

Congressional Research Service (CRS) Report

Tax-Advantaged Accounts for Health Care Expenses

A Side-by-Side Comparison

There are four types of tax-advantaged accounts that can be used to pay for unreimbursed medical expenses (e.g., deductibles, copayments, and services not covered by insurance). Often the subject of legislation and debated in various reform proposals to control the rising cost of health care, these accounts are:

- (1) Health Care Flexible Spending Accounts (FSAs),
- (2) Health Reimbursement Accounts (HRAs),
- (3) Health Savings Accounts (HSAs), and
- (4) Archer Medical Savings Accounts (MSAs).

A recent Congressional Research Service (CRS) Report (which notes that keeping these accounts straight can be difficult) compares their respective eligibility, contribution limits, use of funds, and other characteristics for tax year 2007.

There are a number of controversial issues frequently associated with these accounts. As the CRS Report notes, the tax savings associated with these health care accounts depend on the taxpayers' marginal tax rates. As a result, the accounts are more attractive for higher-income taxpayers. In fact, some consider HSAs more of a vehicle for building retirement income than paying for health care. On the other hand, if accounts are paired with high deductible insurance, it might be argued that the tax savings are appropriate for taking on greater financial risk and using less health care (to the extent this actually occurs). And while FSAs subsidize first-dollar payments for health care and may increase health care spending, because they are available only through employer plans, they likely appear inequitable to taxpayers who cannot have them.

The Report notes that the objective of “consumer driven health plans”—plans where the accounts are paired with high deductible insurance—is to allow owners to choose health care providers and services themselves and to give owners a financial incentive to save for future health care expenses in exchange for accepting the greater risk of a higher insurance deductible. While consumer driven health plans will theoretically slow health care spending and encourage cost-effective care, the Report observes that the effectiveness of this strategy is difficult to measure because **the two accounts most likely to achieve these goals, HRAs and HSAs**, are still too new for adequate assessment.

The CRS Report suggests that it may be simpler and more effective to have fewer accounts available for a variety of expenses, rather than the current multiple tax-advantaged savings accounts for education, retirement, and health care. The Report notes that in 2005, the **President's Advisory Panel on Federal Tax Reform** recommended that MSAs, HSAs, and FSAs be replaced by new *Save for Family* accounts that could be used for health care and education expenses with a \$10,000 annual contribution limits. In addition, President Bush's FY 2008 budget would eliminate FSAs and HRAs, replacing the exclusion for employer-paid coverage with new health insurance standard deductions.

Congressional Research Service (CRS) Report

Tax-Advantaged Accounts for Health Care Expenses

A Side-by-Side Comparison

The four types of currently available tax-favored accounts are:

FSAs. These are employer-established arrangements that are usually funded through salary reduction agreements under Code Sec. 125 . The employee's contribution isn't subject to either income or employment taxes. However, unless the employer offers a grace period for additional claims of up to 2 1/2 months, an employee's unused balance is forfeited at the end of the year. A limited, one-time rollover may be made to a **HSA**.

HRAs. These are employer-established arrangements that are funded *only* through employer contributions. Contributions are not subject to either income or employment taxes under Code Sec. 106 , and health care benefits used for medical care are tax exempt under Code Sec. 105 . Unused balances may be carried over indefinitely, though employers may limit the aggregate carryovers. A limited, one-time rollover may be made to a **HSA**.

HSAs. These are tax-exempt accounts under Code Sec. 223 that can be established (and to which contributions can be made) only when the owner has qualifying high deductible insurance (for 2007, a deductible of at least \$1,100 for self-only coverage and \$2,200 for family coverage) and generally no other coverage, including Medicare. Contributions made by employers are exempt from income and employment taxes, and account owners may deduct contributions they make. Withdrawals for medical expenses are not taxed, but those for other purposes are and are subject to an additional 10% penalty, except in cases of disability, death, or attaining age 65. Unused balances may be carried over from year to year without limit. Contributions are limited (for 2007) to \$2,850 for self-only coverage and \$5,650 for family coverage. An additional contribution of \$800 is allowed to people age 55 and older.

Archer MSAs. These accounts under Code Sec. 220 can be established generally only when account owners have qualifying high deductible insurance and no other coverage. Contributions made by employers are exempt from income and employment taxes, and contributions by account owners (which are allowed only if the employer doesn't contribute) are deductible. Withdrawals are not taxed if used for medical expenses, but those used for other purposes generally are and are subject to an additional 15% penalty. Unused balances may be carried over from year to year without limit. Unlike **HSAs**, eligibility is limited to people who are self-employed or who are employees covered by a high deductible plan established by their small employer (50 or fewer employees, on average). In addition, the minimum deductible levels are higher and the contribution limits are lower than for **HSAs**.

Congressional Research Service (CRS) Report

Tax-Advantaged Accounts for Health Care Expenses

A Side-by-Side Comparison

Summary of General Features of FSAs, HRAs, HSAs, and MSAs /*/

	Health Care Flexible Spending Accounts (FSA)	Health Reimbursement Accounts (HRA)	Health Savings Accounts (HSA)	Medical Savings Accounts (Archer MSA)
Eligibility	<p>Employees whose employers offer this benefit. Former employees may be included.</p> <p>Employers not restricted by size.</p>	<p>Employees whose employers offer this benefit. Former employees may be included.</p> <p>Employers not restricted by size.</p>	<p>Individuals with qualifying health insurance. Ineligible individuals may keep previously established accounts but cannot make contributions.</p>	<p>Individuals with qualifying health insurance who are employees of a small employer (50 or fewer workers) with a high deductible plan or self-employed. Ineligible individuals may keep previously established accounts but cannot make contributions.</p>

Congressional Research Service (CRS) Report

Tax-Advantaged Accounts for Health Care Expenses

A Side-by-Side Comparison

Summary of General Features of FSAs, HRAs, HSAs, and MSAs /*/

	Health Care Flexible Spending Accounts (FSA)	Health Reimbursement Accounts (HRA)	Health Savings Accounts (HSA)	Medical Savings Accounts (Archer MSA)
Definition of qualifying health insurance	No health insurance requirements.	No health insurance requirements, although HRAs are usually combined with high deductible health insurance.	Self-only deductible must be at least \$1,100; the family deductible must be at least \$2,200. Annual out-of-pocket expenses for covered benefits cannot exceed \$5,500 for self-only coverage and \$11,000 for family coverage. Deductible need not apply to preventive care.	Self-only deductible must be at least \$1,900 but not over \$2,850; the family deductible must be at least \$3,750 but not over \$5,650. Annual out-of-pocket expenses for covered benefits cannot exceed \$3,750 and \$6,900, respectively. Deductible need not apply to preventive care if absence of deductible is required by state law.
Contributions	By employer, employee, or both. Usually funded by employee through salary reduction agreement.	Only by employer.	By any person on behalf of an eligible individual.	By employer or account owner, but not both.

Congressional Research Service (CRS) Report

Tax-Advantaged Accounts for Health Care Expenses

A Side-by-Side Comparison

Summary of General Features of FSAs, HRAs, HSAs, and MSAs /*/

	Health Care Flexible Spending Accounts (FSA)	Health Reimbursement Accounts (HRA)	Health Savings Accounts (HSA)	Medical Savings Accounts (Archer MSA)
Annual contribution limits	None required, though employers usually impose a limit.	None required. Employers usually set their contributions below the annual deductible of the accompanying health insurance.	\$2,850 for self-only coverage and \$5,650 for family coverage. Account owners 55 years old or older and not in Medicare can contribute an additional \$800 in 2007.	65% of the deductible for self-only coverage and 75% of the deductible for family coverage.
Qualifying expenses	Most unreimbursed medical expenses, though employers may impose additional limitations. May not be used for long-term care or health insurance premiums.	Most unreimbursed medical expenses, though employers may impose additional limitations. May be used for long-term care and health insurance premiums, if the employer allows.	Most unreimbursed medical expenses. May be used for premiums for long-term care insurance, COBRA, health insurance for those receiving unemployment compensation under federal or state law, and health insurance (other than Medigap policies) for individuals who are 65 years of age and older.	Most unreimbursed medical expenses. May be used for premiums for long-term care insurance, COBRA, and health insurance for those receiving unemployment compensation under federal or state law.

Congressional Research Service (CRS) Report

Tax-Advantaged Accounts for Health Care Expenses

A Side-by-Side Comparison

Summary of General Features of FSAs, HRAs, HSAs, and MSAs /**

	Health Care Flexible Spending Accounts (FSA)	Health Reimbursement Accounts (HRA)	Health Savings Accounts (HSA)	Medical Savings Accounts (Archer MSA)
Allowable nonmedical withdrawals	None	None	Permitted, subject to income tax and 10% penalty except in cases of disability, death, or attaining age 65.	Permitted, subject to income tax and 15% penalty except in cases of disability, death, or attaining age 65.
Carryover of unused funds	Balances remaining at year's end (or up to 2 1/2 months after year's end, if employer permits) are forfeited to employer. A limited, one-time rollover to an HSA is allowed.	Permitted, although some employers limit amount that can be carried over. A limited, one-time rollover to an HSA is allowed.	Full amount may be carried over indefinitely.	Full amount may be carried over indefinitely.
Portability	Balances generally forfeited at termination, although COBRA extensions sometimes apply.	At discretion of employer, though subject to COBRA provisions.	Portable.	Portable.

/ Rules are expressed in general terms. Not all details are shown.**

Note that the dollar amount figures are those that apply for 2007.