

**GROOM**  
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**MEMORANDUM**

May 17, 2004

TO: Clients

FROM: Groom Law Group

RE: Treasury Guidance Restricts Use of Health Savings Account (HSA) with Health Flexible Spending Arrangement (FSA) and/or Health Reimbursement Arrangement

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On May 11, 2004, Treasury and IRS issued the eagerly awaited Rev. Rul. 2004-45, which describes the circumstances under which an individual who is eligible to make contributions to a health savings account ("HSA") may also participate in a health flexible spending arrangement ("FSA") (usually offered as part of a Code section 125 cafeteria plan) and/or a health reimbursement arrangement ("HRA") (described in Notice 2002-45 and Rev. Rul. 2002-41). Commentators were hopeful that the IRS would broadly interpret the new HSA statutory language (Code section 223), which requires that an HSA-eligible individual participate in a high deductible health plan, and generally prohibits that individual from participating in any other non-high deductible health plan that provides coverage for benefits covered under the high deductible health plan. The HSA statute contains exceptions to this rule for non-high deductible health plans that provide coverage for accidents, disability, dental care, vision care, long-term care services, or certain types of "permitted insurance," which includes insurance for a specified disease or illness, and insurance paying a fixed amount per day (or other period) of hospitalization. In addition, the HSA statute provides that benefits that satisfy the definition of "preventive care" (set forth in Notice 2004-23, April 7, 2004) may be provided without a deductible.

Rev. Rul. 2004-45 does not provide the high level of flexibility that commentators sought. As a general rule, the guidance provides that an HSA-eligible individual may not concurrently participate in an HSA and an FSA and/or HRA. However, the guidance is helpful in that it identifies the circumstances under which an FSA and/or HRA may be used with an HSA, and confirms that if HRA benefits are not currently available, an individual who is "covered" by the HRA may nevertheless be an HSA-eligible individual.

Specifically, the guidance provides that an FSA and/or an HRA may be used with an HSA where:

- The FSA and/or HRA are limited-purpose arrangements that only pay or reimburse vision and dental expenses, or preventive care benefits. Presumably, an HRA could reimburse long-term care premiums as well. If the covered benefits are limited in this manner, it does not matter whether the FSA and/or HRA pay benefits without imposing a deductible.
- The FSA and/or HRA only pay or reimburse medical expenses after the minimum annual deductible of the high deductible health plan has been satisfied. The FSA and/or HRA may have separate deductibles different from that provided under the high deductible health plan. In that case, contributions to the HSA are limited to the lower of the deductibles.

In addition, the guidance provides that it is possible for an individual to be covered under both an HRA and an HSA where:

- An individual who is covered under an HRA "suspends" HRA participation by agreeing to forgo the payment or reimbursement from the HRA for medical expenses incurred during a particular HSA coverage period.
- An individual who is an active employee is covered under a retirement HRA that only reimburses medical expenses incurred after the individual retires.

### Conclusion

Rev. Rul. 2004-45 clarifies that HSA participants may not concurrently participate in an HRA and/or an FSA until the minimum deductible under the high deductible health plan is satisfied, except for certain limited coverage. This position is consistent with informal comments that Treasury and IRS officials have offered since enactment of the HSA statute. Although the guidance lacks the flexibility that many hoped for, its prompt issuance does provide information needed by plan sponsors who wish to offer an HSA option as part of their array of health benefits in 2005.

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Please contact Mike Thrasher or Chris Keller at (202) 857-0620 with any questions on HSAs generally, or for further information on this revenue ruling.