already approved by the IRS to be a HSA trustee. This means you don't have to use your health insurance company to set up the HSA but can go somewhere else. Your money can be invested to earn interest over time for your future use. Manage these funds with the same care that you manage your IRA or retirement savings accounts. As you choose an institution to hold your HSA, consider the fees, the interest rate and how easy it will be to deposit and withdraw money (2).

To show the differences between the two plans, Table 1 highlights some of the key points of each (2).

Table 1: **Key Differences between FSA and HSA Accounts**

	Health Savings Account (HSA)	**Flexible Spending Account (FSA)**
Who can open the account?	The employee or employer as long as the employee is enrolled in an HSA-eligible health plan.	The employer on behalf of the employee
Who can contribute?	Employers, employee/account holder or any third party	Employee
Who owns the account?	Employee/account holder	Employee but unspent money goes back to the employer at the end of the year.
Is there an annual contribution limit?	Yes. This amount changes each year. For more information on these, go to http://www.irs.gov/uac/Publication-502,-Medical-and-Dental-Expenses-1	Yes. The IRS allows up to $2,500 per employee but your employer can set a lower amount (3). Therefore, if you and your partner work for the same organization, each can contribute up to the allowed amount in an FSA (4).
Do unused funds carry over to the next year?	Yes	Yes, up to $500.
Can you take the funds with you if you change jobs or retire?	Yes	No
Do you fund the account using pre-tax dollars?	Yes	Yes
Are there savings limits?	For 2014-15, the limit is $3,300 for individuals and $6,550 for families	For 2014-15, the limit is $2500

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Using a Health Flexible Spending or Health Savings Account

1. How Can You Use These Accounts?

Both the health FSA and the HSA can be used for **qualified medical expenses** not covered by your insurance. Some eligible expenses are: copays, deductibles, vision expenses, dental procedures and some medical devices, such as a blood sugar meter for diabetics, canes and wheel chairs. For a full list of allowed services, go to http://www.irs.gov/publications/p969/ar02.html (3).

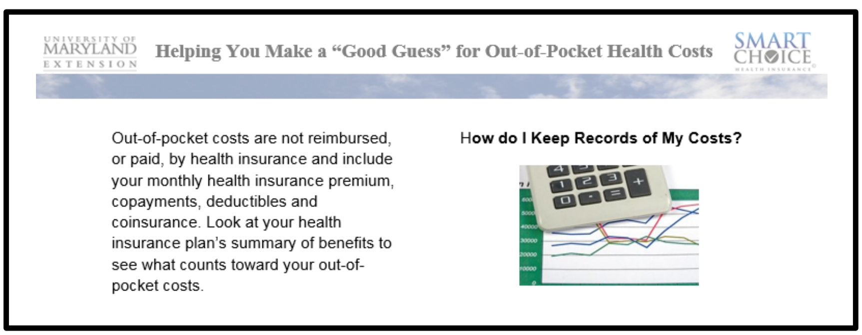
Important Words to Know
Explanation of Benefits- (commonly referred to as an **EOB** form) is a statement sent by a health insurance company to covered individuals explaining what medical treatments and/or services were paid for on their behalf.

2. How do I figure out how much to contribute?

Many people would like to start an account but don't know how much to put in. Because the accounts are used for out-of-pocket expenses, a good place to start is to look at how much you spend on these. You can get this information by saving receipts, looking at your **explanation of benefits**, or calling your doctors' offices and pharmacy to get a print out of all visits and prescription purchases for the year.

It is important to calculate how much you may need to contribute. A list is shown on the next page to help you summarize what is called "Out-of-pocket Costs" or expenses you pay. Fill in the total amount spent for each and then divide by the number of paychecks you receive each year to determine how much to have deducted each pay period. Remember you can only save up to the maximum allowed by your plan.

To learn more about out-of-pocket yearly increases, read the factsheet: *Helping You Make a "Good Guess" for Out-of-Pocket Health Costs.*


Helping You Make a "Good Guess" for Out-of-Pocket Health Costs

Out-of-pocket costs are not reimbursed, or paid, by health insurance and include your monthly health insurance premium, copayments, deductibles and coinsurance. Look at your health insurance plan's summary of benefits to see what counts toward your out-of-pocket costs.

How do I Keep Records of My Costs?

Summary of "Out-of-Pocket" Expenses

Annual Deductible
$________

Office visit copayments (number of visits X copayment amount)
$________

Chiropractic service copayments (number of visits X copayment amount)
$________

Psychiatric services (number of visits X copayment amount)
$________

Medical supplies and equipment
$________

Hospitalization expenses
$________

Prescription drug copayments (number of prescriptions X copayment amount)
$________

Dental preventive visit copayments (number of visits X copayment amount)
$________

Dental services and products (braces, oral surgery, etc.)
$________

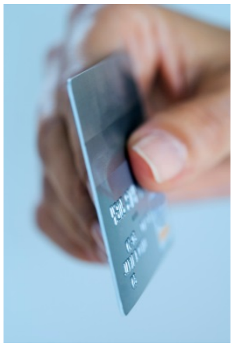
Vision exam copayments (number of visits X copayment amount)
$________

Vision services and products (glasses, contacts, etc.)
$________

Total Out-of-Pocket Costs **$________**

Amount to Contribute each Pay Period=
Total Out-of-Pocket Costs ÷ Number of Pay Periods = **$________**

3. **How do I get the money from the account?**



Many times, the FSA coordinating agency or HSA trustee will issue a debit card or check book. A debit card or check is used to pay at the time of service. Other agencies or trustees may require that you pay cash and then submit documentation for reimbursement. Regardless of how you access the savings account to pay for expenses, documentation is needed to show it was a **qualified medical expense**.

Documentation usually includes:

- Date of service/purchase
- Amount spent
- Receipt of service
- Description of service/diagnosis code
- Prescription from doctor for some over-the-counter medicines

Once submitted, the agency or trustee will review the claim to ensure it's a qualified expense and if so, approve the amount requested.

Wrapping up

Both FSAs and HSAs provide an opportunity to save using pre-tax dollars on qualified health care expenses. This can be a huge tax savings and provides a nice incentive to set money aside. Talking with your employer's benefits office or your financial advisor can help you make the best decision as to which type of account is available to you and what makes the best sense for your financial future.

For more information and resources related to your health and health insurance, please visit http://extension.umd.edu/insure.

References:
1. *IRS Publication 502, Medical and Dental Expenses*. Retrieved June, 1, 2014 from http://www.irs.gov/uac/Publication-502,-Medical-and-Dental-Expenses-1.
2. *Health Savings Accounts (HSAs)*. Retrieved June 1, 2014 from http://healthequity.com/HealthAccounts/HSA.aspx
3. *IRS Publication 969*. Retrieved June 1, 2014 from http://www.irs.gov/publications/p969/ar02.html.
4. *IRS Notice 2012*-40. Retrieved July 9, 2014 from http://www.irs.gov/pub/irs-drop/n-12-40.pdf.

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