The Council for Affordable Health Insurance's

# ISSUES & ANSWERS

Solutions for Today's Health Policy Challenges

No. 121 December 11, 2003

## 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 governing the current federal Archer MSA demonstration project.

**HSAs Are MSAs with Fewer Restrictions**. Both HSAs and MSAs combine a high-deductible health insurance policy 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;
- 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;
- Are a permanent feature of the tax code, and thus are not time-limited as was the MSA demonstration project, which was scheduled to expire on Dec. 31, 2003;
- Allow rollovers from Archer MSAs to HSAs.

MSAs, by contrast, require higher deductibles and tighter restrictions on contributions, are limited to 750,000 people and, as mentioned, require reauthorization before year's end.

We know that people want access to MSA-type plans and the uninsured choose them when buying insurance. The IRS has reported that 73 percent of those choosing MSA plans were previously uninsured, and a January 2003 Zogby International Poll found that 74 percent of likely voters want the option of opening an MSA.

How do HSAs work and what do they mean to you? See below.

### Health Savings Accounts Q & A

| | |
|---|---|
| **Does this account replace the Archer Medical Savings Account Federal Demonstration Project (MSAs)?** | Yes; for tax years after 12/31/2003, the Archer MSA program sunsets and a new program is created called Health Savings Accounts (HSAs). Rollovers from Archer MSAs to HSAs are permitted. |
| **Is there an enrollment cap or restriction on who can have a Health Savings Account?** | There are no enrollment caps with HSAs, and they are available to anyone covered by a qualified high-deductible health plan. |
| **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. |
| **How is the account funded?** | Money is deposited directly into the account. Contributions must be made directly in cash or through §125 Cafeteria Plans. |
| **Is it a personal account?** | Yes. |

| | |
|---|---|
| **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. There is no maximum deductible as there was under an Archer MSA. However, total costs to the insured cannot exceed $5,000 for an individual and $10,000 for a family, including both the deductible and copayments. 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 type of corresponding health coverage is prohibited?** | Specialty insurance including accidents, disability, dental care, vision care and long-term care plans cannot be considered a qualifying high-deductible health plan. These can serve as secondary insurance, however. |
| **Does interest accrue?** | Interest can be accrued tax free in qualified HSAs. |
| **Is the account portable?** | Rollover is allowed. Individual owns the HSA and takes it when leaving employment but the rollover must be completed within 60 days. |
| **What is the tax treatment?** | 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. |
| **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. 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. |
| **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. |

Prepared by Victoria Craig Bunce, Director of Research and Policy,
Council for Affordable Health Insurance.



Council for Affordable Health Insurance
112 S. West Street, Suite 400
Alexandria, VA 22314
Phone: 703/836-6200 Fax: 703/836-6550
Email: mail@cahi.org
www.cahi.org

*For additional information please contact Tom Gardner, Director of Communications, at 703/836-6200 or by email at tgardner@cahi.org.*