

Revenue Ruling 2004-45

2004-22 I.R.B. 971 (June 1, 2004)

[HSAs: Interaction With Other Health Arrangements]

ISSUE

In the situations described below, may an individual make contributions to a Health Savings Account (HSA) under section 223 of the Internal Revenue Code if the individual is covered by a high deductible health plan (HDHP) and also covered by a health flexible spending arrangement (health FSA) or a health reimbursement arrangement (HRA)?

FACTS

Situation 1. An individual is covered by an HDHP (as defined under section 223(c)(2)(A)). The HDHP has an 80/20 percent coinsurance feature above the deductible. The individual is also covered by a health FSA under a section 125 cafeteria plan and an HRA that meets the requirements of Notice 2002-45, 2002-2 C.B. 93. The health FSA and HRA pay or reimburse all section 213(d) medical expenses that are not covered by the HDHP (such as co-payments, coinsurance, expenses not covered due to the deductible and other medical expenses not covered by the HDHP). The health FSA and HRA coordinate the payment of benefits under the ordering rules of Notice 2002-45. The individual is not entitled to benefits under Medicare and may not be claimed as a dependent on another person's tax return.

Situation 2. Same facts as Situation 1, except that the health FSA and HRA are limited-purpose arrangements that pay or reimburse, pursuant to the written plan document, only vision and dental expenses (whether or not the minimum annual deductible of the HDHP has been satisfied). In addition, the health FSA and HRA pay or reimburse preventive care benefits as described in Notice 2004-23, 2004-15 I.R.B. 725.

Situation 3. Same facts as Situation 1, except that the individual is not covered by a health FSA. Under the employer's HRA, the individual elects, before the beginning of the HRA coverage period, to forgo the payment or reimbursement of medical expenses incurred during that coverage period. The decision to forgo the payment or reimbursement of medical expenses does not apply to permitted insurance, permitted coverage and preventive care ("excepted medical expenses"). See section 223(c)(1)(B) and Notice 2004-23. Medical expenses incurred during the suspended HRA coverage period (other than the excepted medical expenses if otherwise allowed to be paid or reimbursed by an HRA), cannot be paid or reimbursed by the HRA currently or later (i.e., after the HRA suspension ends). However, the employer decides to continue to make employer contributions to the HRA during the suspension period and thus the maximum available amount under the HRA is not affected by the suspension but is available for the payment or reimbursement of the excepted medical expenses incurred during the suspension period as well as medical expenses incurred in later HRA coverage periods.

Situation 4. Same facts as Situation 1, except that the health FSA and HRA are post-deductible arrangements that only pay or reimburse medical expenses (including the individual's 20 percent coinsurance responsibility for expenses above the deductible) after the minimum annual deductible of the HDHP has been satisfied.

Situation 5. Same facts as Situation 1, except that the individual is not covered by a health FSA. The employer's HRA is a retirement HRA that only reimburses those medical expenses incurred after the individual retires.

LAW AND ANALYSIS

Section 223(a) allows a deduction for contributions to an HSA for an "eligible individual" for any month during the taxable year. Section 223(c)(1)(A) provides that a n "eligible individual" means, with respect to any month, any individual who is covered under an HDHP on the first day of such month and is not, while covered under an HDHP, "covered under any health plan which is not a high deductible health plan, and which provides coverage for any benefit which is covered under the high deductible health plan"

Section 223(b) provides a limit on amounts that can be contributed to an HSA. The maximum annual contribution limit for an eligible individual with self-only coverage is the amount required by section 223(b)(2)(A). The maximum annual contribution limit for an eligible individual with family coverage is the amount required by section 223(b)(2)(B).

Section 223(c)(2)(A) defines an HDHP as a health plan that satisfies certain requirements with respect to minimum annual deductibles and maximum annual out-of-pocket expenses. Generally, if substantially all of the coverage in a health plan that is intended to be an HDHP is provided through a health FSA or HRA, the health plan is not an HDHP.

In addition to coverage under an HDHP, section 223(c)(1)(B) provides that an eligible individual may have specifically enumerated coverage that is disregarded for purposes of the deductible. Coverage that may be disregarded includes "permitted insurance" and other specified coverage ("permitted coverage"). "Permitted insurance" is coverage under which substantially all of the coverage provided relates to liabilities incurred under workers' compensation laws, tort liabilities, liabilities relating to ownership or use of property, insurance for a specified disease or illness, and insurance that pays a fixed amount per day (or other period) of hospitalization. "Permitted coverage" (whether through insurance or otherwise) is coverage for accidents, disability, dental care, vision care or long-term care. Section 223(c)(2)(C) also provides a safe harbor for the absence of a preventive care deductible. See Notice 2004-23.

The legislative history of section 223 explains these provisions by stating that "eligible individuals for HSAs are individuals who are covered by a high deductible

health plan and no other health plan that is not a high deductible health plan." The legislative history also explains that, "[a]n individual with other coverage in addition to a high deductible health plan is still eligible for an HSA if such other coverage is certain permitted insurance or permitted coverage" H.R. Conf. Rep. No. 391, 108th Cong., 1st Sess. 841 (2003).

Section 125(a) states that no amount will be included in the gross income of a participant in a cafeteria plan solely because, under the plan, the participant may choose among the benefits of the plan. Section 125(d) defines a cafeteria plan as a written plan under which participants may choose among two or more benefits consisting of cash and qualified benefits.

Section 125(f) defines qualified benefits as any benefit not included in the gross income of the employee by reason of an express provision in the Code. Qualified benefits include employer-provided accident and health coverage under section 106, including health FSAs.

Notice 2002-45, 2002-2 C.B. 93, describes the tax treatment of HRAs. The notice explains that an HRA that receives tax-favored treatment is an arrangement that is paid for solely by the employer and not pursuant to a salary reduction election under section 125, reimburses the employee for medical care expenses incurred by the employee and by the employee's spouse and dependents, and provides reimbursement up to a maximum dollar amount with any unused portion of that amount at the end of the coverage period carried forward to subsequent coverage periods.

Notice 2002-45, Part IV, states that if a n employer provides an HRA in conjunction with another accident or health plan and that other plan is provided pursuant to a salary reduction election under a cafeteria plan, then all the facts and circumstances are considered in determining whether the salary reduction is attributable to the HRA. An accident or health plan funded pursuant to salary reduction is not an HRA and is subject to the rules under section 125.

Under section 223, an eligible individual cannot be covered by a health plan that is not a n HDHP unless that health plan provides permitted insurance, permitted coverage or preventive care. A health FSA and an HRA are health plans and constitute other coverage under section 223(c)(1)(A)(ii). Consequently, an individual who is covered by an HDHP and a health FSA or HRA that pays or reimburses section 213(d) medical expenses is generally not an eligible individual for the purpose of making contributions to an HSA. See Rev. Rul. 2004-38, 2004-15 I.R.B. 717, which holds that an individual who is covered by an HDHP that does not provide prescription drug coverage and a separate prescription drug plan or rider that provides benefits before the minimum annual deductible of the HDHP has been satisfied is not an eligible individual for HSA purposes.

However, an individual is an eligible individual for the purpose of making contributions to an HSA for periods the individual is covered under the following arrangements:

Limited-Purpose Health FSA or HRA. A limited-purpose health FSA that pays or reimburses benefits for "permitted coverage" (but not through insurance or for long-term care services) and a limited-purpose HRA that

pays or reimburses benefits for "permitted insurance" (for a specific disease or illness or that provides a fixed amount per day (or other period) of hospitalization) or "permitted coverage" (but not for long-term care services). In addition, the limited-purpose health FSA or HRA may pay or reimburse preventive care benefits. The individual is an eligible individual for the purpose of making contributions to an HSA because these benefits may be provided whether or not the HDHP deductible has been satisfied.

Suspended HRA. A suspended HRA, pursuant to an election made before the beginning of the HRA coverage period, that does not pay or reimburse, at any time, any medical expense incurred during the suspension period except preventive care, permitted insurance and permitted coverage (if otherwise allowed to be paid or reimbursed by the HRA). The individual is an eligible individual for the purpose of making contributions to an HSA. When the suspension period ends, the individual is no longer an eligible individual because the individual is again entitled to receive payment or reimbursement of section 213(d) medical expenses from the HRA. An individual who does not forgo the payment or reimbursement of medical expenses incurred during an HRA coverage period, is not an eligible individual for HSA purposes during that HRA coverage period.

If an HSA is funded through salary reduction under a cafeteria plan during the suspension period, the terms of the salary reduction election must indicate that the salary reduction is used only to pay for the HSA offered in conjunction with the HRA and not to pay for the HRA itself. Thus, the mere fact that an individual participates in an HSA funded pursuant to a salary reduction election does not necessarily result in attributing the salary reduction to the HRA.

Post-Deductible Health FSA or HRA. A post-deductible health FSA or HRA that does not pay or reimburse any medical expense incurred before the minimum annual deductible under section 223(c)(2)(A)(i) is satisfied. The individual is an eligible individual for the purpose of making contributions to the HSA. The deductible for the HRA or health FSA ("other coverage") need not be the same as the deductible for the HDHP, but in no event may the HDHP or other coverage provide benefits before the minimum annual deductible under section 223(c)(2)(A)(i) is satisfied. Where the HDHP and the other coverage do not have identical deductibles, contributions to the HSA are limited to the lower of the deductibles. In addition, although the deductibles of the HDHP and the other coverage may be satisfied independently by separate expenses, no benefits may be paid before the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied.

Retirement HRA. A retirement HRA that pays or reimburses only those medical expenses incurred after retirement (and no expenses incurred before retirement). In this case, the individual is an eligible individual for the purpose of making contributions to the HSA before retirement but loses eligibility for coverage periods when the retirement HRA may pay or reimburse section 213(d) medical expenses. Thus, after retirement, the individual is no longer an eligible individual for the purpose of the HSA.

In the arrangements described, the individual does not fail to be an eligible individual under section 223 and may contribute to an HSA. In addition, combinations of these arrangements which are consistent with these requirements would not disqualify an individual from being an eligible individual. For example, if an employer offers a combined post-deductible health FSA and a limited-purpose health FSA, this would not disqualify an otherwise eligible individual from contributing to an HSA.

An individual may not be reimbursed for the same medical expense by more than one plan or arrangement. However, if the individual has available an HSA, a health FSA and an HRA that pay or reimburse the same medical expense, the health FSA or the HRA may pay or reimburse the medical expense, subject to the ordering rules in Notice 2002-45, Part V, so long as the individual certifies to the employer that the expense has not been reimbursed and that the individual will not seek reimbursement under any other plan or arrangement covering that expense (including the HSA).

HOLDINGS

In Situation 1, the individual is covered by an HDHP and by a health FSA and HRA that pay or reimburse medical expenses incurred before the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied. The health FSA and HRA pay or reimburse medical expenses that are not limited to the exceptions for permitted insurance, permitted coverage or preventive care. As a result, the individual is not an eligible individual for the purpose of making contributions to an HSA. This result is the same if the individual is covered by a health FSA or HRA sponsored by the employer of the individual's spouse. See, Rev. Rul. 2004-38.

In Situation 2, the individual is covered by an HDHP and by a health FSA and HRA that pay or reimburse medical expenses incurred before the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied. However, the medical expenses paid or reimbursed by the health FSA and HRA include only vision and dental benefits (which are permitted coverage) and preventive care. All of these benefits may be covered as a separate health plan, as a separate or optional rider, or as part of the HDHP and whether or not the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied. The individual is an eligible individual for the purpose of making contributions to an HSA.

In Situation 3, the individual elects to forgo the payment or reimbursement of medical expenses incurred during an HRA coverage period. The suspension of payments and reimbursements by the HRA does not apply to permitted insurance, permitted coverage and preventive care (if otherwise allowed to be paid or reimbursed by the HRA). The individual is an eligible individual for the purpose of making contributions to an HSA until the suspension period ends and the individual is again entitled to receive, from the HRA, payments or reimbursements of section 213(d) medical expenses incurred after the suspension period.

In Situation 4, the health FSA and HRA pay or reimburse medical expenses (including the 20 percent coinsurance not otherwise covered by the HDHP) only after the HDHP's minimum annual deductible has been

satisfied. The individual is an eligible individual for the purpose of making contributions to an HSA.

In Situation 5, the HRA is a retirement HRA that only pays or reimburses medical expenses incurred after the individual retires. The individual is an eligible individual for the purpose of making contributions to an HSA before retirement because the HRA will pay or reimburse only medical expenses incurred after retirement.

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).

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