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Q Can health savings accounts benefit our township employees?

The rising cost of health care coverage has caused many individuals and employers to switch from traditional health insurance coverage to high-deductible health plans. The U.S. Congress created health savings accounts (HSAs)—special types of individual retirement accounts—to provide individuals covered by high-deductible health plans a tax-sheltered means of savings to offset out-of-pocket medical expenses. HSAs not only provide potential current tax savings, they also provide an investment vehicle to save money for future medical costs.

Individuals covered by high-deductible plans can contribute an amount equal to all or a part of their annual insurance deductible to an HSA, subject to the annual limits. For 2006, the maximum monthly contribution for an individual with self-only coverage is one-twelfth of the lesser of the annual deductible (\$1,050 minimum), or \$2,700. For family coverage, the maximum monthly contribution is one-twelfth of the lesser of the annual deductible (\$2,100 minimum), or \$5,450.

The following example demonstrates how the plan's annual deductibles impact the maximum amount an individual may contribute to an HSA:

In 2006, Mr. and Mrs. Smith have a high-deductible health plan (HDHP), with coverage for themselves and their two dependent children. The HDHP has an individual family member deductible of \$2,100 and a family deductible of \$5,000. The 2006 maximum contribution is \$5,450. The 2006 maximum individual contribution multiplied by four family members is \$8,400 (\$2,100 multiplied by 4). Therefore, the maximum aggregate annual contribution that the Smiths can make is \$5,000. Again, this is the lesser of the government limits and their potential maximum out-of-pocket expenses.

HSA contributions by an individual are deductible above-the-line in computing adjusted gross income. Unlike cafeteria plans, such as a Section 125 plan, HSAs are completely portable and are not tied to the township in any way. Participants must use the accounts for medical expenses, or the plan distributions are subject to ordinary income taxes and a 10 percent penalty.

After a participant turns 65, the HSA can be used for any purpose, but will be subject to ordinary income taxes—but not the 10 percent penalty tax—for non-medical uses. Any funds remaining upon death of the participant are taxed to the beneficiaries at ordinary income rates, except for spouses, who may treat the HSA as their own.

Q Who can establish an HSA?

Any eligible individual can set up an HSA. An eligible individual: (1) is covered under a high-deductible health plan on the first day of the month; (2) is not covered by any other health plan that is not a HDHP (with certain exceptions for plans providing limited types of coverage); (3) is not entitled to Medicare benefits; and (4) may not be claimed as a dependent on another person's tax return. Individuals between 55 and 65 can make catch-up contributions in addition to regular annual contributions. For 2006, the catch-up contribution limit is \$700. As with regular contributions, catch-up contributions are computed on a monthly basis.

Q Can the township make HSA contributions as part of the employee benefits package?

If the employee is an eligible individual, the township's contribution is treated as employer-provided coverage for medical expenses under an accident or health plan, and is excludable from the employee's gross income up to the deduction limitation. Further, employer contributions are not subject to withholding from wages for income tax or subject to FICA (Social Security) taxes. The eligible individual cannot deduct employer contributions on his or her federal income tax return as HSA contributions or as medical expense deductions.

An employer who makes contributions on employees' behalf must make comparable contributions to the HSAs of all comparable participating employees for that calendar year. If he or

she does not do so, the employer is subject to a 35 percent tax on the aggregate amount contributed to HSAs for that period.

Contributions are comparable if they are the same amount or the same percentage of the annual deductible limit under the high-deductible health plan covering the employees. For these purposes, comparable participating employees: (1) are covered by the employer's high-deductible health plan and are eligible to establish an HSA; (2) have the same category of coverage (individual or family); and (3) have the same category of employment (part- or full-time). IRS regulations provide detailed guidelines for comparable contributions.

Employer contributions are also excludable if made at the election of the employee under a salary reduction arrangement that is part of a cafeteria plan—i.e., a plan which allows employees to use part of his or her salary toward a variety of benefits. Although contributions to an employee's HSA through a cafeteria plan are treated as employer contributions, the comparability rule does not apply.

Prior to entering into HSA arrangements funded by the township, officials are urged to consult the township's benefits consultant. ■

Lyon Charter Township (Oakland Co.) Trustee Brent Hemker, an actuary with Midwest Pension Actuaries (www.midwestpension.com) in Farmington Hills, contributed to this article.

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