

Part III – Administrative, Procedural, and Miscellaneous

Notice 2004-25

PURPOSE

This notice provides transition relief for calendar year 2004 for eligible individuals who establish an HSA or on before April 15, 2005 from the requirement that qualified medical expenses may only be paid or reimbursed by an HSA if incurred after the HSA has been established. This notice modifies prior guidance in Q&A 26 of Notice 2004-2, 2004-2 I.R.B. 269.

Section 1201 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, added section 223 to the Internal Revenue Code to permit eligible individuals to establish Health Savings Accounts (HSAs) for taxable years beginning after December 31, 2003. Because of the short period between the enactment of HSAs and the effective date of section 223, many taxpayers who otherwise would be eligible to establish and contribute to HSAs (i.e., generally, individuals covered by a high deductible health plan (HDHP)) have been unable to do so because they cannot locate trustees or custodians who are willing and able to open HSAs at this time.

BACKGROUND

Contributions to an HSA may only be made by or on behalf of eligible individuals as defined in section 223(c)(1)(A). For any month, an eligible individual must, among other requirements, be covered on the first day of the month by a HDHP (as defined by section 223(c)(2)). Although the amount of the contribution to an HSA is based on the number of months an individual is an eligible individual (i.e., is covered by the HDHP), contributions up to the annual maximum limit generally may be made to the HSA as early as the first day of the taxable year and as late as April 15 of the year following the year for which contributions are made. Notice 2004-2, Q&A 21.

On January 12, 2004, Notice 2004-2 was published, providing general guidance concerning HSAs under section 223. The notice provides that distributions from an HSA exclusively to pay or reimburse qualified medical expenses of the account beneficiary, his or her spouse, or dependents, are excluded from gross income. Answer 26 of the notice states that, “The qualified medical expenses must be incurred only after the HSA has been established.” However, after an HSA is established, distributions from the HSA exclusively to pay or reimburse qualified medical expenses continue to be excluded from the account beneficiary’s gross income whether or not the account beneficiary continues to be an eligible individual. Notice 2004-2, Q&A 28.

TRANSITION RELIEF FOR HSAs ESTABLISHED FOR CALENDAR YEAR 2004

For calendar year 2004, an HSA established by an eligible individual on or before April 15, 2005, may pay or reimburse on a tax-free basis an otherwise qualified medical expense if the qualified medical expense was incurred on or after the later of: (1) January 1, 2004, or (2) the first day of the first month that the individual became an eligible individual under section 223.

EFFECT ON OTHER DOCUMENTS

The rule in the second sentence of Notice 2004-2, Q&A 26, which states that, “The qualified medical expenses must be incurred only after the HSA has been established,” is suspended and replaced by the transition relief in this notice. That rule continues to apply to HSAs established for calendar year 2005 and later years.

DRAFTING INFORMATION

The principal author of this notice is Shoshanna Tanner of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Ms. Tanner on (202) 622-6080 (not a toll-free call).