



congress makes health savings accounts more attractive

MSK Client Alert

December 2006

Under prior law, a participant in a "high deductible health plan" can contribute up to the amount of the plan deductible or a fixed dollar limit set by the IRS, whichever is less, to a tax-free account. If all requirements are met, the amount contributed is tax deductible and amounts used to pay qualifying medical expenses will not be treated as income to the taxpayer. For 2006, the dollar limit set by the IRS was \$5,450 for families and \$2,700 for individuals. Therefore, those who qualified could, in effect, deduct more than \$5,000 in medical expenses that otherwise probably would be non-deductible. If you didn't have that many medical expenses, the funds could be retained in the account for future use. There is no "use-it-or-lose-it" rule for HSAs as there is with flexible spending accounts maintained under employer cafeteria plans.

To qualify as a "high deductible health plan" in 2006, the plan deductible had to be at least \$1,050 for individuals and \$2,100 for families, which was much less than the maximum contribution amount. So, if your plan deductible was less than the maximum contribution amount set by the IRS, under prior law all you could contribute was the amount of the plan deductible. Under the new law, starting in 2007, as long as your plan qualifies as a "high deductible health plan" (which in 2007 will mean a plan deductible of at least \$1,100 for individuals and \$2,200 for families), you will be able to contribute the maximum contribution amount. And the maximum contribution amount will rise to \$2,850 for individuals and \$5,650 for families.

In addition, under the prior law your contribution limit was prorated if you established your account in mid-year. This rule is also repealed in 2007 so that you can contribute the maximum amount even if you don't establish the account at the beginning of the year.

Also under prior law, participation in a flexible spending account under an employer cafeteria plan could disqualify a participant from using an HSA. The new law has several provisions that will help those employees who want to make the transition from a flexible spending account under an employer

attorneys

Robert J. Lowe

practice areas

employee benefits &
executive compensation

msk.com

los angeles
t 310.312.2000
f 310.312.3100

new york
t 212.509.3900
f 212.509.7239

washington, dc
t 202.355.7900
f 202.355.7899



congress makes health savings accounts more attractive

cafeteria plan to an HSA.

One issue that remains, however, is that California is among the states that have not yet conformed their state law to the HSA rules. Thus, until California conforms there will be no deduction available for HSA contributions on California tax returns. Nevertheless, as more employers offer a "high deductible health plan" option, many employees will find having an HSA to be an attractive way to save for medical expenses and generate some additional tax deductions, at least on their federal returns.

For more information, please contact Robert J. Lowe at rlo@msk.com or at (310) 312-3180. Robert is a partner at Mitchell Silberberg & Knupp LLP in the employee benefits and executive compensation practice area.