Health Savings Accounts ("HSAs") and High Deductible Health Plans ("HDHPs"):

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Just when you thought you had a handle on the alphabet soup of health insurance acronyms, there are a couple of new ones you will want to get to know. Health Savings Accounts ("HSAs") and High Deductible Health Plans ("HDHPs") are the latest effort by the federal government to help employers and individuals reign in out of control health care costs. HSAs and HDHPs are designed to provide affordable health insurance coupled with the financial means to pay for uncovered health care costs while reducing the overall cost involved. While all this may sound like a pipe dream, the basic premise of this arrangement (*i.e.*, that individuals will better manage their own health care when they have a financial stake in the game) has some merit.

Here's a basic overview of how HSAs will work: An eligible individual establishes a tax-exempt trust or custodial account (similar to an IRA or an Archer MSA) that must be used exclusively for the purpose of paying qualified medical expenses. The individual also obtains health care coverage under a high deductible health plan that meets specific legal requirements. The individual cannot be covered under another health plan that is not an HDHP. Health care that is eligible for reimbursement under the HDHP is paid by the HDHP. Eligible health care that applies to the HDHP deductible is paid with funds from the HSA.

In order for a health plan to qualify as an HDHP, it must have a deductible of at least $1,000 for an individual and $2,000 for a family, and it must have a maximum annual out-of-pocket level of not more than $5,000 for individuals and $10,000 for families. Another important requirement of HDHPs is that they cannot provide any coverage or benefits (except for "preventive" care) unless and until the annual deductible is met. This last requirement is currently creating obstacles and confusion for many companies operating in states that have certain first dollar benefit mandates. Hopefully, additional guidance from the Treasury Department will clarify this confusion.

Although we are still awaiting additional guidance from the federal government about the specific nuances of HSAs and HDHPs, there are some areas where the guidance has been pretty clear. Here are some things that we know for certain:

1. An HSA is established for the benefit of an individual, is owned by that individual, and is portable! This means that if the HSA is set up in conjunction with employment, the HSA stays with the individual if the individual later changes jobs or leaves the work force entirely.

2. Contributions to an HSA may be made on a pretax basis and the HSA is generally exempt from tax, unless it has ceased to be an HSA. Also, earnings and "internal build-up" on amounts in an HSA and are not includable in gross income while held in the HSA. Unused money in an HSA can be rolled over from year to year.

3. Individuals and/or employers of any size can contribute up to the lesser of the HDHP deductible or $2,600 in a calendar year, and contributions can be made in one or more payments. Additionally, individuals between 55-65 can contribute an additional $500 in 2004, although this additional annual catch-up contribution phases out by 2009.

4. Contributions made by an eligible individual are deductible "above-the-line" in determining adjusted gross income, and are deductible whether or not the individual itemizes deductions. Contributions made by an employer to an employee's HSA are treated as employer-provided coverage for medical expenses under an accident or health plan and are excludable from the employee's gross income.

5. Distributions may be made from an HSA at any time (even after the individual is no longer an eligible individual or is over age 65), and are tax free as long as they are used exclusively to pay for qualified medical expenses of the account beneficiary. Generally, health insurance premiums are not considered qualified medical expenses, but COBRA premiums are qualified expenses. When an eligible individual turns age 65, HSA funds can be used to pay Medicare premiums, but cannot be used to purchase a plan that is supplemental to Medicare.

6. Traditional "preventive" benefits may be reimbursed through an HSA even if the annual deductible of the HDHP is not satisfied. Although it is not exactly clear what types of services constitute preventive care, the Treasury Department has stated that annual physicals, immunizations, screening services, routine prenatal care, well-child care, tobacco cessation programs and obesity weight-loss programs are preventive services and may be reimbursed on a pre-deductible basis. It is also clear that the treatment of existing conditions is not preventive care.

HSAs and HDHPs are more complex than can be represented in this short article so readers should consult an appropriate consultant for further guidance. Another great source of information is IRS Notice 2004-2 which can be found at http://www.irs.gov/irb/2004-02_IRB/ar09.htm.

WMI is anxious to offer an HDHP product that can be used in conjunction with an HSA and is looking forward to additional guidance from the federal government and state agencies. If you have some thoughts on HSAs and HDHPs, I would appreciate hearing from you. I can be reached at davidleo@wpma.com or at (801) 263-8000 (ext. 122).