Administration's Fiscal Year 2007 Budget Proposals for Expanding Health Savings Accounts

The President's FY 2007 Budget proposes expansion of health savings accounts (HSAs) as a means of making health insurance coverage more affordable and accessible to Americans. The Treasury Department estimates that these changes would increase the projected number of Americans with HSAs from the current 14 million to 21 million by 2010, a 50 percent increase.

Initiatives for expanding HSAs would become effective for taxable years beginning after December 31, 2006 and are estimated to reduce federal tax revenues by $59.1 billion over 5 years. The Budget proposal would:

Provide an "above-the-line" deduction and payroll tax credit for high deductible health plan (HDHP) coverage purchased in the individual market. Individuals who purchase an HSA-eligible HDHP in the non-group market could deduct the amount of the premium from their income taxes, regardless of whether they itemize deductions on their federal income tax form. These individuals would also be eligible for a tax credit for payroll taxes. The credit would be the smaller of 15.3 percent of the HDHP premium or 15.3% of the individual's wages subject to employment taxes. Individuals claiming other credits or deductions or covered under public programs would not qualify for the above-the-line deduction or credit. These proposals are intended to create tax parity between employer-provided HDHP coverage and individually-purchased HDHP coverage.

Increase current limits on HSA contributions. Under current law, contributions to HSAs are limited to the lesser of the amount of the HDHP deductible or $2,700 for self-only coverage ($5,450 for family coverage). The budget proposal would increase HSA contribution limits to the amount of the HDHP's out-of-pocket maximum. (Under current law, HDHPs are permitted to have out-of-pocket limits of up to $5,250 for self-only coverage and $10,500 for family coverage). The proposal also provides a payroll tax credit for individuals who make after-tax contributions to their HSAs. The credit would generally be the smaller of 15.3 percent of their HSA contribution or 15.3 percent of wages subject to employment taxes.

Establish a refundable tax-credit for the purchase of HSA-eligible HDHPs by lower income individuals. A new refundable health insurance tax credit (HITC) would be established for the cost of an HDHP purchased by a lower income individual under age 65. The credit would provide a subsidy of up to 90 percent of the HDHP premium for lower-income individuals and phased out at higher incomes ($30,000 for single taxpayers and $60,000 for taxpayers purchasing family coverage). Individuals with no dependents who file a single return and have a modified adjusted gross income (AGI) up to $15,000 would be eligible for the maximum subsidy of up to $1,000. Other filers with modified AGI up to $25,000 would be entitled to the following maximum credits (indexed to inflation):

- $1,000 for a policy covering only one adult, only one child or only two or more children,
- $2,000 for a policy or policies covering two adults or one adult and one or more children, and
- $3,000 for a policy or policies covering two adults plus one or more children.

Allow employers to offer a portable HSA-compatible health plan. The Budget proposes to enhance insurance portability by allowing employers to offer "portable HSA-compatible health plans" that would not be subject to state mandates or regulations. This proposal builds on an earlier proposal to create a national marketplace for health insurance.

Other proposed changes to facilitate the formation and administration of HSAs would:

- Allow HSA funds to be used to pay premiums on a tax-free basis for non-group HDHP coverage.

- Allow an individual to use HSA funds to pay for "qualified medical expenses" that are incurred on or after the first day of HSA-eligible HDHP coverage for a year, providing the HSA is established no later than the date for filing the tax return for that taxable year. (Under current requirements, HSA funds may only be used to pay for qualified medical expenses incurred after the HSA is established).

- Allow employers to contribute existing health reimbursement arrangement (HRAs) balances to the HSAs of employees who would be eligible for HSAs, but for the HRA coverage. The HRA balances would not be taken into account for purposes of the comparability rules or the annual maximum HSA contribution limits.

- Exclude from the comparability rules extra employer contributions to HSAs on behalf of employees who are chronically ill or employees who have spouses or dependents who are chronically ill.

- Allow married couples with non-overlapping HDHP coverage to "stack" the separate maximum contributions up to the out-of-pocket maximum allowed for a family HDHP to determine the amount of the contribution. Currently, married couples with non-overlapping family coverage must use the lowest family HDHP deductible to determine the HSA contribution.

- Allow married couples who are age 55 and over to contribute annual “catch up” contributions ($700 for 2006) to the HSA owned by the other spouse.   Currently, one spouse is not permitted to have his or her catch up contribution made to the HSA owned by the other spouse.

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