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Health Savings Accounts – Favorable IRS And DOL Guidance

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The “”Medicare Prescription Drug, Improvement and Modernization Act of 2003”” (Pub. L. No. 108-173, Dec. 8, 2003) created a new type of tax-favored savings vehicle for health expenses known as a Health Savings Account (HSA). The HSA legislation, contained in new section 223 of the Internal Revenue Code, became effective January 1, 2004. The HSA is a funded account, similar to an IRA, to which individuals under age 65 and/or employers may make annual contributions within specified limits. For 2004, the contribution limits are the lesser of (i) the annual deductible or (ii) \$2,600 self-only or \$5,150 family coverage. The earnings in the account grow on a tax-free basis, and, if used for medical expenses, may be withdrawn on a tax-free basis. When an individual becomes Medicare-eligible, or in the event of death or disability, amounts in the account may be used for any purpose without incurring a tax penalty (although these amounts must be included in income).”

In order to participate in an HSA, an individual must be covered under a “high deductible health plan,” and may not participate in any other non-high deductible health plan, subject to certain exceptions. For 2004, a high deductible health plan is defined as a plan with a minimum annual deductible of \$1,000 for self-only or \$2,000 for family coverage. The annual out-of-pocket cap for the high deductible health plan must not exceed \$5,000 for self-only or \$10,000 for family coverage.

In a strong Administration-backed effort to promote the use of HSAs by employers and individuals, the IRS and DOL have issued substantial helpful guidance within a relatively brief time frame. A summary of the IRS guidance, and the favorable DOL position that exempts most HSAs from ERISA regulation, follows.

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