108TH CONGRESS, 1st Session } HOUSE OF REPRESENTATIVES { REPORT 108–177

HEALTH SAVINGS ACCOUNT AVAILABILITY ACT

JUNE 25, 2003.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. THOMAS, from the Committee on Ways and Means, submitted the following

REPORT

together with

DISSENTING VIEWS

[To accompany H.R. 2351]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 2351) to amend the Internal Revenue Code of 1986 to allow a deduction to individuals for amounts contributed to health savings accounts and to provide for the disposition of unused health benefits in cafeteria plans and flexible spending arrangements, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

CONTENTS

	Page
I. Summary and Background	9
A. Purpose and Summary	9
B. Background and Need for Legislation	9
C. Legislative History	10
II. Explanation of Bill	10
A. Health Savings Accounts (sec. 2 of the bill and new sec. 223 of the Code)	10
B. Disposition of Unused Health Benefits in Flexible Spending Arrangements (sec. 3 of the bill and sec. 125 of the Code)	18
C. Exception to Information Reporting Requirements for Certain Health Arrangements (sec. 4 of the bill and sec. 6041 of the Code)	19
III. Votes of the Committee	20
IV. Budget Effects of the Bill	21
A. Committee Estimate of Budgetary Effects	21
B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority	23

19–006

C. Cost Estimate Prepared by the Congressional Budget Office 23
D. Macroeconomic Impact Analysis 25
V. Other Matters To Be Discussed Under the Rules of the House 25
A. Committee Oversight Findings and Recommendations 25
B. Statement of General Performance Goals and Objectives 26
C. Constitutional Authority Statement 26
D. Information Relating to Unfunded Mandates 26
E. Applicability of House Rule XXI 5(b) 26
F. Tax Complexity Analysis 26
VI. Changes in Existing Law Made by the Bill, as Reported 31
VII. Dissenting Views 50

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Health Savings Account Availability Act".

SEC. 2. HEALTH SAVINGS ACCOUNTS.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 of the Internal Revenue Code of 1986 (relating to additional itemized deductions for individuals) is amended by redesignating section 223 as section 224 and by inserting after section 222 the following new section:

"SEC. 223. HEALTH SAVINGS ACCOUNTS.

"(a) DEDUCTION ALLOWED.—In the case of an individual who is an eligible individual for any month during the taxable year, there shall be allowed as a deduction for the taxable year an amount equal to the aggregate amount paid in cash during such taxable year by such individual to a health savings account of such individual.

"(b) LIMITATIONS.—

"(1) IN GENERAL.—The amount allowable as a deduction under subsection (a) to an individual for the taxable year shall not exceed the sum of the monthly limitations for months during such taxable year that the individual is an eligible individual.

"(2) MONTHLY LIMITATION.—The monthly limitation for any month is 1⁄12 of—

"(A) $2,000, in the case of an eligible individual who—

"(i) has self-only coverage under a minimum deductible plan as of the first day of such month, or

"(ii) is uninsured as of the first day of such month and is not described in subparagraph (B)(ii) with respect to the taxable year which includes such month,

"(B) $4,000, in the case of an eligible individual who—

"(i) has family coverage under a minimum deductible plan as of the first day of such month, or

"(ii) is uninsured as of the first day of such month and, with respect to the taxable year which includes such month—

"(I) is entitled to a deduction for a dependent under section 151(c) (or would be so entitled but for paragraph (2) or (4) of section 152(e)), or

"(II) files a joint return, and

"(C) zero in any other case.

"(3) ADDITIONAL CONTRIBUTIONS FOR INDIVIDUALS 55 OR OLDER.—

"(A) IN GENERAL.—In the case of an individual who has attained the age of 55 before the close of the taxable year, paragraph (2) shall be applied by increasing the $2,000 amount in paragraph (2)(A) and the $4,000 amount in paragraph (2)(B) by the additional contribution amount.

"(B) ADDITIONAL CONTRIBUTION AMOUNT.—For purposes of this section, the additional contribution amount is the amount determined in accordance with the following table:

"For taxable years beginning in:	The additional contribution amount is:
2004	$500
2005	$600
2006	$700
2007	$800
2008	$900
2009 and thereafter	$1,000.

"(4) LIMITATION BASED ON ADJUSTED GROSS INCOME.—

"(A) IN GENERAL.—The dollar amount in paragraph (2)(A) and the dollar amount in paragraph (2)(B) (in each case as increased under paragraph (3))

shall each be reduced (but not below zero) by an amount which bears the same ratio to such dollar amount as—

“(i) the excess of—

“(I) the taxpayer’s adjusted gross income for such taxable year, over

“(II) the applicable dollar amount, bears to

“(ii) $10,000 ($20,000 in the case of a joint return for a taxable year beginning after December 31, 2006).

“(B) NO REDUCTION BELOW $200 UNTIL COMPLETE PHASE-OUT.—No dollar amount shall be reduced below $200 under subparagraph (A) unless (without regard to this subparagraph) such limitation is reduced to zero.

“(C) ROUNDING.—Any amount determined under this paragraph which is not a multiple of $10 shall be rounded to the next lowest $10.

“(D) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined—

“(i) without regard to this section or section 911, and

“(ii) after application of sections 86, 135, 137, 219, 221, 222, and 469.

“(E) APPLICABLE DOLLAR AMOUNT.—For purposes of this paragraph, the term ‘applicable dollar amount’ has the meaning given such term in section 219(g)(3)(B). The rule of section 219(g)(4) (relating to special rule for married individuals filing separately and living apart) shall apply for purposes of the preceding sentence.

“(5) COORDINATION WITH OTHER CONTRIBUTIONS.—The limitation which would (but for this paragraph) apply under this subsection to the taxpayer for any taxable year shall be reduced (but not below zero) by the sum of—

“(A) the aggregate amount which would (but for section 125(h)(1)(B) and subsections (b) and (d) of section 106) be includible in the taxpayer’s gross income for such taxable year, and

“(B) the aggregate amount paid during such taxable year by such individual to Archer MSAs of such individual.

“(6) SPECIAL RULES FOR MARRIED INDIVIDUALS, DEPENDENTS, AND MEDICARE ELIGIBLE INDIVIDUALS.—Rules similar to the rules of paragraphs (3), (6), and (7) of section 220(b) shall apply for purposes of this section.

“(c) DEFINITIONS.—For purposes of this section—

“(1) ELIGIBLE INDIVIDUAL.—

“(A) IN GENERAL.—The term ‘eligible individual’ means, with respect to any month, any individual unless such individual is covered, as of the first day of such month, under any health plan which is not a minimum deductible plan.

“(B) CERTAIN COVERAGE DISREGARDED.—Subparagraph (A) shall be applied without regard to—

“(i) coverage for any benefit provided by permitted insurance, and

“(ii) coverage (whether through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.

“(2) MINIMUM DEDUCTIBLE PLAN.—

“(A) IN GENERAL.—The term ‘minimum deductible plan’ means a health plan—

“(i) in the case of self-only coverage, which has an annual deductible which is not less than $500, and

“(ii) in the case of family coverage, which has an annual deductible which is not less than twice the dollar amount in clause (i) (as increased under subparagraph (B)).

“(B) COST-OF-LIVING ADJUSTMENT FOR ANNUAL DEDUCTIBLES.—

“(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2004, the $500 amount in subparagraph (A)(i) shall be increased by an amount equal to—

“(I) such dollar amount, multiplied by

“(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which such taxable year begins by substituting ‘calendar year 2003’ for ‘calendar year 1992’ in subparagraph (B) thereof.

“(ii) ROUNDING.—If any increase under clause (i) is not a multiple of $50, such increase shall be rounded to the nearest multiple of $50.

“(C) SPECIAL RULES.—

“(i) EXCLUSION OF CERTAIN PLANS.—Such term does not include a health plan if substantially all of its coverage is coverage described in paragraph (1)(B).

"(ii) SAFE HARBOR FOR ABSENCE OF PREVENTIVE CARE DEDUCTIBLE.—A plan shall not fail to be treated as a minimum deductible plan by reason of failing to have a deductible for preventive care.

"(3) PERMITTED INSURANCE.—The term 'permitted insurance' has the meaning given such term in section 220(c)(3).

"(4) FAMILY COVERAGE.—The term 'family coverage' has the meaning given such term in section 220(c)(5).

"(5) ARCHER MSA.—The term 'Archer MSA' has the meaning given such term in section 220(d).

"(d) HEALTH SAVINGS ACCOUNT.—For purposes of this section—

"(1) IN GENERAL.—The term 'health savings account' means a trust created or organized in the United States as a health savings account exclusively for the purpose of paying the qualified medical expenses of the account beneficiary, but only if the written governing instrument creating the trust meets the following requirements:

"(A) Except in the case of a rollover contribution from an Archer MSA, or a health savings account, which is not includible in gross income, no contribution will be accepted—

"(i) unless it is in cash and is contributed by—

"(I) the account beneficiary,

"(II) a member of the family of the account beneficiary, or

"(III) an employer of the account beneficiary, and

"(ii) to the extent such contribution, when added to previous contributions to the trust for the calendar year, exceeds the dollar amount in subsection (b)(2)(B) increased by the additional contribution amount for taxable years beginning in such calendar year.

"(B) The trustee is a bank (as defined in section 408(n)), an insurance company (as defined in section 816), or another person who demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the trust will be consistent with the requirements of this section.

"(C) No part of the trust assets will be invested in life insurance contracts.

"(D) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund.

"(E) The interest of an individual in the balance in his account is nonforfeitable.

"(2) MEMBER OF THE FAMILY.—The term 'member of the family' has the meaning given such term in section 2032A(e)(2).

"(3) QUALIFIED MEDICAL EXPENSES.—The term 'qualified medical expenses' has the meaning given such term in section 220(d)(2), except that—

"(A) subparagraph (B)(i) thereof shall not apply to—

"(i) insurance which constitutes a minimum deductible plan if no portion of the cost of such insurance is paid by an employer or former employer of the account beneficiary or the spouse of such beneficiary, and

"(ii) any health insurance (other than health insurance substantially all of its coverage is coverage described in subsection (c)(1)(B)) if the account beneficiary has attained age 65, and

"(B) subparagraph (C) thereof shall not apply for purposes of this section.

"(4) ACCOUNT BENEFICIARY.—The term 'account beneficiary' means the individual on whose behalf the health savings account was established.

"(5) CERTAIN RULES TO APPLY.—Rules similar to the following rules shall apply for purposes of this section:

"(A) Section 219(d)(2) (relating to no deduction for rollovers).

"(B) Section 219(f)(3) (relating to time when contributions deemed made).

"(C) Except as provided in section 106(d), section 219(f)(5) (relating to employer payments).

"(D) Section 408(g) (relating to community property laws).

"(E) Section 408(h) (relating to custodial accounts).

"(6) CONTRIBUTIONS FROM FLEXIBLE SPENDING ACCOUNTS TREATED AS MADE BY THE EMPLOYER.—Any contribution from a flexible spending account to a health savings account which is not includible in the gross income of the employee by reason of section 125(h) shall be treated as a contribution made by the employer for purposes of this section.

"(e) TAX TREATMENT OF ACCOUNTS.—

"(1) IN GENERAL.—A health savings account is exempt from taxation under this subtitle unless such account has ceased to be a health savings account. Notwithstanding the preceding sentence, any such account is subject to the taxes

imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc. organizations).

"(2) ACCOUNT TERMINATIONS.—Rules similar to the rules of paragraphs (2) and (4) of section 408(e) shall apply to health savings accounts, and any amount treated as distributed under such similar rules shall be treated as not used to pay qualified medical expenses.

"(f) TAX TREATMENT OF DISTRIBUTIONS.—

"(1) AMOUNTS USED FOR QUALIFIED MEDICAL EXPENSES.—Any amount paid or distributed out of a health savings account which is used exclusively to pay qualified medical expenses of any account beneficiary shall not be includible in gross income.

"(2) INCLUSION OF AMOUNTS NOT USED FOR QUALIFIED MEDICAL EXPENSES.—

"(A) IN GENERAL.—Any amount paid or distributed out of a health savings account which is not used exclusively to pay the qualified medical expenses of the account beneficiary shall be included in the gross income of such beneficiary in the manner provided under section 72.

"(B) SPECIAL RULES FOR APPLYING SECTION 72.—For purposes of applying section 72 to any amount described in subparagraph (A)—

"(i) all health savings accounts shall be treated as 1 contract,

"(ii) all distributions during any taxable year shall be treated as 1 distribution,

"(iii) the value of the contract, income on the contract, and investment in the contract shall be computed as of the close of the calendar year in which the taxable year begins, and

"(iv) such distributions shall be treated as made from contributions from members of the family of the account beneficiary to the extent that such distribution, when added to all previous distributions from the health savings account taken into account under this clause, do not exceed the aggregate contributions from members of such family.

"(3) EXCESS CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—

"(A) IN GENERAL.—If any excess contribution is contributed for a taxable year to any health savings account of an individual, paragraph (2) shall not apply to distributions from the health savings accounts of such individual (to the extent such distributions do not exceed the aggregate excess contributions to all such accounts of such individual for such year) if—

"(i) such distribution is made on or before the last day prescribed by law (including extensions of time) for filing the account beneficiary's return for such taxable year,

"(ii) no deduction is allowed under this section with respect to such contribution,

"(iii) such distribution is accompanied by the amount of net income attributable to such excess contribution, and

"(iv) such distribution satisfies the requirements of subparagraph (B).

"(B) RULES RELATED TO ORDERING.—

"(i) DISTRIBUTIONS LIMITED TO CONTRIBUTIONS.—Subparagraph (A) shall apply to distributions to a person only to the extent of the contributions of such person to such accounts during such taxable year.

"(ii) CLASSES OF CONTRIBUTORS.—Subparagraph (A) shall apply only to distributions of such contributions which are made in the following order:

"(I) first, to members of the family of the account beneficiary,

"(II) second, to the account beneficiary,

"(III) third, to employers of the account beneficiary with respect to contributions under section 125(h), and

"(IV) fourth, to employers of the account beneficiary with respect to contributions under section 106(d).

"(iii) LAST-IN FIRST-OUT.—If distributions could be made to more than one person under any subclause of clause (ii), subparagraph (A) shall not apply to any such distribution unless such distribution is of the most recent excess contribution which has not been distributed to the contributor.

"(C) TREATMENT OF NET INCOME.—Any net income described in subparagraph (A)(iii) shall be included in the gross income of the person receiving the distribution for the taxable year in which received.

"(D) EXCESS CONTRIBUTION.—For purposes of subparagraph (A), the term 'excess contribution' means any contribution (other than a rollover contribution from another health savings account, or from an Archer MSA, which is not includible in gross income) to the extent such contribution results in the aggregate contributions to health savings accounts of the account bene-

ficiary for the taxable year to be in excess of the limitation under subsection (b) (determined without regard to paragraph (5) thereof) which applies to such beneficiary for such year.

"(4) ADDITIONAL TAX ON DISTRIBUTIONS NOT USED FOR QUALIFIED MEDICAL EXPENSES.—

"(A) IN GENERAL.—The tax imposed by this chapter on the account beneficiary for any taxable year in which there is a payment or distribution from a health savings account of such beneficiary which is includible in gross income under paragraph (2) shall be increased by 15 percent of the amount which is so includible.

"(B) EXCEPTION FOR DISABILITY OR DEATH.—Subparagraph (A) shall not apply if the payment or distribution is made after the account beneficiary becomes disabled within the meaning of section 72(m)(7) or dies.

"(C) EXCEPTION FOR DISTRIBUTIONS AFTER MEDICARE ELIGIBILITY.—Subparagraph (A) shall not apply to any payment or distribution after the date on which the account beneficiary attains the age specified in section 1811 of the Social Security Act.

"(5) SPECIAL RULES.—Rules similar to the rules of paragraphs (5), (6), (7), and (8) of section 220(f) shall apply for purposes of this section.

"(g) REPORTS.—The Secretary may require the trustee of a health savings account to make such reports regarding such account to the Secretary and to the account beneficiary with respect to contributions, distributions, and such other matters as the Secretary determines appropriate. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required by the Secretary.

"(h) REGULATIONS.—The Secretary may issue regulations to carry out the purposes of this section, including regulations regarding the proper treatment of distributions described in subsection (f)(3) and nondeductible contributions by members of the family of the account beneficiary.".

(b) DEDUCTION ALLOWED WHETHER OR NOT INDIVIDUAL ITEMIZES OTHER DEDUCTIONS.—Subsection (a) of section 62 of such Code is amended by inserting after paragraph (18) the following new paragraph:

"(19) HEALTH SAVINGS ACCOUNTS.—The deduction allowed by section 223.".

(c) ROLLOVERS FROM ARCHER MSAS PERMITTED.—Subparagraph (A) of section 220(f)(5) of such Code (relating to rollover contribution) is amended by inserting "or a health savings account (as defined in section 223(d))" after "paid into an Archer MSA".

(d) EXCLUSIONS FOR EMPLOYER CONTRIBUTIONS TO HEALTH SAVINGS ACCOUNTS.—

(1) EXCLUSION FROM INCOME TAX.—Section 106 of such Code (relating to contributions by employer to accident and health plans) is amended by adding at the end the following new subsection:

"(d) CONTRIBUTIONS TO HEALTH SAVINGS ACCOUNTS.—

"(1) IN GENERAL.—In the case of an employee who is an eligible individual, amounts contributed by such employee's employer to any health savings account of such employee shall be treated as employer-provided coverage for medical expenses under an accident or health plan to the extent such amounts do not exceed the excess of—

"(A) the limitation under section 223(b) (determined without regard to this subsection) which is applicable to such employee for such taxable year, over

"(B) the aggregate amount treated as employer-provided coverage for medical expenses under an accident or health plan under subsection (b).

"(2) SPECIAL RULES.—Rules similar to the rules of paragraphs (2), (3), (4), and (5) of subsection (b) shall apply for purposes of this subsection.

"(3) DEFINITIONS.—For purposes of this subsection, the terms 'eligible individual' and 'health savings account' have the respective meanings given to such terms by section 223.

"(4) CROSS REFERENCE.—

"For penalty on failure by employer to make comparable contributions to the health savings accounts of comparable employees, see section 4980G.".

(2) EXCLUSION FROM EMPLOYMENT TAXES.—

(A) RAILROAD RETIREMENT TAX.—Subsection (e) of section 3231 of such Code is amended by adding at the end the following new paragraph:

"(11) HEALTH SAVINGS ACCOUNT CONTRIBUTIONS.—The term 'compensation' shall not include any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d).".

(B) UNEMPLOYMENT TAX.—Subsection (b) of section 3306 of such Code is amended by striking "or" at the end of paragraph (16), by striking the pe-

riod at the end of paragraph (17) and inserting "; or", and by inserting after paragraph (17) the following new paragraph:

"(18) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d).".

(C) WITHHOLDING TAX.—Subsection (a) of section 3401 of such Code is amended by striking "or" at the end of paragraph (20), by striking the period at the end of paragraph (21) and inserting "; or", and by inserting after paragraph (21) the following new paragraph:

"(22) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d).".

(3) EMPLOYER CONTRIBUTIONS REQUIRED TO BE SHOWN ON W–2.—Subsection (a) of section 6051 of such Code is amended by striking "and" at the end of paragraph (10), by striking the period at the end of paragraph (11) and inserting ", and", and by inserting after paragraph (11) the following new paragraph:

"(12) the amount contributed to any health savings account (as defined in section 223(d)) of such employee or such employee's spouse.".

(4) PENALTY FOR FAILURE OF EMPLOYER TO MAKE COMPARABLE HEALTH SAVINGS ACCOUNT CONTRIBUTIONS.—

(A) IN GENERAL.—Chapter 43 of such Code is amended by adding after section 4980F the following new section:

"SEC. 4980G. FAILURE OF EMPLOYER TO MAKE COMPARABLE HEALTH SAVINGS ACCOUNT CONTRIBUTIONS.

"(a) GENERAL RULE.—In the case of an employer who makes a contribution to the health savings account of any employee with respect to coverage under a minimum deductible plan of the employer during a calendar year, there is hereby imposed a tax on the failure of such employer to meet the requirements of subsection (d) for such calendar year.

"(b) AMOUNT OF TAX.—The amount of the tax imposed by subsection (a) on any failure for any calendar year is the amount equal to 35 percent of the aggregate amount contributed by the employer to health savings accounts of employees for taxable years of such employees ending with or within such calendar year.

"(c) WAIVER BY SECRETARY.—In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed by subsection (a) to the extent that the payment of such tax would be excessive relative to the failure involved.

"(d) EMPLOYER REQUIRED TO MAKE COMPARABLE HEALTH SAVINGS ACCOUNT CONTRIBUTIONS FOR ALL PARTICIPATING EMPLOYEES.—An employer meets the requirements of this subsection for any calendar year if the employer meets the requirements of section 4980E(d) applied by—

"(1) substituting 'health savings account' for 'Archer MSA' each place it appears, and

"(2) not taking into account any contribution made under section 125.

"(e) CONTROLLED GROUPS.—For purposes of this section, all persons treated as a single employer under subsection (b), (c), (m), or (o) of section 414 shall be treated as 1 employer.

"(f) DEFINITIONS.—Terms used in this section which are also used in section 223 have the respective meanings given such terms in section 223.".

(B) CLERICAL AMENDMENT.—The table of sections for chapter 43 of such Code is amended by adding after the item relating to section 4980F the following new item:

"Sec. 4980G. Failure of employer to make comparable health savings account contributions.".

(e) TAX ON EXCESS CONTRIBUTIONS.—Section 4973 of such Code (relating to tax on excess contributions to certain tax-favored accounts and annuities) is amended—

(1) by striking "or" at the end of paragraph (3) of subsection (a),

(2) by inserting "or" at the end of paragraph (4) of subsection (a),

(3) by inserting after paragraph (4) of subsection (a) the following new paragraph:

"(5) a health savings account (within the meaning of section 223(d)),", and

(4) by adding at the end the following new subsection:

"(g) EXCESS CONTRIBUTIONS TO HEALTH SAVINGS ACCOUNTS.—For purposes of this section, in the case of health savings accounts (within the meaning of section 223(d)), the term 'excess contributions' means the sum of—

"(1) the aggregate amount contributed for the taxable year to the accounts (other than a rollover contribution from another health savings account, or from an Archer MSA, which is not includible in gross income) which is in excess of

the limitation under section 223(b) (determined without regard to paragraph (5) thereof), and

"(2) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

"(A) the distributions out of the accounts which were included in gross income under section 223(f)(2), and

"(B) the excess (if any) of—

"(i) the sum of limitations described in paragraph (1), over

"(ii) the amount contributed to the accounts for the taxable year.

For purposes of this subsection, any contribution which is distributed out of the health savings account in a distribution to which section 223(f)(3) applies shall be treated as an amount not contributed.".

(f) TAX ON PROHIBITED TRANSACTIONS.—

(1) Section 4975 of such Code (relating to tax on prohibited transactions) is amended by adding at the end of subsection (c) the following new paragraph:

"(6) SPECIAL RULE FOR HEALTH SAVINGS ACCOUNTS.—An individual for whose benefit a health savings account (within the meaning of section 223(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a health savings account by reason of the application of section 223(e)(2) to such account.".

(2) Paragraph (1) of section 4975(e) of such Code is amended by redesignating subparagraphs (E) and (F) as subparagraphs (F) and (G), respectively, and by inserting after subparagraph (D) the following new subparagraph:

"(E) a health savings account described in section 223(d),".

(g) FAILURE TO PROVIDE REPORTS ON HEALTH SAVINGS ACCOUNTS.—Paragraph (2) of section 6693(a) of such Code (relating to reports) is amended by redesignating subparagraphs (C) and (D) as subparagraphs (D) and (E), respectively, and by inserting after subparagraph (B) the following new subparagraph:

"(C) section 223(g) (relating to health savings accounts),".

(h) EXCEPTION FROM CAPITALIZATION OF POLICY ACQUISITION EXPENSES.—Subparagraph (B) of section 848(e)(1) of such Code (defining specified insurance contract) is amended by striking "and" at the end of clause (iii), by striking the period at the end of clause (iv) and inserting ", and", and by adding at the end the following new clause:

"(v) any contract which is a health savings account (as defined in section 223(d)).".

(i) HEALTH SAVINGS ACCOUNTS MAY BE OFFERED UNDER CAFETERIA PLANS.—Paragraph (2) of section 125(d) (relating to cafeteria plan defined) is amended by adding at the end the following new subparagraph:

"(D) EXCEPTION FOR HEALTH SAVINGS ACCOUNTS.—Subparagraph (A) shall not apply to a plan to the extent of amounts which a covered employee may elect to have the employer pay as contributions to a health savings account established on behalf of the employee.".

(j) CONFORMING AMENDMENTS.—

(1) The table of sections for part VII of subchapter B of chapter 1 of such Code is amended by striking the last item and inserting the following:

"Sec. 223. Health savings accounts.
"Sec. 224. Cross reference.".

(2)(A) Sections 86(b)(2)(A), 135(c)(4)(A), 137(b)(3)(A), 219(g)(3)(A)(ii), and 221(b)(2)(C)(i) are each amended by inserting "223," after "222,".

(B) Section 222(b)(2)(C)(i) is amended by inserting "223," before "911".

(C) Section 469(i)(3)(F)(iii) is amended by striking "and 222" and inserting "222, and 223".

(k) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2003.

SEC. 3. DISPOSITION OF UNUSED HEALTH BENEFITS IN CAFETERIA PLANS AND FLEXIBLE SPENDING ARRANGEMENTS.

(a) IN GENERAL.—Section 125 of the Internal Revenue Code of 1986 (relating to cafeteria plans) is amended by redesignating subsections (h) and (i) as subsections (i) and (j), respectively, and by inserting after subsection (g) the following:

"(h) CONTRIBUTIONS OF CERTAIN UNUSED HEALTH BENEFITS.—

"(1) IN GENERAL.—For purposes of this title, a plan or other arrangement shall not fail to be treated as a cafeteria plan solely because qualified benefits under such plan include a health flexible spending arrangement under which not more than $500 of unused health benefits may be—

"(A) carried forward to the succeeding plan year of such health flexible spending arrangement,

"(B) to the extent permitted by section 223, contributed on behalf of the employee to a health savings account (as defined in section 223(d)) maintained for the benefit of such employee, or

"(C) contributed to a qualified retirement plan (as defined in section 4974(c)), or an eligible deferred compensation plan (as defined in section 457(b)) of an eligible employer described in section 457(e)(1)(A), but only to the extent such amount would not be allowed as a deduction under section 223 if made directly by the employee to a health savings account of the employee (determined without regard to any other contributions made by the employee).

"(2) SPECIAL RULES FOR TREATMENT OF CONTRIBUTIONS TO RETIREMENT PLANS.—For purposes of this title, contributions under paragraph (1)(C)—

"(A) shall be treated as elective deferrals (as defined in section 402(g)(3)) in the case of contributions to a qualified cash or deferred arrangement (as defined in section 401(k)) or to an annuity contract described in section 403(b),

"(B) shall be treated as employer contributions in the case of a plan (other than a plan described in subparagraph (A)) which is described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(C) shall be treated as deferred compensation in the case of contributions to an eligible deferred compensation plan (as defined in section 457(b)), and

"(D) shall be treated in the manner designated for purposes of section 408 or 408A in the case of contributions to an individual retirement plan.

"(3) HEALTH FLEXIBLE SPENDING ARRANGEMENT.—For purposes of this subsection, the term 'health flexible spending arrangement' means a flexible spending arrangement (as defined in section 106(c)) that is a qualified benefit and only permits reimbursement for expenses for medical care (as defined in section 213(d)(1) (without regard to subparagraphs (C) and (D) thereof).

"(4) UNUSED HEALTH BENEFITS.—For purposes of this subsection, with respect to an employee, the term 'unused health benefits' means the excess of—

"(A) the maximum amount of reimbursement allowable to the employee during a plan year under a health flexible spending arrangement, taking into account any election by the employee, over

"(B) the actual amount of reimbursement during such year under such arrangement.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2003.

SEC. 4. EXCEPTION TO INFORMATION REPORTING REQUIREMENTS RELATED TO CERTAIN HEALTH ARRANGEMENTS.

(a) IN GENERAL.—Section 6041 (relating to information at source) is amended by adding at the end the following new subsection:

"(f) SECTION DOES NOT APPLY TO CERTAIN HEALTH ARRANGEMENTS.—This section shall not apply to any payment for medical care (as defined in section 213(d)) made under—

"(1) a flexible spending arrangement (as defined in section 106(c)(2)), or

"(2) a health reimbursement arrangement which is treated as employer-provided coverage under an accident or health plan for purposes of section 106.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to payments made after December 31, 2002.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

The bill, H.R. 2351, as amended, provides for the creation of health savings accounts, which provide for tax-favored savings for health care. The bill also allows for rollovers of limited amounts in flexible spending arrangements and provides an exception from generally applicable information reporting requirements.

B. BACKGROUND AND NEED FOR LEGISLATION

The provisions approved by the Committee reflect the need for individuals to accumulate assets for future health care costs and to

make cost-conscious spending decisions about health care expenses to help reduce the rising cost of health care.

C. LEGISLATIVE HISTORY

The House Committee on Ways and Means marked up the Health Savings Account Availability Act on June 19, 2003, and ordered the bill, as amended, favorably reported by a roll call vote of 23 yeas to 16 nays (with a quorum being present).

II. EXPLANATION OF THE BILL

A. HEALTH SAVINGS ACCOUNTS

(Sec. 2 of the bill and new sec. 223 of the Code)

PRESENT LAW

Overview

Under present law, the Federal tax treatment of health expenses and health coverage depends on the individual's circumstances (e.g., whether the individual is covered under an employer-provided health plan).

Employer-provided health coverage

In general, employer contributions to an accident or health plan are excludable from an employee's gross income (and wages for employment tax purposes).[1] This exclusion for employer-provided health coverage generally applies to coverage provided to employees (including former employees) and their spouses, dependents, and survivors. Benefits paid under employer-provided accident or health plans are also generally excludable from income to the extent they are reimbursements for medical care.[2] If certain requirements are satisfied, employer-provided accident or health coverage offered under a cafeteria plan is also excludable from an employee's gross income and wages.[3]

Present law provides for two general employer-provided arrangements that can be used to pay for or reimburse medical expenses of employees on a tax-favored basis; flexible spending arrangements ("FSAs") and health reimbursement arrangements ("HRAs"). While these arrangements provide similar tax benefits (i.e., the amounts paid under the arrangements for medical care are excludable from gross income and wages for employment tax purposes), they are subject to different rules. A main distinguishing feature between the two arrangements is that while FSAs are generally part of a cafeteria plan and contributions to FSAs are made on a salary reduction basis, HRAs cannot be part of a cafeteria plan and contributions cannot be made on a salary-reduction basis.[4]

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[1] Sec. 106. All "section," "sec.," and "Code" references are to the Internal Revenue Code of 1986, as amended.

[2] Sec. 105. In the case of a self-insured medical reimbursement arrangement, the exclusion applies to highly compensated employees only if certain nondiscrimination rules are satisfied. Sec. 105(h). Medical care is defined under section 213(d) and generally includes amounts paid for qualified long-term care insurance and services.

[3] Sec. 125. Long-term care insurance and services may not be provided through a cafeteria plan.

[4] Notice 2002–45, 2002–28 I.R.B. 93 (July 15, 2002); Rev. Rul. 2002–41, 2002–28 I.R.B. 75 (July 15, 2002).

Amounts paid or accrued by an employer within a taxable year for a sickness, accident, hospitalization, medical expense, or similar health plan for its employees are generally deductible as ordinary and necessary business expenses.[5]

Self-employed individuals

The exclusion for employer-provided health coverage does not apply to self-employed individuals. However, under present law, self-employed individuals (i.e., sole proprietors or partners in a partnership)[6] are entitled to deduct 100 percent of the amount paid for health insurance for themselves and their spouse and dependents.[7]

Itemized deduction for medical expenses

Under present law, individuals who itemize deductions may deduct amounts paid during the taxable year (to the extent not reimbursed by insurance or otherwise) for medical care of the taxpayer, the taxpayer's spouse, and dependents, to the extent that the total of such expenses exceeds 7.5 percent of the taxpayer's adjusted gross income.[8]

Archer medical savings accounts

In general

In general, an Archer medical savings account ("MSA") is a tax-exempt trust or custodial account created exclusively for the benefit of the account holder that is subject to rules similar to those applicable to individual retirement arrangements.[9]

Within limits, contributions to an Archer MSA are deductible in determining adjusted gross income if made by an eligible individual and are excludable from gross income and wages for employment tax purposes if made by the employer of an eligible individual. Earnings on amounts in an Archer MSA are not currently includible in gross income. Distributions from an Archer MSA for qualified medical expenses are not includible in gross income. Distributions not used for qualified medical expenses are includible in gross income and subject to an additional 15-percent tax unless the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (i.e., age 65).

Qualified medical expenses are generally defined as under section 213(d) except that qualified medical expenses do not include expenses for health insurance other than long-term care insurance, premiums for health coverage during any period of continuation coverage required by Federal law, and premiums for health care coverage while an individual is receiving unemployment compensation under Federal or State law.

[5] Sec. 162.

[6] Self-employed individuals include more than two-percent shareholders of S corporations who are treated as partners for purposes of fringe benefit rules pursuant to section 1372.

[7] Sec. 162(l).

[8] Sec. 213. The adjusted gross income percentage is 10 percent for purposes of the alternative minimum tax.

[9] Sec. 220.

Eligible individuals

Archer MSAs are available only to employees of a small employer who are covered under an employer-sponsored high deductible health plan and to self-employed individuals covered under a high deductible health plan.[10] An employer is a small employer if it employed, on average, no more than 50 employees on business days during either of the two preceding calendar years. An individual is not eligible for an Archer MSA if he or she is covered under any other health plan that is not a high deductible health plan (other than a plan providing certain limited types of coverage). Individuals entitled to benefits under Medicare are not eligible individuals. Eligible individuals do not include individuals who may be claimed as a dependent on another person's tax return.

Treatment of contributions

Individual contributions to an Archer MSA are deductible (within limits) in determining adjusted gross income (i.e., "above-the-line"). In addition, employer contributions are excludable from gross income and wages for employment tax purposes (within the same limits), except that this exclusion does not apply to contributions made through a cafeteria plan. In the case of an employee, contributions can be made to an Archer MSA either by the individual or by the individual's employer, but not by both.

The maximum annual contribution that can be made to an Archer MSA for a year is 65 percent of the annual deductible under the high deductible health plan in the case of self-only coverage and 75 percent of the annual deductible in the case of family coverage.

If an employer provides a high deductible health plan coupled with Archer MSAs for employees and makes employer contributions to the Archer MSAs, the employer must make available a comparable contribution on behalf of all employees with comparable coverage during the same period. Contributions are considered comparable if they are either of the same amount or the same percentage of the deductible under the high deductible health plan. If employer contributions do not satisfy the comparability rule during a period, then the employer is subject to an excise tax equal to 35 percent of the aggregate amount contributed by the employer to Archer MSAs of the employer for that period.

Definition of high deductible health plan

A high deductible health plan is a health plan with an annual deductible of at least $1,700 and no more than $2,500 in the case of self-only coverage and at least $3,350 and no more than $5,050 in the case of family coverage. In addition, the maximum out-of-pocket expenses with respect to allowed costs (including the deductible) must be no more than $3,350 in the case of self-only coverage and no more than $6,150 in the case of family coverage.[11] A plan does not fail to qualify as a high deductible health plan merely because it does not have a deductible for preventive care as required by State law. A plan does not qualify as a high deductible health

[10] Self-employed individuals include more than two-percent shareholders of S corporations who are treated as partners for purposes of fringe benefit rules pursuant to section 1372.

[11] The deductible and out-of-pocket expenses dollar amounts are for 2003. These amounts are indexed for inflation in $50 increments.

plan if substantially all of the coverage under the plan is certain permitted insurance or is coverage (whether provided through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.

Treatment of death of account holder

Upon death, any balance remaining in the decedent's Archer MSA is includible in his or her gross estate. If the account holder's surviving spouse is the named beneficiary of the Archer MSA, then, after the death of the account holder, the Archer MSA becomes the Archer MSA of the surviving spouse and the amount of the Archer MSA balance may be deducted in computing the decedent's taxable estate, pursuant to the estate tax marital deduction.[12] If, upon the account holder's death, the Archer MSA passes to a named beneficiary other than the decedent's surviving spouse, the Archer MSA ceases to be an Archer MSA as of the date of the decedent's death, and the beneficiary is required to include the fair market value of the Archer MSA assets as of the date of death in gross income for the taxable year that includes the date of death. The amount includible in gross income is reduced by the amount in the Archer MSA used, within one year after death, to pay qualified medical expenses incurred prior to the death. If there is no named beneficiary for the decedent's Archer MSA, the Archer MSA ceases to be an Archer MSA as of the date of death, and the fair market value of the assets in the Archer MSA as of such date is includible in the decedent's gross income for the year of the death.

Limit on number of MSAs; termination of MSA availability

The number of taxpayers benefiting annually from an Archer MSA contribution is limited to a threshold level (generally 750,000 taxpayers). The number of Archer MSAs established has not exceeded the threshold level.

After 2003, no new contributions may be made to Archer MSAs except by or on behalf of individuals who previously had Archer MSA contributions and employees who are employed by a participating employer.

REASONS FOR CHANGE

The Committee believes that individuals should be encouraged to save for future medical care expenses and that individuals should be allowed to save for such expenses on a tax-favored basis. The Committee believes that it is important for individuals to accumulate assets for health care expenses, such as retiree health and prescription drug costs. The Committee also believes that uninsured individuals should be encouraged to set aside funds for future health costs. The Committee believes that consumers who spend their own savings on health care will make cost-conscious decisions, thus reducing the rising cost of health care.

[12] Sec. 2056.

EXPLANATION OF PROVISION

In general

The provision creates health savings accounts ("HSAs") which provide for tax-favored savings for health care expenses. In general, an HSA is a tax-exempt trust or custodial account created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents and that is subject to rules similar to those applicable to individual retirement arrangements.[13] Within limits, contributions to an HSA are deductible if made by an eligible individual and are excludable from gross income and wages for employment tax purposes if made by the employer of an eligible individual to the extent otherwise deductible (e.g., subject to the AGI limits). Family members may also make nondeductible contributions to an HSA on behalf of an eligible individual. Distributions from an HSA for qualified medical expenses are not includible in gross income. Distributions that are not for qualified medical expenses are includible in gross income and subject to an additional 15 percent tax. The additional 15 percent tax does not apply after the individual attains age 65, death or disability.

Eligible individuals

Eligible individuals are individuals who (1) are covered under a health plan meeting minimum deductible requirements and no other health plan that does not meet the minimum deductible requirements, or (2) are uninsured. Individuals entitled to benefits under Medicare are not eligible individuals. Eligible individuals do not include individuals who may be claimed as a dependent on another person's tax return.

An individual with other coverage in addition to a plan with minimum deductible requirements is still eligible for an HSA if such other coverage is certain permitted insurance or permitted coverage. In addition, an individual is treated as uninsured if his or her only coverage is permitted insurance or coverage. Permitted insurance is: (1) insurance if substantially all of the coverage provided under such insurance relates to (a) liabilities incurred under worker's compensation law, (b) tort liabilities, (c) liabilities relating to ownership or use of property (e.g., auto insurance), or (d) such other similar liabilities as the Secretary may prescribe by regulations; (2) insurance for a specified disease or illness; and (3) insurance that provides a fixed payment for hospitalization. Permitted coverage is coverage (whether provided through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.

A plan meets the minimum deductible requirements if the plan is a health plan with an annual deductible of at least $500 in the case of self-only coverage and at least $1,000 in the case of family coverage. These dollar amounts are indexed for inflation. Under the provision, there are no maximum deductible requirements and no limits on out-of-pocket expenses. A plan is not a minimum deductible plan if it is permitted insurance or is coverage (whether pro-

[13] The provision provides that the present-law requirement applicable to insurance companies that certain policy acquisition expenses must be capitalized and amortized (sec. 848) does not apply in the case of any contract that is an HSA.

vided through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.

Tax treatment of and limits on contributions

Contributions to an HSA made by an eligible individual are deductible (within limits) in determining adjusted gross income (i.e., "above-the-line"). Nondeductible contributions can be made by a family member of an eligible individual. In addition, employer contributions to an HSA (including salary reduction contributions made through a cafeteria plan) are excludable from gross income and wages for employment tax purposes to the extent otherwise deductible (e.g., subject to the AGI limits). In the case of an employee, contributions can be made to an HSA by both the individual (and family members) and the individual's employer. Individual, employer, and family contributions are aggregated for purposes of the maximum annual contribution limit.

The maximum aggregate annual contribution that can be made to an HSA (for all contributions) for a year is $2,000 for persons with self-only coverage and uninsured unmarried individuals with no dependents [14] and $4,000 for individuals with family coverage and uninsured individuals with a spouse or dependents.[15] In the case of individuals age 55 and older, the $2,000 and $4,000 contribution limits are increased to the following amounts respectively: $2,500 in 2004, $2,600 in 2005, $2,700 in 2006, $2,800 in 2007, $2,900 in 2008, and $3,000 in 2009 and thereafter; $4,500 in 2004, $4,600 in 2005, $4,700 in 2006, $4,800 in 2007, $4,900 in 2008, and $5,000 in 2009 and thereafter.

The maximum allowable contribution is phased out for taxpayers with adjusted gross income [16] above certain levels. In the case of single individuals, the phase-out range is $45,000 to $50,000 for 2004, and $50,000 to $60,000 for 2005 and thereafter. For married taxpayers filing a joint return, the phase-out range is $65,000 to $75,000 for 2004, $70,000 to $80,000 for 2005, $75,000 to $85,000 for 2006, and $80,000 to $100,000 for 2007 and thereafter.[17]

An excise tax applies to contributions in excess of the maximum deductible amount. The excise tax is generally equal to six percent of the cumulative amount of excess contributions that are not distributed from the HSA to the contributor.[18]

Amounts can be rolled over into an HSA from another HSA, an Archer MSA, or a health FSA on a tax-free basis. Rollovers from a flexible spending account are limited to up to $500 annually under section three of the bill and are taken into account under the annual contribution limit. Amounts transferred from another HSA or from an Archer MSA are not taken into account under the annual contribution limit.

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[14] Written declarations releasing claim to a dependency exemption under section 152 (e)(2) are disregarded in determining whether an individual has dependents.

[15] The annual contribution limit is the sum of the limits determined separately for each month, based on the individual's status and health plan coverage as of the first day of the month.

[16] Adjusted gross income is defined generally as under the rules relating to individual retirement arrangements ("IRAs"), and is computed after the deduction for contributions to IRAs and before the deduction provided by the provision.

[17] In the case of married taxpayers filing separate returns, the phase-out range is $0 to $10,000. These phase-out ranges are the same as those that apply to deductible contributions to IRAs.

[18] Ordering rules apply to determine the nature of any distributed excess contributions (e.g., nondeductible family contributions or employer contributions).

If an employer makes contributions to employees' HSAs, the employer must make available a comparable contribution on behalf of all employees with comparable coverage during the same period.[19] Contributions are considered comparable if they are either of the same amount or the same percentage of the deductible under the minimum deductible plan. The comparability rule is applied separately to part-time employees (i.e., employees who are customarily employed for fewer than 30 hours per week). The comparability rule does not apply to amounts transferred from an employee's health FSA, Archer MSA, or another HSA.

For example, suppose an employer maintains two plans that meet the minimum deductible requirements, Plan A, with a deductible of $500 for individual coverage and $1,000 for family coverage, and Plan B, with a deductible of $1,000 for individual coverage and $2,000 for family coverage. The employer offers an HSA contribution to full-time employees in Plan A of $250 for individual coverage and $500 for family coverage. In order to satisfy the comparability rule, the employer would have to offer full-time employees covered under Plan B one of the following HSA contributions: (1) $250 for employees with individual coverage and $500 for employees with family coverage or (2) $500 for employees with individual coverage and $1,000 for employees with family coverage. Different contributions (or no contributions) could be made for part-time employees covered under either plan.

If employer contributions do not satisfy the comparability rule during a period, then the employer is subject to an excise tax equal to 35 percent of the aggregate amount contributed by the employer to HSAs of the employer for that period. The excise tax is designed as a proxy for the denial of the deduction for employer contributions. In the case of a failure to comply with the comparability rule which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed to the extent that the payment of the tax would be excessive relative to the failure involved. For purposes of the comparability rule, employers under common control are aggregated.

Taxation of distributions

Distributions from an HSA for qualified medical expenses of the individual and his or her spouse or dependents generally are excludable from gross income. Amounts in an HSA can be used for qualified medical expenses even if the individual is not currently eligible for contributions to the HSA.

Qualified medical expenses generally are defined as under section 213(d) and include expenses for diagnosis, cure, mitigation, treatment, or prevention of disease, including prescription drugs, transportation primarily for and essential to such care, and qualified long-term care expenses. Qualified medical expenses do not include expenses for insurance other than for (1) long-term care insurance, (2) premiums for health coverage during any period of continuation coverage required by Federal law, (3) premiums for health care coverage while an individual is receiving unemployment compensation under Federal or State law, (4) health insur-

[19] The comparable contribution rule does not apply to contributions made through a cafeteria plan.

ance meeting the minimum deductible requirements if no portion of the cost of the insurance is paid by the employer or former employer of the individual or the individual's spouse,[20] and (5) health insurance for individuals who are older than age 65 (including Medicare Part B premiums).

Distributions that are not for medical expenses are includible in gross income (except to the extent that the distribution is attributable to a return of nondeductible family contributions).[21] Distributions includible in gross income are also subject to an additional 15-percent tax unless made after death, disability, or the individual attains the age in which eligible for Medicare (i.e., age 65).

Tax treatment of HSAs after death

Upon death, any balance remaining in the decedent's HSA is includible in his or her gross estate.

If the account holder's surviving spouse is the named beneficiary of the HSA, then, after the death of the account holder, the HSA becomes the HSA of the surviving spouse and the amount of the HSA balance may be deducted in computing the decedent's taxable estate, pursuant to the estate tax marital deduction.[22] The surviving spouse is not required to include any amount in gross income as a result of the death; the general rules applicable to HSAs apply to the surviving spouse's HSA (e.g., the surviving spouse is subject to income tax only on distributions from the HSA for nonmedical purposes). The surviving spouse can exclude from gross income amounts withdrawn from the HSA for expenses incurred by the decedent prior to death, to the extent they otherwise are qualified medical expenses.

If, upon death, the HSA passes to a named beneficiary other than the decedent's surviving spouse, the HSA ceases to be an HSA as of the date of the decedent's death, and the beneficiary is required to include the fair market value of HSA assets as of the date of death in gross income for the taxable year that includes the date of death. The amount includible in income is reduced by the amount in the HSA used, within one year after death, to pay qualified medical expenses incurred by the decedent prior to the death. As is the case with other HSA distributions, whether the expenses are qualified medical expenses is determined as of the time the expenses were incurred. In computing taxable income, the beneficiary may claim a deduction for that portion of the Federal estate tax on the decedent's estate that was attributable to the amount of the HSA balance (calculated in accordance with the present-law rules relating to income in respect of a decedent set forth in sec. 691(c)).

If there is no named beneficiary for the decedent's HSA, the HSA ceases to be an HSA as of the date of death, and the fair market value of the assets in the HSA as of such date is includible in the decedent's gross income for the year of the death. This rule applies in all cases in which there is no named beneficiary, even if the surviving spouse ultimately obtains the right to HSA assets (e.g., if the surviving spouse is the sole beneficiary of the decedent's estate).

[20] Amounts paid by the employer include salary reduction contributions.
[21] Ordering rules apply to determine the extent to which distributions are attributable to nondeductible contributions.
[22] Sec. 2056.

Reporting requirements

Trustees of HSAs may be required to report to the Secretary amounts with respect to contributions, distributions, and other matters as determined appropriate.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2003.

B. DISPOSITION OF UNUSED HEALTH BENEFITS IN FLEXIBLE SPENDING ARRANGEMENTS

(Sec. 3 of the bill and sec. 125 of the Code)

PRESENT LAW

A flexible spending arrangement ("FSA") is defined under the Code as a benefit program which provides employees with coverage under which specified incurred expenses may be reimbursed and the maximum amount of reimbursement which is reasonably available to a participant for such coverage is less than 500 percent of the value of such coverage.[23] A health FSA is an FSA that provides for reimbursement of medical expenses.[24] Health FSAs are typically part of a cafeteria plan and may be funded through salary reduction.[25] Health FSAs are commonly used, for example, to reimburse employees for medical expenses not covered by insurance. There is no special exclusion for benefits provided under an FSA. Thus, health benefits provided under an FSA are excludable from income only if they qualify for exclusion under sections 105 or 106.

FSAs that are part of a cafeteria plan must comply with the rules applicable to cafeteria plans generally. One of these rules is that a cafeteria plan may not offer deferred compensation except through a qualified cash or deferred arrangement.[26] Under proposed Treasury regulations, a cafeteria plan is considered to permit the deferral of compensation if it includes a health FSA which reimburses participants for medical expenses incurred beyond the end of the plan year.[27] Thus, amounts in an employee's account that are not used for medical expenses incurred before the end of a plan year must be forfeited. This rule is often referred to as the "use it or lose it" rule.

REASONS FOR CHANGE

The Committee believes that individuals should not be required to forfeit all amounts reserved for health care expenses simply because the individual has inadequate expenses for that year. The Committee believes that the forfeiture rules cause individuals to make unnecessary medical expenditures at the end of the year to avoid forfeiting their balances.

[23] Sec. 106(c).
[24] FSAs may also be used to provide certain other nontaxable benefits, such as dependent care.
[25] Long-term care insurance cannot be offered through a cafeteria plan. Sec. 125(f).
[26] Sec. 401(k).
[27] Prop. Treas. Reg. 1.125–2 Q&A–5(a).

EXPLANATION OF PROVISION

The provision allows up to $500 of unused health benefits in an employee's health FSA to be carried forward to the employee's account for the next plan year of the health FSA or transferred to a health savings account ("HSA") maintained for the benefit of the employee.[28] Amounts transferred to an HSA are treated as employer contributions for purposes of the HSA rules. Under the provision, if an individual is not eligible to contribute to an HSA for the taxable year, the individual may transfer up to $500 of unused health benefits in the employee's health FSA to a tax-qualified retirement plan, a tax-sheltered annuity (section 403(b)), an individual retirement arrangement ("IRA"), or an eligible deferred compensation plan of a State or local government (section 457). An employee's unused health benefit is the excess of the maximum amount of reimbursement allowable to the employee over the actual amount of reimbursement made during the year. Amounts transferred are subject to the rules and limits on contributions that would otherwise apply.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2003.

C. EXCEPTION TO INFORMATION REPORTING REQUIREMENTS FOR CERTAIN HEALTH ARRANGEMENTS

(Sec. 4 of the bill and sec. 6041 of the Code)

PRESENT LAW

Any person in a trade or business who, in the course of that trade or business, makes specified payments to another person totaling $600 or more in a year, must provide an information report to the IRS (as well as a copy to the recipient) on the payments.[29] Reporting is required to be done on Form 1099. In general, these information reports remind taxpayers of amounts of income that should be reflected on their tax returns and assist the IRS in verifying that taxpayers have correctly reported these amounts.

Treasury regulations specify that fees for professional services, including the services of physicians, must be reported.[30] Treasury regulations also provide a general exception from these information reporting requirements for payments made to corporations, except that this exception is inapplicable if the corporation is "engaged in providing medical and health care services."[31]

Earlier this year, IRS issued a revenue ruling describing whether employer-provided expense reimbursements made through debit or credit cards or other electronic media are excludible from gross income.[32] The ruling states that "payments made to medical service providers through the use of debit, credit, and stored value cards

[28] Section two of the bill provides the eligibility rules for contributions to an HSA.
[29] Section 6041.
[30] Treas. Reg. sec. 1.6041–1(d)(2).
[31] Treas. Reg. sec. 1.6041–3(p)(1). These regulations also provide an exception from these information reporting requirements if the payment is made to a hospital that is tax-exempt or that is owned and operated by a governmental entity.
[32] Rev. Rul. 2003–43, 2003–21 I.R.B. 935 (May 27, 2003).

are reportable by the employer on Form 1099–MISC under section 6041.”[33]

REASONS FOR CHANGE

The Committee wishes to encourage electronic reimbursement of medical expenses through the use of debit or store-valued cards. The Committee believes that the regulatory reporting requirement discourages the use of such cards and that such burden should be removed.

EXPLANATION OF PROVISION

The provision provides an exception from the generally applicable information reporting provisions for payments for medical care made under either: (1) a flexible spending arrangement,[34] or (2) a health reimbursement arrangement that is treated as employer-provided coverage.

EFFECTIVE DATE

The provision applies to payments made after December 31, 2002.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statements are made concerning the vote of the Committee on Ways and Means in its consideration of the bill, H.R. 2351.

MOTION TO REPORT THE BILL

The bill, H.R. 2351, as amended, was ordered favorably reported by a roll call vote of 23 yeas to 16 nays (with a quorum being present). The vote was as follows:

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Thomas	X			Mr. Rangel		X	
Mr. Crane	X			Mr. Stark		X	
Mr. Shaw	X			Mr. Matsui		X	
Mrs. Johnson	X			Mr. Levin		X	
Mr. Houghton	X			Mr. Cardin			
Mr. Herger	X			Mr. McDermott		X	
Mr. McCrery	X			Mr. Kleczka		X	
Mr. Camp	X			Mr. Lewis (GA)		X	
Mr. Ramstad	X			Mr. Neal		X	
Mr. Nussle	X			Mr. McNulty		X	
Mr. Johnson	X			Mr. Jefferson		X	
Ms. Dunn	X			Mr. Tanner		X	
Mr. Collins	X			Mr. Becerra		X	
Mr. Portman	X			Mr. Doggett		X	
Mr. English	X			Mr. Pomeroy		X	
Mr. Hayworth	X			Mr. Sandlin		X	
Mr. Weller	X			Ms. Tubbs Jones		X	
Mr. Hulshof	X						
Mr. McInnis	X						
Mr. Lewis (KY)	X						
Mr. Foley	X						
Mr. Brady	X						
Mr. Ryan	X						

[33] Id.
[34] This term is defined in section 106(c)(2).

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Cantor	X	....	....				

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d)(2) of the rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the revenue provisions of the bill, H.R. 2351 as reported.

The bill is estimated to have the following effects on budget receipts for fiscal years 2003–2008:

ESTIMATED REVENUE EFFECTS OF H.R. 2351, THE ''HEALTH SAVINGS ACCOUNT AVAILABILITY ACT,'' AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS

[Fiscal Years 2004–2008, milliions of dollars]

Provision	Effective	2004	2005	2006	2007	2008	2004–08
1. Health Savings Accounts	tyba 12/31/03	−231	−1,785	−3,410	−4,876	−6,371	−16,673
2. Disposition of Unused Health Benefits in Cafeteria Plans and Flexible spending Arrangements	tyba 12/31/03	−361	−627	−767	−867	−919	−3,542
3. Exception to Information Reporting Requirements for Certain Health Arrangements	pma 12/31/02	−23	−24	−24	−25	−26	−122
Net Total		−615	−2,436	−4,201	−5,768	−7,316	−20,337

Legend for ''Effective'' column: pma = payments made after; tyba = taxable years beginning after.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

B. STATEMENT REGARDING NEW BUDGET AUTHORITY AND TAX EXPENDITURES BUDGET AUTHORITY

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue reducing tax provisions involve increased tax expenditures. (See amounts in table in Part IV.A., above.)

C. COST ESTIMATE PREPARED BY THE CONGRESSIONAL BUDGET OFFICE

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 23, 2003.

Hon. WILLIAM "BILL" M. THOMAS,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2351, the Health Savings Account Availability Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Annie Bartsch.

Sincerely,

DOUGLAS HOLTZ-EAKIN,
Director.

Enclosure.

H.R. 2351—Health Savings Account Availability Act

Summary: H.R. 2351, the Health Savings Account Availability Act, would create health savings accounts (HSAs) to provide for tax-favored savings for health care expenses, allow unused contributions to flexible spending accounts (FSAs) to be carried forward or transferred into certain retirement accounts or HSAs, and waive information reporting requirements for certain health arrangements, including FSAs.

The Joint Committee on Taxation (JCT) estimates that enacting the bill would reduce total federal revenues by $615 million in 2004, by about $20 billion over the 2004–2008 period, and by about $72 billion over the 2004–2013 period. A portion of the reduction would be off-budget. JCT estimates that the reduction in off-budget receipts would be $120 million in 2004, about $1 billion over the 2004–2008 period, and about $4 billion over the 2004–2013 period. CBO estimates that the bill would have no effect on direct spending.

JCT has determined that the bill contains no private sector or intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), and would not affect the budgets of state, local, or tribal governments.

Estimated cost to the Federal Government: The estimated budgetary impact of H.R. 2351 is shown in the following table.

	By fiscal year in millions of dollars—				
	2004	2005	2006	2007	2008
CHANGES IN REVENUES					
Create health savings accounts	−231	−1,785	−3,410	−4,876	−6,371
Allow certain unused health benefits to be carried forward or transferred	−361	−627	−767	−867	−919
Waive information reporting requirements for certain health arrangements	−23	−24	−24	−25	−26
Total Changes:					
On-budget	−495	−2,224	−3,927	−5,436	−6,933
Off-budget [1]	−120	−212	−274	−332	−383
Total	−615	−2,436	−4,201	−5,768	−7,316

[1] A portion of the revenue loss from each of the three provisions in the bill affects off-budget receipts. A breakdown of the on- and off-budget effects for each provision is not available.

Source: The Joint Committee on Taxation.

Basis of estimate: For the purposes of this estimate, it is assumed that H.R. 2351 would be enacted near the end of fiscal year 2003.

Revenues

All revenue estimates were provided by JCT. JCT estimates that, together, the three provisions contained in the bill would reduce total federal revenues by $615 million in 2004, by about $20 billion over the 2004–2008 period, and by about $72 billion over the 2004–2013 period. A portion of the reduction would be off-budget. JCT estimates that the reduction in off-budget receipts would be $120 million in 2004, about $1 billion over the 2004–2008 period, and about $4 billion over the 2004–2013 period.

The largest reduction in revenues would come from the creation of health savings accounts to provide tax-favored savings for health care expenses. Under the proposal, qualified individuals and their employers would be allowed to make contributions to an employee's HSA out of income not taxed to the employer. The amounts of such contributions would be limited depending on age and whether an individual has self-only or family insurance coverage. Family members would also be allowed to contribute to an individual's HSA; however, these contributions would be made out of income subject to federal income and payroll taxes. All contributions, regardless of source, would be counted against the individual's maximum annual contribution limit. Earnings on HSA contributions and distributions from HSAs used to pay for qualified medical expenses would not be taxed. Qualifying medical expenses would generally be those which currently qualify for the itemized deduction for medical expenses. JCT estimates that this provision would reduce governmental receipts by $231 million in 2004, by about $17 billion over the 2004–2008 period, and by about $63 billion over the 2004–2013 period. A portion of this reduction would be off-budget; however, as noted in the preceding table, the breakdown is not available.

H.R. 2351 also would change rules relating to unused contributions to flexible spending accounts and cafeteria plans. Under current law, contributions to an FSA that are not used for medical expenses by the end of a plan year must be forfeited (sometimes referred to as the "use it or lose it" rule.) The bill would allow these unused contributions to be carried forward to the following year's FSA balance, transferred to an HSA, or transferred to certain types

of retirement accounts. JCT estimates that making this change would reduce revenues by $361 million in 2004, by about $4 billion over the 2004–2008 period, and by about $9 billion over the 2004–2013 period. A portion of those reductions would apply to off-budget receipts.

Lastly, the bill would waive certain information reporting requirements for medical care payments made under flexible spending arrangements or certain health reimbursement arrangements. JCT estimates that making this change would reduce revenues by $23 million in 2004, by $122 million over the 2004–2008 period, and by $263 million over the 2004–2013 period. A portion of those reductions would also apply to off-budget receipts.

Summary of the effects on revenues and direct spending: The overall effect of H.R. 2351 on on-budget receipts over the 2003–2013 period is shown in the table below.

	By fiscal year, in millions of dollars—										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Changes in receipts	0	−495	−2,224	−3,927	−5,436	−6,933	−8,055	−8,854	−9,778	−10,657	−11,137
Changes in outlays	Not applicable										

Source: The Joint Committee on Taxation.

Intergovernmental and private sector impact: JCT has determined that the bill contains no private-sector or intergovernmental mandates as defined in UMRA, and would not affect the budgets of state, local, or tribal governments.

Estimate prepared by: Annie Bartsch.

Estimate approved by: G. Thomas Woodward, Assistant Director for Tax Analysis.

D. Macroeconomic Impact Analysis

In compliance with clause 3(h)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986: the effects of the bill on economic activity are so small as to be incalculable within the context of a model of the aggregate economy.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was a result of the Committee's oversight review concerning the need of Americans to adequately provide for health expenses that the Committee concluded that it is appropriate and timely to enact the revenue provisions included in the bill as reported.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. Constitutional Authority Statement

With respect to clause 3(d)(1) of the rule XIII of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 8 ("The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises * * * "), and from the 16th Amendment to the Constitution.

D. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

E. Applicability of House Rule XXI 5(b)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that "A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increases within the meaning of the rule.

F. Tax Complexity Analysis

The following tax complexity analysis is provided pursuant to section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998, which requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service ("IRS") and the Treasury Department) to provide a complexity analysis of tax legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or a Conference Report containing tax provisions. The complexity analysis is required to report on the complexity and administrative issues raised by provisions that directly or indirectly amend the Internal Revenue Code and that have widespread applicability to individuals or small businesses. For each such provision identified by the staff of the Joint Committee on Taxation, a summary description of the provision is provided along with an estimate of the number and type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS and the Treasury Department regarding each of the provisions included in the complexity analysis, including a discussion of the likely effect on IRS forms and any expected impact on the IRS.

1. Health savings accounts (sec. 2 of the bill)

Summary description of provision

The bill creates health savings accounts ("HSAs"), which allow tax-favored savings for health care expenses. Within limits, contributions to an HSA are deductible if made by an eligible individual and are excludable from gross income if made by the employer of an eligible individual (to the extent otherwise deductible). Family members may also make nondeductible contributions to an HSA on behalf of an eligible individual. Earnings on amounts in an HSA are not includible in gross income. Distributions from an HSA for qualified medical expenses are not includible in gross income. Eligible individuals are individuals who (1) are covered under a health plan meeting minimum deductible requirements ($500 for self-coverage and $1,000 for family coverage) and no other non-permitted plan, or (2) are uninsured.

The maximum aggregate annual contributions that can be made to an HSA (for all contributions) is $2,000 for persons with self-only coverage and uninsured unmarried individuals with no dependents and $4,000 for individuals with family coverage and uninsured individuals with a spouse or dependent. Catch-up contributions are also allowed. The maximum allowable contribution is phased out for taxpayers with adjusted gross income above certain levels. The phase-out range for 2004 is $45,000 to $50,000 for single individuals and $65,000 to $75,000 for married taxpayers filing a joint return.

The provision is effective for taxable years beginning after December 31, 2003.

Number of affected taxpayers

It is estimated that the provision will affect at least 30 million individual tax returns.

Discussion

The provision would require modification to the individual income tax forms to provide for the above-the-line deduction for HSA contributions. Additional worksheets may also be required to enable individuals affected by the AGI phase-out to calculate the amount of deduction to which they are entitled. Additional forms and worksheets may also be required to determine the taxable portion, if any, of distributions from HSAs, and to calculate the amount of the additional 15-percent tax owed with respect to any distribution.

Individuals may have to keep additional records in order to demonstrate eligibility for the above-the-line deduction and substantiate qualified medical expenses. Many individuals may not keep records of all such expenses now, because of the floor on the itemized deduction for medical expenses. For those taxpayers who do keep such records now, they will have to separate out certain

types of expenses, because not all deductible medical expenses are qualified medical expenses under the provision (e.g., certain health insurance expenses). The provision may result in additional disputes with the IRS as to what is and is not a qualified expense.

An account holder of an HSA to which nondeductible family member contributions have been made will have to keep records of nondeductible contributions in order to determine the amount of such contributions and the taxable amount, of any nonqualified distributions from the account.

Records will also need to be kept of the source and amount of contributions, in order to properly apply the rules relating to excess contributions and to ensure that excess contributions are distributed properly in order to avoid imposition of the excise tax on excess contributions.

Trustees and custodians of HSAs (e.g., insurance companies, banks, and similar financial institutions) will have increased reporting requirements with respect to HSAs. In some respects, such requirements are similar to those applicable to individual retirement arrangements ("IRAs") and Archer MSAs; however, because the rules for HSAs and IRAs differ, there will also be differences in such requirements.

Employers who make contributions to HSAs will have difficulty in determining whether the contribution is excludable, because the employer generally will not have information regarding an employee's AGI.

HSAs may result in transactional complexity for taxpayers. Because HSAs offer features of tax-free accumulation similar to (and in some cases more generous than) IRAs and employer-sponsored retirement plans, individuals may desire to determine which vehicle is the most advantageous for them, thus increasing tax planning complexity.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, DC, June 23, 2003.

Mr. GEORGE K. YIN,
Chief of Staff, Joint Committee on Taxation,
Washington, DC.

DEAR MR. YIN: Enclosed are the combined comments of the Internal Revenue Service and the Treasury Department on the Health Savings Account provision from the House Ways and Means Committee markup of H.R. 2351, the "Health Savings Account Availability Act," that you identified for complexity analysis in your letter of June 20, 2003.

Our comments are based on the description of that provision in your letter and JCX–63–03, the Joint Committee on Taxation's Description of the Chairman's Amendment in the Nature of a Substitute to H.R. 2351, the "Health Savings Account Availability Act."

Due to the short turnaround time, our comments are provisional and subject to change upon a more complete and in-depth analysis of the provision.

Sincerely,

MARK W. EVERSON.

Enclosure.

COMPLEXITY ANALYSIS OF H.R. 2351, THE HEALTH SAVINGS ACCOUNT AVAILABILITY ACT

Provision

The bill creates health savings accounts (HSAs), which allow tax-favored savings for health care expenses. In general, an HSA is a tax-exempt trust or custodial account—similar to those used for medical savings accounts or individual retirement accounts—created to pay for the qualified medical expenses of the account holder and his or her family.

Within limits, contributions by an eligible individual to his or her HSA are deductible. Contributions made by an employer on behalf of the eligible individual are excludable from income. Family members may make nondeductible contributions to an eligible individual's HSA. Earnings on HSAs are not taxed until distributed. Distributions from an HSA used to pay qualified medical expenses are excludable from income. Distributions used for other purposes are includible in income except to the extent they are attributable to a return of nondeductible family contributions. Includible distributions are subject to an additional 15 percent tax unless made because of the eligible individual's death or disability or after the individual is eligible for Medicare (i.e., age 65).

The maximum aggregate annual contribution that can be made (for all contributions) is $2,000 for persons with self-only insurance coverage and uninsured single individuals with no dependents. The limit is $4,000 for persons with family insurance coverage and uninsured individuals with a spouse or dependent. Increased (catch-up) contribution limits for individuals aged 55 and older are phased in between 2004–2009—e.g., the $2,000 limit for a self-only insured person aged 55 is $2,500 in 2004, and it increases by $100 each year thereafter until it reaches $3,000 in 2009.

The maximum allowable HSA contribution is phased out for taxpayers with adjusted gross income (AGI) above certain levels. The phase-out range for single persons is $45,000 to $50,000 for 2004, and $50,000 to $60,000 for 2005 and thereafter. The phase-out range for married taxpayers filing jointly is $65,000 to $75,000 for 2004, $70,000 to $80,000 for 2005, $75,000 to $85,000 for 2006, and $80,000 to $100,000 for 2007 and thereafter. The range for married persons filing separately is $0 to $10,000. If contributions are made to an HSA that are not permitted for that individual (e.g., if the individual's income is above the limits), an excise tax applies until the contributions are distributed.

Amounts can be rolled over tax free into an HSA from another HSA, an Archer MSA, or a health flexible spending account. If an employer makes contributions to an employee's HSA, the employer must make comparable HSA contributions for all employees. If comparable contributions are not made, a penalty tax equal to 35 percent of HSA contributions made is imposed. Special rules apply to the treatment of HSAs after death of the eligible individual.

The provisions would be effective for taxable years beginning after December 31, 2002.

IRS and Treasury comments

- Three new forms and related instructions would be required beginning in 2004:

1. A new form (similar to Form 8853 for Archer MSAs) would be needed on which taxpayers would complete their HSA deduction for the year, the taxable amount of any distributions not used for qualified medical expenses, and any additional 15 percent tax for nonqualified taxable distributions. This form would also be used to keep track of the account holder's basis in the HSA (from non-deductible contributions). The form and its instructions would need to be updated annually through 2009 to reflect increases in the phase-out ranges and catch-up contribution limits for persons age 55 and over. Programming needed to reflect these increases would be included in IRS' annual update of programming to reflect mandated inflation adjustments.

2. A new 1099 information return (probably Form 1099–HSA) similar to current Form 1099–MSA would be needed for trustees to report HSA distributions to taxpayers and the IRS.

3. A new form (probably Form 5498–HSA) similar to current Form 5498–MSA would be needed for trustees to report annual HSA contributions to taxpayers and the IRS.

- A new line for entering the taxpayer's HSA deduction would have to be added to the Forms 1040, 1040A and 1040NR in 2004. The 2004 instructions would tell taxpayers to report their taxable HSA distributions on the "other income" line of Form 1040 or Form 1040NR. (Since the 1040A currently contains no line entry for other income, taxpayers with income from HSA distributions would be precluded from using that form in that year or such a line entry would have to be added to the 1040A.)
- A mechanism would be needed to add taxable employer HSA contributions to both income and FICA wages—e.g., where the taxpayer's AGI is beyond the phase-out range. One possibility is to treat all employer contributions as taxable wages (entered in boxes 1, 3, and 5 of Form W–2) and let the employee take a deduction for contributions to the extent permitted by his or her AGI—this approach would impose employee and employer FICA on all contributions even if they were totally deductible or excludable. The statutory language of the provision will determine the method for doing this.
- The instructions to Form 1040–ES for 2004 would have to be revised to reflect the deduction.
- Information alerting taxpayers to the deduction and the rules applicable to distributions would have to be reflected in the instructions for Forms 1040, 1040A, 1040NR, 1040EZ, 1040NR–EZ, and TeleFile, beginning in 2004.
- The IRS would need to provide guidance to employers regarding HSAs.
- A new IRS publication dealing with HSAs would likely be needed.
- Form W–2 for 2004 would have to be revised to reflect employer contributions to HSAs.
- The instructions for Forms 940, 941, 940–EZ, 940–PR, Ct–1, Pub. 15 and other IRS publications would have to be revised for 2004 to reflect the employment tax treatment for employers and employees of contributions to HSAs.
- Form 5330, Return Of Excise Taxes Related To Employee Benefit Plans, would have to be revised to reflect the tax on prohibited

transactions within an HSA and the penalty tax for the failure of an employer to make comparable contributions to an HSA.

• Programming changes would be required to reflect the new deduction and/or the new forms, beginning in 2004. Currently, the IRS computation programs are updated annually to incorporate mandated inflation adjustments. Programming changes necessitated by the proposal would be included during that process.

• The Internal Revenue Manual processing procedures would need to be revised to reflect the new HSA deduction and new forms.

• Training materials would need to be revised to include a discussion of the new HSA deduction.

• Technical guidance via regulations, revenue rulings, notices, etc. would likely be needed to clarify the rules regarding minimum deductibles, permitted insurance or permitted coverage, rollovers, excess contributions, comparable contributions, the ordering rules for allocating basis (nondeductible family contributions) to nonqualified HSA distributions, income, gift, and estate tax consequences of nondeductible family contributions, and other concepts.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

* * * * * * *

Subtitle A—Income Taxes

* * * * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * * * *

Subchapter B—Computation of Taxable Income

* * * * * * *

PART I—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, TAXABLE INCOME, ETC.

* * * * * * *

SEC. 62. ADJUSTED GROSS INCOME DEFINED.

(a) GENERAL RULE.—

(1) * * *

* * * * * * *

(19) HEALTH SAVINGS ACCOUNTS.—The deduction allowed by section 223.

* * * * * * *

PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

* * * * * * *

SEC. 86. SOCIAL SECURITY AND TIER 1 RAILROAD RETIREMENT BENEFITS.

(a) * * *

(b) TAXPAYERS TO WHOM SUBSECTION (a) APPLIES.—

(1) * * *

(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term "modified adjusted gross income" means adjusted gross income—

(A) determined without regard to this section and sections 135, 137, 221, 222, *223,* 911, 931, and 933, and

* * * * * * *

PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

* * * * * * *

SEC. 106. CONTRIBUTIONS BY EMPLOYER TO ACCIDENT AND HEALTH PLANS.

(a) * * *

* * * * * * *

(d) CONTRIBUTIONS TO HEALTH SAVINGS ACCOUNTS.—

(1) IN GENERAL.—In the case of an employee who is an eligible individual, amounts contributed by such employee's employer to any health savings account of such employee shall be treated as employer-provided coverage for medical expenses under an accident or health plan to the extent such amounts do not exceed the excess of—

(A) the limitation under section 223(b) (determined without regard to this subsection) which is applicable to such employee for such taxable year, over

(B) the aggregate amount treated as employer-provided coverage for medical expenses under an accident or health plan under subsection (b).

(2) SPECIAL RULES.—Rules similar to the rules of paragraphs (2), (3), (4), and (5) of subsection (b) shall apply for purposes of this subsection.

(3) DEFINITIONS.—For purposes of this subsection, the terms "eligible individual" and "health savings account" have the respective meanings given to such terms by section 223.

(4) CROSS REFERENCE.—

For penalty on failure by employer to make comparable contributions to the health savings accounts of comparable employees, see section 4980G.

* * * * * * *

SEC. 125. CAFETERIA PLANS

(a) * * *

* * * * * * *

(d) CAFETERIA PLAN DEFINED.—For purposes of this section—

(1) * * *

(2) DEFERRED COMPENSATION PLANS EXCLUDED.—

(A) * * *

* * * * * * *

(D) EXCEPTION FOR HEALTH SAVINGS ACCOUNTS.—Subparagraph (A) shall not apply to a plan to the extent of amounts which a covered employee may elect to have the employer pay as contributions to a health savings account established on behalf of the employee.

* * * * * * *

(h) CONTRIBUTIONS OF CERTAIN UNUSED HEALTH BENEFITS.—

(1) IN GENERAL.—For purposes of this title, a plan or other arrangement shall not fail to be treated as a cafeteria plan solely because qualified benefits under such plan include a health flexible spending arrangement under which not more than $500 of unused health benefits may be—

(A) carried forward to the succeeding plan year of such health flexible spending arrangement,

(B) to the extent permitted by section 223, contributed on behalf of the employee to a health savings account (as defined in section 223(d)) maintained for the benefit of such employee, or

(C) contributed to a qualified retirement plan (as defined in section 4974(c)), or an eligible deferred compensation plan (as defined in section 457(b)) of an eligible employer described in section 457(e)(1)(A), but only to the extent such amount would not be allowed as a deduction under section 223 if made directly by the employee to a health savings account of the employee (determined without regard to any other contributions made by the employee).

(2) SPECIAL RULES FOR TREATMENT OF CONTRIBUTIONS TO RETIREMENT PLANS.—For purposes of this title, contributions under paragraph (1)(C)—

(A) shall be treated as elective deferrals (as defined in section 402(g)(3)) in the case of contributions to a qualified cash or deferred arrangement (as defined in section 401(k)) or to an annuity contract described in section 403(b),

(B) shall be treated as employer contributions in the case of a plan (other than a plan described in subparagraph (A)) which is described in section 401(a) which includes a trust exempt from tax under section 501(a),

(C) shall be treated as deferred compensation in the case of contributions to an eligible deferred compensation plan (as defined in section 457(b)), and

(D) shall be treated in the manner designated for purposes of section 408 or 408A in the case of contributions to an individual retirement plan.

(3) HEALTH FLEXIBLE SPENDING ARRANGEMENT.—For purposes of this subsection, the term "health flexible spending arrangement" means a flexible spending arrangement (as defined

in section 106(c)) that is a qualified benefit and only permits reimbursement for expenses for medical care (as defined in section 213(d)(1) (without regard to subparagraphs (C) and (D) thereof).

(4) UNUSED HEALTH BENEFITS.—For purposes of this subsection, with respect to an employee, the term "unused health benefits" means the excess of—

(A) the maximum amount of reimbursement allowable to the employee during a plan year under a health flexible spending arrangement, taking into account any election by the employee, over

(B) the actual amount of reimbursement during such year under such arrangement.

[(h)] *(i)* CROSS REFERENCE.—

For reporting and recordkeeping requirements, see section 6039D.

[(i)] *(j)* REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section.

* * * * * * *

SEC. 135. INCOME FROM UNITED STATES SAVINGS BONDS USED TO PAY HIGHER EDUCATION TUITION AND FEES.

(a) * * *

* * * * * * *

(c) DEFINITIONS.—For purposes of this section—

(1) * * *

* * * * * * *

(4) MODIFIED ADJUSTED GROSS INCOME.—The term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year determined—

(A) without regard to this section and sections 137, 221, 222, *223,* 911, 931, and 933, and

* * * * * * *

SEC. 137. ADOPTION ASSISTANCE PROGRAMS.

(a) * * *

(b) LIMITATIONS.—

(1) * * *

* * * * * * *

(3) DETERMINATION OF ADJUSTED GROSS INCOME.—For purposes of paragraph (2), adjusted gross income shall be determined—

(A) without regard to this section and sections 221, 222, *223,* 911, 931, and 933, and

* * * * * * *

PART VII—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

Sec. 211. Allowance of deductions.

* * * * * * *

[Sec. 223. Cross reference.]

Sec. 223. Health savings accounts.
Sec. 224. Cross reference.

* * * * * * *

SEC. 219. RETIREMENT SAVINGS.

(a) * * *

* * * * * * *

(g) LIMITATION ON DEDUCTION FOR ACTIVE PARTICIPANTS IN CERTAIN PENSION PLANS.—

(1) * * *

* * * * * * *

(3) ADJUSTED GROSS INCOME; APPLICABLE DOLLAR AMOUNT.—For purposes of this subsection—

(A) ADJUSTED GROSS INCOME.—Adjusted gross income of any taxpayer shall be determined—

(i) after application of sections 86 and 469, and

(ii) without regard to sections 135, 137, 221, 222, *223,* and 911 or the deduction allowable under this section.

* * * * * * *

SEC. 220. ARCHER MSAS.

(a) * * *

* * * * * * *

(f) TAX TREATMENT OF DISTRIBUTIONS.—

(1) * * *

* * * * * * *

(5) ROLLOVER CONTRIBUTION.—An amount is described in this paragraph as a rollover contribution if it meets the requirements of subparagraphs (A) and (B).

(A) IN GENERAL.—Paragraph (2) shall not apply to any amount paid or distributed from an Archer MSA to the account holder to the extent the amount received is paid into an Archer MSA *or a health savings account (as defined in section 223(d))* for the benefit of such holder not later than the 60th day after the day on which the holder receives the payment or distribution.

* * * * * * *

SEC. 221. INTEREST ON EDUCATION LOANS.

(a) * * *

(b) MAXIMUM DEDUCTION.—

(1) * * *

(2) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(A) * * *

* * * * * * *

(C) MODIFIED ADJUSTED GROSS INCOME.—The term "modified adjusted gross income" means adjusted gross income determined—

(i) without regard to this section and sections 222, *223,* 911, 931, and 933, and

* * * * * * *

SEC. 222. QUALIFIED TUITION AND RELATED EXPENSES.

(a) * * *

(b) DOLLAR LIMITATIONS.—

(1) * * *

(2) APPLICABLE DOLLAR LIMIT.—

(A) * * *

* * * * * * *

(C) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined—

(i) without regard to this section and sections *223,* 911, 931, and 933, and

* * * * * * *

SEC. 223. HEALTH SAVINGS ACCOUNTS.

(a) DEDUCTION ALLOWED.—In the case of an individual who is an eligible individual for any month during the taxable year, there shall be allowed as a deduction for the taxable year an amount equal to the aggregate amount paid in cash during such taxable year by such individual to a health savings account of such individual.

(b) LIMITATIONS.—

(1) IN GENERAL.—The amount allowable as a deduction under subsection (a) to an individual for the taxable year shall not exceed the sum of the monthly limitations for months during such taxable year that the individual is an eligible individual.

(2) MONTHLY LIMITATION.—The monthly limitation for any month is 1/12 of—

(A) $2,000, in the case of an eligible individual who—

(i) has self-only coverage under a minimum deductible plan as of the first day of such month, or

(ii) is uninsured as of the first day of such month and is not described in subparagraph (B)(ii) with respect to the taxable year which includes such month,

(B) $4,000, in the case of an eligible individual who—

(i) has family coverage under a minimum deductible plan as of the first day of such month, or

(ii) is uninsured as of the first day of such month and, with respect to the taxable year which includes such month—

(I) is entitled to a deduction for a dependent under section 151(c) (or would be so entitled but for paragraph (2) or (4) of section 152(e)), or

(II) files a joint return, and

(C) zero in any other case.

(3) ADDITIONAL CONTRIBUTIONS FOR INDIVIDUALS 55 OR OLDER.—

(A) IN GENERAL.—In the case of an individual who has attained the age of 55 before the close of the taxable year, paragraph (2) shall be applied by increasing the $2,000

amount in paragraph (2)(A) and the $4,000 amount in paragraph (2)(B) by the additional contribution amount.

(B) ADDITIONAL CONTRIBUTION AMOUNT.—For purposes of this section, the additional contribution amount is the amount determined in accordance with the following table:

For taxable years beginning in:	***The additional contribution amount is:***
2004	*$500*
2005	*$600*
2006	*$700*
2007	*$800*
2008	*$900*
2009 and thereafter	*$1,000.*

(4) LIMITATION BASED ON ADJUSTED GROSS INCOME.—

(A) IN GENERAL.—The dollar amount in paragraph (2)(A) and the dollar amount in paragraph (2)(B) (in each case as increased under paragraph (3)) shall each be reduced (but not below zero) by an amount which bears the same ratio to such dollar amount as—

(i) the excess of—

(I) the taxpayer's adjusted gross income for such taxable year, over

(II) the applicable dollar amount, bears to

(ii) $10,000 ($20,000 in the case of a joint return for a taxable year beginning after December 31, 2006).

(B) NO REDUCTION BELOW $200 UNTIL COMPLETE PHASE-OUT.—No dollar amount shall be reduced below $200 under subparagraph (A) unless (without regard to this subparagraph) such limitation is reduced to zero.

(C) ROUNDING.—Any amount determined under this paragraph which is not a multiple of $10 shall be rounded to the next lowest $10.

(D) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined—

(i) without regard to this section or section 911, and

(ii) after application of sections 86, 135, 137, 219, 221, 222, and 469.

(E) APPLICABLE DOLLAR AMOUNT.—For purposes of this paragraph, the term "applicable dollar amount" has the meaning given such term in section 219(g)(3)(B). The rule of section 219(g)(4) (relating to special rule for married individuals filing separately and living apart) shall apply for purposes of the preceding sentence.

(5) COORDINATION WITH OTHER CONTRIBUTIONS.—The limitation which would (but for this paragraph) apply under this subsection to the taxpayer for any taxable year shall be reduced (but not below zero) by the sum of—

(A) the aggregate amount which would (but for section 125(h)(1)(B) and subsections (b) and (d) of section 106) be includible in the taxpayer's gross income for such taxable year, and

(B) the aggregate amount paid during such taxable year by such individual to Archer MSAs of such individual.

(6) SPECIAL RULES FOR MARRIED INDIVIDUALS, DEPENDENTS, AND MEDICARE ELIGIBLE INDIVIDUALS.—Rules similar to the rules of paragraphs (3), (6), and (7) of section 220(b) shall apply for purposes of this section.

(c) DEFINITIONS.—For purposes of this section—

(1) ELIGIBLE INDIVIDUAL.—

(A) IN GENERAL.—The term "eligible individual" means, with respect to any month, any individual unless such individual is covered, as of the first day of such month, under any health plan which is not a minimum deductible plan.

(B) CERTAIN COVERAGE DISREGARDED.—Subparagraph (A) shall be applied without regard to—

(i) coverage for any benefit provided by permitted insurance, and

(ii) coverage (whether through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.

(2) MINIMUM DEDUCTIBLE PLAN.—

(A) IN GENERAL.—The term "minimum deductible plan" means a health plan—

(i) in the case of self-only coverage, which has an annual deductible which is not less than $500, and

(ii) in the case of family coverage, which has an annual deductible which is not less than twice the dollar amount in clause (i) (as increased under subparagraph (B)).

(B) COST-OF-LIVING ADJUSTMENT FOR ANNUAL DEDUCTIBLES.—

(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2004, the $500 amount in subparagraph (A)(i) shall be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which such taxable year begins by substituting "calendar year 2003" for "calendar year 1992" in subparagraph (B) thereof.

(ii) ROUNDING.—If any increase under clause (i) is not a multiple of $50, such increase shall be rounded to the nearest multiple of $50.

(C) SPECIAL RULES.—

(i) EXCLUSION OF CERTAIN PLANS.—Such term does not include a health plan if substantially all of its coverage is coverage described in paragraph (1)(B).

(ii) SAFE HARBOR FOR ABSENCE OF PREVENTIVE CARE DEDUCTIBLE.—A plan shall not fail to be treated as a minimum deductible plan by reason of failing to have a deductible for preventive care.

(3) PERMITTED INSURANCE.—The term "permitted insurance" has the meaning given such term in section 220(c)(3).

(4) FAMILY COVERAGE.—The term "family coverage" has the meaning given such term in section 220(c)(5).

(5) ARCHER MSA.—The term "Archer MSA" has the meaning given such term in section 220(d).

(d) HEALTH SAVINGS ACCOUNT.—For purposes of this section—

(1) IN GENERAL.—The term "health savings account" means a trust created or organized in the United States as a health savings account exclusively for the purpose of paying the qualified

medical expenses of the account beneficiary, but only if the written governing instrument creating the trust meets the following requirements:

(A) Except in the case of a rollover contribution from an Archer MSA, or a health savings account, which is not includible in gross income, no contribution will be accepted—

(i) unless it is in cash and is contributed by—

(I) the account beneficiary,

(II) a member of the family of the account beneficiary, or

(III) an employer of the account beneficiary, and

(ii) to the extent such contribution, when added to previous contributions to the trust for the calendar year, exceeds the dollar amount in subsection (b)(2)(B) increased by the additional contribution amount for taxable years beginning in such calendar year.

(B) The trustee is a bank (as defined in section 408(n)), an insurance company (as defined in section 816), or another person who demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the trust will be consistent with the requirements of this section.

(C) No part of the trust assets will be invested in life insurance contracts.

(D) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund.

(E) The interest of an individual in the balance in his account is nonforfeitable.

(2) MEMBER OF THE FAMILY.—The term "member of the family" has the meaning given such term in section 2032A(e)(2).

(3) QUALIFIED MEDICAL EXPENSES.—The term "qualified medical expenses" has the meaning given such term in section 220(d)(2), except that—

(A) subparagraph (B)(i) thereof shall not apply to—

(i) insurance which constitutes a minimum deductible plan if no portion of the cost of such insurance is paid by an employer or former employer of the account beneficiary or the spouse of such beneficiary, and

(ii) any health insurance (other than health insurance substantially all of its coverage is coverage described in subsection (c)(1)(B)) if the account beneficiary has attained age 65, and

(B) subparagraph (C) thereof shall not apply for purposes of this section.

(4) ACCOUNT BENEFICIARY.—The term "account beneficiary" means the individual on whose behalf the health savings account was established.

(5) CERTAIN RULES TO APPLY.—Rules similar to the following rules shall apply for purposes of this section:

(A) Section 219(d)(2) (relating to no deduction for rollovers).

(B) Section 219(f)(3) (relating to time when contributions deemed made).

(C) Except as provided in section 106(d), section 219(f)(5) (relating to employer payments).

(D) Section 408(g) (relating to community property laws).

(E) Section 408(h) (relating to custodial accounts).

(6) CONTRIBUTIONS FROM FLEXIBLE SPENDING ACCOUNTS TREATED AS MADE BY THE EMPLOYER.—Any contribution from a flexible spending account to a health savings account which is not includible in the gross income of the employee by reason of section 125(h) shall be treated as a contribution made by the employer for purposes of this section.

(e) TAX TREATMENT OF ACCOUNTS.—

(1) IN GENERAL.—A health savings account is exempt from taxation under this subtitle unless such account has ceased to be a health savings account. Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc. organizations).

(2) ACCOUNT TERMINATIONS.—Rules similar to the rules of paragraphs (2) and (4) of section 408(e) shall apply to health savings accounts, and any amount treated as distributed under such similar rules shall be treated as not used to pay qualified medical expenses.

(f) TAX TREATMENT OF DISTRIBUTIONS.—

(1) AMOUNTS USED FOR QUALIFIED MEDICAL EXPENSES.—Any amount paid or distributed out of a health savings account which is used exclusively to pay qualified medical expenses of any account beneficiary shall not be includible in gross income.

(2) INCLUSION OF AMOUNTS NOT USED FOR QUALIFIED MEDICAL EXPENSES.—

(A) IN GENERAL.—Any amount paid or distributed out of a health savings account which is not used exclusively to pay the qualified medical expenses of the account beneficiary shall be included in the gross income of such beneficiary in the manner provided under section 72.

(B) SPECIAL RULES FOR APPLYING SECTION 72.—For purposes of applying section 72 to any amount described in subparagraph (A)—

(i) all health savings accounts shall be treated as 1 contract,

(ii) all distributions during any taxable year shall be treated as 1 distribution,

(iii) the value of the contract, income on the contract, and investment in the contract shall be computed as of the close of the calendar year in which the taxable year begins, and

(iv) such distributions shall be treated as made from contributions from members of the family of the account beneficiary to the extent that such distribution, when added to all previous distributions from the health savings account taken into account under this clause, do not exceed the aggregate contributions from members of such family.

(3) EXCESS CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—

(A) In general.—If any excess contribution is contributed for a taxable year to any health savings account of an individual, paragraph (2) shall not apply to distributions from the health savings accounts of such individual (to the extent such distributions do not exceed the aggregate excess contributions to all such accounts of such individual for such year) if—

(i) such distribution is made on or before the last day prescribed by law (including extensions of time) for filing the account beneficiary's return for such taxable year,

(ii) no deduction is allowed under this section with respect to such contribution,

(iii) such distribution is accompanied by the amount of net income attributable to such excess contribution, and

(iv) such distribution satisfies the requirements of subparagraph (B).

(B) Rules related to ordering.—

(i) Distributions limited to contributions.—Subparagraph (A) shall apply to distributions to a person only to the extent of the contributions of such person to such accounts during such taxable year.

(ii) Classes of contributors.—Subparagraph (A) shall apply only to distributions of such contributions which are made in the following order:

(I) first, to members of the family of the account beneficiary,

(II) second, to the account beneficiary,

(III) third, to employers of the account beneficiary with respect to contributions under section 125(h), and

(IV) fourth, to employers of the account beneficiary with respect to contributions under section 106(d).

(iii) Last-in first-out.—If distributions could be made to more than one person under any subclause of clause (ii), subparagraph (A) shall not apply to any such distribution unless such distribution is of the most recent excess contribution which has not been distributed to the contributor.

(C) Treatment of net income.—Any net income described in subparagraph (A)(iii) shall be included in the gross income of the person receiving the distribution for the taxable year in which received.

(D) Excess contribution.—For purposes of subparagraph (A), the term "excess contribution" means any contribution (other than a rollover contribution from another health savings account, or from an Archer MSA, which is not includible in gross income) to the extent such contribution results in the aggregate contributions to health savings accounts of the account beneficiary for the taxable year to be in excess of the limitation under subsection (b) (determined without regard to paragraph (5) thereof) which applies to such beneficiary for such year.

(4) ADDITIONAL TAX ON DISTRIBUTIONS NOT USED FOR QUALIFIED MEDICAL EXPENSES.—

(A) IN GENERAL.—The tax imposed by this chapter on the account beneficiary for any taxable year in which there is a payment or distribution from a health savings account of such beneficiary which is includible in gross income under paragraph (2) shall be increased by 15 percent of the amount which is so includible.

(B) EXCEPTION FOR DISABILITY OR DEATH.—Subparagraph (A) shall not apply if the payment or distribution is made after the account beneficiary becomes disabled within the meaning of section 72(m)(7) or dies.

(C) EXCEPTION FOR DISTRIBUTIONS AFTER MEDICARE ELIGIBILITY.—Subparagraph (A) shall not apply to any payment or distribution after the date on which the account beneficiary attains the age specified in section 1811 of the Social Security Act.

(5) SPECIAL RULES.—Rules similar to the rules of paragraphs (5), (6), (7), and (8) of section 220(f) shall apply for purposes of this section.

(g) REPORTS.—The Secretary may require the trustee of a health savings account to make such reports regarding such account to the Secretary and to the account beneficiary with respect to contributions, distributions, and such other matters as the Secretary determines appropriate. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required by the Secretary.

(h) REGULATIONS.—The Secretary may issue regulations to carry out the purposes of this section, including regulations regarding the proper treatment of distributions described in subsection (f)(3) and nondeductible contributions by members of the family of the account beneficiary.

SEC. [223] *224*. CROSS REFERENCE.

(a) * * *

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Subchapter E—Accounting Periods and Methods of Accounting

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PART II—METHODS OF ACCOUNTING

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Subpart C—Taxable Year for Which Deductions Taken

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SEC. 469. PASSIVE ACTIVITY LOSSES AND CREDITS LIMITED.

(a) * * *

* * * * * * *

(i) $25,000 OFFSET FOR RENTAL REAL ESTATE ACTIVITIES.—

(1) * * *

* * * * * * *

(3) PHASE-OUT OF EXEMPTION.—

(A) * * *

* * * * * * *

(F) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined without regard to—

(i) * * *

* * * * * * *

(iii) the amounts allowable as a deduction under sections 219, 221, [and 222] *222, and 223*, and

* * * * * * *

Subchapter L—Insurance Companies

* * * * * * *

PART III—PROVISIONS OF GENERAL APPLICATION

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SEC. 848. CAPITALIZATION OF CERTAIN POLICY ACQUISITION EXPENSES.

(a) * * *

* * * * * * *

(e) CLASSIFICATION OF CONTRACTS.—For purposes of this section—

(1) SPECIFIED INSURANCE CONTRACT.—

(A) * * *

(B) EXCEPTIONS.—The term “specified insurance contract” shall not include—

(i) * * *

* * * * * * *

(iii) any qualified foreign contract (as defined in section 807(e)(4) without regard to paragraph (5) of this subsection), [and]

(iv) any contract which is an Archer MSA (as defined in section 220(d))[.]*, and*

(v) any contract which is a health savings account (as defined in section 223(d)).

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Subtitle C—Employment Taxes

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CHAPTER 22—RAILROAD RETIRMENT TAX ACT

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Subchapter D—General Provisions

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SEC. 3231. DEFINITIONS.

(a) * * *

* * * * * * *

(e) COMPENSATION.—For purposes of this chapter—

(1) * * *

* * * * * * *

(11) HEALTH SAVINGS ACCOUNT CONTRIBUTIONS.—The term "compensation" shall not include any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d).

* * * * * * *

CHAPTER 23—FEDERAL UNEMPLOYMENT TAX ACT

* * * * * * *

SEC. 3306. DEFINITIONS.

(a) * * *

(b) WAGES.—For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) * * *

* * * * * * *

(16) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 117, or 132; ⟦or⟧

(17) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(b)⟦.⟧*; or*

(18) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d).

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CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

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Subchapter A—Withholding from Wages

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SEC. 3401. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid—

(1) * * *

* * * * * * *

(20) for any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan (within the meaning of section 105(h)(6)); [or]

(21) for any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(b)[.]*; or*

(22) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d).

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Subtitle D—Miscellaneous Excise Taxes

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CHAPTER 43—QUALIFIED PENSION, ETC., PLANS

Sec. 4971. Taxes on failure to meet minimum funding standards.

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Sec. 4980G. Failure of employer to make comparable health savings account contributions.

* * * * * * *

SEC. 4973. TAX ON EXCESS CONTRIBUTIONS TO CERTAIN TAX-FAVORED ACCOUNTS AND ANNUITIES.

(a) TAX IMPOSED.—In the case of—

(1) * * *

* * * * * * *

(3) an individual retirement annuity (within the meaning of section 408(b)), a custodial account treated as an annuity contract under section 403(b)(7)(A) (relating to custodial accounts for regulated investment company stock), [or]

(4) a Coverdell education savings account (as defined in section 530, *or*

(5) a health savings account (within the meaning of section 223(d)),

* * * * * * *

(g) EXCESS CONTRIBUTIONS TO HEALTH SAVINGS ACCOUNTS.—For purposes of this section, in the case of health savings accounts (within the meaning of section 223(d)), the term "excess contributions" means the sum of—

(1) the aggregate amount contributed for the taxable year to the accounts (other than a rollover contribution from another

health savings account, or from an Archer MSA, which is not includible in gross income) which is in excess of the limitation under section 223(b) (determined without regard to paragraph (5) thereof), and

(2) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

(A) the distributions out of the accounts which were included in gross income under section 223(f)(2), and

(B) the excess (if any) of—

(i) the sum of limitations described in paragraph (1), over

(ii) the amount contributed to the accounts for the taxable year.

For purposes of this subsection, any contribution which is distributed out of the health savings account in a distribution to which section 223(f)(3) applies shall be treated as an amount not contributed.

* * * * * * *

SEC. 4975. TAX ON PROHIBITED TRANSACTIONS.

(a) * * *

* * * * * * *

(c) PROHIBITED TRANSACTION.—

(1) * * *

* * * * * * *

(6) SPECIAL RULE FOR HEALTH SAVINGS ACCOUNTS.—An individual for whose benefit a health savings account (within the meaning of section 223(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a health savings account by reason of the application of section 223(e)(2) to such account.

* * * * * * *

(e) DEFINITIONS.—

(1) PLAN.—For purposes of this section, the term "plan" means—

(A) * * *

* * * * * * *

(E) a health savings account described in section 223(d),

[(E)] *(F)* a Coverdell education savings account described in section 530, or

[(F)] *(G)* a trust, plan, account, or annuity which, at any time, has been determined by the Secretary to be described in any preceding subparagraph of this paragraph.

* * * * * * *

SEC. 4980G. FAILURE OF EMPLOYER TO MAKE COMPARABLE HEALTH SAVINGS ACCOUNT CONTRIBUTIONS.

(a) GENERAL RULE.—In the case of an employer who makes a contribution to the health savings account of any employee with respect to coverage under a minimum deductible plan of the employer during a calendar year, there is hereby imposed a tax on the failure of

such employer to meet the requirements of subsection (d) for such calendar year.

(b) AMOUNT OF TAX.—The amount of the tax imposed by subsection (a) on any failure for any calendar year is the amount equal to 35 percent of the aggregate amount contributed by the employer to health savings accounts of employees for taxable years of such employees ending with or within such calendar year.

(c) WAIVER BY SECRETARY.—In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed by subsection (a) to the extent that the payment of such tax would be excessive relative to the failure involved.

(d) EMPLOYER REQUIRED TO MAKE COMPARABLE HEALTH SAVINGS ACCOUNT CONTRIBUTIONS FOR ALL PARTICIPATING EMPLOYEES.—An employer meets the requirements of this subsection for any calendar year if the employer meets the requirements of section 4980E(d) applied by—

(1) substituting "health savings account" for "Archer MSA" each place it appears, and

(2) not taking into account any contribution made under section 125(h).

(e) CONTROLLED GROUPS.—For purposes of this section, all persons treated as a single employer under subsection (b), (c), (m), or (o) of section 414 shall be treated as 1 employer.

(f) DEFINITIONS.—Terms used in this section which are also used in section 223 have the respective meanings given such terms in section 223.

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—Returns and Records

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PART III—INFORMATION RETURNS

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Subpart B—Information Concerning Transactions with Other Persons

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SEC. 6041. INFORMATION AT SOURCE.

(a) * * *

* * * * * * *

(f) SECTION DOES NOT APPLY TO CERTAIN HEALTH ARRANGEMENTS.—This section shall not apply to any payment for medical care (as defined in section 213(d)) made under—

(1) a flexible spending arrangement (as defined in section 106(c)(2)), or

(2) a health reimbursement arrangement which is treated as employer-provided coverage under an accident or health plan for purposes of section 106.

* * * * * * *

Subpart C—Information Regarding Wages Paid Employees

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SEC. 6051. RECEIPTS FOR EMPLOYEES.

(a) REQUIREMENT.—Every person required to deduct and withhold from an employee a tax under section 3101 or 3402, or who would have been required to deduct and withhold a tax under section 3402 (determined without regard to subsection (n)) if the employee had claimed no more than one withholding exemption, or every employer engaged in a trade or business who pays remuneration for services performed by an employee, including the cash value of such remuneration paid in any medium other than cash, shall furnish to each such employee in respect of the remuneration paid by such person to such employee during the calendar year, on or before January 31 of the succeeding year, or, if his employment is terminated before the close of such calendar year, within 30 days after the date of receipt of a written request from the employee if such 30-day period ends before January 31, a written statement showing the following:

(1) the name of such person,

* * * * * * *

(10) in the case of an employee who is a member of the Armed Forces of the United States, such employee's earned income as determined for purposes of section 32 (relating to earned income credit), **[**and**]**

(11) the amount contributed to any Archer MSA (as defined in section 220(d) of such employee or such employee's spouse**[**.**]**, *and*

(12) the amount contributed to any health savings account (as defined in section 223(d)) of such employee or such employee's spouse.

* * * * * * *

CHAPTER 68—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

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Subchapter B—Assessable Penalties

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PART I—GENERAL PROVISIONS

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SEC. 6693. FAILURE TO PROVIDE REPORTS ON CERTAIN TAX-FAVORED ACCOUNTS OR ANNUITIES; PENALTIES RELATING TO DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS.

(a) REPORTS.—

(1) * * *

(2) PROVISIONS.—The provisions referred to in this paragraph are—

(A) * * *

* * * * * * *

(C) section 223(g) (relating to health savings accounts),

[(C)] *(D)* section 529(d) (relating to qualified tuition programs), and

[(D)] *(E)* section 530(h) (relating to Coverdell education savings accounts).

* * * * * * *

VII. DISSENTING VIEWS

We understand why this bill was enthusiastically endorsed by the Republican Members of this Committee. It advances two of their long-term objectives. It is another in a series of reckless tax cuts designed to deny needed funds for education, veterans, health, anti-poverty, and other programs. It also furthers their long-term objective of destroying employer-provided health care. We do not share those objectives and, therefore, strongly oppose this bill.

The Committee bill will cost $71 billion over the next ten years. The ten-year estimate understates the long-term costs of the bill. In the later years of the budget window, the Committee bill will cost in excess of $10 billion per year. Its cost will accelerate just at the time when the baby boom generation retires, denying resources to meet our commitments to the Social Security and Medicare systems.

The entire cost of the Committee bill will be funded by borrowing, increasing our national debt. The reckless tax cut agenda of this Republican Congress will create one of the largest spending increases in the history of this country. Two years ago, there was talk of actually paying off the entire national debt. As a result of the Republican fiscal policies, now the national debt, instead, will be increased dramatically every year. Interest on that debt will be an ever increasing Federal spending program. Future taxpayers will be faced with the obligation of funding those increased interest payments, but not one dollar of those interest payments will provide any benefit to the average individual.

The Republicans have long been hostile to employer-provided health care coverage. They seem intent on destroying both government and employer-provided health insurance coverage. In the past, the Chairman of the Committee has expressed his interest in dismantling the employment-linked health insurance system on the grounds that it has proven unsuccessful in extending coverage to all or even most Americans, and that it shields individuals far too much from the cost of care and coverage they use (*Medicine and Health,* May 13, 2002).

The Committee bill is an ingenious way of undercutting employer-provided health care coverage. It will provide tax-free savings accounts to individuals but only if the individuals have no health insurance or are covered by policies with relatively high deductibles. Individuals covered by traditional employer-provided health care plans will not be eligible for the new benefits. The Committee bill deliberately creates disincentives for traditional employer-provided health care.

If the Committee bill becomes law, employers currently providing health insurance coverage could use the tax benefits contained in the Committee bill as an excuse for reducing their health care costs. The tax benefits contained in the Committee bill will be

available to individuals covered by employer-provided health care coverage only if the employer plan provides no coverage for at least the first $1,000 of medical expenses. That deductible is greater than the deductible in most employers' plans. As a result, employers can increase the deductible required under their plan and argue that the employees will be benefitted through access to the Committee bill's tax benefits. The Committee bill provides incentives to reduce, not increase, coverage. The insurance cost savings will be enjoyed by the employer because there is no requirement that those savings be passed on to the employee.

For many American families, the tax benefits are worthless. The only thing they will receive from the Committee bill is reduced health care coverage. Not surprisingly, the same six million families deliberately excluded from the recent tax cut also would be excluded from the benefits of the Committee bill. Many other American families with higher incomes cannot take full advantage of the Committee bill because they do not have $4,000 annually in additional savings. The bill is designed to benefit employers, not rank-and-file employees.

It would be our desire to work together on a bipartisan basis with the goal of expanding, not reducing, health care coverage. Unfortunately, our Republican colleagues do not share that goal. Therefore, we are left simply to oppose reckless attacks on current health care coverage.

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