

109TH CONGRESS
2D SESSION

S. _____

To amend the Internal Revenue Code of 1986 to improve and expand the availability of health savings accounts, and for other purposes.

IN THE SENATE OF THE UNITED STATES

Mr. HATCH introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to improve and expand the availability of health savings accounts, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “HSA Improvement and Expansion Act of 2006”.

6 (b) AMENDMENT OF 1986 CODE.—Except as other-
7 wise expressly provided, whenever in this Act an amend-
8 ment or repeal is expressed in terms of an amendment
9 to, or repeal of, a section or other provision, the reference

1 shall be considered to be made to a section or other provi-
2 sion of the Internal Revenue Code of 1986.

3 **SEC. 2. FINDINGS.**

4 The Congress finds the following:

5 (1) The Medicare Prescription Drug, Improve-
6 ment, and Modernization Act of 2003 (Public Law
7 108–173) authorizes health savings accounts (re-
8 ferred to in this section as “HSAs”) into which indi-
9 viduals may make annual contributions of not more
10 than \$2,700, and families may make annual con-
11 tributions of not more than \$5,450, to permit spend-
12 ing by individuals for their health care needs.

13 (2) Federal law provides for obtaining health
14 insurance coverage through a low premium health
15 plan offered with a tax-favored HSA that typically
16 costs substantially less than traditional health insur-
17 ance.

18 (3) Giving individuals more direct control over
19 their health care spending will encourage more pru-
20 dent use of health care services, help make the
21 health care system more responsive to the needs of
22 consumers, and improve access to health coverage
23 for the uninsured.

1 (4) A broad range of improvements to the Fed-
2 eral laws governing HSAs are necessary to make
3 them more attractive to consumers and employers.

4 (5) The number of people covered in January
5 2006 by products combining an HSA with a low pre-
6 mium health plan was 3,168,000, more than triple
7 the 1,031,000 reported in March 2005.

8 (6) HSAs have become an important option for
9 consumers and employers who have struggled to af-
10 ford health insurance coverage.

11 (7) According to a January 2006 census, 31
12 percent of new enrollees in HSAs and low premium
13 health plans in the individual market were previously
14 uninsured.

15 (8) HSAs combined with low premium health
16 plans can provide an affordable and accessible health
17 insurance option for individuals of all ages.

18 (9) 50 percent of all people covered by HSAs
19 and low premium health plans in the individual mar-
20 ket, including dependents covered under family
21 plans, are 40 years of age or older.

22 (10) Many States currently have in effect laws
23 and regulations that require insurers to provide spe-
24 cific benefit coverage in the health insurance plans
25 they offer, preventing individuals and small business

1 from enrolling in low premium health plans and
2 making them ineligible for HSAs.

3 **SEC. 3. ACCELERATED FUNDING FOR HSAS THROUGH DIS-**
4 **TRIBUTIONS FROM BALANCES IN HEALTH**
5 **REIMBURSEMENT AND FLEXIBLE SPENDING**
6 **ARRANGEMENTS AND FROM INDIVIDUAL RE-**
7 **TIREMENT PLANS.**

8 (a) ONE-TIME FSA AND HRA ROLLOVERS TO
9 HSAs.—

10 (1) IN GENERAL.—A plan shall not fail to be
11 treated as a flexible spending arrangement or health
12 reimbursement arrangement under section 105 or
13 106 of the Internal Revenue Code of 1986 merely
14 because—

15 (A) such plan provides for a contribution
16 to the health savings account (as defined in sec-
17 tion 223 of such Code) of the employee which
18 meets the requirements of paragraph (2), and

19 (B) such plan thereafter terminates with
20 respect to such employee.

21 (2) REQUIREMENTS.—A contribution meets the
22 requirements of this paragraph if—

23 (A) in the case of a flexible spending ar-
24 rangement (as defined in section 106(c)(2) of
25 such Code) in existence on June 1, 2006, such

1 contribution is the remaining balance in such
2 arrangement as of the last day of the plan year
3 ending in or before the taxable year in which
4 such contribution is made,

5 (B) in the case of a health reimbursement
6 arrangement in existence on June 1, 2006, such
7 contribution is the remaining balance of the
8 amount to be received in reimbursements under
9 such arrangement as of the last day of the plan
10 year ending in or before the taxable year in
11 which such contribution is made, and

12 (C) such contribution is made by the em-
13 ployer directly to the health savings account of
14 the employee not later than 60 days after the
15 end of the plan year of such flexible spending
16 arrangement or health reimbursement arrange-
17 ment.

18 (3) TREATMENT AS ROLLOVER CONTRIBU-
19 TION.—For purposes of sections 223 and 4973 of
20 such Code, a contribution which meets the require-
21 ments of paragraph (2) shall be treated as a rollover
22 contribution described in section 223(f)(5) of such
23 Code.

24 (4) TAX TREATMENT RELATING TO CONTRIBU-
25 TIONS.—For purposes of this title—

1 (A) INCOME TAX.—Gross income shall not
2 include the amount of any contribution under
3 this subsection.

4 (B) EMPLOYMENT TAXES.—Amounts con-
5 tributed to a health savings account under this
6 subsection shall be treated as a payment de-
7 scribed in section 106(d) of such Code.

8 (C) COMPARABILITY EXCISE TAX.—Section
9 4980G of such Code shall not apply to contribu-
10 tions made under this subsection.

11 (5) TERMINATION.—This paragraph shall not
12 apply to any taxable year beginning after December
13 31, 2011.

14 (b) ONE-TIME DISTRIBUTION FROM INDIVIDUAL RE-
15 TIREMENT PLANS TO FUND HSAs.—

16 (1) IN GENERAL.—Section 402 (relating to tax-
17 ability of beneficiary of employees' trust) is amended
18 by adding at the end the following new subsection:

19 “(1) HEALTH SAVINGS ACCOUNT FUNDING DIS-
20 TRIBUTION FROM INDIVIDUAL RETIREMENT PLANS.—

21 “(1) IN GENERAL.—In the case of an employee
22 who is an eligible individual and who elects the ap-
23 plication of this subsection for a taxable year, gross
24 income of the employee for the taxable year does not
25 include a qualified HSA funding distribution to the

1 extent such distribution is otherwise includible in
2 gross income (determined after the application of
3 paragraph (4)).

4 “(2) QUALIFIED HSA FUNDING DISTRIBUTION.—For purposes of this subsection, the term
5 ‘qualified HSA funding distribution’ means a dis-
6 tribution from an individual retirement plan of the
7 employee to the extent that such distribution is con-
8 tributed to the health savings account of the em-
9 ployee not later than the 60th day after the day on
10 which the employee receives such distribution or in
11 a direct trustee-to-trustee transfer.
12

13 “(3) LIMITATIONS.—

14 “(A) MAXIMUM DOLLAR LIMITATIONS
15 BASED ON OUT-OF POCKET LIMITS IN EFFECT
16 AT TIME OF CONTRIBUTION.—The amount ex-
17 cluded from gross income by paragraph (1)
18 shall not exceed—

19 “(i) in the case of an individual who
20 has self-only coverage under a high deduct-
21 ible health plan as of the first day of the
22 month in which the qualified HSA funding
23 distribution is contributed to the health
24 savings account of the employee, the
25 amount in effect for the taxable year under

1 subclause (I) of section 223(c)(2)(A)(ii),
2 and

3 “(ii) in the case of an individual who
4 has family coverage under a high deduct-
5 ible health plan as of the first day of the
6 month in which the qualified HSA funding
7 distribution is contributed to the health
8 savings account of the employee, the
9 amount in effect for the taxable year under
10 subclause (II) of section 223(c)(2)(A)(ii).

11 “(B) ONE-TIME TRANSFER.—

12 “(i) IN GENERAL.—Except as pro-
13 vided in clause (ii), an individual may
14 make an election under paragraph (1) only
15 for one qualified HSA funding distribution
16 during the lifetime of the individual. Such
17 an election, once made, shall be irrev-
18 ocable.

19 “(ii) CONVERSION FROM SELF-ONLY
20 TO FAMILY COVERAGE.—If a qualified
21 HSA funding distribution is made during a
22 month during which an individual has self-
23 only coverage under a high deductible
24 health plan as of the first day of the
25 month, the individual may elect to make

1 an additional qualified HSA funding dis-
2 tribution during a subsequent month dur-
3 ing which the individual has family cov-
4 erage under a high deductible health plan
5 as of the first day of the subsequent
6 month, except that the limitation otherwise
7 applicable under subparagraph (A)(ii) to
8 the distribution during such subsequent
9 month shall be reduced by the amount of
10 the earlier qualified HSA funding distribu-
11 tion.

12 “(4) APPLICATION OF SECTION 72.—Notwith-
13 standing section 72, in determining the extent to
14 which an amount is treated as includible in gross in-
15 come for purposes of paragraph (1), the aggregate
16 amount distributed from an eligible retirement plan
17 in a taxable year shall be treated as includible in
18 gross income to the extent that such amount does
19 not exceed the aggregate amount which would have
20 been so includible if all amounts distributed from all
21 eligible retirement plans were treated as 1 contract
22 for purposes of determining the inclusion of such
23 distribution under section 72. Proper adjustments
24 shall be made in applying section 72 to other dis-

1 tributions in such taxable year and subsequent tax-
2 able years.

3 “(5) DEFINITIONS.—For purposes of this sub-
4 section—

5 “(A) ELIGIBLE RETIREMENT PLAN.—The
6 term ‘eligible retirement plan’ means an indi-
7 vidual retirement plan (as defined in section
8 7701(a)(37)), including an individual retire-
9 ment plan which is designated as a Roth IRA.

10 “(B) ELIGIBLE INDIVIDUAL.—The term
11 ‘eligible individual’ has the meaning given such
12 term by section 223(c)(1).

13 “(6) RELATED PLANS TREATED AS 1.—For
14 purposes of this subsection, all eligible retirement
15 plans of an employer shall be treated as a single
16 plan.”.

17 (2) COORDINATION WITH LIMITATION ON CON-
18 TRIBUTIONS TO HSAS.—Section 223(b)(4) (relating
19 to coordination with other contributions) is amended
20 by striking “and” at the end of subparagraph (A),
21 by striking the period at the end of subparagraph
22 (B) and inserting “, and”, and by inserting after
23 subparagraph (B) the following new subparagraph:

24 “(C) the aggregate amount contributed to
25 health savings accounts of such individual for

1 such taxable year under section 402(l) (and
2 such amount shall not be allowed as a deduc-
3 tion under subsection (a)).”.

4 (3) 10-PERCENT PENALTY ON EARLY DISTRIBUTIONS NOT TO APPLY.—Section 72(t)(2)(A) of such
5 Code (relating to subsection not to apply to certain
6 distributions) is amended by striking “or” at the
7 end of clause (vi), by striking the period at the end
8 of clause (vii) and inserting “, or”, and by inserting
9 after clause (vii) the following new clause:
10 after clause (vii) the following new clause:

11 “(viii) a qualified HSA funding dis-
12 tribution (as defined by section 402(l)).”.

13 (c) EFFECTIVE DATE.—The amendments made by
14 this section shall apply to taxable years beginning after
15 December 31, 2006.

16 **SEC. 4. PROVISIONS RELATING TO ELIGIBILITY TO CON-**
17 **TRIBUTE TO HSAS.**

18 (a) INDIVIDUALS ELIGIBLE FOR REIMBURSEMENT
19 UNDER SPOUSE’S FLEXIBLE SPENDING ARRANGE-
20 MENT.—Section 223(c)(1) (defining eligible individual) is
21 amended by adding at the end the following new subpara-
22 graph:

23 “(C) SPECIAL RULE FOR CERTAIN FLEXI-
24 BLE SPENDING ARRANGEMENTS.—For purposes
25 of subparagraph (A)(ii), an individual shall not

1 be treated as covered under a health plan de-
2 scribed in such subparagraph merely because
3 the individual is covered under a flexible spend-
4 ing arrangement (within the meaning of section
5 106(c)(2)) which is maintained by an employer
6 of the spouse of the individual, but only if—

7 “(i) the employer is not also the em-
8 ployer of the individual, and

9 “(ii) the individual certifies to the em-
10 ployer and to the Secretary (in such form
11 and manner as the Secretary may pre-
12 scribe) that the individual and the individ-
13 ual’s spouse will not accept reimbursement
14 under the arrangement for any expenses
15 for medical care provided to the indi-
16 vidual.”.

17 (b) INDIVIDUALS OVER AGE 65 AUTOMATICALLY EN-
18 ROLLED IN MEDICARE PART A.—Section 223(b)(7) (re-
19 lating to contribution limitation on medicare eligible indi-
20 viduals) is amended by adding at the end the following
21 new sentence: “This paragraph shall not apply to any indi-
22 vidual during any period the individual’s only entitlement
23 to such benefits is an entitlement to hospital insurance
24 benefits under part A of title XVIII of such Act pursuant
25 to an automatic enrollment for such hospital insurance

1 benefits under the regulations under section 226(a)(1) of
2 such Act.”

3 (c) INDIVIDUALS ELIGIBLE FOR CERTAIN VETERANS
4 BENEFITS.—Section 223(c)(1) (defining eligible indi-
5 vidual), as amended by subsection (a), is amended by add-
6 ing at the end the following new subparagraph:

7 “(D) SPECIAL RULE FOR INDIVIDUALS EL-
8 IGIBLE FOR CERTAIN VETERANS BENEFITS.—
9 For purposes of subparagraph (A)(ii), an indi-
10 vidual shall not be treated as covered under a
11 health plan described in such subparagraph
12 merely because the individual receives periodic
13 hospital care or medical services for a service-
14 connected disability under any law administered
15 by the Secretary of Veterans Affairs but only if
16 the individual is not eligible to receive such care
17 or services for any condition other than a serv-
18 ice-connected disability.”.

19 (d) EFFECTIVE DATE.—The amendments made by
20 this section shall apply to taxable years beginning after
21 December 31, 2006.

22 **SEC. 5. PROVISIONS RELATING TO CONTRIBUTION AND**
23 **LOW PREMIUM HEALTH PLAN LIMITS.**

24 (a) INCREASE IN CONTRIBUTION LIMITS FOR
25 HSAs.—

1 (1) INCREASE IN MONTHLY LIMIT.—

2 (A) IN GENERAL.—Paragraph (2) of sec-
3 tion 223(b) (relating to monthly limitation) is
4 amended to read as follows:

5 “(2) MONTHLY LIMITATION.—In the case of an
6 eligible individual who has coverage under a high de-
7 ductible health plan, the monthly limitation for any
8 month of such coverage is $\frac{1}{12}$ of—

9 “(A) in the case of an eligible individual
10 who has self-only coverage under a high deduct-
11 ible health plan as of the first day of such
12 month, \$2,700, and

13 “(B) in the case of an eligible individual
14 who has family coverage under a high deduct-
15 ible health plan as of the first day of such
16 month, \$5,450.”.

17 (B) CONFORMING AMENDMENTS.—

18 (i) Section 223(d)(1)(A)(ii)(I) is
19 amended by striking “subsection
20 (b)(2)(B)(ii)” and inserting “subsection
21 (b)(2)(B)”.

22 (ii) Section 223(c)(2)(D) is amended
23 to read as follows:

24 “(D) SPECIAL RULE FOR NETWORK
25 PLANS.—In the case of a plan using a network

1 of providers, such plan shall not fail to be treat-
2 ed as a high deductible health plan by reason
3 of having an out-of-pocket limitation for serv-
4 ices provided outside of such network which ex-
5 ceeds the applicable limitation under subpara-
6 graph (A)(ii).”.

7 (2) INCREASE IN LIMIT FOR INDIVIDUALS BE-
8 COMING ELIGIBLE INDIVIDUALS AFTER THE BEGIN-
9 NING OF THE YEAR.—Section 223(b) (relating to
10 limitations) is amended by adding at the end the fol-
11 lowing new paragraph:

12 “(8) INCREASE IN LIMIT FOR INDIVIDUALS BE-
13 COMING ELIGIBLE INDIVIDUALS AFTER THE BEGIN-
14 NING OF THE YEAR.—An individual who first be-
15 comes an eligible individual during a calendar year
16 in a month after January of the calendar year shall,
17 for purposes of computing the limitation under para-
18 graph (1) for any taxable year, be treated as having
19 been an eligible individual during each of the months
20 in such calendar year preceding such first month
21 (and as having been enrolled in each of those
22 months in the same high deductible health plan the
23 individual was enrolled in for such first month).”.

24 (3) APPLICATION OF SPECIAL RULES FOR MAR-
25 RIED INDIVIDUALS.—Paragraph (5) of section

1 223(b) (relating to special rule for married individ-
2 uals) is amended to read as follows:

3 “(5) SPECIAL RULES FOR MARRIED INDIVID-
4 UALS.—

5 “(A) IN GENERAL.—In the case of individ-
6 uals who are married to each other and who are
7 both eligible individuals, the limitation under
8 paragraph (1) for each spouse shall be equal to
9 the spouse’s applicable share of the excess (if
10 any) of—

11 “(i) the dollar amount in effect under
12 paragraph (2)(B) (without regard to any
13 additional contribution amounts under
14 paragraph (3)), over

15 “(ii) the aggregate amount paid to
16 Archer MSAs of such spouses for the tax-
17 able year.

18 “(B) APPLICABLE SHARE.—For purposes
19 of subparagraph (A), a spouse’s applicable
20 share is one-half of the limitation under sub-
21 paragraph (A) unless both spouses agree on a
22 different division.”

23 (4) SELF-ONLY COVERAGE.—Section 223(c)(4)
24 (defining family coverage) is amended to read as fol-
25 lows:

1 “(4) COVERAGE.—

2 “(A) FAMILY COVERAGE.—The term ‘fam-
3 ily coverage’ means any coverage other than
4 self-only coverage.

5 “(B) SELF-ONLY COVERAGE.—If more
6 than 1 individual is covered by a high deduct-
7 ible health plan but only 1 of the individuals is
8 an eligible individual, the coverage shall be
9 treated as self-only coverage.”.

10 (b) FAMILY PLAN MAY HAVE INDIVIDUAL ANNUAL
11 DEDUCTIBLE LIMIT.—Section 223(c)(2) (defining high
12 deductible health plan) is amended by adding at the end
13 the following new subparagraph:

14 “(E) SPECIAL RULE FOR FAMILY COV-
15 ERAGE.—A health plan providing family cov-
16 erage shall not fail to meet the requirements of
17 subparagraph (A)(i)(II) merely because the
18 plan elects to provide both—

19 “(i) an aggregate annual deductible
20 limit for all individuals covered by the plan
21 which is not less than the amount in effect
22 under subparagraph (A)(i)(II), and

23 “(ii) an annual deductible limit for
24 each individual covered by the plan which

1 is not less than the amount in effect under
2 subparagraph (A)(i)(I).”.

3 (c) COST-OF-LIVING ADJUSTMENTS COMPUTED EAR-
4 LIER IN THE CALENDAR YEAR.—Paragraph (1) of section
5 223(g) (relating to cost-of-living adjustment) is amended
6 by adding at the end the following new flush sentence:

7 “In the case of any taxable year beginning after
8 2006, section 1(f)(4) shall be applied for purposes of
9 this paragraph by substituting ‘March 31’ for ‘Au-
10 gust 31’ and the Secretary shall publish the adjusted
11 amounts under subsections (b)(2) and (c)(2)(A) for
12 taxable years beginning in any calendar year no
13 later than June 1 of the preceding calendar year.”.

14 (d) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to taxable years beginning after
16 December 31, 2006.

17 **SEC. 6. DEFINITION OF QUALIFIED MEDICAL EXPENSES.**

18 (a) PREMIUMS FOR LOW PREMIUM HEALTH PLANS
19 TREATED AS QUALIFIED MEDICAL EXPENSES.—Sub-
20 paragraph (C) of section 223(d)(2) is amended by striking
21 “or” at the end of clause (iii), by striking the period at
22 the end of clause (iv) and inserting “, or”, and by adding
23 at the end the following new clause:

24 “(v) a high deductible health plan, but
25 only if the expenses are for coverage for a

1 month with respect to which the account
2 beneficiary is an eligible individual by rea-
3 son of the coverage under the plan.”.

4 (b) SPECIAL RULE FOR CERTAIN MEDICAL EX-
5 PENSES INCURRED BEFORE ESTABLISHMENT OF AC-
6 COUNT.—Paragraph (2) of section 223(d) is amended by
7 adding at the end the following new subparagraph:

8 “(D) CERTAIN MEDICAL EXPENSES IN-
9 CURRED BEFORE ESTABLISHMENT OF ACCOUNT
10 TREATED AS QUALIFIED.—An expense shall not
11 fail to be treated as a qualified medical expense
12 solely because such expense was incurred before
13 the establishment of the health savings account
14 if such expense was incurred—

15 “(i) during either—

16 “(I) the taxable year in which the
17 health savings account was estab-
18 lished, or

19 “(II) the preceding taxable year
20 in the case of a health savings ac-
21 count established after the taxable
22 year in which such expense was in-
23 curred but before the time prescribed
24 by law for filing the return for such

1 taxable year (not including extensions
2 thereof), and

3 “(ii) for medical care of an individual
4 during a period that such individual was
5 an eligible individual.

6 For purposes of clause (ii), an individual shall
7 be treated as an eligible individual for any por-
8 tion of a month the individual is described in
9 subsection (c)(1), determined without regard to
10 whether the individual is covered under a high
11 deductible health plan on the 1st day of such
12 month.”.

13 (c) EFFECTIVE DATE.—The amendments made by
14 this section shall apply to taxable years beginning after
15 December 31, 2006.