HEALTH SAVINGS ACCOUNTS

STATUS

Individuals with a high deductible health plan (and generally no other health plan) may establish and make tax-deductible contributions to a health savings account (HSA). An HSA is a tax-exempt account held by a trustee or custodian for the benefit of the individual. The decision to create and fund an HSA is made on an individual-by-individual basis and does not require any action on the part of the employer.

Contributions made to an HSA by an employer, including contributions made through a cafeteria plan through salary reduction, are excluded from income (and from wages for payroll tax purposes). Contributions made by individuals are deductible for income tax purposes, regardless of whether the individuals itemize their deductions on their tax return (rather than claiming the standard deduction). Income from investments made in HSAs is not taxable and the overall income is not taxable upon disbursement for medical expenses. For 2011, the maximum aggregate annual contribution that could be made to an HSA was $3,050 in the case of self-only coverage and $6,150 in the case of family coverage. The annual contribution limits are increased for individuals who have attained age 55 by the end of the taxable year (referred to as “catch-up contributions”).

A high deductible health plan is a health plan that has an annual deductible that was at least $1,200 for self-only coverage or $2,400 for family coverage for 2011 and that limited the sum of the annual deductible and other payments that the individual must make with respect to covered benefits to no more than $5,950 in the case of self-only coverage and $11,900 in the case of family coverage for 2011.

Distributions from an HSA that are used for qualified medical expenses are excludible from gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income. An additional 10 percent tax* is added for all HSA disbursements not made for qualified medical expenses. The additional 10-percent tax does not apply, however, if the distribution is made after death, disability, or attainment of age of Medicare eligibility (currently, age 65). * *As a result of the enactment of Patient Protection and Affordable Care Act (PPACA), the additional tax on distributions from an HSA that are not used for qualified medical expenses is increased to 20 percent of the disbursed amount, starting in 2011*.

Separately, PPACA made some changes regarding to over the counter drug expenses. Under the provision, the cost of over-the-counter medicines may not be reimbursed with excludible income through a Health FSA, HRA, HSA, or Archer MSA, unless the medicine is prescribed by a physician, effective January 1, 2011.

ANALYSIS

According to the Employee Benefits Research Institute, in 2010, there was $7.7 billion in HSAs and health reimbursement arrangements (HRAs), spread across 5.7 million accounts. This is up from 2006, when there were 1.2 million accounts with $835.4 million in assets, and 2009, when 5 million accounts held $7.1 billion in assets.

The House majority leadership has indicated the House will consider legislation to expand Health Savings Accounts.

Presumably, a new proposal in the House might return the distribution tax back to its original 10 percent level.

Before PPACA, the principal expansion efforts were to adjust the amount allowable as a deduction for health savings accounts and eliminate the restriction on purchasing health insurance from a health savings account.

OUTLOOK

On a policy level it is possible to expand HSAs under the new health care delivery system. However, Democrats have always felt HSAs are just another savings plan for the wealthy. In addition, in the Senate, an expansion would be subject to the Senate's PAYGO rules.