

What's So Bad About Enforcing the Law?

On April 15, the House of Representatives passed H.R. 5719, which would prevent individuals with Health Savings Accounts (HSAs) from easily, but illegally, evading taxes. The law would make individuals with tax-free HSAs document that withdrawals from these accounts are used for medical purposes—just as millions of Americans do when they submit receipts for medical services to a flexible spending account (FSA) administrator. The loudest response to this common sense legislation? Opposition from the insurance industry and its political allies.

HSAs permit individuals with qualifying high-deductible health insurance policies to make pretax contributions to savings accounts. Medical spending from an HSA to cover deductibles, copayments, and many uncovered health services is tax free. Further, interest, dividends, and capital gains earned through the account are also not taxed. For those under 65, nonmedical withdrawals from the HSAs are allowed but taxed and get a 10 percent penalty—like an early withdrawal from an IRA.

While the \$1,100 single and \$2,200 family deductibles required for HSA participation are high enough to discourage many from enrolling in this type of insurance, they can be very attractive to those in high income brackets looking for additional tax advantaged savings options.

The problem is that, under current law, there is no way—short of a tax audit—to tell if tax-advantaged withdrawals from these accounts are legal or illegal. People don't have to verify whether they made a withdrawal for the copay on their child's asthma inhaler or whether it was for gourmet chocolate truffles. Since annual contributions to HSAs can be \$2,900 for a single plan and \$5,800 for a family plan, that can mean a lot of tax-free truffles, and a tax loss for the federal Treasury.

In 2007, approximately 4.5 million Americans were enrolled in an HSA-qualifying health insurance plan, relatively few compared with the 202 million Americans covered by private insurance and the 47 million Americans with no health insurance. The Joint Committee on Taxation estimates that sewing up the loophole in HSA law would increase federal tax revenues by \$308 million over the first eight years. Some see that as small potatoes. So, why should we care?

HSAs are different and far more tax favored than any other health or retirement account. HSAs can generate investment income, and for those under age 65, withdrawals can be used on nonmedical expenses, if taxes and the penalty are paid. For those over 65, only the income tax applies to nonmedical expenses. But most elderly will be able to legally avoid it, since they have plenty of qualified medical care and services (including Medicare premiums, out-of-pocket expenses, and long-term care premiums) to use the withdrawals toward. Since both contributions and withdrawals to HSAs can be tax free, it is one of the most attractive investment vehicles ever created.

Who benefits from this super-charged retirement vehicle? The people who benefit the most are those who would have access to good health insurance under any system and those who have already maxed out other investment vehicles for retirement: the wealthy.

HR 5719 requires only that HSA participants verify that they are in compliance with the law, and not use these vehicles as their personal tax dodge. Opponents of the bill

say that it will unravel the ability of HSAs to control health care costs by adding a layer of bureaucratic administrative costs to withdrawals. But the reality is that bringing HSAs in line with other medical accounts by verifying medical withdrawals will add only about \$24 per year to the administrative costs of an HSA. Controlling health care costs is a worthy goal, but it is unrelated to this issue. The wealthy are disproportionately advantaged by the legal use of HSAs; why would we want to devote more tax dollars to allowing their misuse?