

HSA LEGISLATION SECTION-BY-SECTION

Section 1: The Expanded Health Access, Portability, and Ownership Act

Section 2: Expansion of Health Savings Accounts

Section 2(a) HSA payments for High-Deductible Plan Premiums

Current Law Withdrawals from Health Savings Accounts (HSA) are exempt from federal income taxes if used for qualified medical expenses, with one exception: accounts cannot be used to pay premiums of the associated high deductible health plan (HDHP).

However, payments for four types of insurance are excepted: (1) long-term care insurance, (2) health insurance premiums during periods of continuation coverage required by federal law (e.g., COBRA), (3) health insurance premiums during periods the individual is receiving unemployment compensation, and (4) for individuals age 65 years and older, any health insurance premiums (including Medicare Part B premiums) other than a Medicare supplemental policy.

Problem Americans who purchase their own HSA policies outside of the workplace cannot use tax free money to pay their premiums.

Proposal Give all Americans who purchase an HSA/HDHP on their own, the same tax advantage as those with employer-sponsored insurance. This language permits HSA payments for premiums on high deductible plans other than group plans.

Section 2(b) Medical Expenses Incurred Before Opening an HSA

For HSA purposes, qualified medical expenses would include any medical expense incurred on or after the first day of HSA-eligible coverage for a year. The reimbursement of the expenses by an HSA established no later than the date for filing the return for that taxable year would be excluded from income. (Essentially, this extends the same rules that govern the opening of a new IRA to HSAs.)

Section 2(c)

Current Law Two types of contributions may be made to HSAs, regular and catch-up. The annual contribution limit for self-only coverage is \$2,650 (in 2005, will be adjusted for inflation) or 100% of the insurance deductible, whichever is lower. The annual limit for family coverage is \$5,250 (in 2005, will be adjusted for inflation), 100% of the overall deductible, or the embedded deductible (the deductible applying to one individual) multiplied by the number of covered family members, whichever of the three is lowest.

Problem Employer-based insurance receives a tax subsidy, but out-of-pocket spending receives little. The current contribution limit on HSAs does not allow an account holder to use tax free money to pay for all of their out-of-pocket expenses, nor does it encourage saving for future expenses. Thus, the incentive is to purchase pre-paid health care—not true health insurance.

Proposal Increase the contribution limit for HSA holders to eliminate taxes on all out-of-pocket spending through HSAs. The language specifically increases the contribution limit to the lesser of: 1) the sum of the annual deductible and other annual out-of-pocket expenses or 2) the statutory maximum out-of-pocket expenditure for a high deductible health plan. Tying the contribution limit to out-of-pocket expenses avoids the attack of the HSA being used as a tax shelter for the wealthy. Under this language any out-of-pocket expense is tax-free. This also allows for a revenue estimate of the cost of the proposal. Additionally, the language coordinates contribution limits for families holding more than one HSA plan and give the Secretary regulatory authority over out-of-pocket expenses that are beyond a reasonable likelihood of ever being paid by the account holder (closes loopholes to avoid the tax shelter risk).

Section 2(d)

Current Law Employers may establish tax-free Health Reimbursement Accounts (HRA), or arrangements, to reimburse employees for medical and dental expenses not covered by insurance. Unused balances may be carried over indefinitely, though employers may limit the aggregate carryovers. HRAs are governed by Section 105 of the Internal Revenue Code, which allows health plan benefits used for medical care to be exempt from taxes, and Section 106 of the Code, which allows employer contributions to those plans to be tax-exempt.

Proposal This would allow a one-time HRA-HSA rollover for the establishment of an HSA/HDHP. This allows employers to contribute existing HRA balances to the HSAs of employees who would be eligible individuals but for the HRA coverage (HSA holders can have HDHP coverage and none other to be eligible). This one-time HRA rollover is exempted from the contribution limit under Section 2(b).

Section 3: Employer Flexibility in Contributions

Current Law If employers choose to contribute to the HSAs of their employees, they must do so with equal contributions. Chronically ill employees are often left exposed to greater expected out-of-pocket costs.

Proposal The would allow employers the freedom to contribute more money to an employee's HSA for expenses incurred from treated their chronic illness.

Section 4: Deductibility of Premiums for High Deductible Health Plans

Current Law Employer-based health insurance benefits from tax exclusion for payment of premiums on employee health plans, but individuals purchasing HDHPs must use after-tax dollars to pay their own premiums.

Proposal Allow individuals covered by HSA-qualified high deductible health plans to receive an above-the-line deduction for the amount of high deductible plan premiums in determining adjusted gross income (effective whether or not the individual itemizes

deductions). This levels the playing field for Americans purchasing health insurance on their own by giving them the same tax advantages that employers have.

Section 5: Credit to Enable Tax Free Health Ownership and Savings

Current Law Employer-based health insurance benefits from tax exclusion for payment of premiums on employee health plans, but individuals purchasing HDHPs must use after-tax dollars to pay their own premiums. Additionally, individuals must use after-tax dollars to contribute to their HSA while employers may contribute tax-subsidized money to an employee's HSA.

Proposal For Americans purchasing individual health insurance coverage, allow a tax credit to offset employment taxes on premiums paid for HDHPs. The credit would be equal to the lesser of (1) 15.3 percent (sum of employer/employee Social Security and Medicare payroll taxes) of the HDHP premium or (2) 15.3 percent of the individuals wages subject to employment taxes. This credit would not be allowed for amounts paid for premiums with HSA funds nor for individuals who elect an above-the-line tax deduction for premiums.

Proposal Allow an income tax credit to offset employment taxes on contributions not made by an employer for Americans contributing to their HSA. The credit would be equal to the lesser of (1) 15.3 percent of the after-tax contributions to an HSA or (2) 15.3 percent of wages subject to employment taxes.

Section 6: HSA Qualified Health Insurance Portability

Current Law A significant problem in today's health insurance system is that people generally cannot take their health insurance with them when they change jobs or move across state lines. This exposes workers to "job lock" and to the risk of having their premiums rise substantially if they become ill and lose or leave their job. Barriers to portability of individual health insurance include the federal tax law favoritism of employer-sponsored insurance; regulations in HIPAA, ERISA, and COBRA laws; and state regulatory differences.

Proposal Clarify that "future conversion" premiums can be tax deductible. This ensures that individuals with employer-sponsored insurance would not be tax disadvantaged if they pay advance premiums (future conversion premiums) to guarantee future individual market health insurance coverage (priced at current health status). This bill would ensure that an amount paid as a premium for the right to buy coverage in the future would constitute a medical care expense, and thus it could be deductible under existing law for itemized deduction purposes and could be offered as employer-provided coverage on an income tax and employment tax excludible basis.

Proposal Allow employers to provide taxable contributions (but eligible for an individual above-the-line tax deduction under Section 4 of this Act) to employees who show evidence of individual market HSA-qualified health insurance. This would make it easier

for employees to retain individually owned Portable HSA insurance as they move to new jobs.

Revisions to HIPAA, COBRA, and ERISA laws would clarify that Portable HSA-qualified insurance can be considered an individual market plan even when employers indirectly contribute to its premium. These would exempt the Portable HSA individual market insurance plan from group insurance regulations under HIPAA, COBRA, and title I of ERISA.