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HOUSE OF REPRESENTATIVES

REPORT
109–704

HEALTH OPPORTUNITY PATIENT EMPOWERMENT ACT OF 2006

SEPTEMBER 29, 2006.—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

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 6134]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 6134) to amend the Internal Revenue Code of 1986 to expand health coverage through the use of high deductible health plans and to encourage the use of health savings accounts, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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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 Opportunity Patient Empowerment Act of 2006".

SEC. 2. FSA AND HRA TERMINATIONS TO FUND HSAS.

(a) IN GENERAL.—Section 106 of the Internal Revenue Code of 1986 (relating to contributions by employer to accident and health plans) is amended by adding at the end the following new subsection:

"(e) FSA AND HRA TERMINATIONS TO FUND HSAS.—

"(1) IN GENERAL.—A plan shall not fail to be treated as a health flexible spending arrangement or health reimbursement arrangement under this section or section 105 merely because such plan provides for a qualified HSA distribution.

"(2) QUALIFIED HSA DISTRIBUTION.—The term 'qualified HSA distribution' means a distribution from a health flexible spending arrangement or health reimbursement arrangement to the extent that such distribution—

"(A) does not exceed the lesser of the balance in such arrangement on September 21, 2006, or as of the date of such distribution, and

"(B) is contributed by the employer directly to the health savings account of the employee before January 1, 2012.

Such term shall not include more than 1 distribution with respect to any arrangement.

"(3) ADDITIONAL TAX FOR FAILURE TO MAINTAIN HIGH DEDUCTIBLE HEALTH PLAN COVERAGE.—

"(A) IN GENERAL.—If, at any time during the testing period, the employee is not an eligible individual, then the amount of the qualified HSA distribution—

"(i) shall be includible in the gross income of the employee for the taxable year in which occurs the first month in the testing period for which such employee is not an eligible individual, and

"(ii) the tax imposed by this chapter for such taxable year on the employee shall be increased by 10 percent of the amount which is so includible.

"(B) EXCEPTION FOR DISABILITY OR DEATH.—Clauses (i) and (ii) of subparagraph (A) shall not apply if the employee ceases to be an eligible individual by reason of the death of the employee or the employee becoming disabled (within the meaning of section 72(m)(7)).

"(4) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) TESTING PERIOD.—The term 'testing period' means the period beginning with the month in which the qualified HSA distribution is contributed to the health savings account and ending on the last day of the 12th month following such month.

"(B) ELIGIBLE INDIVIDUAL.—The term 'eligible individual' has the meaning given such term by section 223(c)(1).

"(C) TREATMENT AS ROLLOVER CONTRIBUTION.—A qualified HSA distribution shall be treated as a rollover contribution described in section 223(f)(5).

"(5) TAX TREATMENT RELATING TO DISTRIBUTIONS.—For purposes of this title—

"(A) IN GENERAL.—A qualified HSA distribution shall be treated as a payment described in subsection (d).

"(B) COMPARABILITY EXCISE TAX.—

"(i) IN GENERAL.—Except as provided in clause (ii), section 4980G shall not apply to qualified HSA distributions.

"(ii) FAILURE TO OFFER TO ALL EMPLOYEES.—In the case of a qualified HSA distribution to any employee, the failure to offer such distribution to any eligible individual covered under a high deductible health plan of the employer shall (notwithstanding section 4980G(d)) be treated for purposes of section 4980G as a failure to meet the requirements of section 4980G(b)."

(b) CERTAIN FSA COVERAGE DISREGARDED COVERAGE.—Subparagraph (B) of section 223(c)(1) of such Code (relating to certain coverage disregarded) is amended by striking "and" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", and", and by inserting after clause (ii) the following new clause:

"(iii) for taxable years beginning after December 31, 2006, coverage under a health flexible spending arrangement during any period immediately following the end of a plan year of such arrangement during which unused benefits or contributions remaining at the end of such plan year may be paid or reimbursed to plan participants for qualified benefit expenses incurred during such period if—

"(I) the balance in such arrangement at the end of such plan year is zero, or

"(II) the individual is making a qualified HSA distribution (as defined in section 106(e)) in an amount equal to the remaining balance in such arrangement as of the end of such plan year, in accordance with rules prescribed by the Secretary.".

(c) APPLICATION OF SECTION.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall apply to distributions on or after the date of the enactment of this Act.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall take effect on the date of the enactment of this Act.

SEC. 3. REPEAL OF ANNUAL DEDUCTIBLE LIMITATION ON HSA CONTRIBUTIONS.

(a) IN GENERAL.—Paragraph (2) of section 223(b) of the Internal Revenue Code of 1986 (relating to monthly limitation) is amended—

(1) in subparagraph (A) by striking "the lesser of—" and all that follows and inserting "$2,250.", and

(2) in subparagraph (B) by striking "the lesser of—" and all that follows and inserting "$4,500.".

(b) CONFORMING AMENDMENT.—Section 223(d)(1)(A)(ii)(I) of such Code is amended by striking "subsection (b)(2)(B)(ii)" and inserting "subsection (b)(2)(B)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2006.

SEC. 4. MODIFICATION OF COST-OF-LIVING ADJUSTMENT.

Paragraph (1) of section 223(g) of the Internal Revenue Code of 1986 (relating to cost-of-living adjustment) is amended by adding at the end the following new flush sentence:

"In the case of adjustments made for any taxable year beginning after 2007, section 1(f)(4) shall be applied for purposes of this paragraph by substituting 'March 31' for 'August 31', and the Secretary shall publish the adjusted amounts under subsections (b)(2) and (c)(2)(A) for taxable years beginning in any calendar year no later than June 1 of the preceding calendar year.".

SEC. 5. CONTRIBUTION LIMITATION NOT REDUCED FOR PART-YEAR COVERAGE.

(a) INCREASE IN LIMIT FOR INDIVIDUALS BECOMING ELIGIBLE INDIVIDUALS AFTER BEGINNING OF THE YEAR.—Subsection (b) of section 223 of the Internal Revenue Code of 1986 (relating to limitations) is amended by adding at the end the following new paragraph:

"(8) INCREASE IN LIMIT FOR INDIVIDUALS BECOMING ELIGIBLE INDIVIDUALS AFTER THE BEGINNING OF THE YEAR.—

"(A) IN GENERAL.—For purposes of computing the limitation under paragraph (1) for any taxable year, an individual who is an eligible individual during the last month of such taxable year shall be treated—

"(i) as having been an eligible individual during each of the months in such taxable year, and

"(ii) as having been enrolled, during each of the months such individual is treated as an eligible individual solely by reason of clause (i), in the same high deductible health plan in which the individual was enrolled for the last month of such taxable year.

"(B) FAILURE TO MAINTAIN HIGH DEDUCTIBLE HEALTH PLAN COVERAGE.—

"(i) IN GENERAL.—If, at any time during the testing period, the individual is not an eligible individual, then—

"(I) gross income of the individual for the taxable year in which occurs the first month in the testing period for which such individual is not an eligible individual is increased by the aggregate amount of all contributions to the health savings account of the individual which could not have been made but for subparagraph (A), and

"(II) the tax imposed by this chapter for any taxable year on the individual shall be increased by 10 percent of the amount of such increase.

"(ii) EXCEPTION FOR DISABILITY OR DEATH.—Subclauses (I) and (II) of clause (i) shall not apply if the individual ceased to be an eligible individual by reason of the death of the individual or the individual becoming disabled (within the meaning of section 72(m)(7)).

"(iii) TESTING PERIOD.—The term 'testing period' means the period beginning with the last month of the taxable year referred to in subparagraph (A) and ending on the last day of the 12th month following such month.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2006.

SEC. 6. EXCEPTION TO REQUIREMENT FOR EMPLOYERS TO MAKE COMPARABLE HEALTH SAVINGS ACCOUNT CONTRIBUTIONS.

(a) IN GENERAL.—Section 4980G of the Internal Revenue Code of 1986 (relating to failure of employer to make comparable health savings account contributions) is amended by adding at the end the following new subsection:

"(d) EXCEPTION.—For purposes of applying section 4980E to a contribution to a health savings account of an employee who is not a highly compensated employee (as defined in section 414(q)), highly compensated employees shall not be treated as comparable participating employees.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2006.

SEC. 7. ONE-TIME DISTRIBUTION FROM INDIVIDUAL RETIREMENT PLANS TO FUND HSAS.

(a) IN GENERAL.—Subsection (d) of section 408 of the Internal Revenue Code of 1986 (relating to taxability of beneficiary of employees' trust) is amended by adding at the end the following new paragraph:

"(9) DISTRIBUTION FOR HEALTH SAVINGS ACCOUNT FUNDING.—

"(A) IN GENERAL.—In the case of an individual who is an eligible individual (as defined in section 223(c)) and who elects the application of this paragraph for a taxable year, gross income of the individual for the taxable year does not include a qualified HSA funding distribution to the extent such distribution is otherwise includible in gross income.

"(B) QUALIFIED HSA FUNDING DISTRIBUTION.—For purposes of this paragraph, the term 'qualified HSA funding distribution' means a distribution from an individual retirement plan (other than a plan described in subsection (k) or (p)) of the employee to the extent that such distribution is contributed to the health savings account of the individual in a direct trustee-to-trustee transfer.

"(C) LIMITATIONS.—

"(i) MAXIMUM DOLLAR LIMITATION.—The amount excluded from gross income by subparagraph (A) shall not exceed the excess of—

"(I) the annual limitation under section 223(b) computed on the basis of the type of coverage under the high deductible health plan covering the individual at the time of the qualified HSA funding distribution, over

"(II) in the case of a distribution described in clause (ii)(II), the amount of the earlier qualified HSA funding distribution.

"(ii) ONE-TIME TRANSFER.—

"(I) IN GENERAL.—Except as provided in subclause (II), an individual may make an election under subparagraph (A) only for one qualified HSA funding distribution during the lifetime of the individual. Such an election, once made, shall be irrevocable.

"(II) CONVERSION FROM SELF-ONLY TO FAMILY COVERAGE.—If a qualified HSA funding distribution is made during a month in a taxable year during which an individual has self-only coverage under a high deductible health plan as of the first day of the month, the individual may elect to make an additional qualified HSA funding distribution during a subsequent month in such tax-

able year during which the individual has family coverage under a high deductible health plan as of the first day of the subsequent month.

"(D) FAILURE TO MAINTAIN HIGH DEDUCTIBLE HEALTH PLAN COVERAGE.—

"(i) IN GENERAL.—If, at any time during the testing period, the individual is not an eligible individual, then the aggregate amount of all contributions to the health savings account of the individual made under subparagraph (A)—

"(I) shall be includible in the gross income of the individual for the taxable year in which occurs the first month in the testing period for which such individual is not an eligible individual, and

"(II) the tax imposed by this chapter for any taxable year on the individual shall be increased by 10 percent of the amount which is so includible.

"(ii) EXCEPTION FOR DISABILITY OR DEATH.—Subclauses (I) and (II) of clause (i) shall not apply if the individual ceased to be an eligible individual by reason of the death of the individual or the individual becoming disabled (within the meaning of section 72(m)(7)).

"(iii) TESTING PERIOD.—The term 'testing period' means the period beginning with the month in which the qualified HSA funding distribution is contributed to a health savings account and ending on the last day of the 12th month following such month.

"(E) APPLICATION OF SECTION 72.—Notwithstanding section 72, in determining the extent to which an amount is treated as otherwise includible in gross income for purposes of subparagraph (A), the aggregate amount distributed from an individual retirement plan shall be treated as includible in gross income to the extent that such amount does not exceed the aggregate amount which would have been so includible if all amounts from all individual retirement plans were distributed. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.".

(b) COORDINATION WITH LIMITATION ON CONTRIBUTIONS TO HSAS.—Section 223(b)(4) of such Code (relating to coordination with other contributions) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by inserting after subparagraph (B) the following new subparagraph:

"(C) the aggregate amount contributed to health savings accounts of such individual for such taxable year under section 408(d)(9) (and such amount shall not be allowed as a deduction under subsection (a)).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2006.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

Purpose

The bill, H.R. 6134, as amended, includes provisions for encouraging the use of high deductible health plans and health savings accounts.

Summary

Effective for distributions after the date of enactment and before January 1, 2012, the bill allows certain amounts in a health FSA or HRA to be rolled over into an HSA without violating the otherwise applicable requirements for such arrangements. With respect to coverage for taxable years beginning after December 31, 2006, the bill allows certain FSA coverage during a grace period following the end of a plan year to be treated as disregarded coverage. Effective for taxable years beginning after December 31, 2006, the bill modifies the limit on the annual deductible contributions that can be made to an HSA so that the maximum deductible contribution is not limited to the annual deductible under the high deductible health plan. Effective for adjustments made for taxable years be-

ginning after 2007, the bill requires an earlier indexing period to be used in making cost-of-living adjustments for the HSA dollar amounts that are indexed for inflation. Effective for taxable years beginning after December 31, 2006, the bill allows individuals who become covered under a high deductible plan in a month other than January to make the full deductible HSA contribution for the year if certain requirements are satisfied. Effective for taxable years beginning after December 31, 2006, the bill provides an exception to the comparable contribution requirements which allows employers to make larger HSA contributions for nonhighly compensated employees than for highly compensated employees. Effective for taxable years beginning after December 31, 2006, the bill allows a one-time contribution to an HSA of amounts distributed from an individual retirement arrangement.

B. BACKGROUND AND NEED FOR LEGISLATION

Millions of Americans have no health insurance coverage. Covering America's uninsured is a top priority for the Congress. High deductible health plans provide an opportunity for many uninsured individuals to afford health insurance. High deductible health plans also promote more cost conscious health decisions. Health savings accounts (HSAs) were effective beginning 2004 and are available to individuals with a high deductible health plan (and no other health plan). Health savings accounts allow individuals to pay current medical expenses on a tax-free basis and also to save for future medical expenses on a tax-free basis. While relatively new to the market, HSAs have been very popular with both individuals and employers. The bill includes provisions that will increase the attractiveness of HSAs.

C. LEGISLATIVE HISTORY

Background

H.R. 6134 was introduced on September 21, 2006, and was referred to the Committee on Ways and Means.

Committee action

The Committee on Ways and Means marked up the bill on September 27, 2006, and ordered the bill, as amended, favorably reported.

Committee hearings

The Committee on Ways and Means held a full Committee hearing on June 28, 2006, on health savings accounts.

The Committee held a full Committee hearing on February 15, 2006, on the President's Fiscal Year 2007 Budget with Department of Treasury Secretary John Snow, including the President's proposals relating to high deductible health plans and health savings accounts.

II. Explanation of the Bill

A. PRESENT LAW

Health savings accounts

In general

Individuals with a high deductible health plan (and no other health plan other than a plan that provides certain permitted coverage) may establish a health savings account ("HSA"). In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. In general, HSAs are tax-exempt trusts or custodial accounts created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents.

Within limits, contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual. Contributions to an HSA are excludable from income and employment taxes if made by the employer. Earnings on amounts in HSAs are not taxable. Distributions from an HSA for qualified medical expenses are not includible in gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 10 percent. The 10-percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (i.e., age 65).

Eligible individuals

Eligible individuals for HSAs are individuals who are covered by a high deductible health plan and no other health plan that is not a high deductible health plan and which provides coverage for any benefit which is covered under the high deductible health plan. After an individual has attained age 65 and becomes enrolled in Medicare benefits, contributions cannot be made to an HSA.[1] 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 high deductible health plan is still eligible for an HSA if such other coverage is certain permitted insurance or permitted 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 of Treasury 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 high deductible health plan is a health plan that, for 2006, has a deductible that is at least $1,050 for self-only coverage or $2,100 for family coverage and that has an out-of-pocket expense limit that is no more than $5,250 in the case of self-only coverage and

[1] Sec. 223(b)(7), as interpreted by Notice 2004–2, 2004–2 I.R.B. 269, corrected by Announcement 2004–67, 2004–36 I.R.B. 459.

$10,500 in the case of family coverage.[2] Out-of-pocket expenses include deductibles, co-payments, and other amounts (other than premiums) that the individual must pay for covered benefits under the plan. A plan is not a high deductible health plan if substantially all of the coverage is for permitted coverage or coverage that may be provided by permitted insurance, as described above. A plan does not fail to be a high deductible health plan by reason of failing to have a deductible for preventive care.

Health flexible spending arrangement ("FSAs") and health reimbursement arrangements ("HRAs") are health plans that constitute other coverage under the HSA rules. These arrangements are discussed in more detail, below. An individual who is covered by a high deductible health plan and a health FSA or HRA generally is not eligible to make contributions to an HSA. An individual is eligible to make contributions to an HSA if the health FSA or HRA is: (1) a limited purpose health FSA or HRA; (2) a suspended HRA; (3) a post-deductible health FSA or HRA; or (4) a retirement HRA.[3]

Tax treatment of and limits on contributions

Contributions to an HSA by or on behalf of an eligible individual are deductible (within limits) in determining adjusted gross income (i.e., "above-the-line") of the individual. In addition, employer contributions to HSAs (including salary reduction contributions made through a cafeteria plan) are excludable from gross income and wages for employment tax purposes. In the case of an employee, contributions to an HSA may be made by both the individual and the individual's employer. All contributions are aggregated for purposes of the maximum annual contribution limit. Contributions to Archer MSAs reduce the annual contribution limit for HSAs.

The maximum aggregate annual contribution that can be made to an HSA is the lesser of (1) 100 percent of the annual deductible under the high deductible health plan, or (2) (for 2006) $2,700 in the case of self-only coverage and $5,450 in the case of family coverage.[4] 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. The annual contribution limits are increased for individuals who have attained age 55 by the end of the taxable year. In the case of policyholders and covered spouses who are age 55 or older, the HSA annual contribution limit is greater than the otherwise applicable limit by $700 in 2006, $800 in 2007, $900 in 2008, and $1,000 in 2009 and thereafter. As in determining the general annual con-

[2] The limits are indexed for inflation. The family coverage limits always will be twice the self-only coverage limits (as indexed for inflation). In the case of the plan using a network of providers, the plan does not fail to be a high deductible health plan (if it would otherwise meet the requirements of a high deductible health plan) solely because the out-of-pocket expense limit for services provided outside of the network exceeds the out-of-pocket expense limits. In addition, such plan's deductible for out-of-network services is not taken into account in determining the annual contribution limit (i.e., the deductible for services within the network is used for such purpose).

[3] Rev. Rul. 2004–45, 2004–22 I.R.B. 1. A limited purpose health FSA pays or reimburses benefits for permitted coverage and a limited purpose HRA pays or reimburses benefits for permitted insurance or permitted coverage. A limited purpose health FSA or HRA may also pay or reimburse preventive care benefits. A suspended HRA does not pay medical expense incurred during a suspension period except for preventive care, permitted insurance and permitted coverage. A post-deductible health FSA or HRA does not pay or reimburse any medical expenses incurred before the minimum annual deductible under the HSA rules is satisfied. A retirement HSA pays or reimburses only medical expenses incurred after retirement.

[4] These amounts are indexed for inflation.

tribution limit, the increase in the annual contribution limit for individuals who have attained age 55 is also determined on a monthly basis. As previously discussed, contributions, including catch-up contributions, cannot be made once an individual is enrolled in Medicare.

In the case of individuals who are married to each other and either spouse has family coverage, both spouses are treated as having only the family coverage with the lowest annual deductible. The annual contribution limit (without regard to the catch-up contribution amounts) is divided equally between the spouses unless they agree on a different division (after reduction for amounts paid from any Archer MSA of the spouses).

An excise tax applies to contributions in excess of the maximum contribution amount for the HSA. The excise tax generally is equal to six percent of the cumulative amount of excess contributions that are not distributed from the HSA.

Amounts can be rolled over into an HSA from another HSA or from an Archer MSA.

Comparable contributions

If an employer makes contributions to employees' HSAs, the employer must make available comparable contributions 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 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 for that period. The comparability rule does not apply to contributions made through a cafeteria plan.

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. In general, 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. 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, or (4) in the case of an account beneficiary who has attained the age of Medicare eligibility, health insurance premiums for Medicare, other than premiums for Medigap policies. Such qualified health insurance premiums include, for example, Medicare Part A and Part B premiums, Medicare HMO premiums, and the employee share of premiums for employer-sponsored health insurance including employer-sponsored retiree health insurance. Whether the expenses are qualified medical expenses is determined as of the time the expenses were incurred.

For purposes of determining the itemized deduction for medical expenses, distributions from an HSA for qualified medical expenses are not treated as expenses paid for medical care under section 213. Distributions from an HSA that are not for qualified medical expenses are includible in gross income. Distributions includible in gross income also are subject to an additional 10-percent tax unless made after death, disability, or the individual attains the age of Medicare eligibility (i.e., age 65).

Reporting requirements

Employer contributions are required to be reported on the employee's Form W–2. Trustees of HSAs may be required to report to the Secretary of the Treasury amounts with respect to contributions, distributions, the return of excess contributions, and other matters as determined appropriate by the Secretary. In addition, the Secretary may require providers of high deductible health plans to make reports to the Secretary and to account beneficiaries as the Secretary determines appropriate.

Health flexible spending arrangements and health reimbursement arrangements

Arrangements commonly used by employers to reimburse medical expenses of their employees (and their spouses and dependents) include health flexible spending arrangements ("FSAs") and health reimbursement accounts ("HRAs"). Health FSAs typically are funded on a salary reduction basis, meaning that employees are given the option to reduce current compensation and instead have the compensation used to reimburse the employee for medical expenses. If the health FSA meets certain requirements, then the compensation that is forgone is not includible in gross income or wages and reimbursements for medical care from the health FSA are excludable from gross income and wages. Health FSAs are subject to the general requirements relating to cafeteria plans, including a requirement that a cafeteria plan generally may not provide deferred compensation.[5] This requirement often is referred to as the "use-it-or-lose-it-rule." Until May of 2005, this requirement was interpreted to mean that amounts available from a health FSA as of the end of a plan year must be forfeited by the employee. In May 2005, the Treasury Department issued a notice that allows a grace period not to exceed two and one-half months immediately following the end of the plan year during which unused amounts may be used.[6] An individual participating in a health FSA that allows reimbursements during a grace period is generally not eligible to make contributions to the HSA until the first month following the end of the grace period even if the individual's health FSA has no unused benefits as of the end of the prior plan year.[7] Health FSAs are subject to certain other requirements, including rules that require that the FSA have certain characteristics similar to insurance.

HRAs operate in a manner similar to health FSAs, in that they are an employer-maintained arrangement that reimburses employees for medical expenses. Some of the rules applicable to HRAs and

[5] Sec. 125(d)(2).
[6] Notice 2005–42, 2005–23 I.R.B. 1204.
[7] Notice 2005–86, 2005–49 I.R.B. 1075.

health FSAs are similar, e.g., the amounts in the arrangements can only be used to reimburse medical expenses and not for other purposes. Some of the rules are different. For example, HRAs cannot be funded on a salary reduction basis and the use-it-or-lose-it rule does not apply. Thus, amounts remaining at the end of the year may be carried forward to be used to reimburse medical expenses in the next year.[8] Reimbursements for insurance covering medical care expenses are allowable reimbursements under an HRA, but not under a health FSA.

As mentioned above, subject to certain limited exceptions, health FSAs and HRAs constitute other coverage under the HSA rules.

B. REASONS FOR CHANGE

High deductible health plans, coupled with an HSA, provide families and individuals with the opportunity to gain better access to affordable health care, while encouraging saving for medical costs through tax-deductible contributions and tax-free buildup of earnings. Since their inception in 2004, the use of HSAs has grown rapidly. Despite this growth, the early experience with HSAs has revealed a number of features of present law that the Committee believes create obstacles to the use of HSAs. The Committee bill includes provisions to address these obstacles.

The Committee understands that HRAs and FSAs are common features of many employer-sponsored health plans. However, in some cases, the existence of these plans may present a barrier to adopting high deductible plans and HSAs. Thus, the Committee bill allows individuals in a health FSA or HRA a one-time opportunity to roll over existing balances into an HSA. The Committee bill also provides that, if certain requirements are satisfied, health FSA coverage under the grace period permitted by Treasury rules will not disqualify an individual from making contributions to an HSA. These changes are intended to facilitate the transition to high deductible health plans.

HSAs are designed to provide a savings vehicle to enable individuals to pay for their out of pocket medical expenses. However, under present law, in some cases individuals may be concerned that the HSA may not provide sufficient opportunity to save for possible medical expenses. For example, if an individual enrolls in a high deductible plan during the year, the individual may have exposure for the full deductible under the plan, whereas the permitted contribution to the HSA is limited by the number of months the individual was in the plan. The Committee bill contains a number of provisions designed to address this type of issue. Thus, the bill permits the full contribution to an HSA for individuals who enroll during the year. To prevent abuse of this increased contribution, the individual must remain in a high deductible plan for 12 months. The bill also allows a one-time rollover to an HSA from an IRA (subject to the otherwise applicable HSA contribution limits) and allows employers to make higher HSA contributions for non-highly compensated employees than for highly compensated employees. The Committee bill permits individuals to make the maximum dollar contribution to an HSA, regardless of the deductible

[8] Guidance with respect to HRAs, including the interaction of FSAs and HRAs in the case an individual is covered under both, is provided in Notice 2002–45, 2002–2 C.B. 93.

under the high deductible plan, thus allowing individuals to save for expenses in addition to those subject to the deductible, including expenses not covered by the high deductible plan.

Finally, the bill modifies the method by which the cost-of-living adjustments are made for purposes of determining whether a plan is a high deductible plan. This change will allow individuals, insurers, and employers to know in advance of a year what plans will qualify an individual for an HSA.

C. EXPLANATION OF PROVISION

1. Allow rollovers from health FSAs and HRAs into HSAs for a limited time

The provision allows certain amounts in a health FSA or HRA to be distributed from the health FSA or HRA and contributed through a direct transfer to an HSA without violating the otherwise applicable requirements for such arrangements. The amount that can be distributed from a health FSA or HRA and contributed to an HSA may not exceed an amount equal to the lesser of (1) the balance in the health FSA or HRA as of September 21, 2006 or (2) the balance in the health FSA or HRA as of the date of the distribution. The balance in the health FSA or HRA as of any date is determined on a cash basis (i.e., expenses incurred that have not been reimbursed as of the date the determination is made are not taken into account). Amounts contributed to an HSA under the provision are excludable from gross income and wages for employment tax purposes, are not taken into account in applying the maximum deduction limitation for other HSA contributions, and are not deductible. Contributions must be made directly to the HSA before January 1, 2012. The provision is limited to one distribution with respect to each health FSA or HRA of the individual.

The provision is designed to assist individuals in transferring from another type of health plan to a high deductible health plan. Thus, if an individual for whom a contribution is made under the provision does not remain an eligible individual during the testing period, the amount of the contribution is includible in gross income of the individual. An exception applies if the employee ceases to be an eligible individual by reason of death or disability. The testing period is the period beginning with the month of the contribution and ending on the last day of the 12th month following such month. The amount is includible for the taxable year of the first day during the testing period that the individual is not an eligible individual. A 10-percent additional tax also applies to the amount includible.

A modified comparability rule applies with respect to contributions under the provision. If the employer makes available to any employee the ability to make contributions to the HSA from distributions from a health FSA or HRA under the provision, all employees who are covered under a high deductible plan of the employer must be allowed to make such distributions and contributions. The present-law excise tax applies if this requirement is not met.

For example, suppose the balance in a health FSA as of September 21, 2006, is $2,000 and the balance in the account as January 1, 2008 is $3,000. Under the provision, a health FSA will not

be considered to violate applicable rules if, as of January 1, 2008, an amount not to exceed $2,000 is distributed from the health FSA and contributed to an HSA of the individual. The $2,000 distribution would not be includible in income, and the subsequent contribution would not be deductible and would not count against the annual maximum tax deductible contribution that can be made to the HSA. If the individual ceases to be an eligible individual as of June 1, 2008, the $2,000 contribution amount is included in gross income and subject to a 10-percent additional tax. If instead the distribution and contribution are made as of June 30, 2008, when the balance in the health FSA is $1,500, the amount of the distribution and contribution is limited to $1,500.

The present law rule that an individual is not an eligible individual if the individual has coverage under a general purpose health FSA or HRA continues to apply. Thus, for example, if the health FSA or HRA from which the contribution is made is a general purpose health FSA or HRA and the individual remains eligible under such arrangement after the distribution and contribution, the individual is not an eligible individual.

Effective date.—The provision is effective for distributions and contributions on or after the date of enactment and before January 1, 2012.

2. Certain FSA coverage treated as disregarded coverage

The provision provides that, for taxable years beginning after December 31, 2006, in certain cases, coverage under a health flexible spending arrangement ("FSA") during the period immediately following the end of a plan year during which unused benefits or contributions remaining at the end of such plan year may be paid or reimbursed to plan participants for qualified expenses is disregarded coverage. Such coverage is disregarded if (1) the balance in the health FSA at the end of the plan year is zero, or (2) in accordance with rules prescribed by the Secretary of Treasury, the entire remaining balance in the health FSA at the end of the plan year is contributed to an HSA as provided under another provision of the bill.[9]

Thus, for example, if as of December 31, 2006, a participant's health FSA balance is zero, coverage under the health FSA during the period from January 1, 2007, until March 15, 2007 (i.e., the "grace period") is disregarded in determining if tax deductible contributions can be made to an HSA for that period. Similarly, if the entire balance in an individual's health FSA as of December 31, 2006, is distributed and contributed to an HSA (as under another provision of the bill) coverage during the health FSA grace period is disregarded.

It is intended that the Secretary will provide guidance under the provision with respect to the timing of health FSA distributions contributed to an HSA in order to facilitate such rollovers and the establishment of HSAs in connection with high deductible plans. For example, it is intended that the Secretary would provide rules under which coverage is disregarded if, before the end of a year, an individual elects high deductible plan coverage and to contribute

[9] The amount that can be contributed is limited to the balance in the health FSA as of September 21, 2006.

any remaining FSA balance to an HSA in accordance with the provision even if the trustee-to-trustee transfer cannot be completed until the following plan year. Similar rules apply for the general provision allowing amounts from a health FSA or HRA to be contributed to an HSA in order to facilitate such contributions at the beginning of an employee's first year of HSA eligibility.

The provision does not modify the permitted health FSA grace period allowed under existing Treasury guidance.

Effective date.—The provision is effective after the date of enactment with respect to coverage for taxable years beginning after December 31, 2006.

3. Repeal of annual plan deductible limitation on HSA contribution limitation

The provision modifies the limit on the annual deductible contributions that can be made to an HSA so that the maximum deductible contribution is not limited to the annual deductible under the high deductible health plan. Under the provision, the maximum aggregate annual contribution that can be made to an HSA is $2,700 (as indexed for inflation after 2006) in the case of self-only coverage and $5,450 (as indexed for inflation after 2006) in the case of family coverage.

Effective date.—The provision is effective for taxable years beginning after December 31, 2006.

4. Earlier indexing of cost of living adjustments

Under the provision, in the case of adjustments made for any taxable year beginning after 2007, the Consumer Price Index for a calendar year is determined as of the close of the 12-month period ending on March 31 of the calendar year (rather than August 31 as under present law) for the purpose of making cost-of-living adjustments for the HSA dollar amounts that are indexed for inflation (i.e., the contribution limits and the high-deductible health plan requirements). The provision also requires the Secretary of Treasury to publish the adjusted amounts for a year no later than June 1 of the preceding calendar year.

Effective date.—The provision is effective for adjustments made for taxable years beginning after 2007.

5. Allow full contribution for months preceding month that taxpayer is an eligible individual

In general, the provision allows individuals who become covered under a high deductible plan in a month other than January to make the full deductible HSA contribution for the year. Under the provision, an individual who is an eligible individual during the last month of a taxable year is treated as having been an eligible individual during every month during the taxable year for purposes of computing the amount that may be contributed to the HSA for the year. Thus, such individual is allowed to make contributions for months before the individual was enrolled in a high deductible health plan. For the months preceding the last month of the taxable year that the individual is treated as an eligible individual solely by reason of the provision, the individual is treated as having been enrolled in the same high deductible health plan in which

the individual was enrolled during the last month of the taxable year.

If an individual makes contributions under the provision and does not remain an eligible individual during the testing period, the amount of the contributions attributable to months preceding the month in which the individual was an eligible individual which could not have been made but for the provision are includible in gross income. An exception applies if the employee ceases to be an eligible individual by reason of death or disability. The testing period is the period beginning with the last month of the taxable year and ending on the last day of the 12th month following such month. The amount is includible for the taxable year of the first day during the testing period that the individual is not an eligible individual. A 10-percent additional tax also applies to the amount includible.

For example, suppose individual "A" enrolls in high deductible plan "H" in December of 2007 and is otherwise an eligible individual in that month. A was not an eligible individual in any other month in 2007. A may make HSA contributions as if she had been enrolled in plan H for all of 2007. If A ceases to be an eligible individual (e.g., if she ceases to be covered under the high deductible health plan) in June 2008, an amount equal to the HSA deduction attributable to treating A as an eligible individual for January through November 2007 is included in income in 2008. In addition, a 10-percent additional tax applies to the amount includible.

Effective date.—The provision is effective for taxable years beginning after December 31, 2006.

6. Modify employer comparable contribution requirements for contributions made to nonhighly compensated employees

The provision provides an exception to the comparable contribution requirements which allows employers to make larger HSA contributions for nonhighly compensated employees than for highly compensated employees. Highly compensated employees are defined as under section 414(q) and include any employee who was (1) a five-percent owner at any time during the year or the preceding year; or (2) for the preceding year, (A) had compensation from the employer in excess of $100,000[10] (for 2006) and (B) if elected by the employer, was in the group consisting of the top-20 percent of employees when ranked based on compensation. Nonhighly compensated employees are employees not included in the definition of highly compensated employee under section 414(q).

The comparable contribution rules continue to apply to the contributions made to nonhighly compensated employees so that the employer must make available comparable contributions on behalf of all nonhighly compensated employees with comparable coverage during the same period.

For example, an employer is permitted to make a $1,000 contribution to the HSA of each nonhighly compensated employee for a year without making contributions to the HSA of each highly compensated employee.

Effective date.—The provision is effective for taxable years beginning after December 31, 2006.

[10] This amount is indexed for inflation.

7. One-time rollovers from IRAs into HSAs

The provision allows a one-time contribution to an HSA of amounts distributed from an individual retirement arrangement ("IRA"). The contribution must be made in a direct trustee-to-trustee transfer. Amounts distributed from an IRA under the provision are not includible in income to the extent that the distribution would otherwise be includible in income. In addition, such distributions are not subject to the 10-percent additional tax on early distributions.

In determining the extent to which amounts distributed from the IRA would otherwise be includible in income, the aggregate amount distributed from the IRA is treated as includible in income to the extent of the aggregate amount which would have been includible if all amounts were distributed from all IRAs of the same type (i.e., in the case of a traditional IRA, there is no pro-rata distribution of basis). As under present law, this rule is applied separately to Roth IRAs and other IRAs.

The amount that can be distributed from the IRA and contributed to an HSA is limited to the otherwise maximum deductible contribution amount to the HSA computed on the basis of the type of coverage under the high deductible health plan at the time of the contribution. The amount that can otherwise be contributed to the HSA for the year of the contribution from the IRA is reduced by the amount contributed from the IRA. No deduction is allowed for the amount contributed from an IRA to an HSA.

Under the provision, only one distribution and contribution may be made during the lifetime of the individual, except that if a distribution and contribution are made during a month in which an individual has self-only coverage as of the first day of the month, an additional distribution and contribution may be made during a subsequent month within the taxable year in which the individual has family coverage. The limit applies to the combination of both contributions.

If the individual does not remain an eligible individual during the testing period, the amount of the distribution and contribution is includible in gross income of the individual. An exception applies if the employee ceases to be an eligible individual by reason of death or disability. The testing period is the period beginning with the month of the contribution and ending on the last day of the 12th month following such month. The amount is includible for the taxable year of the first day during the testing period that the individual is not an eligible individual. A 10-percent additional tax also applies to the amount includible.

The provision does not apply to simplified employee pensions ("SEPs") or to SIMPLE retirement accounts.

Effective date.—The provision is effective for taxable years beginning after December 31, 2006.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means in its consideration of the bill, H.R. 6134, the "Health Opportunity Patient Empowerment Act of 2006".

MOTION TO REPORT THE BILL

The bill, H.R. 6134, was ordered favorably reported, as amended, by a rollcall vote of 24 yeas to 14 nays (with a quorum being present). The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Thomas	X			Mr. Stark		X	
Mr. Shaw	X			Mr. Levin		X	
Mrs. Johnson	X			Mr. Cardin		X	
Mr. Herger	X			Mr. McDermott		X	
Mr. McCrery	X			Mr. Neal		X	
Mr. Camp	X			Mr. McNulty			
Mr. Ramstad	X			Mr. Tanner		X	
Mr. Nussle	X			Mr. Becerra		X	
Mr. Johnson	X			Mr. Doggett		X	
Mr. English	X			Mr. Pomeroy		X	
Mr. Hayworth	X			Ms. Tubbs Jones		X	
Mr. Weller	X			Mr. Thompson		X	
Mr. Hulshof	X			Mr. Larson		X	
Mr. Lewis (KY)	X			Mr. Emanuel		X	
Mr. Foley	X					X	
Mr. Brady	X					X	
Mr. Reynolds	X						
Mr. Ryan	X						
Mr. Cantor	X						
Mr. Linder	X						
Mr. Beauprez	X						
Ms. Hart	X						
Mr. Chocola	X						
Mr. Nunes	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. 6134 as reported.

The bill is estimated to have the following effects on budget receipts for fiscal years 2007–2011:

**ESTIMATED BUDGET EFFECTS OF H.R. 6134,
THE "HEALTH OPPORTUNITY PATIENT EMPOWERMENT ACT OF 2006,"
AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS**

Fiscal Years 2007 - 2011

[Millions of Dollars]

Provision	Effective	2007	2008	2009	2010	2011	2007-11
1. Allow a one-time rollover of HRA and health FSA funds into an HSA (sunset for taxable years beginning after 12/31/11) [1]	do/a DOE	-2	-4	-4	-4	-5	-19
2. Disregard grace period health FSA coverage for purposes of eligibility for deductible HSA contributions if FSA has zero balance at end of prior plan year or remaining balance from prior plan year is transferred to an HSA	[2]	*Negligible Revenue Effect*					
3. Repeal the limitation on HSA contributions that corresponds to the annual deductible under the high-deductible insurance policy [3]	tyba 12/31/06	-10	-17	-27	-30	-38	-121
4. Compute cost-of-living adjustments for HSA provisions earlier in the calendar year (March in lieu of August)	afya 2007	*Negligible Revenue Effect*					
5. Allow full contribution for months preceding month that taxpayer is in high deductible plan	tyba 12/31/06	-11	-29	-33	-36	-37	-147
6. Modify comparability rules so that employers may make larger contributions to HSAs of non-highly compensated employees than to HSAs of highly compensated employees	tyba 12/31/06	*Negligible Revenue Effect*					
7. Allow a one-time rollover of IRA funds to an HSA [4]	tyba 12/31/06	*Negligible Revenue Effect*					
NET TOTAL		**-23**	**-50**	**-64**	**-70**	**-80**	**-287**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be October 1, 2006.

Legend for "Effective" column:
- afya = adjustments for years after
- do/a = distributions on or after
- DOE = date of enactment
- tyba = taxable years beginning after

[1] Rollover may not exceed the balance in the HRA or health FSA on September 21, 2006.

[2] Effective on the date of enactment with respect to coverage for taxable years beginning after December 31, 2006.

[3] Under the provision, HSA contributions would be permitted up to the statutory limits in present-law sections 223(b)(2)(A)(ii) and (B)(ii) of the Internal Revenue Code, which are $2,700 for single coverage and $5,450 for family coverage for 2006. These limits are indexed for inflation and may change for taxable years beginning in 2007, when the provision would become effective.

[4] A limit would apply to the sum of: (1) the amount allowed as a deductible contribution to the HSA; and (2) the amount rolled over from the IRA to the HSA. The sum of these two amounts would not be permitted to exceed the otherwise maximum annual deductible contribution.

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, September 28, 2006.

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. 6134, the Health Opportunity Patient Empowerment Act of 2006.

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

Sincerely,

DONALD B. MARRON,
Acting Director.

Enclosure.

H.R. 6134—Health Opportunity Patient Empowerment Act of 2006

Summary: H.R. 6134 would make various changes to rules regarding health savings accounts (HSAs). It would allow fully deductible contributions for the entire year in which a high-deductible insurance policy is purchased, repeal certain limitations on HSA contributions, and allow a one-time rollover of funds from certain other accounts into HSAs, among other changes.

The Joint Committee on Taxation (JCT) estimates that enacting H.R. 6134 would reduce federal revenues by $23 million in 2007, by $287 million over the 2007–2011 period, and by $1.0 billion over the 2007–2016 period. These estimates include reductions in off-budget receipts from Social Security payroll taxes of $3 million in 2007, $30 million over the 2007–2011 period, and $147 million over the 2007–2016 period. The Congressional Budget Office (CBO) estimates that enacting H.R. 6134 would not affect direct spending.

JCT has determined that the legislation contains no private-sector or intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA).

Estimated cost to the Federal Government: The estimated budgetary impact of H.R. 6134 is shown in the following table.

	By fiscal year, in millions of dollars—									
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CHANGES IN REVENUES										
Allowing Fully Deductible Contributions for Prior Months	−11	−29	−33	−36	−37	−37	−35	−33	−28	−22
Repealing a Limitation on HSA Contributions	−10	−17	−27	−30	−38	−50	−66	−115	−170	−190
Allowing a Rollover of Certain Funds Into an HSA	−2	−4	−4	−4	−5	−2	0	0	0	0
Estimated Revenues	−23	−50	−64	−70	−80	−89	−101	−148	−198	−212
On-Budget	−20	−46	−58	−63	−70	−78	−87	−125	−164	−177
Off-Budget [a]	−3	−4	−6	−7	−10	−11	−14	−23	−34	−35

[a] A portion of the revenue loss from each of the three provisions affects off-budget receipts. However, the only significant off-budget effects are from the provision repealing a limitation on HSA contributions. The estimated off-budget effects of the other two provisions are negligible.

Source: The Joint Committee on Taxation.

Note: HSA = Health Savings Account.

Basis of estimate: H.R. 6134 would change rules regarding health savings accounts. JCT estimates that enacting H.R. 6134 would reduce federal revenues by $23 million in 2007, by $287 million over the 2007–2011 period, and by $1.04 billion over the 2007–2016 period. These estimates include reductions in off-budget receipts from Social Security payroll taxes of $3 million in 2007, $30 million over the 2007–2011 period, and $148 million over the 2007–2016 period.

Three provisions of the bill would have significant effects on revenues, JCT estimates. First, the bill would permit taxpayers starting an HSA partway through a year to contribute up to the full annual limit. The taxpayer must, however, maintain a high-deductible health plan for a full year or pay tax and penalty on the contribution. JCT estimates that this provision would reduce revenues by $11 million in 2007, by $147 million over the 2007–2011 period, and by $302 million over the 2007–2016 period.

Second, H.R. 6134 would repeal the limitation on contributions to HSAs that corresponds to the annual deductible under the high-deductible insurance policy. Under current law, contributions are limited to the lesser of the annual deductible or a specified amount (currently $2,700 for single coverage and $5,450 for family coverage) that is indexed for inflation. JCT estimates that this provision would reduce revenues by $10 million in 2007, by $121 million over the 2007–2011 period, and by $712 million over the 2007–2016 period. Of those revenue reductions, a portion would be off-budget—totaling $148 million over the 2007–2016 period.

Finally, the bill would allow employees to start an HSA by making a one-time transfer of amounts in a health reimbursement account for flexible spending account as of September 21, 2006. Such a transfer would have to be completed by January 1, 2012. JCT estimates that the provision would reduce revenues by $2 million in 2007, by $19 million over the 2007–2011 period, and by $21 million over the 2007–2016 period.

Intergovernmental and private-sector impact: JCT has determined that the legislation contains no private-sector or intergovernmental mandates as defined in UMRA.

Estimated prepared by: Emily Schlect.

Estimated 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 staff of 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 Americans' need for health insurance coverage and the need to save for medical expenses that the Committee concluded that it is appropriate and timely to enact the 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 (Pub. L. No. 104–4).

The Committee has determined that the revenue provisions of the bill do not contain Federal mandates on the private sector. The Committee has determined that the revenue provision of the bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments. With respect to the non-revenue provisions of the bill, see the CBO letter in part IV.C., above.

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

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code (the "Code") and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Code and that have "widespread applicability" to individuals or small businesses.

G. TAX EARMARKS

Pursuant to House Resolution 1000, the staff of the Joint Committee on Taxation has determined that the bill as reported contains no tax earmarks within the meaning of that Resolution.

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 III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

* * * * * * *

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

(a) * * *

* * * * * * *

(e) FSA AND HRA TERMINATIONS TO FUND HSAS.—

(1) IN GENERAL.—A plan shall not fail to be treated as a health flexible spending arrangement or health reimbursement arrangement under this section or section 105 merely because such plan provides for a qualified HSA distribution.

(2) QUALIFIED HSA DISTRIBUTION.—The term "qualified HSA distribution" means a distribution from a health flexible spending arrangement or health reimbursement arrangement to the extent that such distribution—

(A) does not exceed the lesser of the balance in such arrangement on September 21, 2006, or as of the date of such distribution, and

(B) is contributed by the employer directly to the health savings account of the employee before January 1, 2012.

Such term shall not include more than 1 distribution with respect to any arrangement.

(3) ADDITIONAL TAX FOR FAILURE TO MAINTAIN HIGH DEDUCTIBLE HEALTH PLAN COVERAGE.—

(A) IN GENERAL.—If, at any time during the testing period, the employee is not an eligible individual, then the amount of the qualified HSA distribution—

(i) shall be includible in the gross income of the employee for the taxable year in which occurs the first month in the testing period for which such employee is not an eligible individual, and

(ii) the tax imposed by this chapter for such taxable year on the employee shall be increased by 10 percent of the amount which is so includible.

(B) EXCEPTION FOR DISABILITY OR DEATH.—Clauses (i) and (ii) of subparagraph (A) shall not apply if the employee ceases to be an eligible individual by reason of the death of the employee or the employee becoming disabled (within the meaning of section 72(m)(7)).

(4) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection.—

(A) TESTING PERIOD.—The term "testing period" means the period beginning with the month in which the qualified HSA distribution is contributed to the health savings account and ending on the last day of the 12th month following such month.

(B) ELIGIBLE INDIVIDUAL.—The term "eligible individual" has the meaning given such term by section 223(c)(1).

(C) TREATMENT AS ROLLOVER CONTRIBUTION.—A qualified HSA distribution shall be treated as a rollover contribution described in section 223(f)(5).

(5) TAX TREATMENT RELATING TO DISTRIBUTIONS.—For purposes of this title.—

(A) IN GENERAL.—A qualified HSA distribution shall be treated as a payment described in subsection (d).

(B) COMPARABILITY EXCISE TAX.—

(i) IN GENERAL.—Except as provided in clause (ii), section 4980G shall not apply to qualified HSA distributions.

(ii) FAILURE TO OFFER TO ALL EMPLOYEES.—In the case of a qualified HSA distribution to any employee, the failure to offer such distribution to any eligible individual covered under a high deductible health plan of the employer shall (notwithstanding section 4980G(d)) be treated for purposes of section 4980G as a failure to meet the requirements of section 4980G(b).

* * * * * * *

PART VII—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

* * * * * * *

SEC. 223. HEALTH SAVINGS ACCOUNTS.

(a) * * *

(b) LIMITATIONS.—

(1) * * *

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

(A) in the case of an eligible individual who has self-only coverage under a high deductible health plan as of the first day of such month, ⟦the lesser of—

⟦(i) the annual deductible under such coverage, or

⟦(ii) $2,250, or⟧ *$2,250.*

(B) in the case of an eligible individual who has family coverage under a high deductible health plan as of the first day of such month, ⟦the lesser of—

⟦(i) the annual deductible under such coverage, or

⟦(ii) $4,500.⟧ *$4,500.*

* * * * * * *

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

(A) the aggregate amount paid for such taxable year to Archer MSAs of such individual, ⟦and⟧

(B) the aggregate amount contributed to health savings accounts of such individual which is excludable from the taxpayer's gross income for such taxable year under section 106(d) (and such amount shall not be allowed as a deduction under subsection (a))⟦.⟧*, and*

(C) the aggregate amount contributed to health savings accounts of such individual for such taxable year under section 408(d)(9) (and such amount shall not be allowed as a deduction under subsection (a)).

* * * * * * *

(8) INCREASE IN LIMIT FOR INDIVIDUALS BECOMING ELIGIBLE INDIVIDUALS AFTER THE BEGINNING OF THE YEAR.—

(A) IN GENERAL.—For purposes of computing the limitation under paragraph (1) for any taxable year, an indi-

vidual who is an eligible individual during the last month of such taxable year shall be treated—

(i) as having been an eligible individual during each of the months in such taxable year, and

(ii) as having been enrolled, during each of the months such individual is treated as an eligible individual solely by reason of clause (i), in the same high deductible health plan in which the individual was enrolled for the last month of such taxable year.

(B) FAILURE TO MAINTAIN HIGH DEDUCTIBLE HEALTH PLAN COVERAGE.—

(i) IN GENERAL.—If, at any time during the testing period, the individual is not an eligible individual, then—

(I) gross income of the individual for the taxable year in which occurs the first month in the testing period for which such individual is not an eligible individual is increased by the aggregate amount of all contributions to the health savings account of the individual which could not have been made but for subparagraph (A), and

(II) the tax imposed by this chapter for any taxable year on the individual shall be increased by 10 percent of the amount of such increase.

(ii) EXCEPTION FOR DISABILITY OR DEATH.—Subclauses (I) and (II) of clause (i) shall not apply if the individual ceased to be an eligible individual by reason of the death of the individual or the individual becoming disabled (within the meaning of section 72(m)(7)).

(iii) TESTING PERIOD.—The term "testing period" means the period beginning with the last month of the taxable year referred to in subparagraph (A) and ending on the last day of the 12th month following such month.

(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section.—

(1) Eligible individual

(A) * * *

(B) CERTAIN COVERAGE DISREGARDED.—Subparagraph (A)(ii) 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**[**.**]***, and*

(iii) for taxable years beginning after December 31, 2006, coverage under a health flexible spending arrangement during any period immediately following the end of a plan year of such arrangement during which unused benefits or contributions remaining at the end of such plan year may be paid or reimbursed to plan participants for qualified benefit expenses incurred during such period if—

(I) the balance in such arrangement at the end of such plan year is zero, or

(II) the individual is making a qualified HSA distribution (as defined in section 106(e)) in an amount equal to the remaining balance in such arrangement as of the end of such plan year, in accordance with rules prescribed by the Secretary.

* * * * * * *

(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 described in subsection (f)(5) or section 220(f)(5), no contribution will be accepted—

(i) * * *

(ii) to the extent such contribution, when added to previous contributions to the trust for the calendar year, exceeds the sum of—

(I) the dollar amount in effect under [subsection (b)(2)(B)(ii)] *subsection (b)(2)(B)*, and

* * * * * * *

(g) COST-OF-LIVING ADJUSTMENT.—

(1) IN GENERAL.—Each dollar amount in subsections (b)(2) and (c)(2)(A) shall be increased by an amount equal to—

(A) * * *

* * * * * * *

In the case of adjustments made for any taxable year beginning after 2007, section 1(f)(4) shall be applied for purposes of this paragraph by substituting "March 31" for "August 31", and the Secretary shall publish the adjusted amounts under subsections (b)(2) and (c)(2)(A) for taxable years beginning in any calendar year no later than June 1 of the preceding calendar year.

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Subchapter D—Deferred Compensation, etc.

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PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

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Subpart A—General Rule

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SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.

(a) * * *

* * * * * * *

(d) TAX TREATMENT OF DISTRIBUTIONS.—

(1) * * *

* * * * * * *

(9) DISTRIBUTION FOR HEALTH SAVINGS ACCOUNT FUNDING.—

(A) IN GENERAL.—In the case of an individual who is an eligible individual (as defined in section 223(c)) and who elects the application of this paragraph for a taxable year, gross income of the individual for the taxable year does not include a qualified HSA funding distribution to the extent such distribution is otherwise includible in gross income.

(B) QUALIFIED HSA FUNDING DISTRIBUTION.—For purposes of this paragraph, the term "qualified HSA funding distribution" means a distribution from an individual retirement plan (other than a plan described in subsection (k) or (p)) of the employee to the extent that such distribution is contributed to the health savings account of the individual in a direct trustee-to-trustee transfer.

(C) LIMITATIONS.—

(i) MAXIMUM DOLLAR LIMITATION.—The amount excluded from gross income by subparagraph (A) shall not exceed the excess of—

(I) the annual limitation under section 223(b) computed on the basis of the type of coverage under the high deductible health plan covering the individual at the time of the qualified HSA funding distribution, over

(II) in the case of a distribution described in clause (ii)(II), the amount of the earlier qualified HSA funding distribution.

(ii) ONE-TIME TRANSFER.—

(I) IN GENERAL.—Except as provided in subclause (II), an individual may make an election under subparagraph (A) only for one qualified HSA funding distribution during the lifetime of the individual. Such an election, once made, shall be irrevocable.

(II) CONVERSION FROM SELF-ONLY TO FAMILY COVERAGE.—If a qualified HSA funding distribution is made during a month in a taxable year during which an individual has self-only coverage under a high deductible health plan as of the first day of the month, the individual may elect to make an additional qualified HSA funding distribution during a subsequent month in such taxable year during which the individual has family coverage under a high deductible health plan as of the first day of the subsequent month.

(D) FAILURE TO MAINTAIN HIGH DEDUCTIBLE HEALTH PLAN COVERAGE.—

(i) IN GENERAL.—If, at any time during the testing period, the individual is not an eligible individual, then the aggregate amount of all contributions to the health savings account of the individual made under subparagraph (A)—

(I) shall be includible in the gross income of the individual for the taxable year in which occurs the

first month in the testing period for which such individual is not an eligible individual, and

(II) the tax imposed by this chapter for any taxable year on the individual shall be increased by 10 percent of the amount which is so includible.

(ii) EXCEPTION FOR DISABILITY OR DEATH.—Subclauses (I) and (II) of clause (i) shall not apply if the individual ceased to be an eligible individual by reason of the death of the individual or the individual becoming disabled (within the meaning of section 72(m)(7)).

(iii) TESTING PERIOD.—The term "testing period" means the period beginning with the month in which the qualified HSA funding distribution is contributed to a health savings account and ending on the last day of the 12th month following such month.

(E) APPLICATION OF SECTION 72.—Notwithstanding section 72, in determining the extent to which an amount is treated as otherwise includible in gross income for purposes of subparagraph (A), the aggregate amount distributed from an individual retirement plan shall be treated as includible in gross income to the extent that such amount does not exceed the aggregate amount which would have been so includible if all amounts from all individual retirement plans were distributed. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

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Subtitle D—Miscellaneous Excise Taxes

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CHAPTER 43—QUALIFIED PENSION, ETC., PLANS

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

(a) * * *

* * * * * * *

(d) EXCEPTION.—For purposes of applying section 4980E to a contribution to a health savings account of an employee who is not a highly compensated employee (as defined in section 414(q)), highly compensated employees shall not be treated as comparable participating employees.

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VII. DISSENTING VIEWS

Get your facts first, then you can distort them as you please.—Mark Twain

Passage of H.R. 6134 is reckless and inappropriate. Health Savings Accounts (HSAs) have only been available since 2004 and we have limited information about the effect of these products on the insurance market. Neither the Department of Treasury nor the Joint Committee on Taxation were able to provide any evidence at the mark-up of H.R. 6134 that the changes made in the bill are warranted. Before we allocate an additional billion dollars to expand,[1] Congress should have more information. Furthermore, given the potential of HSAs to displace or otherwise undermine more comprehensive health insurance benefits offered through employers—which cover nearly 60 percent of the working population—Congress should not create additional incentives to proliferate these schemes.

Preliminary analysis by the Government Accountability Office (GAO)—the only independent source to review available IRS data from tax returns—shows that HSAs primarily benefit individuals in the highest tax bracket.[2] Specifically, the GAO found that the average adjusted gross income of tax filers reporting HSA contributions in 2004 was $133,000, compared to $51,000 for all tax filers under age 65 in 2004. The GAO also found that more than half of tax filers with HSAs in 2004 did not make any withdrawals, indicating that these accounts are used primarily as a tax shelter. Another survey found that 20 percent of employers admit that they established HSAs primarily as a tax shelter for their workers.[3]

Proponents of HSAs often claim that they will help the uninsured. They cite data from the insurance industry showing approximately one-third of the people enrolling in high-deductible health insurance plans that qualify for an HSA were previously uninsured. But this finding is not unique to high deductible/HSA plans; it is true for all plans purchased through the individual and small group market. Indeed, the number of people in the United States without health insurance has increased by two million since HSAs took effect in 2004, and the most recent data from the Census Bureau indicate that nearly 47 million Americans are uninsured, a disgraceful new record.

Not surprisingly, the Joint Committee on Taxation (JCT) estimates that H.R. 6134 will do virtually nothing to help the uninsured, having only a "negligible effect" on the number of people

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[1] Joint Committee on Taxation estimate of HR 6134, September 25, 2006.

[2] Government Accountability Office, GAO 06–798: "Consumer-Directed Health Plans. Early Enrollee Experiences with Health Savings Accounts and Eligible Health Plans." Washington, DC; August 2006.

[3] Mercer Human Resources Consulting, "2005 National Survey of Employer-Sponsored Health Plans." Washington, DC; April 3, 2006.

with health insurance.[4] Moreover, the JCT also estimates that H.R. 6134 will result in just 300,000 additional people opening an HSA over the next 10 years, further stating that "almost all of these accountholders would have been previously insured."[5] Thus, rather than providing assistance to those truly in need, H.R. 6134 gives an additional tax break to people who already have health insurance. In the current fiscal environment and in light of other more pressing matters before this Congress, we believe it is irresponsible to give an additional billion dollars in tax breaks to top wage earners.

In these waning days of the 109th Congress, there are much better ways to spend $1 billion. As Rep. Becerra highlighted during the mark-up, if Congress does not act to supplement funding for the State Children's Health Insurance Program (S-CHIP), 600,000 children across America will likely lose their health insurance coverage next year. The S-CHIP shortfall would cost less than the $1 billion being spent on H.R. 6134. Maintaining health insurance for children is a much more important endeavor than providing yet another tax-preferred savings vehicle that will primarily benefit the rich.

Even if we were inclined to support the legislation—which we are not—it would still be too soon to act. Although tax records are available from 2004—the first year HSAs were available—the Department of the Treasury has repeatedly refused to release data that would inform the debate on HSAs. Nor has Treasury released assumptions behind their budget estimates on HSAs despite our repeated annual written requests.[6] Again, it is wrong for Congress to expand this new, untested program without a more complete picture of its beneficiaries and the broader implications of HSAs.

[4] Joint Committee on Taxation estimate of HR 6134, September 25, 2006.

[5] *ibid.*

[6] Congressman Stark Letter to Secretary Snow, Department of the Treasury, February 8, 2005 and Congressmen McDermott and Stark Letter to Secretary Snow, Department of the Treasury, February 17, 2006.

The single positive outcome of the Committee action on H.R. 6134 is that we have received a commitment from the Chairman to make a joint request to the Treasury to release the IRS data on HSAs for 2004 and, even if preliminary, 2005. As Thomas Jefferson said, "Information is the currency of democracy." We look forward to working with the Chairman in this endeavor.

SANDER LEVIN.
JIM MCDERMOTT.
MICHAEL R. MCNULTY.
RAHM EMANUEL.
RICHARD E. NEAL.
BEN CARDIN.
STEPHANIE TUBBS JONES.
C.B. RANGEL.
PETE STARK.
LLOYD DOGGETT.
XAVIER BECERRA.
JOHN B. LARSON.
JOHN LEWIS.