BUSINESS PROVISIONS IN THE 2003 HEALTH SAVINGS ACT

Included within the recently passed 2003 Health Savings Act were a number of new health related tax rule changes affecting businesses. The purpose of these comments is to provide you with a brief overview of these new rules.

■ Health Savings Accounts (HSAs)

HSAs are new tax-advantaged savings accounts which can be used to pay for medical expenses incurred by individuals, their spouse or their dependents. An HSA will work very much like a traditional IRA, except the account holder will be able to use the money for health care costs. However, the participant must be enrolled in a high deductible health insurance plan. Then the tax-deductible savings account (HSA) may be opened. Here are more details regarding HSAs as they affect employers:

- Employers will be able to deduct contributions to HSAs (within prescribed limits) for employees who are eligible.

- Cafeteria plans will be able to offer HSAs as part of their "menu" of choices.

- HSAs will be portable when an employee changes employers. Contributions and earnings will belong to the account holder, not an employer.

- HSAs will be available starting in 2004.

- Employers will be required to report amounts contributed to an HSA on the employee's Form W-2.

- Nondiscrimination rules will apply to employer contributions to HSAs. Employers who make a contribution to an HSA for an employee during a year generally will be required to make available comparable contributions to the HSAs of all comparable participating employees during the same year. Otherwise, the employer will be hit with an excise tax. Contributions will be considered comparable if they are either of the same amount or the same percentage of the annual deductible under the plan.

■ Exclusion for federal drug subsidy under prescription drug plans

The 2003 Health Savings Act requires the Social Security Administration to provide subsidies to each sponsor of a qualified retiree prescription drug plan for qualified covered retirees under the plan. In general, these subsidy payments will equal 28% of a covered retiree's plan-related prescription drug costs greater than $250 but not greater than $5,000.

The 2003 Health Savings Act provides that gross income does not include any special subsidy received under this provision. This new income exclusion is not taken into account for purposes of determining whether any deduction is allowable with respect to the cost taken into account in determining the payment. A taxpayer will be able to claim a deduction for prescription drug expenses incurred, even though he receives an excludable subsidy related to the same expenses.

For corporations, the 2003 Health Savings Act provides that the adjustment to adjusted current earnings (ACE) for items that are excluded from gross income but taken into account in determining earnings and profits doesn't apply to amounts excluded under this provision. Thus, the exclusion applies for both regular tax and alternative minimum tax, including the adjustment for adjusted current earnings.

- **Payments for medical care under FSAs or HRAs aren't subject to information reporting rules**

  Under the new law, effective for payments made after 2002, the information at source reporting requirements don't apply to any payment for medical care made under:

  1. A flexible spending arrangement (FSA), i.e., one which is funded by employee contributions on a pre-tax salary-reduction basis to provide coverage, or reimbursement, for specified expenses (e.g., qualified medical expenses or dependent care assistance costs), or

  2. A health reimbursement arrangement (HRA), i.e., an employee benefit plan that is paid for solely by an employer (it is not provided under a salary reduction election) to reimburse employees for specified medical expenses incurred for themselves and their dependents, as long as the expenses are not covered by other forms of insurance.

Please keep in mind that I've described only the highlights of these new rules.

This Hot Topic is an informative publication for our clients and friends of the Firm. It is designed to provide accurate information on the subject matter covered. We recommend you consult with your legal and other advisors to determine if the information is applicable in your specific circumstances. If these advisors are not available to you, please feel free to contact Barry N. Finkelstein, CPA at 972/934-1577 or e-mail at info@facpa.com.