

HSAs - TAX-ADVANTAGED PAYMENT OF MEDICAL EXPENSES



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The Issue: Health Savings Accounts (HSAs) are a tax-advantaged option available to people who have a high-deductible health insurance plan (HDHP). Congress is now considering whether to impose additional documentation and substantiation requirements on tax-free payments of medical expenses from HSAs.

AHIA/NAIFA Position: A requirement that expenses that can be paid on a tax-free basis must be documented and substantiated is potentially reasonable. However, AHIA believes the proposed additional HSA documentation requirement will be burdensome and costly for HSA/HDHP policyholders. It will also raise HIPAA privacy issues for HSA trustees (usually, banks) and policyholders.

AHIA and NAIFA are opposed to the HSA provision in H.R. 5719. The provision would create additional complexity and cost to HSA account holders and/or extend HIPAA medical privacy rules to HSA trustees, usually banks. AHIA/NAIFA members serving the small business health insurance market have found HSAs used in conjunction with high-deductible health plans offer an affordable health care solution. We oppose Congressional policy that would curtail their future use, and, as a result, add to the ranks of uninsured individuals and families.

Background: On April 15, the House, on a mostly party-line vote (238-179), passed The Taxpayer Assistance and Simplification Act of 2008 (H.R. 5719). The bill includes a provision to require substantiation for withdrawals from health savings accounts over and above current law requirements.

Under current law, HSAs (tax-favored savings accounts that are used in conjunction with high deductible health plans) can be used to pay for any “qualified” medical expense. A “qualified medical expense” is one that would be deductible, without regard to the income threshold, under Internal Revenue Code (IRC) section 213. Non-medical withdrawals are permitted, but are taxed as income and assessed a 10 percent penalty.

Specifically, the HSA documentation provisions in H.R. 5719 would require trustees of HSAs (usually banks) to report annually both to the Treasury/IRS and to the HSA account owner “the aggregate amount paid or distributed from an HSA that has been determined through independent substantiation...to have been used exclusively for qualified medical expenses.” The annual report must also disclose amounts paid by the HSA for which there is no independent substantiation.

The legislative language also specifies that HSA payments that are not substantiated will be “deemed as not used exclusively for qualified medical expenses” and thus will not qualify as a medical expense. As a result, unsubstantiated expenses paid from an HSA – even if they are pure medical expenses – will trigger income and penalty tax liability.

If enacted, H.R.5719's proposed HSA substantiation requirements would add enormous costs to administering HSAs. The documentation and substantiation requirements would force HSA trustees (banks) to establish an internal department or to use an outside administrator to administer the verification and reporting requirements. This would impose a substantial additional cost, which the HSA trustee would likely have to pass along to the consumer. The administrative burden would be increased even more by the imposition of HIPAA medical privacy rules on the trustee since HSA owners would by necessity have to share sensitive medical information with the trustee/outside administrator to "prove" the validity of the expense. These additional expenses would no doubt slow the growth of HSA plan implementations and may cause individuals and groups to cancel existing high-deductible health plans. This would be a step backwards in the attempt to control rising health care benefit plan costs.

A requirement that expenses that can be paid on a tax-favored basis must be documented and substantiated is reasonable. However, current IRS procedures for tracking HSA expenditures are sufficient. Financial institutions file IRS Form 1099 SA to report distributions, IRS Form 5498 SA to report contributions received and fair market value. Employers file W-2s which contain specific HSA contribution information, and the account holder files IRS Form 8889 for self reporting contributions and distributions. HSA account activity is subject to audits from the IRS and account holders are advised to retain their receipts documenting qualified medical expenses.

About AHIA/NAIFA: AHIA's mission is to provide advocacy, services, and education to professional advisors in order to support a private, competitive health care insurance marketplace. AHIA members are NAIFA Federation members actively involved in the sale of group and individual health related products including disability, long-term care, critical illness, Medicare supplement insurance and work site products. Visit AHIA's website at www.ahia.net.

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