

April 2004

Additional Guidance on Health Savings Accounts: A Beginning

Please recall our January 26, 2004 Management Alert regarding the new Health Savings Account (HSA) vehicles that were established under the Medicare Prescription Drug, Improvement and Modernization Act of 2003. That Act put in place Internal Revenue Code Section 223 establishing HSAs. [click here for a copy of that Management Alert] Also, in our client teleconference in February, we described the structure and requirements for these new HSAs and noted that, although HSAs were available beginning January 1, 2004, there were several unanswered questions.

On March 30, 2004, the Treasury Department and the IRS issued a series of releases providing additional guidance on HSAs. This guidance has answered some, but not all, of the open questions that individuals and employers have faced when analyzing whether to establish HSAs. Most of these questions have centered around the definition of a "high deductible health plan" or "HDHP". You may recall that in order for an individual to be eligible to contribute to an HSA, that individual must be covered under an HDHP and not covered under a health plan which is not an HDHP. To qualify as an HDHP, a health plan has to have a high deductible (i.e., at least \$1,000 for single coverage and at least \$2,000 for family coverage) and have a maximum out-of-pocket limit (i.e., no more than \$5,000 for single coverage and \$10,000 for family coverage). No benefits may be paid under an HDHP until the minimum deductible is met, except for preventive care. Also, individuals may have certain other permissible insurance or other coverages that would not be considered health plans that are not HDHPs.

Preventive Care

Initially, no guidance was available on the meaning of preventive care for HDHPs as the section the statute refers us to is blank. Fortunately, the IRS has now issued Notice 2004-23. This Notice provides a safe harbor list

of preventive care benefits that may be provided under an HDHP without destroying its status as such. Under this safe harbor, preventive care includes, but is not limited to:

- ◆ Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals.
- ◆ Routine prenatal and well-child care.
- ◆ Child and adult immunizations.
- ◆ Tobacco cessation programs.
- ◆ Obesity weight-loss programs.
- ◆ Screening services (such as cancer, heart and vascular diseases, infectious diseases, mental health conditions, substance abuse, metabolic conditions, nutritional conditions, endocrine conditions, musculoskeletal disorders, obstetric and gynecologic conditions, pediatric conditions, and vision and hearing disorders screenings).

The Notice specifically states, however, the preventive care does not include any service or benefit intended to treat an existing illness, injury or condition. The IRS also stated that even though certain state laws may require insured health plans to offer coverage for certain health care without regard to a deductible, the Notice and other IRS guidance shall govern whether any specific health care is "preventive care", not the state law characterization of the health care.

Unfortunately, neither the Notice nor the other guidance addresses how employers' employee assistance programs, or EAPs, will be treated. Some EAPs are health plans, and if an EAP health plan offers benefits that are

not subject to the minimum deductible, the EAP may be a non-HDHP which would disqualify an individual from being eligible for an HSA. The IRS has asked for comments on how benefits under EAPs, mental health programs and wellness programs may qualify as preventive care.

Prescription Drug Benefits

Most employer health plans, even those that have high deductibles, offer prescription drug benefits that are subject to copayments, but are not subject to deductibles. Therefore, a question was raised whether prescription drugs might be considered preventive care or otherwise exempted from the deductible requirement for HDHPs as other permissible coverage. Revenue Ruling 2004-38 has answered this question in the negative; although Revenue Procedure 2004-22 has provided some transition relief for those who wish to move forward with setting up HSAs.

A plan that offers prescription drug benefits is a health plan and, the IRS stated in its Revenue Ruling, is not in the list of other permissible insurance or coverage. As prescription drugs are also not in the list of preventive care under Notice 2004-23, if the prescription drug benefits are not subject to the minimum deductible for HDHPs the covered person will be ineligible to contribute to an HSA.

However, if a person is covered by an HDHP and has prescription drug program coverage (either as a rider or separate plan), the Revenue Procedure provides some transition relief from this Ruling. For 2004 and 2005, an individual who would otherwise be eligible to contribute to an HSA but for the separate prescription drug benefit coverage will be an "eligible individual" and may make contributions to an HSA based on the annual deductible of his or her HDHP.

Other Transition Relief

Initial guidance from the IRS on HSAs required that in order for a medical expense to be reimbursable from an HSA, it must be incurred after the HSA is established. (But, note that the person does not need to be an "eligible individual" at the time of a distribution.) The IRS concedes that individuals and employers have been unable to establish HSAs as of yet because they cannot locate willing and able trustees and custodians. Generally, vendors have only recently offered or announced 2004 offerings of HSAs. As a result, for the 2004 year, an HSA established on or before April 15, 2005 may pay or reimburse (on a tax-free basis) qualified medical expenses if the expense was incurred on or after the later of (i) January 1, 2004; or (ii) the first day of the first month that the individual became an "eligible individual."

If you have questions about health savings accounts (HSAs) and other consumer-driven health plan designs, please contact the Seyfarth Shaw Employee Benefits Group attorney with whom you work or any employee benefits attorney listed on the website at www.seyfarth.com.

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