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Answering Your Questions About Health Savings Accounts

What are HSAs? According to America's Health Insurance Plans, the HSA program has grown from 438,000 people covered in 2004 to 3.2 million people in 2005. The U.S. Treasury projects that by 2010, with no improvements to the current HSA law, there could be as many as 14 million HSA policies covering 25 million to 30 million people. If changes to the law are made, there could be 21 million HSA policies covering as many 40 million to 45 million people.

HSAs are growing in popularity due to plan design. HSAs 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. Specifically, Health Savings Accounts for tax year 2007:

- Must be coupled with a health insurance policy with a minimum deductible of \$1,100 for an individual, with total annual out-of-pocket expenses of no more than \$5,500, or \$2,200 for a family deductible, with total annual out-of-pocket expenses of no more than \$11,000;
- Allow annual contributions to the account up to 100 percent of the annual deductible as well as permit "catch-up" contributions for individuals aged 55 and over (an additional \$800 per individual);

- Allow both employers and individuals to contribute to the HSA; and
- Place no limit on the total number of accounts and are a permanent feature of the tax code.

We know that people want access to HSA-type plans and the uninsured choose them when buying insurance:

- America's Health Insurance Plans (AHIP) surveyed its members selling HSA plans and found that as of January 2006, 3.2 million people were covered by the HSA/HDHP. Of this amount, 31 percent of new enrollees in the individual market were previously uninsured, and 33 percent were in the small group market with employers who previously did not offer health coverage.
- A Watson Wyatt study shows that 29 percent of employers now provide access to a high-deductible plan, along with a reimbursement mechanism, such as a health savings account (HSA). Another 33 percent plan to add one by 2007.

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

Health Savings Accounts Q & A

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Is there any restriction on who can have a Health Savings Account?	There are no income limits on HSAs (you don't have to be working or have earned income); 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.
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? Can the employer control it?	Yes; the HSA is a personal account. No; the employer cannot control the HSA.

How is the account funded?	Contributions must be made directly into the account in cash. Contributions can be made as late as April 15 of the following year. All contributions are aggregated. Employers are allowed to make additional contributions for lower paid workers.
What type of corresponding health coverage is needed?	Qualifying high-deductible health plans must have a minimum deductible of \$1,100 for individuals and \$2,200 for family coverage. Total costs to the insured <i>cannot exceed</i> \$5,500 for an individual and \$11,000 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 \$5,500 for an individual or \$11,000 for a family. All amounts are indexed by law 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. Employees can have a limited-purpose health FSA or HRA, a suspended HRA, a post-deductible health FSA or HRA, or a retirement HRA (see IRS Publication 969).
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 permitted?	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. An employee is allowed a one-time rollover from an HRA or FSA as long as it is before 01/01/2012. Also allowed is one-time transfer from an IRA to an HSA. Rollovers cannot exceed the HSA contribution limit or excess contribution rules (i.e., penalty and tax) apply.
Does interest accrue?	Interest can be accrued tax free in qualified HSAs.
Is the account portable?	Yes; completely portable. 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 receiving unemployment compensation are allowed. Qualified expenses also include prescription drugs, qualified long-term care services, Medicare expenses (but not Medigap premiums), 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 non-medical 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. <i>Those distributions are included as taxable income but are not subject to the 10% penalty.</i>
What is the contribution amount?	For 2007, the maximum allowable contribution to an HSA is \$2,850 for individual coverage and \$5,650 for family coverage. Taxpayers allowed full-year contributions for part-year coverage. However, they must maintain a qualified high deductible health plan for a full year beginning in the month the HSA begins or pay a tax on the contribution plus 10% penalty.
Is there a “catch-up” contribution provision for older workers?	Catch-up contributions for individuals who are 55 or older is increased by statute — for 2007 it is \$800.
Are HSAs employee welfare benefit plans?	The Department of Labor 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.
Who or what entity may be a trustee or custodian of HSAs?	A bank, a credit union, 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 or custodian responsibilities?	The Secretary of Treasury may require trustees of HSAs to make reports to the secretary and the account beneficiary.