

handbook

Consumer-Driven Health Handbook



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Chapter 1:

Introduction to Consumer-Driven Health Care

Chapter at a Glance	
Subchapter	Summary
Why We Wrote this Handbook	Explains the purpose of the Handbook, who helped us write it, and that it's not tax or legal advice, or a plan document or SPD.
What is Consumer-Driven Health Care?	Briefly describes the continuing development of consumer-driven health care concepts.
HRAs, HSAs, and Health FSAs at a Glance	Contains a chart that compares the different forms of health reimbursement accounts.

Why We Wrote This Handbook

UnitedHealth Group stands firmly behind the concept of consumer-driven health care. We believe that, when properly designed, delivered, and utilized, consumer-driven health plans and concepts will make you a smarter and more effective user of health care services; will improve the quality of the health care services you receive and the quality of your health; and will make paying for health care services more affordable for the vast majority. In recent years, particularly with the development of the health reimbursement account (HRA) and the health savings account (HSA), consumer-driven health care has received much attention and emphasis. But even with that attention and emphasis, many consumers remain confused, uncertain and sometimes a bit skeptical about what it really is, how it works, and how simple it is to use.

We wrote this Handbook to maximize your understanding and use of the consumer-driven health plans that we offer. As a health insurer and third party administrator, we are committed to helping you and your employer understand the basic concepts of consumer-driven health care. Our goal is that, with this education, you will understand how to get more value from your health plan and the information resources that are available to you, and will actively engage in effectively using your consumer-driven health coverage.

Acknowledgments

We gratefully acknowledge Christine Keller and Groom Law Group, a highly respected and nationally known employee benefits law firm and for her assistance in developing the Handbook. Her knowledge and depth of experience with consumer-driven health care were invaluable as we worked to develop this guide to the law that governs consumer-driven health care.

Disclaimers

Consumer-driven health plans are subject to a variety of federal and state laws. The Handbook explains these laws in general as they exist as of the date the Handbook is issued. We intend to update the Handbook periodically to reflect changes in the law that governs consumer-driven health care, and to reflect modified interpretations of the law, as the Internal Revenue Service, the U.S. Department of Treasury, and other agencies issue additional interpretive guidance. The Handbook is not, however, intended to be and is not legal or tax advice to you, your dependents, your employer or anyone else. We encourage you to consult your own legal, tax and/or financial advisor(s) about specific personal questions you have about the legal, tax and financial implications of consumer-driven health care.

The Handbook generally explains typical consumer-driven health concepts and designs, but does not describe the specific plan design or terms of your employer's or any other employer's plan. For this reason, we also encourage you to read the summary plan description or insurance certificate of coverage (whichever applies) for your employer's plan for the specific rules that apply under your employer's plan.

What is Consumer-Driven Health Care?

Consumer-driven health care is a term used to describe health plans that are intended to improve your health care choices and your control over your health care purchases, and to help you be a more educated and careful consumer when you purchase health care services. The key concepts associated with consumer-driven health plans include:

- Your member responsibility, which consists of the amounts you pay from your own pocket for the Deductibles, Copays, and Coinsurance payments that are required by your health plan, up to the Out-of-Pocket Maximum that applies to you.
- A health reimbursement account that helps you pay the out-of-pocket expenses that are your member responsibility, and to which your employer, you and/or both of you may contribute. The account can either be a health reimbursement account (HRA), health savings account (HSA), or health flexible spending account (Health FSA).
- Health coverage that pays benefits after you meet the Deductible that applies under your health plan's terms, and that pays for Preventive Care Services before you meet the Deductible.
- Information resources that help you make informed decisions in partnership with your physician or health care professional, and that provide useful information about physicians and health care professionals who are "in the network," the cost of health care services, and options for accessing health care that may save you money.

The member responsibility concepts, such as Deductibles, Copays, and Coinsurance have been components of traditional health care coverage in one form or another for many years, along with network and non-network benefit designs. They continue to be intended to motivate you to think about the overall cost of the services you obtain (and not just the premium that you pay for the health coverage), and to purchase services in a way that results in lower overall costs to you and to your health plan.

The current emphasis on consumer-driven health coverage resulted in large part from recent law changes which created the HRA and the HSA, as well as continuing concern by employers, employees and self-employed persons about the increasing cost of health coverage and health services. This led to the development of new products by health insurers and third party administrators, and their increasing use and acceptance.

Though not the intended result, traditional health care coverage often ends up operating much like an “all you can eat” buffet. Plan members pay a premium for health care coverage (often with only a small Deductible and/or employee Coinsurance percentage, and usually a moderate Copay), then purchase health services perhaps without much thought to the actual overall cost.

Many health care policy experts believe that traditional health care coverage encourages overuse and inappropriate use of health care services, and that this overuse and inappropriate use contributes to the rising costs of health care coverage. Many of these experts also believe that traditional health care coverage discourages health care professionals from providing health care services in the consumer-friendly way that other businesses are commonly offering, such as by offering clear and complete schedules of services and related cost information.

We, and other consumer-driven health care advocates, believe that directly involving you in paying for your health care services through your member responsibility and with help from your HRA or HSA, will cause you to educate yourself and to make more prudent decisions about your consumption of health care services. We believe this will emphasize price competition among physicians and other health care professionals and give you a better value for your health care dollars. Finally, and most importantly, we believe this will improve the overall quality of your health.

Reimbursement Accounts at a Glance

The following chart introduces you to some of the key features of the HRA, HSA, and Health FSA by briefly answering some frequently asked questions. We more fully explain each of these questions and other concepts in the following chapters in the Handbook.

Question	HRA	HSA	Health FSA
1. What is this account?	An account funded by your employer that you can use to pay for certain medical expenses, that you, your spouse and/or your dependents incur.	A trust or custodial account that you and your employer can contribute to (if you are enrolled in a High-Deductible Health Plan (HDHP) and meet other requirements) and that can establish to pay for certain medical expenses that you, your spouse and/or your dependents incur.	An account to which you can make pre-tax contributions, and which reimburses you for certain medical expenses that you, your spouse and/or your dependents incur.
2. Who is eligible for this account?	Any employee, subject to the employer's specific plan design restrictions.	Any individual who is covered by a High-Deductible Health Plan (HDHP) and who does not, with certain exceptions, have other health care coverage that is not HDHP.	Any employee, subject to the employer's specific plan design restrictions.
3. Must my employer set up my account?	Yes. Your employer establishes your HRA for you.	Generally, no. Your HSA is your account, and you are responsible for establishing it with your HSA trustee or custodian, much as you would an IRA.	Yes. Your employer establishes your Health FSA for you.
4. Who may contribute to my account?	Your employer.	Your employer, you, and any other person.	Your employer and you.
5. May I make pre-tax contributions to my account?	No, only your employer may contribute to your HRAs.	Yes, if your employer allows.	Yes, if your employer allows.

Question	HRA	2006 HSA	Health FSA
<p>6. What (if any) is the limit on contributions to this account?</p>	<p>There is no legal limit, however, your employer, at its discretion, determines the amount of its contribution to your HRA.</p>	<p>The limit changes annually. For 2005, the limit is the lesser of the Deductible required by your HDHP, or \$2,650 if you have employee-only coverage, and \$5,250 if you have family coverage. These limits increase to \$2,700 for employee only coverage and \$5,450 for family coverage. If you are between 55 and 65, you can also make additional catch-up contributions (of up to \$600 in 2005 and \$700 in 2006).</p>	<p>There is no legal limit, however, employers usually impose a reasonable limit on the dollar amount that you can contribute to your Health FSA.</p>
<p>7. What expenses may I pay or be reimbursed for with my account?</p>	<p>Unreimbursed medical expenses as described in IRS Code Section 213(d), subject to any restrictions that are stated in your health plan.</p>	<p>Unreimbursed medical expenses as described in IRS Code Section 213(d) other than insurance premiums (with certain exceptions).</p>	<p>Unreimbursed medical expenses as described in IRS Code Section 213(d) other than insurance premiums subject to any restrictions that are stated in your health plan.</p>
<p>8. Do I have to prove that my expenses are qualified medical expenses?</p>	<p>Yes; however your health plan's claims handling process may automatically establish that your claims are for permitted expenses.</p>	<p>You do not need to prove this to your HSA custodian, but you should keep receipts that document that the expenses are qualified medical expenses for use if the IRS audits your tax return.</p>	<p>Yes; however your Health FSA's claims handling process may automatically establish that your claims are for permitted expenses.</p>
<p>9. May I pay for non-medical expenses with my account?</p>	<p>No.</p>	<p>Yes, but when you use your HSA for non-qualified medical expenses, the payment or distribution is, in most cases, taxable income subject to your regular income tax rate, and subject to an additional 10% tax.</p>	<p>No.</p>

Question	HRA	HSA	Health FSA
<p>10. What are the federal tax consequences for me of contributions to my account?</p>	<p>Your employer's contributions are excludable from your gross income, and not taxable to you.</p>	<ul style="list-style-type: none"> • Your employer's contributions are excludable from your gross income, and not taxable to you. • If your employer allows you to make pre-tax contributions, the amount you contribute is not taxable to you and is not subject to income, FICA or FUTA taxes. • If you make after-tax contributions, or if anyone other than your employer contributes to your HSA, you can deduct the contributions on your federal income tax return. 	<p>If you make pre-tax contributions via payroll deduction, the amount you contribute is not taxable to you and is not subject to income, FICA or FUTA taxes.</p>
<p>11. Does my account earn interest or other earnings, and if so, is it taxable?</p>	<p>While permissible, most employers do not credit interest or other earnings to their employees' HRAs.</p>	<p>Yes, you can earn interest or other earnings on your HSA, depending on the investment alternatives available to you and the investments you select. The earnings on your HSA are generally not taxable to you while in your account or when withdrawn to pay for qualified medical expenses.</p>	<p>While permissible, most employers do not credit interest or other earnings to their employees' Health FSAs.</p>
<p>12. Must I elect coverage for a full plan year?</p>	<p>Yes.</p>	<p>No, but you must elect coverage under an HDHP for the full plan year.</p>	<p>Yes.</p>
<p>13. During the year can I change the amount and timing of my contributions to my account?</p>	<p>You cannot contribute to your HRA.</p>	<p>Yes, and without being limited by the Code Section 125 change in status rules that apply to Health FSAs.</p>	<p>Yes, but only if you have a Code Section 125 change in status or other permissible event.</p>

Question	HRA	HSA	Health FSA
<p>14. Can I use my full year contribution before the money or credit is actually deposited in or credited to my account?</p>	<p>No, you can use your employer's contributions to your HRA only after they are deposited or credited.</p>	<p>No, you can use your and your employer's contributions to your HSA only after they are deposited.</p>	<p>Yes, you can use the full amount of your full year pre-tax contributions to your Health FSA before it is actually withheld from your paycheck and credited to your account.</p>
<p>15. If I leave my job do I have a right to continue coverage under COBRA?</p>	<p>Yes, under COBRA you have a right to elect continuation coverage for your health coverage including the funds available in your HRA. If you elect COBRA coverage, you continue to receive additional HRA contributions from your employer.</p>	<p>No. COBRA does not apply to HSAs. However, your HSA and the money in it are yours, not your employer's, and you can continue to use your HSA to pay for qualified medical expenses that you pay for after you leave your job.</p>	<p>Yes, under COBRA you have a right to elect continuation coverage for the remainder of the year in which your COBRA qualifying event occurs, which allows you to use up the funds remaining in your Health FSA.</p>
<p>16. If I don't spend all the money in my account one year, do I lose it?</p>	<p>The "use it or lose it rule" that applies to Health FSAs does not apply to HRAs. Most employers allow unused HRA funds to be carried over, thus, if your employer allows carryovers, you will not lose your unused HRA funds.</p>	<p>No. You own your HSA, and any unused funds are yours and remain in your HSA. You can use them at any time to pay for qualified medical expenses.</p>	<p>Until recently, under the "use it or lose it rule," you forfeited any Health FSA funds that remained at the end of a calendar year. However, effective for 2005, employers can, but are not required to, let employees use up their unused Health FSA funds for a plan year, in the first 2½ months of the next year.</p>
<p>17. Can I have a combination of accounts (FSA, HSA and/or HRA) at the same time?</p>	<p>You can have both an HRA and Health FSA.</p>	<p>Generally, an HRA and a Health FSA are not High Deductible Health Plans, will cause you to not be an Eligible Individual, and will prevent you from contributing to an HSA; however, there are some exceptions.</p>	<p>You can have both an HRA and Health FSA.</p>

Chapter 2. What You Should Know about HRAs and Consumer-Driven Health Plans

Chapter at a Glance	
Subchapter	Summary
What is a Consumer-Driven Health Plan?	Explains the concept of Consumer-Driven Health Plan coverage.
What is an HRA?	Defines the HRA.
What is a Typical Consumer-Driven Health Plan Design?	Describes the common components of Consumer-Driven Health Plan and HRA designs.
Who Can Participate in an HRA?	Explains the general eligibility rules.
Who Can Contribute to Your HRA and How Much Can They Contribute?	Explains who can contribute to an HRA for you and the amounts they can contribute.
How Does a Consumer-Driven Health Plan with an HRA Work?	Explains: <ul style="list-style-type: none"> • Who sets up your HRA; • The Deductibles that apply; • How to use your HRA to meet your Deductible; • The gap between your HRA and the Deductible; and • When your Consumer-Driven Health Plan starts to pay your claims for Covered Services.
What Medical Expenses Can You Pay with Your HRA?	Explains the types of medical expenses that you can pay with an HRA.
What Happens to Your HRA When . . . ?	Explains what the law allows your employer to do with your remaining HRA funds when: <ul style="list-style-type: none"> • You don't use up your HRA in a year; • You change medical coverage options; • Your employment ends; or • You become divorced.
Tax Issues that Affect You and Your HRA	Explains that: <ul style="list-style-type: none"> • Your employer's contributions to your HRA are not taxable to you; and • No cost-of-living adjustments apply to HRAs.

What is a Consumer-Driven Health Plan?

This chapter explains one of the most common forms of consumer-driven health coverage, a medical plan that includes a Health Reimbursement Account (HRA). The health plan that is offered with an HRA and the health plan that allows you to open a Health Savings Account (HSA) are both forms of “consumer-driven health coverage” or “consumer-driven health plans.” However, the federal tax law that allows you to open an HSA places specific limits on the Deductible and Out-of-Pocket Maximum that your health plan contains which we explain in detail in Chapter 3. Because of the federal tax law, these consumer-driven health plans are commonly referred to as High-Deductible Health Plans or HDHPs. HRAs, however, can be offered alone or with health coverage that does not meet the federal HDHP rules. To make it easier for you to distinguish between the two forms of consumer-driven health plans as you use this Handbook, we refer to the health coverage that is typically offered with an HRA as a Consumer-Driven Health Plan, and the health coverage that allows you to open an HSA as a High Deductible Health Plan.

See Other Sources of Information in Appendix II for additional sources of information about consumer-driven health coverage.

What is an HRA?

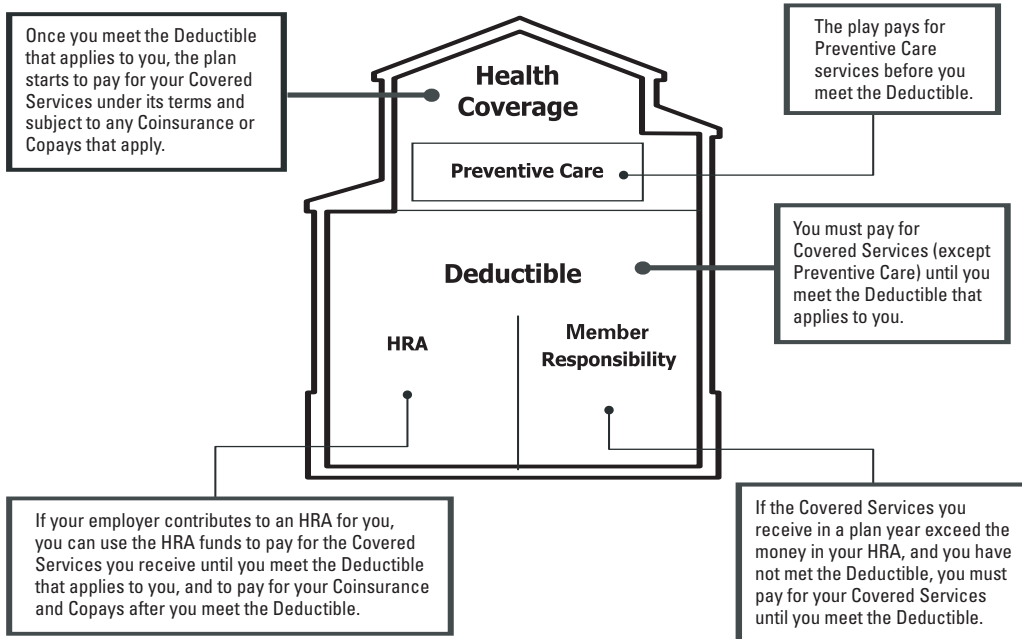
An HRA is an account to which your employer can make contributions that is not taxable to you, and which you can use to pay for certain medical care expenses. The IRS first recognized the HRA in 2002 in two rulings that include the following provisions:

- Only your employer can contribute to an HRA for you. You cannot contribute to an HRA for yourself.
- Generally you can use your HRA to pay for medical care that, if you paid for it yourself, would be deductible on your tax return.
- If in a plan year you don't use up the money that is in your HRA, the unused funds can remain in your HRA and you can use them to pay for medical expenses you incur in a subsequent year or years.
- Any contributions your employer makes to your HRA are not taxable to you and payments made from the HRA are also not taxable to you.

Note: The IRS uses the phrase “health reimbursement arrangement,” but many in the health care industry, including UnitedHealth Group, refer to them as “health reimbursement accounts” in keeping with the wide use of “health savings account” and “health care flexible spending account.”

What is a Typical Consumer-Driven Health Plan Design?

Consumer-Driven Health Plans that include HRAs usually have the following basic characteristics and structure; however, the specific design characteristics vary according to each employer's needs.



Characteristic	Employer Design Variables
Preventive Care Coverage	<ul style="list-style-type: none"> • Definition of covered preventive care services may vary among employers.
Deductible	<ul style="list-style-type: none"> • Dollar amount of Deductibles varies by Coverage Level. • Dollar amount of Deductibles is larger for Non-Network services. • Many employers do not apply the Deductible to prescription drugs or to Preventive Care.
HRA	<ul style="list-style-type: none"> • HRAs can be offered with a CDHP and without a CDHP. • Contribution amounts vary among employers. • Contribution amounts vary by Coverage Level. • Form of employer contribution varies (can be cash or bookkeeping credit). • Timing of employer contribution varies. • Expenses that can be paid with HRA varies among employers.
Member Responsibility	<ul style="list-style-type: none"> • Amounts vary among employers. • Amounts vary by Coverage Level. • Amounts are larger for Non-Network services.

Characteristic	Employer Design Variables
Health Coverage	Many employers require their employees to pay for a portion of the cost of Covered Services in the form of Copays and/or Coinsurance, but limit the employees' expenses to the Out-of-Pocket Maximum.
Information Tools and Resources	<ul style="list-style-type: none"> • Web sites that contain information about such things as Network Physicians and other health care professionals, services and costs, wellness programs and general wellness information, discounts on health services, and purchasing prescription drugs via mail. • Customer service centers or other resources that you can call for more information about all of these things.

Who Can Participate in an HRA?

Federal tax guidance allows current and former employees (including retired employees), and their eligible dependents to participate in an HRA. Federal tax guidance does not, however, require employers to allow all current and former employees to participate. Employers can specify or limit the employees who are eligible to participate in an HRA, as long as they do not violate the nondiscrimination rules that apply to HRAs.

No HRAs for Self-Employed Persons

Federal tax law does not permit self-employed persons to participate in HRAs. If you are a sole proprietor, a partner in a partnership, a more than 2% shareholder in a subchapter S corporation, or a member of a limited liability company that is taxed as a partnership, you are self-employed and cannot participate in an HRA.

If, however, you are a sole proprietor, a partner in a partnership, or a member of a limited liability company that is taxed as a partnership and you sponsor an HRA for your employees if your spouse or other tax dependent is a bona fide employee and not deemed to be self-employed, then you can contribute to an HRA for them if the HRA passes the nondiscrimination tests that apply. Spouses and tax dependents of persons who are more than 2% shareholders in a subchapter S corporation are considered self-employed and cannot participate in an HRA that is sponsored by the subchapter S corporation.

Who Can Contribute to Your HRA and How Much Can They Contribute?

Only your employer can contribute to your HRA for you. You cannot make pre-tax contributions to an HRA. Your employer's contributions to your HRA are not taxable to you, and the payments from your HRA (whether they're made to you or to your provider) are not taxable to you.

Federal tax guidance does not limit the dollar amount that your employer can contribute to your HRA. The amount your employer contributes is a matter of design and employer choice. As a practical matter, when employers offer a Consumer-Driven Health Plan with an HRA, they typically contribute to the HRA a reasonable percentage (but not all) of the Deductible that applies under the plan.

How Does a Consumer-Driven Health Plan with an HRA Work?

When an employee elects coverage under a Consumer-Driven Health Plan that offers an HRA, he or she receives the health coverage as well as the employer's contributions or credits to the HRA.

Assumptions: In this Handbook and the following subsections and examples, we assume that the employer offers a Consumer-Driven Health Plan that is bundled with an HRA, the employee's election activates both the health coverage and the HRA contributions, and a UnitedHealth Group affiliate insures or administers the plan, and administers the HRA. Other insurers and administrators may follow different administrative processes.

Read your summary plan description or certificate of coverage for the specific rules that apply under your Consumer-Driven Health Plan.

Who Sets Up Your HRA and When

Your employer sets up your HRA for you. Employers can set up “HRA bookkeeping accounts” to which they make “bookkeeping credits” for their contributions. They are bookkeeping accounts, not bank accounts and do not have money in them. Employers can also actually contribute money to their employees’ HRAs. Some employers credit HRAs with interest and others do not. Employers can also credit or make their contributions in a single sum at the beginning of a year, or on a periodic schedule. These are matters of design and employer choice.

How to Use Your Consumer-Driven Health Plan and Your HRA

This section explains, in general terms, UnitedHealth Group's suggestions for:

- Using your HRA to pay for Covered Services that you must pay for until you meet the Deductible(s) that applies to you under your plan; and
- Submitting claims to your Consumer-Driven Health Plan and your HRA.

Your Member Responsibility: Meeting the Deductible and Using Your HRA

- Your plan may contain several different Deductibles, such as Deductibles that apply to services from Network Physicians and other health care professionals and higher Deductibles that apply to services from Non-Network Physicians and other health care professionals, as well as Deductibles that apply to different Coverage Levels.
- Your employer’s summary plan description or your certificate of coverage typically identifies the Covered Services that are and are not subject to the Deductible. Many, but not all, employers design their plans so that the Deductible does not apply to Preventive Care services or to prescription drugs.
- Before your employer’s plan pays for Covered Services that are subject to the Deductible, you must pay for them until you meet the Deductible that applies to you.
- You can use your employer’s contribution to your HRA to pay for Covered Services that are subject to the Deductible.
- The Deductible is usually larger than your employer’s contribution to your HRA. If you use all of your HRA funds before the end of a year, you are responsible for paying for Covered Services until you meet the remainder of the applicable Deductible for that year.

Before You Meet the Deductible: Submit Your Claims to the Consumer-Driven Health Plan First

When you receive a Covered Service before you meet the Deductible that applies to you, you should not pay for the Covered Service first. Instead, your Network Physician (or you or your Non-Network Physician) should submit your claim to your plan for processing to make sure that:

- Your claim is for a Covered Service;
- You receive the benefit of any discounts that have been negotiated with a Network Physician;
- The claim is paid with the funds available in your HRA and/or your Health FSA if you have one; and
- The claim is “counted toward” your Deductible(s) and your Out-of-Pocket Maximum(s).

Your insurer or administrator of your plan will notify your provider that you have not met the Deductible and are responsible for payment of the claim. Depending on how your insurer or administrator administers your employer's plan, the insurer or administrator may then pay your provider with the funds available in your HRA.

More Member Responsibility: Paying Claims After You Use Your HRA Credits and Before You Meet the Deductible

If you use up your HRA credits before you meet the Deductible that applies to you, you are responsible for paying for the Covered Services until you meet the remainder of the Deductible. For the same reasons that apply to claims that are paid with your HRA, you should not pay for the Covered Service first, and your Network Physician (or you or your Non-Network Physician) should submit your claim to your plan first.

After You Meet the Deductible: The CDHP Starts Paying for Your Covered Services

Once you meet the Deductible that applies to you, the plan starts paying your claims for Covered Services, but subject to any Coinsurance or Copay that applies to the service you receive.

Examples

The following examples explain how UnitedHealth Group’s affiliates generally administer or insure a CDHP and HRA, as well as administer the employee’s Health FSA. The examples assume that the employee receives several common services and that once the employee’s HRA is depleted, the employee’s claims are automatically forwarded to the employee’s Health FSA, (if he or she has one) and that the HRA contributions, and the Network and Non-Network Deductibles, Coinsurance, and Out-of-Pocket Maximums, are as follows for the employee-only Coverage Level:

	Network			Non-Network		
HRA Credit	Deductible	Coinsurance	Out-of-Pocket Maximum	Deductible	Coinsurance	Out-of-Pocket Maximum
\$400	\$1,000	Plan pays 85%	\$2,000	\$1,500	Plan pays 55%	\$4,500
		Employee pays 15%			Employee pays 15%	

Example 1: Preventive Care Services. Mr. Adams sees a Network Physician for a Preventive Care physical. The Network Expense is \$300. The Network Physician submits a claim to the plan for the physical. The claim is processed, and is determined to be a Covered Service performed by a Network Physician which is not subject to the plan's Deductible. The plan pays the \$300 Network Expense to the Network Physician and Mr. Adams pays nothing.

Example 2: Urgent Care Services. Mr. Adams visits a Network Physician which is an urgent care center. The Network Expense is \$200. The Network Physician submits a claim to the plan for the urgent care visit. The claim is processed, and is determined to be a Covered Service performed by a Network Physician, which is subject to the plan's Deductible. Mr. Adams must satisfy the \$1,000 individual Network Deductible before the plan pays for the visit. Mr. Adams is responsible for paying the \$200 claim. He has \$400 in his HRA and the HRA will use it to pay the urgent care center. This payment will reduce his HRA balance to \$200 ($\$400 - \200). The payment counts toward his \$1,000 Network Deductible and the remaining Network Deductible is \$800 ($\$1,000 - \200).

Example 3: Outpatient Services. Mr. Adams sees a Network Physician for an outpatient procedure. The Network Expense is \$500. The Network Physician submits a claim to the plan for the outpatient procedure. The claim is processed, and is determined to be a Covered Service performed by a Network Physician, which is subject to the plan's Deductible. Mr. Adams must satisfy the remainder of his individual Network Deductible balance of \$800 before the Plan pays for the procedure. Mr. Adams is responsible for paying the \$500 claim. He has \$200 in his HRA and the HRA will use it to pay the Network Physician. This payment reduces his HRA balance to \$0. Mr. Adams must pay the \$300 remainder of the Network Expense to the Network Physician. This is the gap. If he does not have a Health FSA that a UnitedHealth Group company administers, he must pay it himself. If he does have a Health FSA that a UnitedHealth Group company administers, the remaining \$300 will automatically be paid to the Network Physician out of his Health FSA. The HRA payment and the payment from his Health FSA or his personal payment of \$300 count toward his remaining \$800 Network Deductible and the remaining Network Deductible is \$300.

What Medical Expenses Can You Pay with Your HRA?

The expenses you can pay with your HRA are determined in part by law and in part by your employer's plan design. Generally, the law allows you to use your HRA to pay for medical care expenses, as they are defined in Code Section 213(d), that are not covered or reimbursable by insurance or some other form of medical coverage.

This generally means that the law allows you to use your HRA to pay for Covered Services until you meet the Deductible that applies to you under your employer's plan; any Copays and Coinsurance payments that apply to you; and any medical care expenses you incur that are not covered by your Consumer-Driven Health Plan. However, your employer's plan may be designed to simplify administration of your HRA so that you cannot use your HRA to pay for such things as prescription drug Copays, medical care expenses that are not covered by the employer's plan, and Balance Billings that you receive from Non-Network Physicians and other health care professionals.

Can You Have an HRA and a Health FSA?

Federal tax law allows you to participate in both an HRA and a Health FSA. If, however, you are covered by an HRA, and also enroll in a Health FSA, federal tax rules and the design of the two plans determine the expenses you can and cannot pay with the two types of accounts. The tax rules and plan design also determine the order in which you must use your HRA funds and your Health FSA contributions, when either of them can pay the expense.

Federal tax law generally requires that when both the HRA and the Health FSA cover the same expenses, you must use the HRA funds first. However, the law also allows your employer to reverse that rule, and require that your Health FSA pay for the medical expense first. This is important to know because, when an expense can be paid or reimbursed with your HRA credits as well as by your Health FSA, if your Consumer-Driven Health Plan says that your HRA credits must be used first, you cannot use your Health FSA for those expenses until you have first used up all of your HRA credits, and vice versa. As a practical matter, the order in which your HRA and Health FSA funds are used for specific medical care expenses is determined by your employer.

In addition to deciding the order in which you can use your HRA and Health FSA, your employer can design your HRA and Health FSA so that they cover different and mutually exclusive expenses. For example, your HRA may only allow you to use it to pay for Covered Services, and your Health FSA may allow you to use it to pay for both for Covered Services and for Code Section 213(d) Expenses that are not Covered Services. If your employer's plans are designed so that the Health FSA pays last for Covered Services, you can pay for a Covered Service with your Health FSA only after you use up the funds in your HRA. If you incur a Code Section 213(d) Expense that is not a Covered Service, you can pay it with your Health FSA without submitting it through your HRA first.

Can You Have an HRA and an HSA?

The law that governs HSAs limits the extent to which you can participate in an HRA or a Health FSA when you are enrolled in a High Deductible Health Plan and want to open a Health Savings Account. These rules are explained in *Can You Have an HSA, an HRA and/or a Health FSA?* in Chapter 4.

What Happens to Your HRA When . . . ?

You Don't Use Up Your HRA Credits in a Year

When you don't use up your HRA credits in a year (and remain employed and participating in your employer's plan):

- Your employer's plan can (but is not required to) allow your unused HRA funds to roll over to the next year. The "use it or lose it" rule that applies to Health FSAs does not apply to HRAs.
- What happens to your unused HRA funds at the end of a year depends on your employer's plan design:
 - The tax guidance does not require your employer to permit this rollover.
 - If your employer does allow the rollover, your employer may limit the dollar amount that can be rolled over and accumulated in your HRA.
- If your employer does permit all or a portion of your unused HRA funds to be rolled over, you typically can use the funds in the subsequent year or years for Covered Services that you must pay for until you meet the Deductible that applies under your employer's plan, or to pay your Copays or your Coinsurance for Covered Services.

You Elect a Different Medical Coverage Option While You Remain Employed

When, after participating in a Consumer-Driven Health Plan with an HRA, you later elect coverage under a different type of medical option, such as a High Deductible Health Plan option that allows you to establish an HSA, or a medical option that offers neither an HRA nor HSA:

- Your employer cannot distribute unused HRA funds to you (you cannot "cash out" your HRA).
- If you elect coverage under a High Deductible Health Plan and open an HSA after participating in a Consumer-Driven Health Plan with an HRA, federal tax guidance does not allow you or your employer to roll over to your new HSA any unused funds that remain in your HRA when your coverage under the Consumer-Driven Health Plan ends.
- Your employer can (but is not required to) hold the unused HRA funds "in suspense" for you, in the event that you again participate in the HRA at a future date.

Your Employment Ends

When your employment ends and you no longer participate in the Consumer-Driven Health Plan, your employer cannot cash out or distribute your unused HRA funds to you, however, you do have a right to continue coverage under the plan (including the HRA) under COBRA. As a general rule, you can elect to continue coverage under the plan including the HRA, for yourself (and any covered dependents). Your unused HRA balance remains available to you and your covered dependents; and your employer must continue to credit contributions to your HRA while your COBRA coverage is in effect. You should refer to your employer's summary plan description or certificate of coverage for the specific COBRA rules that apply under your employer's plan.

Example: Mary is married and has three children. She is enrolled at the family Coverage Level in her employer's Consumer-Driven Health Plan and has an HRA. Her employer contributes \$1,200 each year to the HRAs of employees who elect coverage at the family coverage level and credits the \$1,200 contribution on January 1 of the year. When Mary's employment ends, she has an unused HRA balance of \$3,600. Mary is entitled to and elects continuation coverage under COBRA for her family for the maximum 18 month continuation period, and pays the applicable COBRA premiums. For the remainder of the year in which her employment ends, the \$3,600 in HRA funds is available to her and her dependents. Because her employer credited her HRA with the \$1,200 contribution on January 1, she receives no further credits for the year in which her employment ends. Any unused amounts carry forward to and are available to Mary and her dependents in the following year. Also, in the following year(s) or portion of a year during which COBRA coverage is in effect, Mary's employer must make the same contribution to the HRA that it makes for active employees who have elected coverage at the family coverage level.

Your Spouse's Coverage Ends Because You Divorce

If an employee and spouse divorce, the spouse typically loses coverage under the employer's Consumer-Driven Health Plan, and becomes eligible to elect COBRA continuation coverage. The COBRA rules can be very complicated in this situation and you should refer to your employer's summary plan description or certificate of coverage for the COBRA rules that apply under its plan. As a general rule, however, the former spouse can elect COBRA continuation coverage under the plan (including the HRA) for a period of up to 36 months, and the unused HRA balance that exists when coverage ends because of the divorce, is duplicated and made available to the former spouse. During that time, the employer must continue to credit the former spouse's HRA with the same dollar amount of HRA contributions it makes for single active employees.

Example: Mary and Frank are married and have no children, but divorce mid-year. Mary is enrolled in her employer's Consumer-Driven Health Plan at the employee plus spouse level and has an HRA. Her employer contributes \$800 each year to the HRAs of employees who elect coverage at that level. When Mary and Frank divorce, they have an unused HRA balance of \$1,600 and they have not incurred any health claims or used any of the HRA funds for the year. Frank is entitled to and elects COBRA continuation coverage at the employee only Coverage Level for the maximum 36 month continuation period, and begins to pay the applicable COBRA premiums. For the remainder of the year in which the divorce occurs, \$1,600 is available to Frank in his HRA as a COBRA continuee. Any unused funds in their HRAs carry forward and are available for use in the subsequent year. For the remainder of the year in which the divorce occurs and in the following year(s) (or portion of a year), Mary's employer must contribute to her HRA, and separately to Frank's HRA, the same amount that it contributes to the HRAs of active employees with employee only coverage.

Tax Issues that Affect You and Your HRA

Taxation and Reporting of Employer Contributions to Your HRA

Under federal and state tax law, the contributions your employer makes to your HRA, and the benefits paid from your HRA are not taxable to you, and are not reported to the IRS in your annual Form W-2 or to any other governmental agency.

Cost of Living Adjustments Do Not Apply

Since contributions to HRAs are not limited by law, the annual cost-of-living adjustments that apply to HSAs do not apply to HRAs.

Chapter 3: What You Should Know about HSAs and High Deductible Health Plans

Chapter at a Glance	
Subchapter	Summary
What is a High Deductible Health Plan?	Describes High Deductible Health Plans as defined in the Code, including the minimum Deductible and Out-of-Pocket Maximums that apply to them.
What is an HSA?	Defines the HSA.
What is a Typical High Deductible Health Plan and HSA Design?	Describes the common components of High Deductible Health Plan and HSA designs.
Who Can Open an HSA?	Explains who is an Eligible Individual who can open an HSA.
Who Can Contribute to Your HSA and How Much Can You and They Contribute?	Explains: <ul style="list-style-type: none"> • That your employer, you and others can make tax advantaged contributions to an HSA for you; • How much you and others can contribute; • The deadline for your contributions; and • Special rules that affect contributions to your HSA.
What You Should Know About Opening an HSA	Explains: <ul style="list-style-type: none"> • How to open an HSA, whether with Exante Bank or another financial institution; • When to open your HSA; and • The investment returns that may be available and the fees that may be charged to your HSA.
How Do an HDHP and HSA Work?	Explains: <ul style="list-style-type: none"> • The Deductibles that apply; • How to use your HSA to meet your Deductible; • The gap between your HSA and the Deductible; and • When your HDHP starts to pay your claims for Covered Services.

Chapter at a Glance	
Subchapter	Summary
What Medical Expenses Can You Pay with Your HSA?	Explains: <ul style="list-style-type: none"> • That you can use your HSA to pay for Qualified Medical Expenses and defines them; and • The tax consequences of using your HSA to pay for non-Qualified Medical Expenses.
How to Use or Withdraw Funds From Your HSA Using . . .	Explains how to use the funds in your HSA by using: <ul style="list-style-type: none"> • Your debit card; • Your ATM card; and • Your HSA checks.
What Happens to Your HSA When . . . ?	Explains what happens when: <ul style="list-style-type: none"> • You don't use up your HSA in a year; • You change medical coverage options; • Your employment ends; or • You become divorced.
Tax Issues that Affect You and Your HSA	Explains: <ul style="list-style-type: none"> • The annual cost of living adjustments and how they affect you; • The tax reporting rules for HSA contributions; and • That state and federal tax treatment of HSAs are different in several states.

See Other Sources of Information in Appendix II for additional sources of information about consumer-driven health coverage.

What is a High Deductible Health Plan?

The term High Deductible Health Plan (HDHP) is the legal name for a health plan that pays for Covered Services only after you meet a minimum Deductible (except that Preventive Care is not subject to the Deductible), and that pays the full cost of Covered Services once you meet an annual Out-of-Pocket Maximum that does not exceed a statutory maximum. To be an HDHP, a health plan's:

- Annual Deductible must be at least \$1,000 for employee-only coverage and \$2,000 for family coverage in 2005 (and \$1,050 and \$2,100, respectively, in 2006); and
- Annual Out-of-Pocket Maximum must be less than \$5,100 for employee-only coverage and \$10,200 for family coverage in 2005 (and \$5,250 and \$10,500, respectively, in 2006).

If your health plan meets these requirements it is a High Deductible Health Plan.

If you enroll in an HDHP mid-year, federal tax law does not allow the Deductible and the Out-of-Pocket Maximum to be prorated or reduced to reflect your part-year enrollment. Also, there are no exceptions to the HDHP requirements for part-time employees, which means that if you are a part-time employee, you are subject to the same Deductible and Out-of-Pocket Maximum that apply to full-time employees.

Exception to the Deductible: Preventive Care

Federal tax law allows (but does not require) an HDHP to waive (or not apply) the Deductible to Preventive Care services. Many (but not all) employers design their HDHPs so that the Deductible does not apply to Preventive Care or, alternatively, apply a Deductible to Preventive Care that is lower than the statutory minimum Deductible. Under current federal tax guidance the following services are considered Preventive Care:

- Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals;
- Routine prenatal and well-child care;
- Child and adult immunizations;
- Tobacco cessation programs;
- Obesity weight-loss programs; and
- Screening services, including cancer screening, heart and vascular diseases screening, infectious diseases screening, mental health conditions and substance abuse screening, metabolic, nutritional, and endocrine conditions screening, musculoskeletal disorders screening, obstetric and gynecologic conditions screening, pediatric conditions screening, and vision and hearing disorders screening.

Preventive Care generally does not include services that are intended to treat an existing illness, injury, or condition. However, in situations where it is unreasonable or impractical to perform another procedure to treat the condition, any treatment that is incidental or ancillary to a Preventive Care service or screening is also considered Preventive Care.

Note: Some services that are Preventive Care under the federal tax definition may not be covered by your HDHP. Read your summary plan description or certificate of coverage for the Preventive Care services covered by your plan.

Exception to the Deductible: Prescription Drugs for Preventive Care

Effective in 2006, the Deductible under an HDHP must apply to prescription drugs, with one exception: The Deductible need not be applied to prescription drugs that are used for Preventive Care. Under existing federal tax guidance, prescription drugs are used for Preventive Care when they are:

- Taken before risk factors develop for a disease that has not yet manifested itself;
- Taken before a disease becomes clinically apparent; or to prevent recurrence of a disease from which a person has recovered; or
- Used in Preventive Care procedures and services such as weight loss and tobacco cessation programs.

While the law permits HDHPs to waive or not apply the Deductible to Preventive Care prescription drugs, determining when a prescription drug is used for Preventive Care is challenging, and many employers continue to evaluate whether and how to carve them out of the Deductible in 2006 and future years.

Status of HRA or Health FSA Coverage as Non-HDHP Coverage

General purpose HRAs and Health FSAs are not High Deductible Health Plans. If you participate in one or both of them you are not an Eligible Individual and cannot contribute to an HSA, unless the HRA or Health FSA meets the rules explained in *Can You Have an HSA, and an HRA or a Health FSA?* in Chapter 4 of this Handbook.

What is an HSA?

The HSA was created when Congress passed the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. An HSA is a trust or custodial account that you, if you are an Eligible Individual, and can establish with a bank, insurance company, or other IRS-approved trustee, to pay for certain medical expenses with your pre-tax or taxable contributions and/or your employer's nontaxable contributions to your HSA.

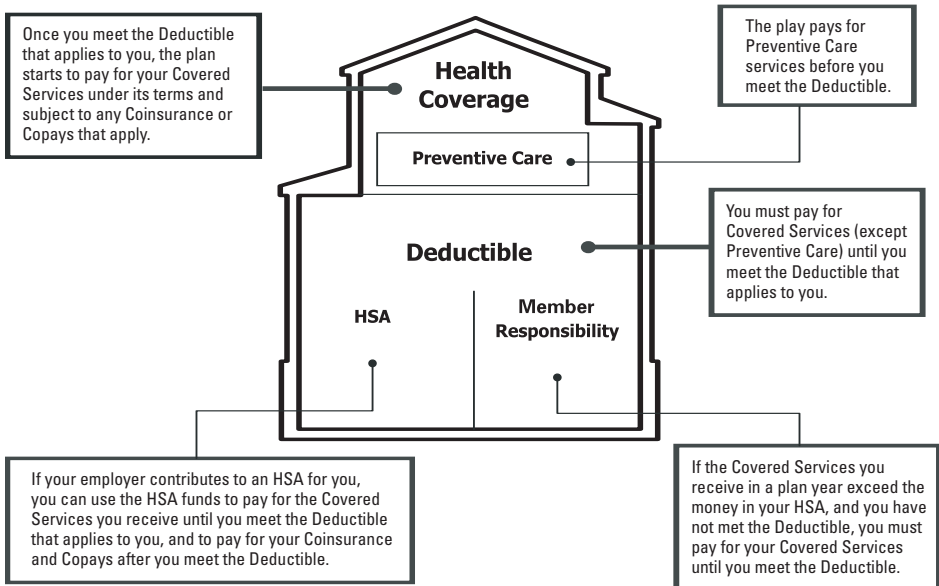
HSAs Are Generally Not ERISA Plans

Generally, HSAs are not employer-sponsored benefit plans and are not governed by ERISA, and employees do not have the rights that ERISA provides (even if the employer contributes to their HSAs) when:

- The employee's participation in the HSA is voluntary;
- The employer allows the employee to open the HSA with one or more HSA custodians or trustees, and allows the employee to move his or her HSA to another custodian or trustee;
- The employer does not limit distributions from the HSA, except as allowed by federal tax law;
- The employer does not make investment decisions for the employee or influence the employee's investment decision;
- The employer does not represent that the HSA is an Employer welfare benefit plan maintained by the employer; and
- The employer does not receive compensation in connection with the HSA

What is a Typical High Deductible Health Plan and HSA Design?

HDHP and HSA designs usually have the following basic characteristics and structure; however, the specific design characteristics vary according to each employer's needs. The characteristics and structure are similar to those for Consumer-Driven Health Plans which we described in Chapter 2.



Characteristic	Employer Design Variables
Preventive Care Coverage	<ul style="list-style-type: none"> • Definition of covered Preventive Care services may vary among employers.
Deductible	<ul style="list-style-type: none"> • Dollar amount of Deductibles varies by Coverage Level. • Dollar amount of Deductibles is larger for Non-Network services. • The law does not require the Deductible to be applied to Preventive Care. Many employers do not apply the Deductible to Preventive Care.
HSA	<ul style="list-style-type: none"> • Most employers do not sponsor or maintain their employees' HSAs and the HSAs are generally not covered by ERISA. • Employers are not required to contribute to their employees' HSAs, but many do. • Contribution amounts vary among employers and by Coverage Level. • Timing of employer contributions varies. • Many, but not all, employers allow employees to make pre-tax HSA contributions via payroll deduction.
Member Responsibility	<ul style="list-style-type: none"> • Amount varies among employers and by Coverage Levels. • Amount is larger for Non-Network services.

Characteristic	Employer Design Variables
Health Coverage	<ul style="list-style-type: none"> • Many employers require their employees to pay for a portion of the cost of Covered Services in the form of Copays and/or Coinsurance. • Coinsurance percentages and Copays vary among employers.
Information Tools and Resources	<ul style="list-style-type: none"> • Web sites that contain information about such things as Network Physicians and other health care professionals, services and costs, wellness programs and general wellness information, discounts on health services, and purchasing prescription drugs via mail. • Customer service centers or other resources that you can call for more information about all of these things.

High Deductible Health Plans often, but not always, contain all of these design elements, and when they do the dollar amounts of the Deductibles, HSA contributions, Coinsurance percentages, and Out-of-Pocket Maximums may vary from plan to plan and employer to employer.

Who Can Open an HSA?

Federal tax law allows only Eligible Individuals to open and contribute to an HSA. You are an Eligible Individual if, with respect to any month, you:

- Are covered under an HDHP as of the first day of the month;
- Are not covered under a non-High Deductible Health Plan;
- Are not enrolled in Medicare (meaning, generally, that you have not reached age 65); and
- Cannot be claimed as a dependent on another person's tax return.

If you are an Eligible Individual for at least one month, you may open and contribute to an HSA. If you cease to be an Eligible Individual, you can continue to use your HSA to pay for Qualified Medical Expenses, but cannot make additional contributions.

Self-Employed Persons Can Open HSAs

Federal tax law permits self-employed persons to open HSAs if they meet these rules and are Eligible Individuals. If you are a sole proprietor, a partner in a partnership, a 2% or more shareholder in a subchapter S corporation, or a member of a limited liability company that is taxed as a partnership, you can be an Eligible Individual and open an HSA if you meet these rules; however, you cannot make pre-tax contributions through a Code Section 125 cafeteria plan.

Special Rule: Permitted Coverage and Permitted Insurance

A health or other insurance plan that provides either of the following does not prevent you from being an Eligible Individual and opening and contributing to an HSA:

- Coverage, whether through insurance or otherwise, for accidents, disability, dental care, vision care, or long-term care.
- Insurance in which substantially all of the coverage is for:
 - Liabilities incurred under workers' compensation laws;
 - Tort liabilities;
 - Liabilities relating to ownership or use of property;
 - Insurance for a specified disease or illness; or
 - Insurance that pays a fixed amount per day or other period of hospitalization.

Example 1: If you are covered by an HDHP and are also covered by a dental or vision insurance policy or plan, the dental or vision coverage does not prevent you from being an Eligible Individual and opening and contributing to an HSA.

Example 2: If you are covered by an HDHP and are also covered by insurance for one or more specific diseases, such as cancer, diabetes, asthma or congestive heart failure, that coverage does not prevent you from being an Eligible Individual opening and contributing to an HSA.

Who Can Contribute to Your HSA and How Much Can You and They Contribute?

Employers Can Contribute to Their Employees' HSAs

Employers can, but are not required to, contribute to their employees' HSAs. If your employer contributes to your HSA, the contributions are excludable from your federal taxable income and are not taxable to you. Employers can structure their contributions several ways. Most of them contribute a fixed dollar amount (e.g., \$100) to their employees' HSAs. Others make "matching" contributions through their Code Section 125 cafeteria plans (e.g., they contribute \$.50 to the HSA for every dollar the employee contributes).

You and Others Can Contribute to Your HSA

You Can Make Tax Deductible Contributions

You can contribute after-tax money to your HSA, and if you do, you may take an above-the-line tax deduction on your federal Form 1040 individual tax return for the tax year in which or for which you make the contributions. This means that you will not pay income tax on the money that you contribute to your HSA. You do not have to itemize your deductions (i.e., file a Schedule A with the Form 1040) to take this deduction. However, you do have to complete the standard Form 1040 and not the Form 1040-EZ.

You Can Make Pre-Tax Payroll Deduction Contributions

You can also make pre-tax contributions to your HSA via payroll deduction, if your employer allows them. If you make them:

- You avoid the employee share of the federal FICA tax, which results in greater tax savings than when you contribute after-tax amounts to the HSA and take the allowable income tax deduction.
- Your tax liability and payments are reduced throughout the year when each contribution is made via payroll, and you do not need to wait until the end of the year to reduce your income taxes.
- You may be more likely to obtain the maximum tax advantage because your salary reduction election is effective at the beginning of the plan year and contributions are automatically deducted from your salary throughout the year.
- Your investment earnings accumulate faster if you make your contributions earlier in the year rather than waiting until the year ends.

Others Can Make Tax Deductible Contributions for You

You, your employer and any other person may contribute to your HSA. If the contributor is not your employer, you can take an above-the-line tax deduction for the contribution on your federal Form 1040 individual tax return.

How Much You and Others Can Contribute to Your HSA

You, your employer, and others can contribute to your HSA only for the months in a year during which you are an Eligible Individual. For 2005 and 2006, the aggregate total that you, your employer and any others can contribute to your HSA (assuming that you are an Eligible Individual for the entire year) is the lesser of:

- For 2005, \$2,650 for employee-only coverage and \$5,250 for family coverage, and for 2006, \$2,700 for employee only coverage and \$5,450 for family coverage; and
- The individual Deductible that applies under your HDHP if you have employee-only coverage, or the family Deductible that applies if you elected a different Coverage Level.

These limits are indexed each year for inflation.

The Deadline for Contributing

Your deadline for making HSA contributions for a calendar year is the due date of your federal individual income tax return for that calendar year, which is usually April 15 of the following year, or the first business day following April 15 if it falls on a weekend.

What Happens if You Contribute Too Much

If your HSA contributions exceed the limit that applies to you in a year, the amount that exceeds the limit is an excess contribution. If your contributions are after-tax contributions, you cannot deduct the excess portion on your individual income tax return for the year. Excess contributions are subject to an excise tax of 6 percent for each tax year during which they remain in your HSA. You can avoid this excise tax for a given year by withdrawing the excess contribution and the related interest earnings from your HSA before your income tax return for the year is due (including extensions).

Example: Joe has employee-only coverage under his employer's HDHP and the individual Deductible that applies to him is \$1,000. In 2005 he contributes \$1,100 to his HSA with after-tax dollars, which is \$100 more than the contribution limit that applies to him. The \$100 contribution earns \$4 of interest during the year. If Joe withdraws the \$100 excess contribution and the \$4 of interest from the HSA before April 17, 2006 (the due date for Joe's income tax return), then the 6% excise tax does not apply to Joe, and the distribution to him is not taxable. The interest earnings on the excess contribution are taxable to Joe, however, and he is required to include the \$4 in interest in his 2006 tax return. If Joe's contributions are made via pre tax payroll deduction, the distribution of the \$100 contribution would be taxable to him, however the 6% excise tax would not apply.

Special Rules that Affect Contributions to Your HSA

If You are Married

If you are married and both you and your spouse are covered by an HDHP (whether one HDHP or two separate HDHPs), are Eligible Individuals, and wish to open an HSA, you must each open a separate HSA, since joint ownership of an HSA is not permitted. If only one of you is an Eligible Individual, only the Eligible Individual may open and contribute to an HSA. The contribution limits for married individuals are as follows:

- If the two of you have family coverage under one HDHP and are both Eligible individuals, you are each treated as having family coverage. The contribution limit for each of you is one-half of the family HDHP Deductible, unless you agree on a different division.
- If each of you has family coverage under separate HDHPs, you are each treated as having family coverage with the lower of the two family Deductibles that apply under the two HDHPs. The contribution limit for each of you is one-half of that lower HDHP Deductible, unless you agree on a different division.

Example 1: Joe and Sally are married, are both under age 55 and they have two dependent children. Joe is enrolled in an HDHP and elected the family Coverage Level. The family Deductible is \$5,000. Joe has no non-HDHP coverage, and is an Eligible Individual. Sally also has employee-only coverage under a non-HDHP, which means that she is not an Eligible Individual and cannot open or contribute to an HSA. Joe can open an HSA and he (and his employer or any others) can contribute up to \$5,000 to his HSA.

Example 2: The facts are the same as in example 1, except that Sally has no non-HDHP coverage and is therefore also an Eligible Individual because she is covered under Joe's HDHP. Sally can open her own HSA, and she and Joe can each contribute to their respective HSAs an amount equal to half of the Deductible under Joe's HDHP (\$2,500) (or any other division they agree upon).

Example 3: The facts are the same as in example 1, except that Sally has family coverage under her employer's separate HDHP, with a \$3,000 family Deductible. Both Joe and Sally are treated as having a family HDHP with the lower \$3,000 Deductible, and can each contribute to their respective HSAs an amount equal to half of that Deductible (\$1,500) (or any other division they agree upon).

If You are Enrolled in Medicare

If you are eligible for and enrolled in either Medicare Part A or Part B, you are not an Eligible Individual and you (and others for you) cannot contribute to an HSA. If you are eligible for, but not actually enrolled in Medicare Part A or Part B, and you are otherwise an Eligible Individual, you (and others for you) may contribute to an HSA until the month that you actually enroll in Medicare.

Catch-Up Contributions If You are 55 or Older

Eligible Individuals who are age 55 and older can make additional "catch-up" contributions to their HSAs. For 2005 the catch-up contribution limit is \$600, for 2006 it is \$700, and the limit increases by \$100 per year until it reaches \$1,000 in 2009. Catch-up contributions are not required to be prorated in the year in which you turn 55, but you can make them only for the months during which you are an Eligible Individual.

If both you and your spouse are Eligible Individuals, are age 55 or older, and each of you wants to make "catch-up" contributions, you can do so, but you must each open and contribute to your own separate HSAs. Catch-up contributions cannot be allocated between spouses.

Example: If you are an Eligible Individual for the entire year, and reach age 55 at any point in 2005, you can make an additional \$600 contribution to your HSA for 2005. Thus, if you are an Eligible Individual on January 1, 2005, and turn 55 later in the year, you can contribute an additional \$600 for 2005. If, however, you become an Eligible Individual mid-year, such as July 1, 2005, and reach age 55 at any point in 2005, you can make catch-up contributions only for the six months during which you're an Eligible Individual. This means that the \$600 limit is prorated and you can contribute an additional \$300 for 2005 (6 months of Eligible Individual status/12 months x \$600).

If You Have an Umbrella/Embedded Individual Deductible

Some HDHPs have both an "umbrella" family Deductible, which is the dollar amount that the family unit as a unit must pay for Covered Services before the HDHP pays benefits for all members of the family, and a lower "embedded individual Deductible," which is the lower dollar amount that any one family member must pay for Covered Services before the HDHP pays benefits for that individual family member. The embedded individual deductible must be at least as much as the minimum required Deductible for family coverage, which, for 2005 is \$2,000, and for 2006 is \$2,100.

If you have family coverage under an HDHP that provides both an umbrella Deductible and an embedded individual Deductible, the limit on your contributions is the lower of:

- The maximum HSA contribution limit for family coverage (\$5,250 for 2005 and \$5,450 for 2006);
- Your HDHP's umbrella Deductible amount; or
- Your HDHP's embedded individual Deductible multiplied by the number of family members covered by the HDHP.

What You Should Know about Opening an HSA

General Information

If you are an Eligible Individual you can open or establish an HSA with a qualified HSA trustee or custodian. The general process is very similar to the way you open an IRA. You do not need permission from your employer or the IRS to establish an HSA.

How to Open Your HSA

The specific process for opening an HSA varies among trustees and custodians. Generally, many trustees and custodians require that you complete an application form in writing, sign it, and mail or fax it to them. Some trustees and custodians are, however, developing account opening processes that allow some aspects of the account opening process to be handled electronically.

Opening Your HSA with Exante Bank

If your employer allows UnitedHealth Group's affiliate, Exante Bank, to offer its HSA custodial services to you, either Exante Bank or your employer will provide the account opening process and/or forms to you, and the terms and conditions that apply to your HSA with Exante Bank.

When to Open Your HSA

It's important that you open your HSA as soon as you enroll in an HDHP because your HSA can only be used to pay for or reimburse you for Qualified Medical Expenses that you incur after you "establish" your HSA. This is an important and subtle rule, and one that can surprise you when you enroll in an HDHP for the first time. If you use your HSA to pay for or reimburse yourself for expenses that you incur before you establish your HSA, the

payment is taxable to you and is subject to the additional 10% tax that applies to distributions for non-Qualified Medical Expenses. Typically, you enroll in an HDHP first, and then open your HSA. Depending on your employer, you may be able to enroll in the HDHP online or via paper enrollment forms, or both. If your employer's HDHP enrollment process allows it, you may be able to select your HSA trustee or custodian when you enroll in the HDHP, which may in turn cause the trustee or custodian to send the HSA account opening forms to you and/or start the HSA opening process.

Completing the steps necessary to open your HSA before your HDHP coverage begins will ensure that your HSA will be established as early as possible. Many trustees and custodians allow you to complete the necessary account opening forms or other process shortly before the date your HDHP coverage becomes effective, though the HSA is not considered established until the date your coverage under the HDHP is effective. If you take advantage of this, your HSA will be considered opened and established on the date your HDHP coverage is effective, and you will be allowed to use your HSA funds to pay for Qualified Medical Expenses, if any, that you may incur in those first days that your HDHP coverage is effective.

Note: If your HDHP coverage is effective on a day that is not the first day of a month, you are not an Eligible Individual until the first day of the following month, and even if you complete the account opening forms early, your HSA will not be effective until the first day of the following month.

When the IRS Considers Your HSA to be Established

The IRS considers your HSA to be “established” once you have done what your account trustee or custodian requires you to do to establish the account. This may include completing and submitting appropriate paperwork and making a minimum deposit. Contact your HSA trustee or custodian for information about opening your HSA account.

Request Account Opening Information from Exante Bank

If Exante Bank is your HSA custodian, you can call **1-800-791-9361** for more information about opening an HSA and the terms and conditions that apply to your HSA.

Investment Earnings on Your HSA

As a general rule, HSAs can be invested in the same types of investments in which IRAs can be invested. These include bank accounts, annuities, certificates of deposit, stocks, mutual funds and bonds. You cannot, however, invest your HSA in life insurance contracts or in collectibles (such as art works, stamps, coins and antiques, etc.). The investment vehicles that are available to HSA customers vary among trustees and custodians, and the investments available to you depend on the trustee or custodian you choose. In part because HSAs are such a new concept, many trustees and custodians currently offer limited investment options. As the HSA market becomes more established, however, the number and different types of investment vehicles may expand.

How Do an HDHP and an HSA Work?

In this explanation, we assume that the employer offers an HDHP, the employee opens an HSA with Exante Bank, and a UnitedHealth Group company insures or administers the HDHP. Other insurers, administrators and banks may follow administrative processes that are different in some respects, but this explanation should help you understand how they are generally administered.

How to Use Your HDHP and Your HSA

This section is very similar to *How to Use Your CDHP and HRA* in Chapter 2, and explains, in general terms, UnitedHealth Group's suggestions for how to:

- Use your HSA to pay for Covered Services that you must pay for until you meet the Deductible that applies to you under your employer's HDHP; and
- Submit claims to your HDHP and your HSA.

Your Member Responsibility: Meeting the Deductible

- Your plan may contain several different Deductibles, such as Deductibles that apply to services from Network Physicians and other health care professionals and higher Deductibles that apply to services from Non-Network Physicians and other health care professionals; as well as and Deductibles that apply to different Coverage Levels.
- Your employer's summary plan description or your certificate of coverage typically identifies the Covered Services that are and are not subject to the Deductible. Many, but not all, employers design their HDHPs so that the Deductible does not apply to Preventive Care services.
- Before your employer's HDHP pays for Covered Services that are subject to the Deductible, you must pay for them until you meet the Deductible that applies to you.
- You can use your and your employer's contributions to your HSA to pay for Covered Services that are subject to the Deductible.
- The Deductible is usually larger than your employer's contribution to your HSA. If you use all of your HSA funds before the end of a year, you are responsible for paying for Covered Services until you meet the remainder of the applicable Deductible for that year.

Before You Meet the Deductible: Submit Your Claims to the HDHP First

When you receive a Covered Service before you meet the Deductible that applies to you, you should not pay for the Covered Service first. Instead, your Network Physician (or you or your Non-Network Physician) should submit your claim to your plan for processing to make sure that:

- Your claim is for a Covered Service;
- You receive the benefit of any discounts that have been negotiated with a Network Physician; and
- The claim is "counted toward" your Deductible and your Out-of-Pocket Maximum if appropriate.

The insurer or administrator of your plan will notify your provider that you have not met the Deductible and are responsible for payment of the claim, and the physician or other health care professional should bill you directly. You then pay the bill directly to the physician or other health care professional and can use your HSA funds.

More Member Responsibility: Paying Claims After You Use Up Your HSA Funds and Before You Meet the Deductible

If you use up your HSA funds before you meet the Deductible that applies to you (or you choose to not use your HSA funds), you are responsible for paying for the Covered Services you receive, until you meet the remainder of the Deductible. For the same reasons that apply to claims that you pay with your HSA, you should not pay for the Covered Service first.

After You Meet the Deductible: The HDHP Starts Paying for Your Covered Services

Once you meet the Deductible that applies to you, the HDHP starts paying your claims for Covered Services, but subject to any Coinsurance requirement or Copays that apply to the service you receive.

Example: Assume that a typical HDHP is designed so that the employer's HSA contributions, the Network and Non-Network Deductibles, Coinsurance, and Out-of-Pocket Maximums are as follows for the employee-only Coverage Level:

	Network			Non-Network		
HSA Contribution	Deductible	Coinsurance	Out-of-Pocket Maximum	Deductible	Coinsurance	Out-of-Pocket Maximum
Employer \$400	\$1,500	Plan pays 85%	\$3,000	\$2,000	Plan pays 55%	\$5,000
Employee \$1,100		Employee pays 15%			Employee pays 45%	

Example 1: Mr. Adams sees a Network Physician for a Preventive Care physical. The Network Expense is \$300. The Network Physician submits a claim to the HDHP for the physical. The claim is processed, and is determined to be a Covered Service performed by a Network Physician which is not subject to the HDHP's Deductible. The HDHP pays the \$300 Network Expense to the Network Physician and Mr. Adams pays nothing.

Example 2: Mr. Adams visits a Network Physician which is an urgent care center. The Network Expense is \$200. The Network Physician submits a claim to the HDHP for the urgent care visit. The claim is processed, and is determined to be a Covered Service performed by a Network Physician, which is subject to the HDHP's Deductible. Mr. Adams must satisfy the \$1,000 individual Network Deductible before the Plan pays for the visit. Mr. Adams is responsible for paying the \$200 claim. He has \$400 in his HSA and can use it to pay the urgent care center. If he uses his HSA funds, the payment will reduce his HSA balance to \$200 (\$400 - \$200). The payment counts toward his \$1,000 Network Deductible and the remaining Network Deductible is \$800 (\$1,000 - \$200).

Example 3: Mr. Adams sees a Network Physician for an outpatient procedure. The Network Expense is \$500. The Network Physician submits a claim to the HDHP for the outpatient procedure. The claim is processed, and is determined to be a Covered Service performed by a Network Physician, which is subject to the HDHP's Deductible. Mr. Adams must satisfy the remainder of his individual Network Deductible balance of \$800 before the Plan pays for the procedure. Mr. Adams is responsible for paying the \$500 claim. He has \$200 in his HSA and can use it to pay the Network Physician. If he uses his HSA funds, the payment reduces his HSA balance to \$0. The HSA payment counts toward his remaining \$800 Network Deductible and the remaining Network Deductible is \$600. Mr. Adams must pay the \$300 remainder of the Network Expense to the Network Physician. This is the gap. He must pay the Network Physician himself.

What Medical Expenses Can You Pay with Your HSA?

You Can Pay for Qualified Medical Expenses for You, Your Spouse, and Your Eligible Dependents

The funds that you or others deposit to your HSA may be distributed on a tax-free basis to pay for your Qualified Medical Expenses as well as those of your spouse and dependents. Your spouse and dependents do not need to be covered under your HDHP for you to take a tax-free HSA distribution to pay for their medical expenses.

Qualified Medical Expenses are amounts you pay for you, your spouse or your dependents for Code Section 213(d) Medical Expenses (with some exceptions), that are not compensated for by insurance or otherwise, and are not reimbursable by another health plan. Generally, Qualified Medical Expenses include:

- Expenses for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, including over-the-counter medicine and drugs;
- Transportation and lodging expenses that are incurred primarily for and essential to medical care; and
- Amounts paid for certain away from home lodging that is primarily for and essential to medical care.

Generally, insurance premiums are not Qualified Medical Expenses except premiums for:

- COBRA continuation coverage under a group health plan;
- A qualified long-term care insurance contract as defined in Code Section 7702B(b) (within certain limits);
- A health plan during a period in which the individual is receiving unemployment compensation under any federal or state law; and
- For individuals over age 65, premiums for Medicare Part A, B, or D, Medicare HMO, and the employee share of premiums for employer-sponsored health insurance, including premiums for employer-sponsored retiree health insurance. Medigap premiums are not Qualifying Medical Expenses.

If You're Not Sure

If you are not sure whether an expense is a Qualifying Medical Expense, read IRS Publication 502, which lists the medical expenses that are deductible on your federal income tax return. Except for premiums and over the counter drugs, any expense that is described as a deductible expense in Publication 502 is a Qualifying Medical Expense. You can obtain a copy of Publication 502 from the IRS' Web site at www.irs.gov.

You Decide Whether to Use or Save Your HSA Funds

You have the freedom to decide whether and when to use your HSA funds to pay for Qualified Medical Expenses (or other expenses) that you incur. Some people may decide to pay for some expenses out of other personal funds and to save their HSA funds for future medical expenses or general retirement purposes.

Who is Your Spouse or Eligible Dependent?

The eligibility rules under your HDHP may be different from and more restrictive than these rules. These rules apply for purposes of using your HSA funds. Your spouse is a person of the opposite sex to whom you are legally married as permitted under applicable state law. Code Section 152 determines who is an eligible dependent (other than a spouse) for HSA purposes. Under Code Section 152, generally, your dependent is either:

- A Qualifying Child, which is your daughter, son, stepchild, sibling, or stepsibling (or descendent of any of any of these) who shares your principal place of abode for more than one half of the taxable year and who is 18 or younger for the entire calendar year, or is younger than 24 and a student for the entire calendar year (the age limits do not apply if the child is permanently and totally disabled); or
- Your Qualifying Relative, which is someone who:
 - Is not your Qualifying Child or the Qualifying Child of any other taxpayer;
 - Is related to you as listed in Code Section 152, which includes but is not limited to, your child and grandchild, your brother, sister, step-brother, step-sister, your parents or grandparents, your step-parents, and your aunt or uncle), or is an individual who, for the entire calendar year, is a member of your household and whose principal place of abode is your home;
 - Receives more than half of his or her support from you for the calendar year in which the taxable year begins; and
 - Whose gross income for the year is equal to or less than the Code Section 151(d) dependency exemption amount (\$3,200 in 2005).

You Can Use Your HSA for a Domestic Partner Who is Your Qualifying Relative

Whether or not your HDHP covers your domestic partner, if your domestic partner meets the Code Section 152 definition of a Qualifying Relative you can use your HSA to pay for his or her Qualified Medical Expenses, and the payments are not taxable to you. You can use your HSA to pay for your domestic partner's medical expenses even if he or she is not your Qualifying Relative, but the payments will be taxable income to you and will be subject to the additional 10% tax on taxable HSA distributions.

You Must Determine Whether Your Expense is a Qualified Medical Expense

You are responsible for determining whether an expense is a Qualified Medical Expense. You are not required to submit a receipt or other information about the expense to the HSA trustee or custodian when you request a distribution, or to the IRS when you file your tax return. However, you do have to retain your Qualified Medical Expense receipts to substantiate your expenses in the event the IRS or your state taxing authority audits your individual income tax return.

What Happens if You Use Your HSA for Non-Qualified Medical Expenses

If you use your HSA funds for expenses that are not Qualified Medical Expenses, the payments or reimbursements are taxable to you and are subject to an additional 10 percent tax. You must report distributions for expenses that are not Qualified Medical Expenses in your federal income tax return.

Note: The additional 10 percent tax does not apply if the distribution for a non-Qualified Medical Expense is made after you reach age 65, become disabled, or die.

How to Use or Withdraw Funds from Your HSA Using . . . Your Debit Card

Many trustees and custodians will offer a debit card when you open your HSA. As a general rule, you can use the debit card to pay for your Qualified Medical Expenses when you receive the services or receive a bill for them from your physician or other health care professional.

Your ATM Card

If Exante Bank is your HSA trustee or custodian, you will receive a Health Savings Account MasterCard® Debit Card. You can use the card when making point-of-service purchases such as at a pharmacy, when paying a bill to a provider, or to withdraw money from your HSA through an ATM, where the provider or ATM accepts MasterCard.

Your HSA Checks

Your HSA trustee or custodian may provide you with checks that you can use to pay for your Qualified Medical Expenses or to reimburse yourself for expenses you've paid.

What Happens to Your HSA When . . . ?

You Don't Use Up Your HSA Funds in a Year

Your HSA is your personal account. You own it. Your employer does not. When you don't use up your HSA funds in a year the extra funds remain in your HSA, earn interest (or other earnings as applicable under your HSA), and are available for use in future years. As with HRAs, the "use it or lose it" rule that applies to Health FSAs does not apply to HSAs, and you do not forfeit or lose any unused funds.

You Use Up Your HSA Funds in a Year

If you use up the funds in your HSA in a year, and you (and/or others) have contributed the maximum amount to your HSA for that year, you must pay with other personal funds, any medical expenses that you incur during that year and are responsible for paying. However, you can continue to maintain your HSA and make additional contributions in the subsequent year or years.

You Elect a Different Medical Coverage Option While You Remain Employed

If you change medical coverage options so that the new option is also an HDHP, you can continue to maintain and contribute to your HSA. If the Deductible is different from the previous option, the limit on your HSA contributions may change. If you change medical coverage options so that the new option is not an HDHP, you will no longer be an Eligible Individual. This means that you cannot make additional contributions to the HSA. However, you may continue to use the HSA for Qualified Medical Expenses or for taxable distributions for other expenses.

Your Employment Ends

Since your HSA is your personal account, you own it, and your employer does not, you remain the owner of your HSA when your employment ends. If, after your employment ends, you continue to be enrolled in a High Deductible Health Plan, you can continue to contribute to your HSA. If your trustee or custodian will not keep your existing HSA after your employment ends, you can open a second HSA with another trustee or custodian, and either request an HSA distribution that you roll over to the new HSA within 60 days, or request a trustee to trustee transfer.

Your Spouse's Coverage Ends Because You Divorce

If you and your spouse divorce and you are the HSA account holder, you cannot withdraw amounts from your HSA on a non-taxable basis to pay your former spouse's medical expenses, and if you do withdraw for them, the distribution is taxable to you and subject to the 10 percent additional tax.

You can transfer all or a portion of the HSA to your former spouse as part of the divorce proceedings. If you do, the transfer is not taxable to either of you, the HSA continues to be an HSA, and your former spouse can use it for his or her Qualifying Medical Expenses.

You Die

When you die, what happens to your HSA funds depends upon who you name as the beneficiary of your HSA. If your spouse is your beneficiary, he or she becomes the HSA account holder, and the transfer is not taxable. If your beneficiary is not your spouse the HSA ceases to be an HSA, and the funds in the HSA are distributed to the beneficiary in a taxable distribution. The non-spouse beneficiary can reduce the taxable amount of the distribution by the amount of any of your Qualified Medical Expenses that you incur before you die, and that are paid from the HSA within a year after you die.

Tax Issues that Affect You and Your HSA

How the Annual Cost of Living Adjustments Affect You

Each year, the annual Deductible and Out-of-Pocket Maximum limits that apply to HDHPs are adjusted for inflation using annual cost-of-living adjustments (COLAs). The COLAs are announced by Treasury late in each calendar year. They are usually effective as of January 1 of the next calendar year for calendar year HDHPs, and as of the first day of the plan year that starts after January 1, for fiscal year plans.

The statutory HSA contribution limit is also adjusted for inflation each year. However, because the HSA contribution limit is the lower of the Deductible under the HDHP and the statutory limit, this adjustment should affect you only if the Deductible under your HDHP is higher than the statutory limit.

Who Reports HSA Activity to IRS

You must report on Form 8889, which you file with your Form 1040 individual income tax return, any contributions you (or someone on your behalf) make to your HSA, and any payments you make or reimbursements you receive from your HSA. With this form you also calculate your deduction for the after-tax contributions you (or someone other than your employer) has made to your HSA, the amount of any excess contributions to your HSA that are timely withdrawn, and the additional tax on any taxable payments or reimbursements from your HSA.

If you have excess contributions in your HSA in a tax year, you must also file Form 5329 and calculate and pay the tax on any excess contributions that are not removed by the applicable deadline (the April 15 due date, with extensions).

Your employer reports in box 12 of your Form W-2, using code "W", any amounts your employer contributed to your HSA and that you contributed via pre-tax payroll deduction.

Your HSA trustee or custodian must file Form 5498-SA to report contributions to your HSA, including rollovers, and Form 1099-SA to report distributions from your HSA.

How State and Federal Tax Treatment of HSAs Differ

Although most states follow the federal tax law with respect to determination of taxable income, some states do not provide tax benefits for HSAs. Currently, in seven states the state tax consequences of HSA participation differ from the federal tax consequences (e.g., where HSA employer contributions that are excludable for federal tax purposes are required to be included in state taxable income, where interest earned on the HSA is taxed, and/or where the contributions are not deductible on the state tax return). They are: Alabama, California, Maine, Massachusetts, New Jersey, Pennsylvania, and Wisconsin. These rules continue to change, and we encourage you to review the instructions for your state income tax return and consult your own tax advisor for specific guidance on how your state's law affects you and your HSA.

Chapter 4: What You Should Know about How Health FSAs, HRAs and HSAs Work Together

The purpose of this chapter is to explain the tax rules that limit the extent to which you can participate in a Health FSA when you are participating in an HRA or an HSA, as well as to briefly explain some of the general tax rules that apply to Health FSAs.

Chapter at a Glance	
Subsection	Summary
What is a Health FSA?	Defines the general purpose Health FSA.
Who Can Participate in a Health FSA?	Explains the general eligibility rules.
Who Can Contribute to Your Health FSA and How Much Can They Contribute?	Explains who can contribute to your Health FSA and the amounts they can contribute.
What Medical Expenses Can You Pay with Your Health FSA?	Explains the types of medical expenses that you can pay with a Health FSA.
What Happens When You Don't Use Up Your Health FSA?	Explains the use it or lose it rule.
Can You Have an HRA and a Health FSA, and if so, What Can You Pay with Each Account?	Explains the tax rules and employer plan design decisions that determine the expenses that you can pay with your HRA and Health FSA, and the order in which you must use the two accounts.
Can You Have an HRA and an HSA or a Health FSA, and if so, What Can You Pay with Each Account?	Explains the tax rules and employer plan design decisions that determine the expenses that you can pay with each of the three accounts when you have an HSA, and the order in which you must use the accounts.

What is a Health FSA?

A health care flexible spending account (“Health FSA”) is an account, offered by an employer through a Code Section 125 cafeteria plan, to which employees can make pre-tax contributions that can be used to reimburse the employee for medical expenses that are not otherwise covered or reimbursed by another health or insurance plan. Any contributions you make to your Health FSA are made via pre-tax payroll deduction and are not taxable to you, and payments made or reimbursements to you from your Health FSA are also not taxable to you.

A Health FSA is subject to many rules under Section 125 including:

- Generally, you can use a Health FSA to pay for medical care expenses, as they are defined in Code Section 213(d) that you incur for yourself, your spouse and your tax dependents;
- If you don't use all of the funds in your Health FSA in a calendar year, you forfeit them under the “use it or lose it rule”;
- You cannot use your Health FSA for health insurance premiums or for expenses that are reimbursed or reimbursable by another source; and
- You can only change your Health FSA contribution election prospectively during a calendar year when you experience a change in status or other permitted events.

While Health FSAs are subject to many rules, we primarily address in this chapter the rules that relate to the similarities and differences between Health FSAs, HRAs and HSAs, and the extent to which you can have more than one of these types of accounts.

Who Can Participate in a Health FSA?

Federal tax guidance allows current and former employees (such as former employees who receive severance pay) to participate in a Health FSA. Federal tax guidance does not, however, require employers to allow all current and former employees to participate. Employers can specify the employees who are eligible to participate in a Health FSA, as long as they do not violate any nondiscrimination rules that apply to Health FSAs.

No Health FSAs for Self-Employed Persons

Federal tax law does not permit self-employed persons to participate in Health FSAs. They can, however, sponsor a Health FSA plan for their employees. If you are a sole proprietor, a partner in a partnership, a more than 2% shareholder in a subchapter S corporation, or a member of a limited liability company that is taxed as a partnership, you are self-employed and cannot participate in a Health FSA.

If, however, you are a sole proprietor, a partner in a partnership, or a member of a limited liability company that is taxed as a partnership and you sponsor a Health FSA plan for your employees as long as your spouse or other tax dependent is a bona fide employee and not deemed to be self-employed, then your spouse or other dependent can participate in the Health FSA and make pre-tax contributions to it, assuming the plan passes the nondiscrimination tests that apply. Spouses and tax dependents of persons who are more than 2% shareholders in a subchapter S corporation are considered self-employed and cannot participate in a Health FSA plan that is sponsored by the subchapter S corporation.

Who Can Contribute to Your Health FSA and How Much Can They Contribute?

You and your employer can contribute to your Health FSA, however, most employers do not contribute to their employees' Health FSAs. Your pre-tax contributions are usually deducted from each paycheck, but this can vary depending on your employer's Health FSA plan's rules. Once you have decided on the amount you want to contribute, you can only change this amount when certain permitted events occur, including but not limited to change in status events and changes in cost or coverage.

Federal tax law does not limit the dollar amount that you and/or your employer can contribute to your Health FSA. However, employers typically set a maximum limit on contributions to Health FSAs.

What Happens When You Don't Use Up Your Health FSA?

The general and long-standing rule is that you forfeit any money contributed to your Health FSA that you do not spend during your period of coverage, which is typically the 12 month plan year for your employer's Health FSA plan. Generally this means that during the year you must spend all of the money that you contribute to your Health FSA during the plan year, or you will lose it. However, the IRS recently issued a ruling that allows, but does not require, employers to offer a period of up to 2-½ months following the end of a plan year during which participants can continue to incur expenses and request reimbursement for them from their unused Health FSA balance for the prior year. This 2-½ month "extension" creates technical issues for employers and Health FSA administration, as well as employees who want to participate in an HDHP and contribute to an HSA. Some employers will take advantage of the new rule in 2005 and/or 2006, and others will not.

What Medical Expenses Can You Pay with Your Health FSA?

Like an HRA, the expenses you can pay with your Health FSA are determined in part by law and in part by your employer's Health FSA Plan design. Federal tax law generally allows you to use your Health FSA to pay for medical care expenses:

- That are permitted under Code Section 213(d) (Code Section 213(d) Expenses);
- That you incur for yourself, your spouse or your tax dependents during the period of time that you're covered by your employer's Health FSA plan;
- That you do not deduct on your personal income tax return; and
- That are not reimbursable or reimbursed by some other form of health insurance or coverage.

Code Section 213(d) Expenses are expenses for health care (as defined in Code Section 213(d)), which generally include amounts paid for:

- The diagnosis, mitigation, cure, treatment or prevention of disease, or for the purpose of affecting any structure or body function.
- Certain transportation and lodging expenses that are incurred primarily for and are essential to such medical care.

While many medical expenses are Code Section 213(d) Expenses, there are also many that are not, which include, but are not limited to:

- Expenses for cosmetic procedures, treatments and other services that are directed at improving appearance and that do not meaningfully promote the proper function of the body or prevent or treat illness or disease (unless such they are necessary to correct a deformity that arises from or is directly related to a congenital abnormality, a personal injury that results from an accident or trauma, or a disfiguring disease);
- Illegal operations or treatments; and
- Expenses that merely benefit your general health.

If a UnitedHealth Group affiliate administers your employer's Health FSA plan, you may also access myuhc.com[®] for a list of expenses that are generally reimbursable through a Health FSA. For more information about the types of expenses that you can pay through your Health FSA, read the summary plan description for your employer's Health FSA plan.

Can You Have an HRA and a Health FSA, and if so, What Can You Pay with Each Account?

Federal tax law allows you to participate in both an HRA and a Health FSA. If, however, you are participating in an HRA, and also enroll in a Health FSA, federal tax rules and the design of the two plans determine the expenses you can and cannot pay with the two types of accounts. The tax rules and plan design also determine the order in which you must use your HRA funds and your Health FSA contributions, when either of them can pay the expense.

Federal tax law generally requires that when both the HRA and the Health FSA cover the same expenses, you must use the HRA funds first. However, the law also allows your employer to reverse that rule, and require that your Health FSA pay for the medical expense first. This is important to know because, when an expense can be paid or reimbursed with your HRA credits as well as by your Health FSA, if your Consumer Driven Health Plan says that your HRA credits must be used first, you cannot use your Health FSA for those expenses until you have first used up all of your HRA credits, and vice versa. As a practical matter, the order in which your HRA and Health FSA funds are used for specific medical care expenses is determined by your employer and the third party administrator or insurer of its health plan.

Your employer's HRA and Health FSA may also be designed so that they cover different and mutually exclusive expenses. For example, your HRA may only allow you to use it to pay for Covered Services, and your Health FSA may allow you to use it for Covered Services and for Code Section 213(d) Expenses that are not Covered Services. If your employer's plans are designed so that the Health FSA pays last for Covered Services, you can pay for a Covered Service with your Health FSA only after you use up the funds in your HRA; and if you incur a Code Section 213(d) Expense that is not a Covered Service, you can run it through your Health FSA without running it through your HRA first.

Read the summary plan description or certificate of coverage for your employer's Consumer-Driven Health Plan, and the SPD for its Health FSA plan, for the specific rules that apply to you.

Can You Have an HSA and an HRA or a Health FSA?

Depending on your employer's Health FSA plan design, you generally can use a Health FSA to pay for Covered Services that you must pay for until you meet the Deductible that applies to you under the medical plan in which you're enrolled, as well as any Copays and Coinsurance payments that your medical plan requires you to pay and any Code Section 213(d) Expenses that are not covered by the medical plan in which you're enrolled. However, this kind of general purpose Health FSA plan design and similarly, a general purpose HRA plan design prevents you from opening and contributing to an HSA because they are non-High Deductible Health Plans. General purpose HRAs and Health FSAs typically cover most Code Section 213(d) expenses and do not apply a Deductible before paying or reimbursing you for them, which makes them non-High Deductible Health Plans. If you participate in a general purpose HRA or Health FSA, you are not an Eligible Individual and cannot open or contribute to an HSA.

There are, however, several types of HRAs and Health FSAs that do not prevent you from being an Eligible Individual. The two more commonly offered types are the Limited Purpose Health FSA and the Post-Deductible Health FSA:

- Limited Purpose HRA or Health FSA. A Limited Purpose HRA or Health FSA pays or reimburses expenses for dental, vision, or preventive care that is not covered by an employer's CDHP or HDHP.
- Post-Deductible HRA or Health FSA. A Post-Deductible Health FSA pays for Covered Services you obtain under your HDHP, but only after you meet the statutory minimum Deductible that applies under your High Deductible Health Plan.

While federal tax law allows these alternate forms of HRAs and Health FSAs, your employer is not required to offer them to you. Whether or not to offer one or more of them is a plan design matter for your employer.

Appendix I – Glossary

We developed the following definitions specifically for this Consumer-Driven Health Plan Handbook, and we provide them to you as a frame of reference as you read the Handbook. The definitions are consistent with the tax law, where applicable. If, however, you participate in a Consumer-Driven Health Plan or a High-Deductible Health Plan, you should refer to its terms for the specific definitions that apply to you.

Balance Billing

The difference between the Non-Network Expense and the Non-Network Physician's Billed Charge for a Covered Service. You are responsible for paying this amount to a Non-Network Physician or health care professional.

Billed Charge

If the health plan negotiates a fee with a Non-Network Physician or health care professional for a Covered Service, the Billed Charge is that negotiated fee. If the fee is not negotiated, the Billed Charge is the actual, non-discounted fee that the Non-Network Physician or health care professional charges for a Covered Service.

COBRA

The Consolidated Omnibus Budget Reconciliation Act of 1985, as amended from time to time.

Code

The United States Internal Revenue Code of 1986, as amended from time to time.

Code Section 213(d) Medical Expenses

Expenses for health care as defined in Code Section 213(d) which generally include amounts paid for:

- The diagnosis, mitigation, cure, treatment or prevention of disease or for the purpose of affecting any structure or body function; and
- Certain transportation and lodging expenses that are incurred primarily for and are essential to such medical care.

Coinsurance

Sharing, between you and your health plan, of the cost of Covered Services. Your Coinsurance is the portion of the Network Expense that you are responsible for paying to a Network Physician, usually expressed as a percentage. If you obtain services from a Non-Network Physician, your Coinsurance is the portion of the Non-Network Expense that you are responsible for paying to the Non-Network Physician. The health plan's Coinsurance is the portion of the Network Expense that the plan is responsible for paying to a Network Physician or the portion of the Non-Network Expense that the plan is responsible for paying to a Non-Network Physician, also expressed as a percentage.

Consumer Driven Health Plan (CDH Plan)

For the purposes of this Handbook, a health plan that offers an HRA, and which requires covered persons to meet applicable Deductibles, but which does not meet the statutory definition of a High Deductible Health Plan.

Copay

The fixed dollar amount you must pay directly to a physician at the time you receive certain Covered Services, such as prescription drugs.

Coverage Level

Any of several different enrollment categories in which you can enroll under most health plans, and which may include some or all of the following:

- Employee
- Employee plus Spouse or Employee plus One
- Employee plus Children
- Family

Covered Services

Services and supplies that are listed in a health plan's schedule of benefits and provided while the person who receives the services is eligible to participate in and covered under the health plan.

Deductible

The fixed dollar amount you must pay for Covered Services each plan year before your health plan begins to pay benefits.

ERISA

The Employee Retirement Income Security Act of 1974, as amended from time to time, is a federal law that regulates the administration of employee benefit plans that are subject to its rules.

Health Care Flexible Spending Account (Health FSA)

An employee's account in a health care flexible spending account plan that is set up under Code Section 125, to which the employee makes pre-tax contributions via payroll deduction, and which can be used to reimburse the employee for Code Section 213(d) Medical Expenses.

Health Reimbursement Account (HRA)

An account that an employer sets up for employees who elect coverage under a Consumer-Driven Health Plan which offers an HRA, and to which the employer makes nontaxable contributions for its employees, and which generally can be used to pay for Code Section 213(d) Medical Expenses.

Health Savings Account (HSA)

An account that is established by an Eligible Individual who elects medical coverage under a High Deductible Health Plan with a bank or insurance company for the purpose of paying Qualified Medical Expenses.

High-Deductible Health Plan (HDHP)

A health plan, as defined by Code Section 223:

- That does not pay benefits until the covered person meets a Deductible that satisfies a statutory minimum amount (the minimum deductible amount depends on the coverage level the covered person elects); and
- Under which the covered person's out-of-pocket expenses do not exceed a statutory maximum amount.

IRS

The United States Department of Internal Revenue Service.

Network

A group of Network Physicians or health care professionals who have entered into an agreement to provide Covered Services at a discounted rate.

Network Expense

The negotiated discounted fee for Covered Services that a Network Physician or health care professional agrees to accept as full payment for such services.

Network Physician

A physician or other healthcare professional who has entered into an agreement to provide Covered Services at a discounted rate that is referred to as a Network Expense.

Non-Network Expense

The portion of a Non-Network Physicians and other health care professionals Billed Charge for a Covered Service that the health plan uses in determining the Coinsurance that the health plan and you each pay for the Covered Service. If the plan negotiates a fee with a Non-Network Physician, the Non-Network Expense is that negotiated fee. If a fee is not negotiated, the Non-Network Expense is generally determined under the rules set forth in the applicable health plan document.

Non-Network Physician

A physician or other healthcare professional that has not entered into an agreement to provide Covered Services at a discounted rate.

Out-of-Pocket Maximum

The maximum dollar amount that you have to pay under the terms of your health plan in a calendar year for Covered Services.

Qualified Medical Expense

For the purposes of contributing to and using the funds in your Health Savings Account, amounts you pay for medical care for yourself, your spouse and your other eligible dependents, which are not paid for by insurance or other sources, and which may include but are not limited to:

- Code Section 213(d) Medical Expenses, which include but are not limited to:
 - Payments you make for Covered Services until you meet the Deductible that applies to you;
 - Your Coinsurance payments for Covered Services;
 - Your Copayments for prescription drugs;
- Premium payments for:
 - Continuation coverage under COBRA;
 - Coverage under certain long-term care insurance contracts;
 - Coverage under a health plan when you receive federal or state unemployment compensation; and
- If you are at least age 65, health insurance coverage other than a Medicare supplemental policy.

Appendix II – Other Sources of Information

The following chart identifies several additional resources through which you can obtain more information about Consumer Driven Health Plans and HRAs, High Deductible Health Plans and HSAs, and Health FSAs.

This Appendix II identifies several Websites that contain various tools, applications and information that may help you better understand and use the medical coverage that is available to you. Please note that the content of these Websites and applications may change from time to time.

Resource	Content	How to Access
UnitedHealthcare's myuhc.com [®] Web site	<ul style="list-style-type: none"> • Assess your personal health habits, learn techniques to stay healthy and get other useful information about general health and wellness. • View (track) your claims information online. • Use the customized physicians directory to find a physician who participates in your local network. • Select a hospital in your area based on its performance review. • Find pharmacy* information to help you make informed decisions regarding medications for you and your family • Simplify how you manage you healthcare account with immediate online access to the answers you need quickly and easily. • Print a temporary ID card or request a replacement card anytime. 	Access myuhc.com .
Definity Health's Web site	<p>Beginning January 1, 2006, UnitedHealthcare consumer-driven health plan members will access definityhealth.com by signing on myuhc.com. This member Web site includes:</p> <ul style="list-style-type: none"> • My Account: View claims activity; track HRA and FSA (when combined with HRA) account balances; and view claims history. NOTE: HSA balances are not viewable on "My Account." • My Benefits: View a snapshot of benefits, SPD and Member Handbook; request a new ID card; and print temporary ID card. • Doctors and Hospitals: Find a physician or other health care professional. • Pharmacy*: Price prescription drugs (retail vs. home delivery, generic vs. brand, pill-splitting, etc.); assess drug interactions; arrange refills and home delivery; and locate a pharmacy. 	Access www.definityhealth.com .

* You must have UnitedHealthcare pharmacy benefits to see pharmacy information on myuhc.com or definityhealth.com.

Resource	Content	How to Access
	<ul style="list-style-type: none"> • Health Care Prices: Use pricing tools to estimate condition, procedure, office visit and/or pharmacy expenses. • Health Resources: Investigate information using Healthwise Knowledgebase, Personal Health Record, health calculators, consumerism tips, and health risk assessment. • Other online Wellness programs. 	
U.S. Department of the Treasury's Web site	<ul style="list-style-type: none"> • Frequently asked questions about HSAs and HRAs; • A link to IRS forms and publications that are contained in the IRS Web site; • Summaries of the tax rules that apply to HSAs; • Links to the technical guidance that IRS and DOL have published about HSAs; and • List of links to other resources that address HSAs. 	Access www.treas.gov.
IRS Web site	<ul style="list-style-type: none"> • Federal tax forms and instructions; • Publications, • Notices, • Revenue procedures, • Private letter rulings, and • Other guidance, all of which address HRAs, HSAs and Health FSAs. 	Accessing www.irs.gov.
IRS Publication 502, <i>Medical and Dental Expenses</i>	Explains the medical and dental expenses that are deductible on your federal tax return.	<ul style="list-style-type: none"> • Via the Internet by accessing www.irs.gov and searching the "Forms and Publications" link. • Via phone by calling 1-800-TAX-FORM 1-800-829-3676 and requesting Publication 502.
IRS Publication 969, <i>Health Savings Accounts and Other Tax-Favored Health Plans</i>	Summarizes some of the tax rules that apply to HRAs, HSAs and Health FSAs.	<ul style="list-style-type: none"> • Via the Internet by accessing www.irs.gov and searching the "Forms and Publications" link. • Via phone by calling 1-800-TAX-FORM (1-800-829-3676) and requesting Publication 969.

It just makes sense.®

Insurance coverage provided by or through: United HealthCare Insurance Company, United HealthCare Insurance Company of New York, or their affiliates.

Administrative services to self-funded plans provided by United HealthCare Services, Inc., United HealthCare Insurance Company, or United HealthCare Service LLC.

Health Plan coverage provided by or through: United HealthCare of Alabama, Inc., United HealthCare of Arizona, Inc., United HealthCare of Arkansas, Inc., United HealthCare of Colorado, Inc., UnitedHealthcare of Florida, Inc., United HealthCare of Georgia, Inc., UnitedHealthcare of Illinois, Inc., United HealthCare of Kentucky, Ltd., United HealthCare of Louisiana, Inc., UnitedHealthcare of the Mid-Atlantic, Inc., United HealthCare of the Midlands, Inc., United HealthCare of the Midwest, Inc., United HealthCare of Mississippi, Inc., UnitedHealthcare of New England, Inc., UnitedHealthcare of New Jersey, Inc., UnitedHealthcare of New York, Inc., UnitedHealthcare of North Carolina, Inc., United HealthCare of Ohio, Inc., United HealthCare of Tennessee, Inc., UnitedHealthcare of Texas, Inc., United HealthCare of Utah, UnitedHealthcare of Wisconsin, Inc.



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