MEDICARE PRESCRIPTION DRUG, IMPROVEMENT AND MODERNIZATION ACT OF 2003
Prepared by: Joy Johnson Wilson, Health Policy Director
### Health Savings Accounts

**Sec. 1201**

- Creates tax-free Health Savings Accounts (HSAs) for qualified medical expenses.
- Authorizes Health Savings Accounts (HSAs) to be established by any individuals who purchase a “High Deductible Health Plan (HDHP),” a health plan with an annual deductible of at least $1,000 for self-coverage and a $5,000 cap on out-of-pocket expenses (indexed annually) or an annual deductible of at least $2,000 for family coverage and a $10,000 cap on out-of-pocket expenses (indexed annually). For 2005, the maximum annual out-of-pocket amount for HDHP self coverage increases to $5,100 and to $10,200 for family coverage. The minimum deductible amounts, $1,000 for self coverage and $2,000 for family coverage remain unchanged in 2005.
- Individuals may contribute up to 100% of the health plan deductible.
- For 2004 the maximum annual contribution is $2,600 for self-only policies and $5,150 for family policies (indexed annually). For 2005 (indexed amounts were published 11/19/04) the maximum annual contribution for self-only policies is $2,650 and $5,250 for family policies. For any individual, the maximum contribution is the lesser of the indexed amount or the deductible of the HDHP.
- Preventive care services, coverage for accidents, disability, dental care, vision care, and long-term care is not subject to the deductible.
- Individuals age 55-65 may make additional “catch-up” contributions of up to $500 in 2004, increasing to $1,000 annually in 2009 and thereafter. A married couple may make two catch-up contributions as long as both spouses are at least 55.
- Contributions may be made by individuals, family members, and employers and are tax deductible, even if the account beneficiary does not itemize. Employer contributions are made on a pre-tax basis and are not taxable to the employee.
- Employers are permitted to offer HSAs through a cafeteria plan.
- Health Savings Account distributions are tax-free if they are used to pay for qualified medical expenses. Qualified expenses include prescription drugs, qualified long-term care services and long-term care insurance, COBRA coverage, Medicare expenses (except Medigap expenses), and retiree health expenses for individuals age 65 and older. Distributions made for any other purpose are subject to income tax and a 10 percent penalty. The 10 percent penalty is also waived for distributions made by individuals age 65 and older.

**Note:** The U.S. Department of Treasury has published a number of publications providing guidance on Health Savings Accounts, click here for more detail: [http://www.treas.gov/offices/public-affairs/hsa/technical-guidance/](http://www.treas.gov/offices/public-affairs/hsa/technical-guidance/). The Treasury Department published a major guidance, Notice 2004-50 on Health Savings Accounts on July 23, 2004 (revised and updated 8/9/04). This guidance was clarified on 9/9/04.

### Tax Treatment of Federal Subsidy to Employers for Retiree Prescription Drug Coverage

**Sec. 1202**

- Provides that the 28% employer subsidy for retiree prescription drug coverage is excludable from taxable income.
- Provides that gross income does not include any special subsidy payment received under section 1860D-22 of the Social Security Act. The exclusion applies for purposes of both the regular tax and the alternative minimum tax (including the adjustment for adjusted current earnings).
- The exclusion is not taken into account in determining whether a deduction is allowable with respect to costs taken into account in determining the subsidy payment. Accordingly, a taxpayer could claim a deduction for prescription drug expenses incurred even though the taxpayer also received an excludible subsidy related to the same expenses.
- Effective for taxable years ending after the date of enactment.

---

66 This is an additional incentive to for-profit employers to retain their existing prescription drug coverage for retirees. There is no additional incentive for state and local governments because they have no federal income.