DESCRIPTION OF THE PROVISIONS OF H.R. 5858, A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1986 TO IMPROVE HEALTH SAVINGS ACCOUNTS, AND FOR OTHER PURPOSES

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by the
HOUSE COMMITTEE ON WAYS AND MEANS
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INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on May 31, 2012, of H.R. 5858, "A Bill to Amend the Internal Revenue Code of 1986 to Improve Health Savings Accounts and for Other Purposes."[1] This document,[2] prepared by the staff of the Joint Committee on Taxation, provides a description of these provisions.

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[1] Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended.

[2] This document may be cited as follows: Joint Committee on Taxation, *Description of the Provisions of H.R. 5858, A Bill to Amend the Internal Revenue Code of 1986 to Improve Health Savings Accounts and for Other Purposes* (JCX-47-12), May 29, 2012. This document can also be found on the internet at www.jct.gov.

A. Saver's Credit for Contributions to Health Savings Accounts

<u>Health Savings Accounts</u>

<u>General rules</u>

An individual with a high deductible health plan (and no other health plan other than a plan that provides certain permitted insurance or permitted coverage) may establish a health savings account ("HSA"). In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. In general, HSAs are tax-exempt trusts or custodial accounts created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents. Thus, earnings on amounts in HSAs are not taxable.

Subject to limits, contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual.[3] Contributions made by an employer to an HSA are excludible from income and wages for employment tax purposes. For 2012, the maximum aggregate annual contribution that can be made to an HSA is $3,100 in the case of self-only coverage and $6,250 in the case of family coverage. The annual contribution limits are increased by $1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as "catch-up contributions"). An excise tax applies to contributions in excess of the maximum contribution amount for the HSA unless the excess contributions (and earnings allocable thereto) are distributed no later than the due date for the individual's Federal income tax return for the year.

Distributions from an HSA for qualified medical expenses are not includible in gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 20 percent. The 20-percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (*i.e.*, age 65).

<u>Cafeteria plan</u>

A cafeteria plan is a separate written plan of an employer under which all participants are employees, and participants are permitted to choose among at least one permitted taxable benefit (for example, current cash compensation) and at least one qualified benefit (generally an employer-provided benefit excludible from gross income, such as employer-provided health coverage). If an employee receives a qualified benefit based on his or her election between the qualified benefit and a taxable benefit under a cafeteria plan, the qualified benefit generally is not includible in gross income.[4] The amount of the cash compensation forgone pursuant to an election under a cafeteria plan is generally referred to as a salary reduction contribution. One of the choices that may be offered under a cafeteria plan is the choice between cash compensation and the employer making a salary reduction contribution to an HSA.

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[3] Sec. 223(a).

[4] Sec. 125(a).

W-2 reporting requirements

An employer must include the amount of any contributions made to an employee's HSA on the employee's Form W-2.[5] There is no requirement to separate on the Form W-2 the amount of any salary reduction contribution to an HSA under a cafeteria plan from any other contribution made by an employer to an HSA.

Saver's credit

Present law provides a nonrefundable tax credit for eligible taxpayers who make qualified retirement savings contributions.[6] Subject to AGI limits, the credit is available to individuals who are 18 or older, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return. The AGI limits for 2012 (as indexed for inflation) are $57,500 for married taxpayers filing joint returns, $43,125 for head of household taxpayers, and $28,750 for single taxpayers and married taxpayers filing separate returns.

For purposes of the credit, qualified retirement savings contributions include (1) elective deferrals to a section 401(k) plan, a section 403(b) plan, a governmental section 457 plan, a SIMPLE IRA, or a SEP; (2) contributions to a traditional or Roth IRA; and (3) voluntary after-tax employee contributions to a qualified retirement plan or annuity or a section 403(b) plan. The maximum amount of qualified retirement savings contributions taken into account for purposes of the credit is $2,000. The amount of any contribution eligible for the credit is reduced by distributions received by the taxpayer (or by the taxpayer's spouse if the taxpayer files a joint return) from any plan or IRA to which eligible contributions can be made during the taxable year for which the credit is claimed, the two taxable years prior to the year the credit is claimed, and during the period after the end of the taxable year for which the credit is claimed and prior to the due date for filing the taxpayer's return for the year. Certain distributions are disregarded for purposes of this rule, such as corrective distributions of qualified retirement savings contributions. Distributions that are rolled over to another retirement plan do not affect the credit.

The credit is a percentage of the taxpayer's qualified retirement savings contributions up to $2,000. The credit percentage depends on the AGI of the taxpayer, varying from 10 percent to 50 percent, as shown in the table below. The credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets minimum tax liability as well as regular tax liability.

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[5] Sec. 6051(a)(12)

[6] Sec. 25B.

Table 1.–Credit Rates for Saver's Credit (for 2012)

Joint Filers	Heads of Households	All Other Filers	Credit Rate
$0 – $34,500	$0 – $25,875	$0 – $17,250	50 percent
$34,501 – $37,500	$25,876 – $28,125	$17,251 – $18,750	20 percent
$37,501 – $57,500	$28,126 – $43,125	$18,751 – $28,750	10 percent

Description of Proposal

Under the proposal, deductible contributions to an HSA made by a taxpayer and salary reduction contributions under a cafeteria plan made by an employer to an HSA for the taxpayer qualify for the saver's credit. These HSA contributions are aggregated with qualified retirement savings contributions to determine the amount of credit to which a taxpayer is entitled. Thus, the present law limit of $2,000 applies to aggregate contributions (both HSA contributions and qualified retirement savings contributions) taken into account in determining the amount of the credit.

HSA contributions are generally subject to the same rules as apply to qualified retirement savings contributions including the reduction in the amount of qualified contributions due to distributions received by the taxpayer (or by the taxpayer's spouse if the taxpayer files a joint return with the spouse) during certain periods. However, distributions from an HSA used for qualified medical expenses are disregarded in determining the amount by which qualified contributions are reduced for distributions. Further, as in the case of corrective distributions of qualified retirement savings contributions, distributions of excess HSA contributions plus allocable earnings (made before the due date of the taxpayer's Federal income tax return) are also disregarded in determining the amount by which qualified contributions are reduced for distributions.

In order to identify salary reduction contributions to an HSA under a cafeteria plan for purposes of the saver's credit, the proposal also includes a requirement that the employer separately state on an employee's Form W-2 the amount of salary reduction contributions made to an HSA under a cafeteria plan.

Effective Date

The proposal applies for taxable years beginning after December 31, 2012.

B. Special Rule for Certain Medical Expenses Incurred Before Establishment of Health Savings Account

Present Law

Health Savings Accounts

An individual with a high deductible health plan (and no other health plan other than a plan that provides certain permitted insurance or permitted coverage) may establish a health savings account ("HSA").[7] In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. In general, HSAs are tax-exempt trusts or custodial accounts created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents. Thus, earnings on amounts in HSAs are not taxable.

Subject to limits, contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual. Contributions to an HSA are excludible from income and wages for employment tax purposes if made by the employer. For 2012, the maximum aggregate annual contribution that can be made to an HSA is $3,100 in the case of self-only coverage and $6,250 in the case of family coverage. The annual contribution limits are increased by $1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as "catch-up contributions"). Contributions, including catch-up contributions, cannot be made once an individual is enrolled in Medicare.

Distributions from an HSA for qualified medical expenses are not includible in gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 20 percent. The 20-percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (*i.e.*, age 65).

In order for a distribution from as an HSA to be excludible as a payment for a qualified medical expense, the medical expense must be incurred on or after the date that the HSA is established.[8] Thus, a distribution from an HSA is not excludible as payment used for a qualified medical expense if the medical expense is incurred after a taxpayer enrolls in a high deductible health plan but before the taxpayer establishes an HSA.

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[7] Sec. 223. Generally, a high deductible health plan is a health plan that, for 2012, has an annual deductible that is at least $1,200 for self-only coverage or $2,400 for family coverage and that has an out-of-pocket expense limit that is no more than $6,050 in the case of self-only coverage and $12,100 in the case of family coverage. Out-of-pocket expenses include deductibles, co-payments, and other amounts (other than premiums) that the individual must pay for covered benefits under the plan. A plan does not fail to be a high deductible health plan by reason of failing to have a deductible for preventive care.

[8] Q&A-26 of Notice 2004-2, 2004-1 C.B. 269.

Description of Proposal

Under the proposal, if an HSA is established during the 60-day period beginning on the date that an individual's coverage under a high deductible health plan begins, then the HSA is treated as having been established on the date that such coverage begins for purposes of determining if an expense incurred is a qualified medical expense. Thus, if a taxpayer establishes an HSA within 60 days of the date that the taxpayer's coverage under a high deductible health plan begins, any distribution from an HSA used as a payment for a medical expense incurred during that 60-day period after the high deductible health plan coverage began is excludible from gross income as a payment used for a qualified medical expense even though the expense was incurred before the date that the HSA was established.

Effective Date

The proposal applies with respect to high deductible health plan coverage commencing after the date of enactment.

C. Allow Both Spouses to Make Catch-Up Contributions to the Same HSA

Present Law

An individual with a high deductible health plan and no other health plan (other than a plan that provides certain permitted insurance or permitted coverage) may establish a health savings account ("HSA"). In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. In general, HSAs are tax-exempt trusts or custodial accounts created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents. Thus, earnings on amounts in HSAs are not taxable.

Subject to limits, contributions to an HSA made by or on behalf of an eligible individual are deductible in determining adjusted gross income of the individual (that is, an "above-the-line" deduction). Contributions to an HSA by an employer for an employee (including salary reduction contributions made through a cafeteria plan) are excludible from income and from wages for employment tax purposes. Distributions from an HSA for qualified medical expenses are not includible in gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 20 percent. The 20-percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (*i.e.*, age 65).

For 2012, the maximum aggregate annual contribution that can be made to an HSA is $3,100 in the case of self-only coverage and $6,250 in the case of family coverage.[9] The annual contribution limits are increased by $1,000 for an eligible individual who has attained age 55 by the end of the taxable year (referred to as "catch-up contributions").[10] All HSA contributions are aggregated for purposes of the maximum annual contribution limit, and contributions to Archer MSAs reduce the annual HSA contribution limit. The annual HSA contribution limit for an individual is generally the sum of the limits determined separately for each month (1/12 of the maximum aggregate annual contribution amount), based on the individual's status and health plan coverage as of the first day of the month.[11]

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[9] Under section 4973, an excise tax applies to contributions in excess of the maximum contribution amount for the HSA. The excise tax generally is equal to six percent of the cumulative amount of excess contributions that are not distributed from the HSA.

[10] Contributions, including catch-up contributions, cannot be made once an individual is enrolled in Medicare.

[11] Under a special rule, an individual who is an eligible individual during the last month of a taxable year is treated as having been an eligible individual for every month in the taxable year for purposes of computing the amount that may be contributed to the HSA for the year. Thus, the individual may contribute the maximum aggregate annual contribution amount. However, if the individual ceases to be an eligible individual within a certain period, contributions that could not otherwise have been made are generally includible in income and are subject to a 10-percent additional tax.

If eligible individuals are married to each other and either spouse has family coverage, both spouses are treated as having only family coverage, so that the annual contribution limit for family coverage applies. This annual contribution limit (without regard to any catch-up contribution amounts) is reduced by any Archer MSA contributions and then divided equally between the spouses unless they agree on a different division.

If both spouses of a married couple are eligible individuals, each may contribute to an HSA, but they cannot have a joint HSA.[12] Under the rule described above, however, the spouses may divide their annual contribution limit by allocating the entire amount to one spouse to be contributed to that spouse's HSA.[13] This rule does not apply to catch-up contribution amounts, though. Thus, if both spouses are at least age 55 and eligible to make catch-up contributions, each must make the catch-up contribution to his or her own HSA.[14]

Description of Proposal

Under the proposal, if both spouses of a married couple are eligible for catch-up contributions and either has family coverage, the annual contribution limit that can be divided between them includes both catch-up contribution amounts. Thus, for example, they can agree that their combined catch-up contribution amount is allocated to one spouse to be contributed to that spouse's HSA. In other cases, as under present law, a spouse's catch-up contribution amount is not eligible for division between the spouses; the catch-up contribution must be made to the HSA of that spouse.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2012.

[12] Notice 2004-50, 2004-2 C.B. 196, Q&A-63.

[13] Notice 2004-50, Q&A-32. Funds from that HSA can be used to pay qualified medical expenses for either spouse on a tax-free basis. Notice 2004-50, Q&A-36.

[14] Notice 2008-59, 2008-2 C.B. 123, Q&A-22.

D. Individuals Eligible for Veterans Benefits for a Service-Connected Disability

Present Law

An individual with a high deductible health plan and no other health plan (other than a plan that provides certain permitted insurance or permitted coverage) is generally eligible to make deductible contributions to a health savings account ("HSA"), subject to certain limits (an "eligible individual"). HSA contributions made on behalf of an eligible individual by an employer are excludible from income and wages for employment tax purposes. Eligibility for HSA contributions is generally determined monthly, based on the individual's status and health plan coverage as of the first day of the month. Contributions to an HSA cannot be made once an individual is enrolled in Medicare.

An individual with other coverage in addition to a high deductible health plan is still eligible to make HSA contributions if such other coverage is permitted insurance or permitted coverage. Permitted insurance is: (1) insurance if substantially all of the coverage provided under such insurance relates to (a) liabilities incurred under worker's compensation law, (b) tort liabilities, (c) liabilities relating to ownership or use of property (*e.g.*, auto insurance), or (d) such other similar liabilities as the Secretary of Treasury may prescribe by regulations; (2) insurance for a specified disease or illness; and (3) insurance that provides a fixed payment per day (or other period) for hospitalization. Permitted coverage is coverage (whether provided through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care. Coverage under certain health flexible spending arrangements or health reimbursement arrangements is also permitted.

Under IRS guidance, an otherwise eligible individual who is eligible for medical benefits under a program of the Department of Veterans Affairs (VA), but who has not actually received such benefits during the preceding three months, continues to be an eligible individual.[15] However, an individual is not eligible to make HSA contributions for any month if the individual has received VA medical benefits at any time during the previous three months unless the benefits are for permissible coverage or preventive care.[16]

Description of Proposal

Under the proposal, an individual does not fail to be treated as an eligible individual for any period merely because the individual receives VA medical benefits for a service-connected disability.

The proposal does not otherwise change the application of the present-law rule for individuals eligible for VA medical benefits. Thus, an otherwise eligible individual who is eligible for VA medical benefits, but who has not actually received such benefits during the preceding three months, continues to be an eligible individual. However, an individual is not

[15] Notice 2004-50, 2004-2 C.B. 196, Q&A-5.

[16] Notice 2004-50, Q&A-5; Notice 2008-59, 2008-2 C.B. 123, Q&A-9.

eligible to make HSA contributions for any month if the individual has received VA medical benefits at any time during the previous three months unless the benefits are for permissible coverage or preventive care (or for a service-connected disability).

Effective Date

The proposal applies to months beginning after December 31, 2012.

E. Distributions by Certain Early Retirees for Health Coverage Treated as Qualified Medical Expense

Present Law

An individual with a high deductible health plan and no other health plan (other than a plan that provides certain permitted insurance or permitted coverage) may establish a health savings account ("HSA"). In general, HSAs are tax-exempt trusts or custodial accounts created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents.

Distributions from an HSA for qualified medical expenses are not includible in gross income.[17] Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 20 percent. The 20-percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (*i.e.*, age 65).

Payments for insurance are generally not qualified medical expenses that can be paid from an HSA on a tax-free basis, subject to certain exceptions. For example, an exception applies for health insurance expenses, other than for a Medicare supplemental policy, of an HSA holder who is at least age 65.

Description of Proposal

Under the proposal, in the case of an HSA holder who is at least age 55 but not age 65, qualified medical expenses include expenses for coverage under a group health plan (that is, an employer-sponsored health plan) in which the HSA holder is enrolled by reason of being a former employee or a surviving spouse of a former employee. Thus, in that case, expenses for such coverage can be paid from an HSA on a tax-free basis.

Effective Date

The proposal is effective for amounts paid for coverage for periods after December 31, 2012.

[17] Amounts in an HSA can be used for qualified medical expenses even if the individual is not currently eligible to make HSA contributions.