

## HEALTH SAVINGS ACCOUNTS IRS ISSUES COMPREHENSIVE GUIDANCE

*The Internal Revenue Service recently issued long-awaited comprehensive guidance on health savings accounts (“HSAs”). (See our Bulletins Nos. 03-133 and 03-137 for background on the HSA rules.) The Service published Notice 2004-50 which includes 88 questions and answers detailing, among other things, (i) the use of HSA distributions to pay long-term care insurance premiums, (ii) separate insurance contracts covering “permitted insurance”, and (iii) prescription drugs that may be considered “preventive care.” The guidance also addresses issues applicable to employers sponsoring HSAs, HSA trustees and custodians, and insurance companies. It bolsters the IRS’ attempt to help HSAs (a policy priority for the Bush Administration) gain traction in the marketplace.*

### **HSA DISTRIBUTIONS USED TO PAY LONG-TERM CARE INSURANCE PREMIUMS**

Although, HSA distributions generally cannot be used to pay premiums for most health insurance (see our Bulletin No. 03-133), such distributions may be used to pay long-term care insurance premiums (see our Bulletin No. 04-01). Also, an HSA may provide contributions through a cafeteria plan under Revenue Code section 125 (see Bulletins Nos. 03-133 and 03-137). The new Notice states that, even though section 125 prohibits using contributions under a cafeteria plan to pay long-term care insurance premiums, the prohibition does not apply here. Therefore, individuals may use HSA distributions to pay for such premiums through a cafeteria plan (see Q&A-40 of the Notice).

However, as we concluded in our Bulletin No. 04-01, the new Notice continues to provide that payments for long-term care premiums are limited to the gross income amounts provided for under Revenue Code section 213(d)(10) (see Q&A-41 of the Notice). The new Notice also confirms that HSA distributions which include employer contributions that are used to pay for long-term care insurance premiums are not taxable to the employee (unlike employer-provided coverage through a flexible spending account (“FSA”), which is taxable to the employee) (see Q&A-42 of the Notice).

### **SEPARATE INSURANCE CONTRACTS COVERING “PERMITTED INSURANCE”**

In order to be eligible to contribute to an HSA, an individual must be covered under a high deductible health plan (“HDHP”) and not simultaneously covered under a non-high deductible health plan (“NHDHP”). Revenue Code section 223(c)(1)(B) provides an exception to this rule stating that an individual may be covered under both a NHDHP and an HDHP, so long as the NHDHP provides coverage for certain “permitted insurance” (i.e., insurance coverage for, among other things, liabilities related to workers’ compensation, insurance for a specified disease or illness, or hospitalization insurance).

## RA Bench

The new IRS Notice clarifies the type of “specified diseases or illnesses” that may be covered and the type of insurance delivery mechanism that may be utilized. Specifically, an eligible individual may be covered by both an HDHP and one or more separate insurance contracts (i.e., NHDHPs) for one or more specified diseases or illnesses, such as cancer, diabetes, asthma or congestive heart failure (see Q&A-7 of the Notice). The Notice also states that coverage for such “permitted insurance” may not be provided on a self-insured basis (see Q&A-8 of the Notice), i.e., coverage must be fully-insured through a regulated insurance company. However, it is still unclear as to how many contracts or specified diseases or illnesses may be covered under an NHDHP in addition to those covered under a HDHP.

### **USE OF CERTAIN PRESCRIPTION DRUGS CONSTITUTE “PREVENTIVE CARE”**

An HDHP will not fail to be treated as an HDHP because the plan does not have a deductible for “preventive care.” In Notice 2004-23 (issued on March 30, 2004), the IRS issued considerable guidance regarding the types of “preventive care” benefits that may be provided by an HDHP prior to satisfaction of the deductible. Those types include, tobacco cessation and obesity weight-loss programs. Notice 2004-50 further amplifies that medical screening, which includes the treatment of a condition that is incidental or ancillary to a preventive care service, shall not disqualify an HDHP under the rules (see Q&A-26 of the Notice). In addition, drugs used to prevent the reoccurrence of a disease or to reduce the risk for a disease that has not yet manifested itself shall be considered “preventive” in nature. In particular, treatment of high-cholesterol with cholesterol-lowering drugs or drug treatment for recovering heart attack or stroke victims shall constitute “preventive care” (see Q&A-27 of the Notice).

### **OTHER HIGHLIGHTS**

The following are some highlights of the rules applicable to employers sponsoring HSAs, HAS trustees and custodians, and insurance companies:

- Employers may match employee HSA contributions (similar to matching contributions made under a Revenue Code section 401(k) plan), but only if contributions are made through a Revenue Code section 125 cafeteria plan (see Q&A-47 of the Notice (see also Q&A-46)).
- Generally, employers may provide benefits under Employee Assistance Plans (“EAPs”), disease management, or wellness programs without disqualifying an individual from contributing to an HSA (see Q&A-10 of the Notice).
- Employers are responsible for determining (i) whether an employee is covered under an HDHP or an NHDHP and the deductible amount and (ii) the employee’s age (for catch-up contributions) (see Q&A-81 of the Notice).

## RA Bench

- An insurance company or bank (including a similar financial institution as defined in Revenue Code section 408(n)) can be an HSA trustee or custodian and model HSA trust agreements and IRS forms are available for HSA trustees and custodians (see Q&As-72 and 62 of the Notice).
- Generally, an individual may defer receiving an HSA distribution to pay for medical expenses to later taxable years (see Q&A-39 of the Notice).
- HSA funds may be invested in investments approved for IRAs (e.g., bank accounts, annuities, certificates of deposit, stocks, mutual funds, or bonds). HSAs may not invest in life insurance contracts (see Q&A-65 of the Notice).
- HDHPs may provide a reasonable lifetime limit on benefits and continue to be considered HDHPs for the purposes of establishing an HSA (see Q&A-14 of the Notice).
- Amounts incurred for non-covered benefits (including amounts in excess of usual, customary, and reasonable (“UCR”) amounts or financial penalties) are not counted toward the HDHP’s deductible or out-of-pocket limit (see Q&A-21 of the Notice).
- An HDHP may negotiate and provide discounted prices for health services from providers, and such discounted prices will not prevent the plan from being an HDHP under the HSA rules (see Q&A-25 of the Notice).