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AVOIDING THE 10% THRESHOLD FOR MEDICAL EXPENSES

When it comes time to pay your income tax bill, most Americans want to pay the lowest amount possible. One of the ways taxpayers seek to do this is by increasing the number of deductions they take on their tax return each year.

So it's not surprising that one of the common questions we receive from our clients is whether or not they can deduct their medical expenses. While the simple answer is "yes," the reality for most taxpayers is "no." However, with a little planning, that answer can be "yes."

WHAT HAPPENS IF YOU DON'T PLAN AHEAD?

If you fail to plan ahead, you will struggle to claim your medical expenses as an itemized deduction when April 15th arrives. You will lose the ability to deduct the bulk of these expenses because they need to surpass 10% of your Adjusted Gross Income (AGI) to be usable as an itemized deduction. This means that taxpayers who make $100,000 during the year will not be able to deduct the first $10,000 in medical expenses. That handicap essentially means you will not be able to deduct any medical expenses, unless you incur heavy medical bills in a single year. And if you are paying AMT (the Alternative Minimum Tax) – don't even think about it.

SO WHAT IS THE SOLUTION?

The best way to counteract this nasty little piece of the tax code is to set up an HSA (Health Savings Account) and contribute to it each year. When you contribute to an HSA you get the privilege of deducting the amount of your contributions from your income and you bypass the 10% threshold. You can do this even if you don't choose to itemize your deductions!

And as an added bonus (do we sound like an infomercial?) - the money you put into your HSA, as well as the earnings of the account, can be taken out tax free as long as they are used for qualified medical expenses. While you cannot pay your health insurance premiums with funds from an HSA, you can pay most other medical expenses. Additionally, once you turn 65 you can use the HSA to pay your Medicare or other healthcare premiums.

REQUIREMENTS FOR AN HSA

In order to qualify for an HSA you must have a high-deductible health plan - defined as a healthcare plan with:

1. An annual deductible of at least $1,300 for individual coverage or at least $2,600 for family coverage.
2. Maximum annual out-of-pocket expenses of $6,550 for individual coverage or $13,100 for family coverage.

Once you have your HSA set up you can contribute up to $3,400 per year for individual coverage and $6,750 for family coverage. If you are over the age of 55 you can contribute an additional $1,000 annually.

HOW DO YOU SET UP AN HSA?

If your employer offers a high-deductible health plan, they should also give you the ability to contribute to an HSA. You can also open an account on your own through a qualified HSA provider, such as a bank or insurance company (go to www.hsasearch.com for a list of qualified HSA providers).

KEY TAKEAWAYS

If you don't plan ahead and contribute to a Health Savings Account then you will find that most, if not all of your medical expenses will be ineligible for a deduction due to the 10% threshold that must be met before deducting medical expenses. By setting up and contributing to a Health Savings Account you can deduct your full contribution to the account and have the flexibility to pay your medical bills with tax-free withdrawals from the account.

Failing to order your affairs to minimize your tax burden could cost you significant money – so don't wait to take action. If you have additional questions or need some planning help, please reach out to us.

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