

IRS Notice 2004-50 COMPREHENSIVE HSA GUIDANCE

On July 23, 2004, the IRS released a set of Q&As intended to provide comprehensive guidance on Health Savings Accounts (HSAs) in the form of IRS Notice 2004-50. A complete copy of the notice is available at <http://www.treas.gov/press/releases/reports/hsanotice200450072304.pdf>.

The following summarizes key Q&As from the Notice.

OTHER HEALTH COVERAGE

VA Medical Benefits

An individual that is eligible to receive VA medical benefits is not eligible to participate in an HSA if they have received VA medical benefits at any time during the prior three months. In addition, an individual that is eligible and participating in an HSA is not eligible to make contributions to the HSA for a month if during the prior three months the individual has received VA medical benefits.

TRICARE

TRICARE (i.e. the health care program for active duty military members) coverage options do not meet the requirements to be considered a high deductible health plan (HDHP) and therefore individuals covered under TRICARE are not eligible to participate in an HSA.

Discount Medical and Drug Cards

Access to a discount card that allows an individual to obtain medical or prescription drugs at a discounted price does not disqualify an individual from eligibility to participate in an HSA, as long as the individual still has to pay the remaining cost of the care, after the discount is applied, until the HDHP deductible is met.

Employee Assistance Programs (EAP)/Disease Management/Wellness Programs

Coverage under an EAP, Disease Management, Wellness or other similar program does not disqualify an individual from eligibility to participate in an HSA, as long as the program does not provide significant benefits for medical care or treatment.

EFFECTIVE DATE OF HSA COVERAGE

The regulations require that an individual have coverage under an HDHP on the first day of the month to be eligible to participate in an HSA for that month. So, an individual that becomes covered by the employer's HDHP on a date other than the first of a month will not be eligible to participate in an HSA until the first of the month following the date HDHP coverage began.

HIGH DEDUCTIBLE HEALTH PLANS (HDHPs)

Family Coverage

Family coverage, as referenced in the regulations on HSAs, means any coverage other than single or self-only. Coverage types like Employee + 1 or Employee & Child are considered family coverage for purposes of the regulation.

Plan Lifetime Maximum

Amounts excluded from coverage under an HDHP as a result of the plan's lifetime maximum benefit are not considered out-of-pocket expenses for purposes of determining if the plan meets the minimum requirements to be considered an HDHP. The lifetime maximum must be considered reasonable and not simply be a plan design to circumvent the maximum out-of-pocket requirements of the regulation.

Annual or Lifetime Maximums for Specific Benefits

Amounts excluded from coverage under an HDHP as a result of a reasonable benefit specific maximum are not considered out-of-pocket expenses for purposes of determining if the plan meets the minimum requirements to be considered an HDHP. Such benefit maximums will only be considered reasonable if significant benefits for other services remain available under the plan once the maximum is reached.

UCR (Usual, Customary and Reasonable)

Amounts excluded from coverage under an HDHP as a result of a UCR reduction are not considered out-of-pocket expenses for purposes of determining if the plan meets the minimum requirements to be considered an HDHP.

Precertification Penalty

Amounts excluded from coverage under an HDHP as a result of a precertification penalty (flat dollar or percentage based) are not considered out-of-pocket expenses for purposes of determining if the plan meets the minimum requirements to be considered an HDHP.

Cumulative Individual Deductibles and Family Coverage

Cumulative individual deductibles that are part of a plan of family coverage could disqualify the coverage as an HDHP if the number of individuals in a family results in the potential for an out-of-pocket expense in excess of \$10,000 for the family. For example, a \$2000 individual deductible without a family limit and 100% coverage thereafter would not be considered an HDHP for a family of 6 or more because the potential out-of-pocket (6 X \$2000) exceeds \$10,000.

Copayments and Benefit Specific Deductibles

For purposes of determining if a plan meets the requirements of an HDHP, deductibles (annual and benefit specific), coinsurance and copayments must be included as out-of-pocket expenses.

PREVENTIVE CARE

Treatment of an Injury/Illness during a Preventive Care Visit

The exception to allow benefits for preventive care prior to satisfaction of the minimum deductible of an HDHP includes treatment of an existing injury/illness that is incidental or part of a preventive care visit, and situations where it would be impractical or unreasonable to perform the treatment separately of the preventive care visit (e.g. the removal of colon polyps found during a screening colonoscopy).

Prescription Drugs and the Preventive Care Exception

Drugs and medications can be considered preventive care and part of the preventive care exception to allow benefits prior to the minimum deductible of an HDHP when they are taken to prevent the reoccurrence of a disease the individual has recovered from and when taken by an individual in relation to a disease they have developed risk factors for but has yet to show symptoms of. For example, cholesterol reducing drugs used to prevent heart disease in a person with high cholesterol would be considered preventive care and ACE inhibitors used to prevent a reoccurrence of heart attack or stroke in a recovered individual would be considered preventive care.

In addition, drugs and medicines used as part of a preventive care procedure defined in IRS Notice 2004-23 (Preventive Care) are considered preventive care. These preventive care procedures include obesity weight-loss and tobacco cessation programs.

CONTRIBUTIONS

Single/Family Deductibles and Calculating the Maximum Contribution

The maximum annual contribution to an HSA is calculated as follows for a family plan with single/family deductibles. The lesser of:

- The maximum annual contribution for family coverage (\$5,150 for 2004);
- The family deductible amount;
- The individual deductible amount multiplied by the number of family members covered under the plan.

DISTRIBUTIONS

Expenses for Non-HDHP Covered Family Members

Distributions from an HSA are allowed for qualified medical expenses of the enrollee and any dependents. Only the HSA account holder must be eligible to participate in an HSA, the dependents of the account holder do not have to be eligible for an HSA individually.

Time Limits on Tax Free Distributions

Unlike a Section 125 plan, HSA expenses do not have to be incurred and reimbursed during the same year. HSA distributions may be deferred to later taxable years for expenses incurred in the current year. The only requirement is that the expenses must be incurred after the HSA was established.

Payment of Retiree Health Contributions

Health insurance premiums or contributions are only reimbursable for individuals that reached the age 65 or more. In that case, premium or contribution cost may be made from the HSA account for health coverage. This exception applies equally to fully insured or self funded plans.

Payment of Medicare Premiums

For an individual that is Medicare eligible due to age (i.e. 65 years of age or more), Medicare premiums may be reimbursed as a qualified expense under an HSA.

COMPARABILITY/DISCRIMINATION TESTING

Employer Matching Contributions to HSA

An employer who provides matching contributions to an HSA based on the employee's contribution or a percentage thereof does not satisfy the requirements of 4980G requiring comparable contributions to all employees. The only time this could be considered compliant is if each employee was making the same contribution and therefore received the same employer contribution. Note that employer contributions that are made through a Section 125 Cafeteria Plan, while subject to the discrimination testing for a Cafeteria Plan, is not subject to the comparability requirements of 4980G.

CAFETERIA PLANS AND HSAs

Section 125 Change in Status Rules

Because eligibility and contributions for an HSA are determined on a month-by-month basis, rather than annually as with other Section 125 benefits, an employee that elects to make HSA contributions through a Cafeteria Plan may change that election at any time as long as the new election is effective prospectively.

Advance Funding of HSA by Employer

An employer can, but is not required to, provide advance funding to the HSA of an individual that incurs medical expenses in excess of the current HSA balance. If the employer chooses to provide advance funding in this situation, it must make the benefit available to all participating employees and make it available throughout the cafeteria plan year. Any such funding by the employer must be repaid by the employee prior to the end of the plan year.

Negative Elections for HSAs under a Cafeteria Plan

A negative election process (i.e. elections remain in force from year to year unless revoked) is allowable in relation to an HSA offered through a cafeteria plan.

ACCOUNT ADMINISTRATION

Joint HSA for Husband and Wife

Joint HSA accounts are not allowed. Each individual that is eligible to participate in an HSA must open a separate HSA account for himself or herself.

Permissible Investments for HSA Funds

HSA funds may be invested in the investment vehicles that are approved for use with IRAs (e.g. bank accounts, annuities, CDs, stocks, mutual funds or bonds). HSA funds cannot be invested in life insurance contracts or collectibles (e.g. works of art, antiques, gems, metals, stamps, coins..etc.).

Commingling of Funds

HSAs require that individual accounts be maintained for each individual HSA and that such accounts not be commingled except in the holding of assets within a common trust fund or common investment fund.

Administration and Maintenance Fees

Amounts withdrawn from an HSA to pay administration and maintenance fees on the account are not considered taxable distributions to the account holder.

Trustees

Generally, only a life insurance company or bank can be an HSA trustee or custodian. Other entities may apply according to the procedures of the regulation for approval to be a trustee or custodian.

Rollover Restrictions in Trust or Custodial Agreements

The account holder's right to transfer amounts from HSA to another HSA or to change trustees of the account cannot be restricted.

Distribution Restrictions in Trust or Custodial Agreements

Only the account holder may determine how the funds in their HSA will be used. The plan agreements cannot limit the distributions to only cover expenses of the account holder or limit the nature of what may be reimbursed. The custodian or trustee may however place reasonable restrictions on the frequency and amount of distributions.

Responsibilities of Employers that Contribute to an Employee's HSA

Prior to making contributions to an employee's HSA account, the employer is responsible to determine if the employee is covered under a HDHP or other plan offered by the employer and what the employee's age is for purposes of catch-up contributions.

Recouping Employer Contributions to an HSA on Termination of Employment

An account holder's interest in an HSA is non-forfeitable. An employer making contributions to an employee's HSA account cannot recoup contributions to the account once they have been made.

Annual Adjustment of Minimum Deductibles and Maximum Out-of-Pockets

Annual cost of living adjustments relating to the HDHP may be made on the plan renewal date, if that date is later than January 1, but must be applied within a 12 month period ending on the renewal date. Compliance with the deductible and out-of-pocket requirements for HDHP will be based on compliance with the requirements as of the first day of the first month of the current plan year.