
*Tax Changes and Various
Health-Related Savings
Accounts*

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General Tax Treatment Employer-Provided Health Benefits

- Employer-Provided Health Insurance
 - Health coverage through employers is excluded from gross income for income tax and payroll tax purposes
 - Exclusion applies to benefits for employee, spouse, children, and qualified dependents

General Tax Treatment

Employer-Provided Health Benefits

- Some employers provide health insurance coverage through cafeteria plans
 - Employees choose between cash (includible in income) or qualified benefits (generally not includible in income)
 - Qualified benefits include accident, health, or group-term life insurance and coverage under a dependent care programs

General Tax Treatment Employer-Provided Health Benefits

- Flexible Spending Arrangements
 - Provides coverage for specified, incurred expenses eligible for reimbursement
 - Generally, funded with employee salary reduction amounts
 - Contributions to the FSA are excludible from income (as a salary reduction) for Federal income and employment tax purposes
 - Amounts that remain in the FSA at the end of the year do not carry forward to the following year (*use it or lose it*)

General Tax Treatment Employer-Provided Health Benefits

- Health Reimbursement Arrangements
 - Plan through which employers may reimburse employees for medical expenses
 - HRA funded with *employer contributions* (as opposed to FSAs with employee amounts)
 - Amounts paid or accrued by an employer for its employees are generally deductible as ordinary and necessary business expense
 - Payments received by individuals for medical expense are not includible in income
 - Amounts carryover from year-to-year, but are forfeited when employee leaves

Miscellaneous Tax Treatment

- self-employed individuals may deduct 100 percent of amounts paid for health insurance coverage (tax years 2003 and thereafter)
- self-employed deduction is available above-the-line (for purposes of computing adjusted gross income, i.e. do not have to itemize)

Miscellaneous Tax Treatment

- Schedule A – Itemized deductions for medical expenses
 - Itemizers may deduct medical expenses that exceed 7.5 percent of their adjusted gross income
 - Allowable medical expenses include: amounts paid for diagnosis or treatment of disease, transportation and lodging costs on trips necessary for medical care, qualified long-term care services, and long-term care medical insurance

Health Savings Options

- Archer Medical Savings Accounts
 - Tax-exempt accounts used solely to pay medical expenses (not previously reimbursed)
 - No new accounts may be created
- Health Savings Accounts
 - High deductible Health Plan (HDHP)
 - Qualified Health Savings Account
 - Contributions excluded from income (within limits)
 - Account earnings not subject to tax
 - Amounts remain in account for future expenses

Health Savings Options

Reasons for Change

- Rising Costs in the Employer-Provided Market
 - Premium cost sharing is increasing over time – Individuals are being asked to contribute a larger share
 - Availability of employer provided health insurance decreasing over time
 - More limits on benefits and coverage over time

Health Savings Options

Recent Legislative Changes

Medicare Modernization Act of 2003

- HSAs became available in 2004
 - (taxable years beginning after December 31, 2003)
- Allow \$500 of unused FSA balances to carry forward to the employee health account (or HSA or HSSA)
 - (proposed for taxable years beginning after December, 2006)

Health Savings Options

Directions for Legislative Changes

- Employer Market
 - Expand certain features (add flexibility)
 - Coordinate with FSAs and HRAs
 - Expand options for retiree health savings

Health Savings Options

Directions for Legislative Changes

- Individual Market (non-group)
Administration Proposal
 - Provide tax credits for lower-income individuals without health insurance
 - Create matching funds for contributions made by low-income individuals

Health Savings Options

Evidence So Far

- 70 Percent of employees have *access* to employer-sponsored health insurance
 - *53 percent participated*
- Trend is moving toward high deductible health plans in employer market
 - Estimates indicate that large employers are offering HDHP with HSA to employees at an increasing rate
 - Current estimates suggest 3-4 million currently covered by HDHP with HSA

Health Savings Options

Evidence So Far

- Individual Market beginning to see greater participation of HDHP with HSA
 - Approximately 1-2 million new enrollees in non-group market (*estimates vary, but enrollment is expected to increase to 3.2 million, see "HSAs: Early Estimates of National Take-up," Feldman, Parente, Abraham, Christianson, and Taylor, Nov/Dec 2005*)
- Significant Number of HRAs
 - 2.6 million employees estimated to have HRAs at the end of 2005
 - (*Source: Inside Consumer Directed Health, 2004, by Aetna*)

Health Savings Options Policy Considerations

Lower-Income Individuals

- Learning from the Earned Income Credit
 - Participation rates very low in early years
 - Many did not understand the credit
 - Many were non-filers for income tax purposes, but still eligible for EIC

Health Savings Options Policy Considerations

Lower-Income Individuals

- Learning from the Earned Income Credit
 - Timing of credits (April of following year too late to encourage current year purchase of insurance)
 - Allow advance credits through payroll system
 - Encourage employers to obtain group insurance (administratively), without cost sharing

Health Savings Options Policy Considerations

Lower-Income Individuals

- Learning from the Retirement Plans
 - Opt-out option for employer coordinated health benefits (even without subsidy)
 - Many retirement plans require participants to opt-out rather than sign-up for benefits
 - Participation rates reportedly 86 percent for most employers that have opt-out option

Health Savings Options Policy Directions

- Health Savings Accounts
 - Offer an important option for saving for anticipated and unanticipated future health expenses
 - Success in the individual market depends upon modifying policy to meet realistically the needs of target populations
 - Success in the employer market depends upon allowing flexibility and increasing the ease of administration

Health Savings Options Areas for Additional Study

- Better understanding the uninsured
 - Certain populations choose not to insure
 - Certain populations are unable to obtain affordable health insurance (e.g. 60 to 64 year olds, chronically ill)
 - How the uninsured obtain medical services
- Better understanding take up rates
 - Differences between group and non-group behavior