

Part I

Section 223. - Health Savings Accounts

Rev. Rul. 2004-38

ISSUE

May an individual contribute to a Health Savings Account (HSA) under section 223 of the Internal Revenue Code if the individual is covered by both a high deductible health plan (HDHP) that does not cover prescription drug benefits and by a separate prescription drug plan (or rider) that does not qualify as an HDHP because the plan provides benefits before the individual has satisfied the minimum annual deductible required by section 223(c)(2)(A)?

FACTS

Individual A is covered by a health plan that satisfies the requirements for an HDHP under section 223(c)(2), including the minimum annual deductible required by section 223(c)(2)(A). The HDHP does not include coverage for prescription drug benefits. Individual A is also covered by another plan (or rider) which provides prescription drug benefits. The prescription drug coverage is not subject to a deductible, but requires a copayment for each prescription. Individual A has no other health coverage, is not eligible for Medicare and may not be claimed as a dependent on another's return.

LAW AND ANALYSIS

Section 223(a) allows a deduction for contributions to an HSA for an "eligible individual." Section 223(c)(1)(A) provides that an "eligible individual" means, with respect to any month, any individual who, in addition to other requirements, is covered under an HDHP on the first day of such month and is not, while covered under an HDHP, "covered under any health plan which is not a high deductible health plan, and which provides coverage for any benefit which is covered under the high deductible health plan."

Section 223(c)(2)(A) defines an HDHP as a health plan that satisfies certain requirements with respect to minimum annual deductibles and maximum annual out-of-pocket expenses.

Section 223(c)(1)(B) provides that, in addition to coverage under an HDHP, an eligible individual may also have specifically enumerated coverage that is disregarded for purposes of the deductible. Disregarded coverage includes "permitted insurance" and other specified coverage ("permitted coverage"). "Permitted insurance" is coverage under which substantially all of the coverage provided relates to liabilities incurred under workers' compensation laws, tort liabilities, liabilities re-



lating to ownership or use of property, insurance for a specified disease or illness, and insurance that pays a fixed amount per day (or other period) of hospitalization. "Permitted coverage" (whether through insurance or otherwise) is coverage for accidents, disability, dental care, vision care or long-term care. Prescription drug benefits are not listed as permitted insurance or as permitted coverage under section 223(c)(1)(B).

The legislative history of section 223 explains these provisions by stating that "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." The legislative history also explains that, "[a]n 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." H.R. Conf. Rep. No. 391, 108th Cong., 1st Sess. 841 (2003).

Under section 223, an eligible individual cannot be covered by a health plan that is not an HDHP unless that health plan provides coverage for permitted insurance or permitted coverage. A plan that provides benefits for prescription drugs is a health plan. Prescription drug benefits are not in the list of permitted insurance or permitted coverage. Consequently, an individual who is covered by both an HDHP and by a prescription drug plan is not an eligible individual for the purpose of contributing to an HSA unless the prescription drug coverage is also an HDHP (i.e., the prescription drug plan does not provide benefits unless the required minimum annual deductible under section 223(c)(2)(A) for an HDHP has been satisfied).

HOLDINGS

Individual A is covered by both an HDHP that does not cover prescription drugs and by a separate prescription drug plan (or rider) that provides benefits before the minimum annual deductible of the HDHP has been satisfied. Individual A is not an "eligible individual" under section 223(c)(1)(A) and may not make contributions to an HSA. The result is the same if this prescription drug benefit is provided as a benefit under a health plan (and not separately) or as a benefit for Individual A under a spouse's plan.

However, if a separate prescription drug plan (or rider) does not provide benefits until the minimum annual deductible of the HDHP has been satisfied, or the prescription drug plan is part of an HDHP and subject to the minimum annual deductible, Individual A is an eligible individual under section 223(c)(1)(A).

See Rev. Proc. 2004-22 published elsewhere in this Internal Revenue Bulletin for information concerning transition relief.

DRAFTING INFORMATION

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