The Council for Affordable Health Insurance's

ISSUES & ANSWERS

Solutions for Today's Health Policy Challenges

No. 125 July 2004

Answering Your Questions about Health Savings Accounts

Recently, Congress enacted a new tax-preferred option known as Health Savings Accounts (HSAs) as part of the Medicare reform package. HSAs are essentially Medical Savings Accounts (MSAs), but without the restrictions that governed the expired federal Archer MSA demonstration project. The Archer MSA program phased out at the end of 2003 and a new program called Health Savings Accounts replaced it. Rollovers from Archer MSAs to HSAs are permitted and those who were eligible individuals prior to Dec. 31, 2003, may continue with the Archer MSAs if they choose to or may opt to roll over their Archer MSA balance into an HSA.

HSAs Are MSAs with Fewer Restrictions. Both HSAs and MSAs combine a high-deductible health insurance policy (HDHP) with a savings account. The high-deductible policy protects the insured from the cost of a catastrophic illness, prolonged hospitalization or a particularly unhealthy year. The savings account is controlled by the insured and is intended to pay small and routine health care expenses. But there are some very important differences between MSAs and HSAs. Specifically, Health Savings Accounts:

- Must be coupled with a health insurance policy with a minimum deductible of $1,000 for an individual, with total annual out-of-pocket expenses of $5,000, or $2,000 for a family deductible, with total annual out-of-pocket expenses of $10,000;
- Allow annual contributions to the account up to 100 percent of the annual deductible as well as permit "catch-up," or increased, contributions for individuals aged 55 and over;
- Allow both employers and individuals to contribute to the account;
- Place no limit on the total number of accounts and are a permanent feature of the tax code; and
- Allow rollovers from Archer MSAs to HSAs.

MSAs, by contrast, require higher deductibles and tighter restrictions on contributions, were limited to 750,000 people and, as mentioned, required annual reauthorization.

We know that people want access to HSA-type plans and the uninsured choose them when buying insurance. Data released by Assurant Health indicated that 43% of HSA applicants were previously uninsured; 77% of HSA purchasers are families with children; 45% of HSA purchasers are from households of four or more people; 70% of HSA purchasers are over age 40; 29% of purchasers have family incomes of less than $50,000 per year; and 19% of purchasers have family incomes of less than $40,000 per year.

How do HSAs work and what do they mean for you?

Health Savings Accounts Q & A	
Does this account replace the Archer Medical Savings Account Federal Demonstration Project (MSAs)?	Yes; for tax years after 2003, the Archer MSA program sunset and a new program replaced it called Health Savings Accounts (HSAs). Rollovers from Archer MSAs to HSAs are permitted. Those individuals who are eligible individuals prior to 12/31/2003 may continue with the Archer MSAs if they so choose or may opt to roll over their Archer MSA balance into an HSA.
Is there an enrollment cap or restriction on who can have a Health Savings Account?	There is no enrollment cap on HSAs; they are available to anyone covered by a qualified high-deductible health plan.
Is there medical expense transition relief?	Prior IRS guidance provided that HSAs may only reimburse medical expenses incurred after the HSA is established. IRS guidance released March 30, 2004, provides that for 2004, an HSA established by an eligible individual on or before April 15, 2005, may reimburse expenses incurred on or after the later of January 1, 2004, or the first day of the first month that the individual became an eligible individual. Additional IRS guidance released on June 18, 2004, provides transition relief for individuals in states where HDHPs are not available because state laws bar or limit a deductible for certain benefits. For months before January 1, 2006, a health plan which would otherwise qualify as a HDHP except that it complies with state law requirements that certain benefits be provided without a deductible or below the minimum annual deductible, will be treated as a HDHP for HSAs.
Who is eligible?	To receive a tax deduction for contributions to the account, an individual must be covered under a qualified high-deductible health plan. The person must also be below Medicare eligibility age (65), and not covered under any other health plan which duplicates any benefits in the qualified high-deductible plan. (Exception: individuals may maintain coverage for accidents, disability, dental care, vision care and long-term care or "permitted insurance.")
Who owns the account?	Individual/employee.
Who funds the account?	Taxpayer and/or employer. If the employer contributes to the employee's account, the contribution must be the same for all employees, and the employer receives a tax deduction as a normal business expense.
What is the tax treatment for contributions?	For tax purposes, contributions to the HSA can be made by either the employer or the individual or both. If contributions are made by the individual, it is an "above the line" tax deduction. If contributions are made by the employer, it is not taxable income to the employee (excluded from income), and the employer receives a tax deduction. Contributions to the HSA may be made by others on behalf of the individual, but the individual receives the tax deduction.
Is it a personal account?	Yes.

How is the account funded?	Money is deposited directly into the account. Contributions must be made directly in cash or through §125 Cafeteria Plans. All contributions are aggregated. If an employer contributes to HSA, it must be "comparable" for all employees participating in the HSA – if not, there is an excise tax equal to 35% of the amount contributed to the HSA.
What type of corresponding health coverage is needed?	Qualifying high-deductible health plans must have a minimum deductible of $1,000 for individuals and $2,000 for family coverage. Total costs to the insured cannot exceed $5,000 for an individual and $10,000 for a family, including both the deductible and copayments. Since the law does not specifically detail a maximum deductible, the out-of-pocket spending cap in effect becomes the maximum deductible. Thus, a plan that pays 100% of all costs above the deductible could have a deductible as high as $5,000 for an individual or $10,000 for a family. All amounts are indexed for inflation. High-deductible health plans are allowed to offer first-dollar coverage for preventive care and still qualify. Penalties for going out of the PPO network do not count toward the total costs to the insured.
What constitutes preventive care?	Generally, a high-deductible health plan cannot provide benefits before the deductible is satisfied, but there is an exception for preventive care benefits. The IRS guidance issued March 30, 2004, provides a safe-harbor list of benefits that can be provided by a high-deductible health plan, generally clarifying that traditional preventive care benefits – such as annual physicals, immunizations and screening services -- are preventive care for purposes of HSAs, as well as routine prenatal and well-child care, tobacco cessation programs and obesity weight-loss programs. The March 30 guidance clarifies that preventive care generally does not include treatment of existing conditions.
Are some types of health coverage prohibited?	Specialty insurance including accidents, disability, dental care, vision care and long-term care plans cannot be considered qualifying high-deductible health plans. These can, however, serve as secondary insurance. IRS guidance released May 11, 2004, states that eligible individuals may continue to contribute to an HSA while also covered by the following types of employer-provided plans that reimburse medical expenses: limited purpose FSAs/HRAs that restrict reimbursements to certain permitted benefits such as vision, dental or preventive care; suspended HRAs where the employee has elected to forgo health reimbursements for the covered period; post-deductible FSAs/HRAs that only provide reimbursements after the minimum annual deductible has been satisfied; and retirement HRAs that only provide reimbursements after an employee retires.
Are prescription drug benefit plans or riders allowed along with the high deductible health plan?	Prior IRS guidance noted that an eligible individual must be covered by a high-deductible health plan. IRS guidance issued March 30, 2004, clarifies that individuals covered by a health plan that provides prescription drug benefits before the minimum annual deductible of a high-deductible health plan has been satisfied may not make contributions to an HSA. However, there is transition relief to those individuals covered by both a high-deductible health plan and by a separate health plan or rider that provides prescription drug benefits before the deductible of the high-deductible health plan is satisfied. Such individuals continue to be eligible to contribute to HSAs until 2006.
Does interest accrue?	Interest can be accrued tax free in qualified HSAs.
Is the account portable?	Rollover is allowed. Individuals own their HSA and take it when leaving employment, but the rollover must be completed within 60 days.
What is the tax treatment of distributions?	Account distributions are tax free for qualified medical expenses as defined by §213(d) of the IRC. Tax-free distributions to pay premiums for long-term care insurance, COBRA continuation, and health insurance while unemployed are allowed. Qualified expenses also include prescription drugs, qualified long-term care services, Medicare expenses (but not Medigap), and retiree health expenses for individuals age 65 and older. Tax-free distributions may be made for medical expenses for persons covered by a high-deductible health plan, but they may also make tax-free distributions for their spouse or any dependent even if such individuals are not covered by the high-deductible health plan.
Can funds be used for nonmedical expenses?	Non-medical distributions are included in gross income and therefore taxed, as well as subject to a 10% penalty. The only exception allowed is non-medical distributions for those individuals age 65 and over or who are disabled or deceased. *Those distributions are included as taxable income but are not subject to the 10% penalty.*
Are there time or participation limits?	No.
What is the contribution amount?	Annual contributions to the account follow the Archer MSA law and are indexed for inflation back to 1997. Contributions are tax deductible up to the lesser of (1) the qualified annual deductible amount, or (2) $2,250 for individual coverage and $4,500 for family coverage. For 2004, the maximum allowable contribution to a Health Savings Account is $2,600 for individual coverage and $5,150 for family coverage, provided the insured has a deductible at least that high.
Is there a tax on excess contributions?	Yes.
Is there a "catch-up" contribution provision for older workers?	Individuals age 55 or older may contribute more to the account per year. Starting in 2004, an additional $500 contribution is allowed, increasing $100 per year, up to $1,000 per year in 2009 and thereafter. Married individuals may each make a catch-up contribution.
Are HSAs employee welfare benefit plans?	The DOL issued guidance on April 7, 2004, stating that HSAs (the savings account) generally will not constitute "employee welfare benefit plans" for purposes of the provisions of Title I of ERISA. However, unless the high-deductible health plan sponsored by the employer is exempt from Title I of ERISA (government or church plans), employer-sponsored high-deductible health plans will be considered employee welfare benefit plans within the meaning of ERISA section 3(1) subject to Title I.
Are there other income eligibility requirements?	No.
Who or what entity may be a trustee of HSAs?	A bank, an insurance company, or another person who can demonstrate to the satisfaction of the secretary of HHS that the manner of such person is consistent with trustee requirements.
Are there any additional trustee responsibilities?	The secretary of HHS may require trustees of HSAs to make reports to the secretary and the account beneficiary.

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