

Health Savings Accounts And Other Health Plan Structures: What Practitioners Need To Know

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A. Introduction To Health Savings Accounts (“HSAs”)

1. Background

- a. Section 1201 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, added section 223 to the Internal Revenue Code (“Code”) to permit eligible individuals in high deductible health plans to establish HSAs. (All section references are to the Code unless otherwise indicated.)
- b. HSAs receive tax-favored contributions by or on behalf of eligible individuals, and the amounts in an HSA may be accumulated over the years or distributed on a tax-free basis to pay or reimburse qualified medical expenses.
- c. A number of the rules that apply to HSAs are similar to rules that apply to IRAs under sections 219, 408, and 408A, and to Archer Medical Savings Accounts (Archer MSAs) under section 220. For example, an HSA is established for the benefit of an individual, is owned by that individual, and is portable.

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2. Principal Guidance To Date

- a. Notice 2004-2 (January 12, 2004), providing basic guidance on “eligible individuals,” “high-deductible health plans,” contributions, distributions, tax treatment, comparability requirements, etc.
- b. Notice 2004-23 (April 12, 2004), providing a safe harbor for preventive care benefits provided before satisfaction of the minimum deductible.
- c. Rev. Rul. 2004-38 (April 12, 2004), holding that prescription drug benefits may not be provided before satisfaction of the minimum deductible.
- d. Rev. Proc. 2004-22 (April 12, 2004), providing transition relief through 2005 for prescription drug benefits provided before satisfaction of the minimum deductible.
- e. Rev. Rul. 2004-45 (June 1, 2004), providing rules relating to contributions to HSAs by individuals who are also covered by health flexible spending accounts (FSAs) and/or health reimbursement accounts (HRAs).
- f. Notice 2004-50 (August 16, 2004), providing more detailed guidance on eligible individuals, high deductible health plans, preventive care, contributions, distributions, comparability, rollovers, administration, trustees and custodians, and other issues.
- g. Department of Labor Advisory Opinion 2004-09A (December 22, 2004), addressing the application of the prohibited transaction rules to incentive contributions by insurers and banks to HSAs.
- h. Notice 2005-8 (January 24, 2005), outlining rules on the ability of partnerships and S corporations to deduct contributions to partners’ and shareholder-employees’ HSAs.
- i. Rev. Rul. 2005-25 (April 14, 2005), holding that an individual who otherwise qualifies as an eligible individual does not fail to be an eligible individual merely because the individual’s spouse has non-HDHP family coverage, if the spouse’s non-HDHP family coverage does not cover the individual.

3. Other Sources Of Information

- a. The HSA Coalition, an umbrella organization of groups that support HSAs, released a guidebook on HSAs on December 7, 2004, entitled *HSA Road Rules for Consumers, Employers, Insurers, Banks, Credit Unions and Administrators*, which summarizes the Treasury Department's guidance on HSAs. The guidebook is available on the Web at www.hsainsider.com.
- b. IRS Publication 969, *Health Savings Accounts and Other Tax-Favored Health Plans* discusses HSAs, and IRS Publication 502, *Medical and Dental Expenses*, provides a list of qualified medical expenses that may be reimbursed tax-free from HSAs. These publications are available on the Web at www.irs.gov.
- c. The Treasury Department has guidance items, including HSA FAQs, available on the Web at www.ustreas.gov/offices/public-affairs/hsa/.
- d. America's Health Insurance Plans ("AHIP"), a national trade association representing the health insurance industry, launched an Internet site in December 2004 that aims to offer a clearinghouse of information on HSAs, including a list of insurers who offer HSAs and high-deductible health plans. This website is at www.hsadecisions.org.

B. HSA Rules

1. Individuals Eligible For HSA Contributions

- a. An eligible individual, with respect to any month, is an individual who is:
 - i. Covered under a high deductible health plan ("HDHP") on the first day of such month;
 - ii. With certain exceptions, is not covered by any other health plan that is not an HDHP, and which provides coverage for any benefit which is covered under the HDHP; and
 - iii. May not be claimed as a dependent on another person's tax return. §§223(b)(6); 223(c)(1)(A); see Notice 2004-2, Q&A 2.
- b. An HDHP is a health plan that satisfies certain requirements with respect to deductibles and out-of-pocket expenses. Notice 2004-2, Q&A 3.
 - i. For calendar year 2005, in the case of self-only coverage, the annual deductible must be at least \$1,000. In the case of family coverage, the annu-

al deductible must be at least \$2,000. Both of these amounts are to be indexed from time to time for inflation. §223(c)(2)(A); Notice 2004-2, Q&A 3; Rev. Prov. 2004-71.

ii. For calendar year 2005, in the case of self-only coverage, out-of-pocket expenses must be capped (either by plan design or by express terms) at \$5,100. In the case of family coverage, out-of-pocket expenses must be capped at \$10,200. Both of these amounts are to be indexed annually for inflation. §223(c)(2)(A); Notice 2004-50, Q&A 17; Rev. Prov. 2004-71.

iii. An HDHP may (but is not required to) provide preventive care benefits without a deductible or with a deductible below the minimum annual deductible. Section 223(c)(2)(C); Notice 2004-23.

(1) Preventive care includes, but is not limited to, periodic health evaluations such as annual physicals, including related tests and diagnostic procedures; routine prenatal and well-child care; child and adult immunizations; tobacco cessation programs; obesity weight-loss programs; and screening services (a list of safe harbor preventive care screening services is provided at the end of Notice 2004-23).

(2) Preventive care does not generally include any service or benefit intended to treat an existing illness, injury, or condition.

(3) If state law requires certain health care to be provided without regard to a deductible, the standards set forth in Notice 2004-23 will control (rather than classification of such care under state law) in determining whether such care is preventive.

iv. An HDHP may not provide prescription drug benefits before the minimum annual deductible has been satisfied. Rev. Rul. 2004-38.

(1) Transitional relief allows prescription drug services to be offered for months before January 1, 2006, without being subject to the high-deductible requirement, if offered either as a separate drug plan or as a rider to the HDHP. Rev. Proc. 2004-22.

(2) Certain drugs or medications, however, qualify for the preventive care safe harbor described above. Drugs are preventive when taken by a person with risk factors for a disease that has not yet become clinically apparent (e.g., statins taken to lower cholesterol), or