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Health Savings Accounts Get Clarification And Relief

Could this be the real IRS? Or has someone taken over the service while we weren't looking? In an unprecedented flurry of illumination and absolution, the IRS has issued Notices 2004-23 and 2004-25, Revenue Ruling 2004-38 and Revenue Procedure 2004-22. All of these disperse information regarding health savings accounts (HSAs).

The notices, revenue ruling and revenue procedure can be broken down into three distinct issues: the definition of preventive care, prescription drug coverage and covering expenses incurred before opening an HSA.

Background

HSAs (see my February 2004 commentary) are individually owned health reimbursement accounts that allow untaxed dollars to fund the account. Interest or dividends accumulate in a tax-free environment, and payment of qualified medical expenses has no additional tax consequences.

Individuals making tax-favored contributions to their HSAs must be covered by a qualified, high-deductible health plan (HDHP). The HDHP must satisfy minimum deductible amounts with certain out-of-pocket maximums. Account holders may not be covered by any other insurance plan that is not an HDHP or that covers benefits provided by the HDHP.

However, the account holder may obtain

definite "permitted insurance" or "permitted coverage" products, such as policies that provide dental, vision, accident, disability and long term care benefits. The HDHP may also provide preventive care that is below the minimum deductible amount or without a deductible.

Preventive Care

Notice 2004-23 explains preventive care as additional coverage that can be provided without jeopardizing the "no other insurance" rule for HSAs, such as:

- Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations such as annual physicals.
- Routine prenatal and well-child care.
- Child and adult immunizations.
- Tobacco cessation programs.
- Obesity weight-loss programs.
- Screening services (chart on page 94).

One further point about preventive care—IRC Section 220 details the interaction with state law healthcare requirements in defining preventive care. This notice is quick to point out that no such connection exists with the newest HSA legislation.

Prescription Drug Coverage

How can an HSA participant obtain an HDHP and still get prescription drugs without paying full price? Well, they can't. Revenue Ruling 2004-38 reiterates the "no other insurance" rule outlined in the

Notice 2004-23
Safe Harbor Preventive Care Screening Services

Cancer

Breast Cancer (mammogram)
Cervical Cancer (pap smear)
Colorectal cancer
Prostate Cancer (PSA test)
Skin Cancer
Oral Cancer
Ovarian Cancer
Testicular Cancer
Thyroid Cancer

Heart and Vascular

Abdominal Aortic Aneurysm
Carotid Artery Stenosis
Coronary Heart Disease
Hemoglobinopathies
Hypertension
Lipid Disorders

Infectious Diseases

Bacteriuria
Chlamydial Infection
Gonorrhea
Hepatitis B Virus Infection
Hepatitis C
Human Immunodeficiency Virus (HIV) Infection
Syphilis
Tuberculosis Infection

Mental Health and Substance Abuse

Dementia
Depression
Drug Abuse
Problem Drinking
Suicide Risk
Family Violence

Metabolic Nutritional and Endocrine

Anemia, Iron Deficiency
Dental and Periodontal Disease
Diabetes Mellitus
Obesity in Adults
Thyroid Disease

Musculoskeletal

Osteoporosis

Obstetric and Gynecologic

Bacterial Vaginosis in Pregnancy
Gestational Diabetes Mellitus
Home Uterine Activity Monitoring
Neural Tube Defects
Preeclampsia
Rh Incompatibility
Rubella
Ultrasonography in Pregnancy

Pediatric

Child Developmental Delay
Congenital Hypothyroidism
Lead Levels in Childhood and Pregnancy
Phenylketonuria
Scoliosis, Adolescent Idiopathic

Vision and Hearing

Glaucoma
Hearing Impairment in Older Adults
Newborn Hearing

original HSA statute.

There is an example in the facts and analysis section that says an individual's HDHP doesn't cover prescription drugs. However, the individual is covered by another plan for prescription drugs that is not subject to the HDHP deductible and allows for a co-payment amount per prescription.

In this case, a plan that provides benefits for prescription drugs is a health plan. In addition, a prescription drug benefit is not in the list of permitted insurance or permitted coverage benefits. In short, having any prescription drug coverage that kicks in before the minimum deductible is met would disqualify an otherwise eligible

HSA account holder from making tax-free contributions to his account.

Transition Relief

Availability of both a qualifying HDHP and a trustee or custodian to initiate the account has been in short supply. When the HSA legislation was passed, HDHPs in the marketplace contained co-payment arrangements for prescription drug coverage, or provided a rider for prescriptions. Either arrangement would disqualify the HDHP from being considered an eligible product under HSA legislation.

Revenue Procedure 2004-22 suspends, in part, Revenue Ruling 2004-38 pertaining to prescription drug benefits within the qualified HDHP. Account holders who would otherwise qualify except for such drug benefits have until January 1, 2006, to obtain coverage as outlined in Revenue Ruling 2004-38.

IRC Section 223 clearly states that medical expenses may only be paid by an HSA if they are incurred after the HSA is established. However, the service realizes that banking institutions may not have had time to gear up for this new type of account, thus making it impossible for otherwise eligible individuals to begin paying for medical expenses with tax-free dollars.

Therefore, Notice 2004-25 states that any HSA established before April 15, 2005, by a qualified individual may pay eligible medical expenses on a tax-free basis. The medical expenses were to have been 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."

And that's not all—the IRS has indicated they will be providing more HSA guidance in June. So stay tuned. □

The information is not intended to be legal, accounting or other professional advice. We assume no liability whatsoever in connection with its use, nor are these comments directed to specific situations.