The Basics of HSAs

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HSA Overview

- HSA is money put in a special account owned by an individual to pay for current and future medical expenses
- Must be used in conjunction with “High Deductible Health Plan” (HDHP)
  - Insurance that does not cover first dollar medical expenses (except for prevention)

HSA Overview

- HSAs were created in Medicare legislation signed into law by President Bush on December 8, 2003
- HSAs modeled after Archer MSAs

<u>Who Is Eligible for HSAs?</u>

- Any individual that:
  - Is covered by a HDHP
  - Is <u>not</u> covered by other health insurance
    - does not apply to specific injury insurance and accident, disability, dental care, vision care, long-term care
  - Is <u>not</u> eligible for Medicare
  - Can’t be claimed as a dependent on someone else’s tax return

What Is a "High Deductible Health Plan" (HDHP)?

- Health insurance plan with minimum deductible of:
  - $1,000 (self-only coverage)
  - $2,000 (family coverage)
- Annual out-of-pocket (including deductibles and co-pays) does not exceed:
  - $5,000 (self-only coverage)
  - $10,000 (family coverage)
  - These amounts are indexed for inflation
- HDHPs can have:
  - first dollar coverage (no deductible) for preventive care
  - higher out-of-pocket (copays & coinsurance) for non-network services

Preventive Care

- Notice 2004-23 provides a safe harbor list of preventive care that HDHP can provide as first-dollar coverage before minimum deductible is satisfied
  - Periodic health evaluations (e.g., annual physicals)
  - Screening services (e.g., mammograms)
  - Routine pre-natal and well-child care
  - Child and adult immunizations
  - Tobacco cessation programs
  - Obesity weight loss programs

<u>Preventive Care</u>

- Preventive care generally does <u>not</u> include any service or benefit intended to treat an existing illness, injury or condition
- Considering whether disease management, employee assistance programs, and wellness programs should be included in definition of “preventive care”

Prescription Drugs

- Rev. Rul. 2004-38 clarifies that an individual covered by a prescription drug benefit plan that does not satisfy the HDHP minimum annual deductible may <u>not</u> contribute to an HSA
- Rev. Proc. 2004-22 provides transition relief until January 1, 2006 if the individual is covered by a prescription drug benefit provided by a separate plan or rider from the HDHP

HSA Contribution Rules

- Contribution to HSA can be made by the employer or the individual, or both
  - If made by the individual, it is an “above-the-line” deduction
  - If made by the employer, it is not taxable to the employee (excluded from income)
  - Can be made by others on behalf of individual and deducted by the individual
- All contributions are aggregated

HSA Contribution Rules

- Maximum amount that can be contributed to an HSA (and deducted) = lesser of:
  - Amount of High Deductible

    or
  - Maximum specified in law (indexed annually by M-CPI)
    - $2,600 (self-only coverage) - 2004
    - $5,150 (family coverage) - 2004
- Reduced by any contribution to an Archer MSA

HSA Contribution Rules

	Deductible	Out-of-Pocket Maximum	Maximum HSA Deposit (2004)
Single Coverage	$1,000	$5,000	$1,000
	$1,500	$5,000	$1,500
	$2,000	$5,000	$2,000
	$2,500	$5,000	$2,500
	$3,000	$5,000	$2,600
Family Coverage	$2,000	$10,000	$2,000
	$3,000	$10,000	$3,000
	$4,000	$10,000	$4,000
	$5,000	$10,000	$5,000
	$6,000	$10,000	$5,150

HSA Contribution Rules

- HSA contribution rules more generous than Archer MSAs
  - Contributions to Archer MSAs are limited to:
    - 75% of the deductible amount for family (65% for self-only plans)
    - Employee's compensation or self-employment income
  - If employer made a contribution, employee could not

HSA Contribution Rules

- For individuals age 55 and older, additional “catch-up” contributions to HSA allowed
  - 2004 - $500
  - 2005 - $600
  - 2006 - $700
  - 2007 - $800
  - 2008 - $900
  - 2009 and after - $1,000
- Contributions must stop once an individual is eligible for Medicare

HSA Contribution Rules

- Rollovers from Archer MSAs and other HSAs permitted
- Contributions can be made through cafeteria plans
- Employer contributions to HSA must be "comparable" for all employees participating in the HSA
  - If not comparable, there will be an excise tax equal to 35% of the amount the employer contributed to employees' HSAs

HSA Contribution Rules

- In order to meet the requirement that the employer make comparable contributions, the employer must make contributions:
  - which are the same amount

    or
  - which are the same percentage of the annual deductible
- Count only employees who are eligible individuals covered by the employer and who have the "same category of coverage" (i.e., self-only or family)
- Part-time employees are tested separately
  - "Part-time" means customarily employed fewer than 30 hours per week

<u>HSAs, HRAs & FSAs</u>

- Rev. Rul. 2004-45 clarifies that individuals entitled to benefits for health FSAs or HRAs that reimburse expenses below the minimum annual deductible of the HDHP may <u>not</u> contribute to an HSA
- Ruling also provides that eligible individuals will not be disqualified from contributing to an HSA due to coverage by certain types of plans or combinations of these plans in addition to an HDHP

HSAs, HRAs & FSAs

- Permitted HSA/HRA/FSA combinations:
  - Limited purpose FSAs and HRAs that restrict reimbursements to certain permitted benefits such as vision, dental, or preventive care benefits
  - Post-deductible FSAs or HRAs that only provide reimbursement after the minimum annual deductible has been satisfied
  - Retirement HRAs that only provide reimbursement after an employee retires
  - Suspended HRAs where the employee has elected to forgo health reimbursements for the coverage period

HSA Distributions

- Distribution is tax-free if taken for “qualified medical expenses”
  - Now includes over-the-counter drugs
- Cannot be used to pay for other health insurance except:
  - COBRA continuation coverage
  - Health plan coverage while receiving unemployment compensation
  - For individuals eligible for Medicare:
    - Medicare premiums and out-of-pocket expenses (Part A, Part B, Medicare HMOs, new prescription drug coverage)
    - employee share of premiums for employer-based coverage
    - Cannot pay Medigap premiums
  - Qualified long-term care insurance

HSA Distributions

- Distributions are tax-free if taken for:
  - person covered by the high deductible
  - spouse of the individual
  - any dependent of the individual
- Spouse and dependents don’t need to be covered by the HDHP
- If not used for qualified medical expenses, then amount is included in income
- 10% additional tax if taken for non-medical expenses, except when taken after:
  - Individual dies or becomes disabled
  - Individual is eligible for Medicare

HSA Distributions

- HSA trustee must report all distributions
  - Trustee not required to determine whether distributions are used for medical purposes; the individual does that

- Trustee reporting requirements
  - 1099-SA
  - 5498-SA

HSA Distributions

- Should the HSA account holder keep receipts? YES!
  - May need to prove to IRS that distributions from HSA were for medical expenses
  - May also need to prove that deductible was met under the HDHP
  - Not all medical expenses paid out of the HSA have to be charged against the deductible (e.g. dental care, vision care)

Estate Treatment of HSAs

- If married, the spouse inheriting the HSA is treated as the owner
- In other cases:
  - The account will no longer be treated as an HSA upon the death of the individual
  - The account will become taxable to the recipient of it (including the estate of the individual)
    - Taxable amount will be reduced by any qualified medical expenses incurred by the deceased individual before death and paid by the recipient of the HSA
    - The taxable amount will also be reduced by the amount of estate tax paid due to inclusion of the HSA into the deceased individual’s estate

Advantages of HSAs

- HSA accounts encourage savings for future medical expenses
  - Non-covered services under future coverage
  - When employer-sponsored coverage is lost during periods of unemployment
    - COBRA continuation coverage
    - other coverage
  - Medical expenses after retirement (before Medicare eligibility)
  - Insurance coverage after Medicare eligibility (except Medigap)
  - Out-of-pocket expenses for Medicare
  - Long-term care expenses

Advantages of HSAs

- Accounts are owned by the individual (not an employer). The individual decides:
  - How much to contribute
  - How much to use for medical expenses
  - Which medical expenses to pay from the account
  - Whether to pay for medical expenses from the account or save the account for future use
  - Which company will hold the account
  - What type of investments to grow account

Advantages of HSAs

- Accounts are completely portable, regardless of:
  - Whether the individual is employed or not
  - Which employer the individual works for
  - Which state an individuals moves to
  - Age or marital status changes
  - Future medical coverage

Advantages of HSAs

- No “use it or lose it rules” like Flexible Spending Arrangements (FSAs)
  - Unspent balances in accounts remain in the account until spent on medical care
  - Encourages account holders to spend their funds more wisely on their medical care
  - Encourages account holders to shop around for the best value for the health care dollars

- Accounts can grow through investment earnings, just like an IRA
  - Many different investment options could be pursued
  - Individual chooses investment option that best meets their needs

Advantages of HSAs

- HDHP premiums should be cheaper than health insurance with traditional deductibles

- Favorable tax treatment
  - Contributions
  - Disbursements
  - Investment earnings

- President Bush has proposed an above-the-line deduction for HDHP premiums

How to Open an HSA

- Purchase HDHP coverage
  - Check current insurance company
  - Contact licensed agent or broker
  - Contact state insurance department
- Establish a “trustee”
  - Banks
  - Credit unions
  - Insurance companies
  - Model form available soon

Treasury Assistance

- Guidance issued to date
  - December 22, 2003
    - Notice 2004-2
  - March 30, 2004
    - Notice 2004-23
    - Notice 2004-25
    - Rev. Rul. 2004-38
    - Rev. Proc. 2004-22
  - May 11, 2004
    - Rev. Rul. 2004-45

Treasury Assistance

- Upcoming guidance
  - Model application form
    - In final stages of approval
  - Outstanding issues
    - Expected in June

Treasury Assistance

- Web site
  - www.treas.gov
- E-mail address
  - HSAInfo@do.treas.gov
- Voice mailbox
  - (202) 622-4HSA

- Taking referrals from 1-800-MEDICARE