



# The Council for Affordable Health Insurance's ISSUES & ANSWERS

Solutions for Today's Health Policy Challenges

No. 117

July 9, 2003

## ***Health Savings Accounts and Health Savings Security Accounts: A Comparison with MSAs, FSAs and HRAs***

With the alarming increases in health care costs, employers are looking to consumer-driven health plans to help rein in expenditures. Consumer-driven plans, which include Medical Savings Accounts (MSAs), Health Reimbursement Arrangements (HRAs), Flexible Spending Accounts (FSAs), defined-contribution plans and the newly introduced Health Savings Accounts (HSAs) and Health Savings Security Accounts (HSSAs), give individuals more control over the money being used to purchase health care. The goal of such plans is to give people more choices and encourage them to be value-conscious shoppers in the health care marketplace.

Unfortunately, many consumers and employers are confused about which approach is best. The *Washington Post* recently ran a story proclaiming that the American Postal Workers Union was giving its employees a "Medical Spending Account" option. However, a full reading of the story made it clear that postal workers were getting an HRA option, not an MSA. Indeed, establishing a tax-free MSA would be illegal under current federal MSA legislation.

The Council for Affordable Health Insurance (CAHI) has prepared this analysis in an effort to help clear up the confusion.

**Medical Savings Accounts.** MSAs are health plans that 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 smaller and routine health care expenses. The program is due to sunset on December 31, 2003, unless Congress extends it by law.

Deposits to federally qualified MSAs (often referred to as Archer MSAs) are tax free. MSA money not spent by year's end may be rolled over to the next year and grow with interest tax free or withdrawn. Those who withdraw MSA money for purposes other than health

care expenses must pay the taxes they avoided, plus a 15 percent penalty.

Congress authorized federally qualified MSAs under the Health Insurance Portability and Accountability Act of 1996 (HIPAA). At the same time, it imposed on Archer MSAs a number of restrictions that reduce their workability and appeal. For example, only the self-employed and employees working for small businesses can have a tax-free MSA. And employers or employees can contribute money to an MSA, but not both.

**Flexible Spending Accounts.** Congress authorized FSAs under the Revenue Act of 1978. FSAs allow employees to contribute some of their own salary to an account to pay for health care expenses or their share of health insurance premiums. Like Archer MSAs, contributions to an FSA are exempt from both income and payroll taxes. However, under the tax code, only employers can set up this program for their employees, thus excluding the self-employed and millions of employees who are prohibited from creating their own accounts.

But the biggest downside of FSAs is the use-it-or-lose-it provision. Although employees contribute the money, employers get to keep any unspent balance at year's end. Because it is difficult for a family to predict its annual medical expenses, employees often overfund their accounts and by December find themselves spending on unnecessary or frivolous health care so they will not have to forfeit the remaining money.

**Health Reimbursement Arrangements.** HRAs are the most recent form of consumer-driven health plans allowed by law. In June 2002, the IRS authorized them and published guidance regarding their tax treatment.

Notice that it is not called a Health Reimbursement "Account" (a common mistake) but "Arrangement." HRAs allow the employee to use the employer's money solely for medical expenses. The funds are owned by the employer, not by the employee, and they

may not be withdrawn for nonmedical expenditures. If withdrawals are permitted for nonmedical expenses, the plan will be disqualified for all employees, and they will owe taxes on all amounts paid out of the HRA, including all prior medical reimbursements. Unspent HRA balances may accumulate from year to year, and employers may or may not allow departing employees access to the balances after they have left the company. With some exceptions, the large majority of employers are not making the funds available.

**Health Savings Accounts and Health Savings Security Accounts.** HSAs and HSSAs, currently being considered by Congress (H.R. 2596 was added as part of H.R. 1 – the House-passed Medicare reform legislation), function similar to Medical Savings Accounts but without many of the barriers that have limited the use and effectiveness of MSAs. The legislation creates two new tax-preferred savings accounts for health care expenses.

1. Health Savings Accounts allow tax-deductible contributions from employers and individuals up to 100 percent of the deductible of a qualified high-deductible policy (between \$1,000 and \$2,250 for individuals and \$2,000 and \$4,500 for families). In addition, up to \$500 in unused FSA funds can be rolled over into the HSA. Qualified medical withdrawals are tax free and there is no income-related eligibility requirement to establish an HSA.
2. Health Savings Security Accounts are limited to qualified individuals based on income. Tax preferences phase out above \$75,000 for individuals and \$150,000 for families. Both the uninsured and those wanting lower qualifying deductibles (\$500 for individuals and \$1,000 for families) than allowed under HSAs may participate. Individuals and the uninsured with no dependents may contribute up to \$2,000 annually to an HSA, up to \$4,000 for families and the uninsured with dependents. Individuals, employers and family members may contribute to the HSSA. In addition, up to \$500 in unused FSA funds may be rolled over into the HSSA. If an individual is not eligible for an HSSA, the FSA funds can be transferred to a pension plan. HSSAs also have a “catch up provision,” which is not available under an HSA. Specifically, individuals age 55 and older may make additional “catch-up contributions” to an HSSA. The additional contribution is \$500 in 2004 and will gradually increase to \$1,000 by 2009.

**It’s All about Incentives.** One of the main differences between the FSA, HRA, MSA and now the HSA/HSSA is the financial incentive to be a value-conscious health care consumer. FSA funds do not accrue to the employee and therefore offer the employee little incentive to control spending — at least at the end of the year. Indeed, the only way to gain value from the money is to spend it. If HRAs are treated like FSAs, they could *increase* health care spending rather than reduce it, as any consumer-driven plan should.

These problems could be fixed, however. Congress could change the FSA’s use-it-or-lose-it rule to a use-it-or-save-it provision. It could give employees an ownership right to their HRA funds. And it could reduce or remove the restrictions imposed on MSAs. The HSA provision in H.R. 2596 would achieve several of these goals, creating significant new consumer-oriented options in the health care marketplace.

For a side-by-side comparison of MSAs, HRAs, FSAs and HSAs and HSSAs, please see the table. *(Note: HSAs and HSSAs have passed the House but not the Senate. While this analysis is the best current understanding of the bill’s provisions, the conference bill may change the current limitations or exclude HSAs and HSSAs from the final legislation. CAHI will provide subsequent updates if the legislation changes significantly. This information is current as of July 9, 2003.)*

---

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

---

Copyright © 2003. The Council for Affordable Health Insurance

All rights reserved. Reproduction or distribution without the express consent of CAHI is prohibited.

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



**Council for  
Affordable Health  
Insurance**

***Health Savings Accounts and Health Savings Security Accounts:  
A Comparison with MSAs, FSAs and HRAs***

	<b>Current MSA</b>	<b>Proposed HSAs</b>	<b>Proposed HSSA</b>	<b>Current FSA</b>	<b>Current HRA</b>
<b>Who “owns” it?</b>	Individual/employee of small employer and the self-employed.	Individual/employee.	Individual/employee.	Individual/employee.	Employer.
<b>Who funds it?</b>	Employer or employee (but not both), or self-employed individual.	Individual and/or employer.	Individual, employer, and/or family member (after tax contribution if family member).	Typically funded by employee.	Employer only (self-employed precluded).
<b>How is it funded?</b>	Money is deposited directly into the account.	Money is deposited directly into the account.	Money is deposited directly into the account.	A set amount of pretax wages designated by the employee is deposited directly into an account.	Employer reimburses employee when presented with a valid receipt.
<b>Is it a personal account?</b>	Yes.	Yes.	Yes.	Yes.	It is an “Arrangement,” not an “Account.”
<b>What type of corresponding health plan is allowed?</b>	Only high deductible.	Only high deductible between \$1,000 to \$2,250 with total out of pocket of \$3,000 for an individual. Family is \$2,000 to \$4,500 with total out of pocket of \$5,500.	Individuals are eligible even if they have no health plan. If they do have a health plan, the minimum deductible must be \$500 for an individual or \$1,000 for family coverage.	Any type of health plan arrangement.	Any type of health plan arrangement.
<b>Does interest accrue?</b>	Interest can be accrued tax free in qualified MSAs.	Interest can be accrued tax free in qualified HSAs.	Interest can be accrued tax free in qualified HSSAs.	Interest not accrued.	Interest not accrued or addressed in IRS regulations.

	<b>Current MSA</b>	<b>Proposed HSAs</b>	<b>Proposed HSSA</b>	<b>Current FSA</b>	<b>Current HRA</b>
<b>Is it portable?</b>	Rollover is allowed — individual owns MSA, takes it when leaving employment.	Rollover is allowed — individual owns HSA, takes it when leaving employment.	Rollover is allowed — individual owns HSSA and takes it when leaving employment.	Unused funds must be spent by year’s end (or by termination of employment before year’s end), otherwise individual loses money.	HRAs cannot be rolled over to a new employer. An employer is under no obligation to continue the arrangement after employee departure, however an employer may chose to continue reimbursing a former employee’s expenses from the HRA.
<b>Can funds be used for non-medical expenses?</b>	Funds used for non-medical expenses are taxed as income and incur a 15% penalty. After age 65 there is no penalty.	Funds used for non-medical expenses are taxed as income and incur a 15% penalty. After age of Medicare eligibility there is no penalty.	Funds used for non-medical expenses are taxed as income and incur a 15% penalty. After age of Medicare eligibility there is no penalty.	No, health portion of FSA only used for expenses defined under §213(d) of IRC.	No, only expenses defined under §213(d) of IRC.
<b>What is the tax treatment?</b>	Qualified MSAs are tax free as long as funds are spent on medical care defined under §213(d).	Qualified HSAs are tax free as long as funds are spent on medical care defined under §220(d) (2).	Qualified HSSAs are tax free as long as funds are spent on medical care defined under §220(d) (2).	Contributions to FSA are tax free and so reduce annual taxable income.	Reimbursements to employee are tax free as long as they are used on qualified health care purchases.
<b>What changes in current law if HSAs and HSSAs are enacted?</b>	No new MSAs after 12/31/03, but those who have MSAs may keep them indefinitely. Unused funds from an MSA may either be kept in the MSA or rolled over into HSA with no penalty, so long as the transfer to the HSA occurs within 60 days of the MSA distribution.	Permanent program with no participation cap.	Permanent program with no participation cap.	Up to \$500 of unused FSA money may be rolled over into an HSA without penalty.	N/A
<b>Is there a “catch up” contribution provision for older workers?</b>	Not available.	Not available.	Yes. Those age 55 and older may make additional contributions to the HSSA – starts at \$500 in 2004 and increases to \$1,000 by 2009.	Not available.	Not available.
<b>Are there other income eligibility requirements?</b>	No.	No.	Yes; contributions phase out above \$75,000 for individuals and \$150,000 for families.	No.	No.
<b>How are unused FSA balances treated?</b>	N/A	Up to \$500 may be transferred annually from the FSA to the HSA. If there is no HSA, the funds may be transferred to a pension.	Up to \$500 may be transferred annually from the FSA to the HSSA. If there is no HSSA, the funds may be transferred to a pension.	Money is forfeited back to employer at year’s end if there are any remaining FSA funds.	N/A

*(Note: HSAs and HSSAs have passed the House but not the Senate. While this analysis is the best current understanding of the bill’s provisions, the conference bill may change the current limitations or exclude HSAs and HSSAs from the final legislation. CAHI will provide subsequent updates if the legislation changes significantly. This information is current as of July 9, 2003.)*