UNIVERSITY OF MARYLAND EXTENSION

Solutions in your community

SMART CHOICE | SMART USE

Be smart about health insurance

UNIVERSITY OF DELAWARE COOPERATIVE EXTENSION

# Saving for Health & Medical Expenses: Health 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 cover these costs and reduces concerns about being able to pay a bill.

You can save money in your emergency fund or you can use a savings accounts that provides 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**. By putting this money aside pre-tax, you pay no Federal, FICA or State taxes on the amount deducted from your paycheck that funds your FSA. The biggest benefit of using pre-tax dollars to fund these accounts is that is saves you on taxes and may leave you with more

**Important Words to Know**

**Pre-tax dollars** - sometimes described as pre-tax income, this is your gross income before income taxes are withheld. Any contribution you make to an FSA or HSA comes out of your pre-tax income.

This lowers your income, making it so you pay less taxes on what you make.

**Qualified Medical Expenses** – the 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 qualify.

Qualified expenses are defined by IRS code. You can find these are by going to: https://www.irs.gov/pub/irs-pdf/p502.pdf money to pay for health care and other expenses.

Though the Health 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.

## Health Flexible Spending Account

1. **What is it?**

A Health Flexible Spending Account (or Health FSA) is an account using pre-tax dollars. You can then be reimbursed for **qualified medical expenses**. Health FSAs may be part of your employer's benefits plan package; you cannot open one as an individual consumer. The money you choose to save is taken from your paycheck and placed in an account managed by a third-party agency. The IRS sets new limits each year so you'll need to check guidelines annually.

Your employer decides how to manage unspent money by the end of the year. There are two ways the IRS allows unspent money to be used. First, you can be given up to 2 ½ extra months to use the money in your Health FSA account. Second, you may be able to carry over up to $500 into the next year. Your employer can offer one but not both options and is not required to offer either option. For more information on your plan, contact your employer's benefits office.

At the end of the plan year, you may lose any money left over in your Health FSA. So it's important to plan carefully and not put more money in your Health 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 FSA?**

Health FSAs are offered by employers, often during open enrollment. If offered, you can sign up for a Health FSA during this period. For 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**. This provides the same tax reduction benefits as Health FSAs. 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. Don't worry; any money in the HSA that 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, 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]

**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.

## Using a Health Flexible Spending Account 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]

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 the amount you paid 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, calculate the total amount of out-of-pocket costs 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*, found on extension.umd.edu/insure

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

Many times, the Health 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. Others may have you pay cash and then submit receipts for reimbursement. With either method, 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

The claim will be reviewed and if it is a qualified expense, the amount requested will be approved.

**Wrapping Up**

Both Health FSAs and HSAs provide an opportunity to save on qualified health care expenses. This can bring a 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 learn 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. *IRS Publication 969*. Retrieved June 1, 2014 from http://www.irs.gov/publications/p969/ar02.html.
3. *IRS Notice 2012*-40. Retrieved July 9, 2014 from http://www.irs.gov/pub/irs-drop/n-12-40.pdf.


**Publication citation:**


Brown, V. & Pippidis, M. (August 2015). *Saving for Health & Medical Expenses: Health Flexible Spending Accounts and Health Savings Accounts*. College Park, MD: University of Maryland.

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

| | **Health Flexible Spending Account (FSA)** | **Health Savings Account (HSA)** |
|---|---|---|
| **Who can open the account?** | The employer on behalf of the employee | The employee or employer as long as the employee is enrolled in an HSA-eligible health insurance plan. |
| **Who can contribute?** | Employee | Employers, employee/account holder or any third party |
| **Who owns the account?** | Employee but unspent money goes back to the employer at the end of the year. | Employee/account holder |
| **Is there an annual contribution limit?** | Yes. The IRS allows up to a certain limit each year per employee but your employer can set a lower amount, The limit set each year is adjusted for inflation.[3] If you and your partner work for the same organization, each can contribute up to the allowed amount in an FSA.[4]<br>For more information go to: http://www.irs.gov/publications/p969/ar02.html | Yes. The IRS allows up to certain limits each year. It is adjusted for inflation each year. For more information on these, go to http://www.irs.gov/publications/p969/ar02.html |
| **Do unused funds carry over to the next year?** | If your employer allows it, up to $500 can be carried over. | Yes |
| **Can you take the funds with you if you change jobs or retire?** | No | Yes |
| **Do you fund the account using pre-tax dollars?** | Yes | Yes |

## 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 = $________**

**Total Out-of-Pocket Costs ÷ Number of Pay Periods = $________**

**Amount to Contribute each Pay Period = $________**

**Virginia Brown (vbrown12@umd.edu) and Maria Pippidis (pippidis@udel.edu)**

This publication, *Saving for Health & Medical Expenses: Health Flexible Spending Accounts and Health Savings Accounts (FS-)* is a series of publications of the University of Maryland Extension and Insuring Your Health. The information presented has met UME peer review standards, including internal and external technical review. For more information on related publications and programs, visit http://extension.umd.edu/insure. Please visit http://extension.umd.edu to find out more about Extension programs in Maryland.