

**SB 340**

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**SENATE COMMITTEE ON HEALTH  
TESTIMONY REGARDING SB 340  
RELATING TO MEDICAL SAVINGS ACCOUNTS**

**TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**

**DATE: FEBRUARY 6, 2009**

**TIME: 9:30AM**

**ROOM: 016**

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This measure proposes to establish medical savings accounts, which allow for pretax contributions by employees and a deduction for contributions by employers.

The Department of Taxation (Department) offers the following comments—

**HEALTH SAVINGS ACCOUNTS ARE ALREADY AVAILABLE**—The Department points out that Hawaii income tax law currently conforms to the provisions in the Internal Revenue Code allowing tax advantaged health savings accounts. Because a similar pretax account is already available for taxpayers, this Medical Savings Account may be unnecessary.

**EMPLOYERS RECEIVE A DEDUCTION FOR HEALTH INSURANCE COSTS**—The medical savings account established in this measure seeks to provide a deduction to employers for contributions of cash to the medical savings account. Employers currently already are incentivized to provide health insurance coverage to the employees.

**EMPLOYEES RECEIVE NO ADDITIONAL BENEFIT BEYOND CURRENT HSAs**—The Department points out that employees will receive no additional benefit than their current HSA opportunities, which are also pretax contributions.

**REVENUE LOSS**—Assuming there is an additional revenue loss due to this bill, the Department cannot support the tax provision in this measure because it is not factored into the budget. The Department must be cognizant of the biennium budget and financial plan. This measure has not been factored into either.

# HMSA



An Independent Licensee of the Blue Cross and Blue Shield Association

February 6, 2009

The Honorable David Ige, Chair  
The Honorable Josh Green M.D., Vice Chair

Senate Committee on Health

**Re: SB 340 – Medical Savings Accounts**

Dear Chair Ige, Vice Chair Green and Members of the Committee:

The Hawaii Medical Service Association (HMSA) appreciates the opportunity to testify on SB 340 which would establish Medical Savings Accounts (MSAs) in Hawaii.

Although federal provisions allow MSAs, the type of high deductible health plan that must be associated with an MSA is not permitted under Hawaii's Prepaid Health Care Act (PHCA) and therefore cannot be offered to employer groups. This removes the majority of consumers from being able to benefit from the creation of MSA affiliated plans.

Additionally, HMSA already offers an individual high deductible health plan but has had very few members choose this plan. We believe from experience that Hawaii consumers have grown accustomed to the plan benefit structure under the PHCA and therefore are less likely to be interested in high deductible products.

Thank you for the opportunity to testify today.

Sincerely,

A handwritten signature in cursive script that reads "Jennifer Diesman".

Jennifer Diesman  
Assistant Vice President  
Government Relations

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Medical savings accounts

BILL NUMBER: SB 340

INTRODUCED BY: Slom

**BRIEF SUMMARY:** Adds a new part to HRS chapter 235 to establish medical savings accounts (MSA). On and after 12/31/09, an employer may offer to establish medical savings accounts and may contribute up to a maximum of \$3,000 to an employee's account. An employee may also establish a medical savings account if his employer does not establish an account. If an employer contributes less than the maximum for a year, the employee may elect to contribute the difference. All employee contributions to medical savings account shall be made on a pretax basis. Employer contributions to an employee's medical savings account shall constitute a deduction from the employer's state taxable income.

Delineates eligible expenses that may be paid out of the account. Requires the employee to submit documentation of medical expenses paid by the employee in the tax year to the account administrator who shall reimburse the employee from the employee's account. Further establishes provisions relating to the use of account moneys and withdrawal of funds.

Moneys in the medical savings account, including interest income, shall not be taxable as Hawaii gross income if they are: (1) in an employee's medical savings account; and (2) withdrawn to pay eligible medical expenses. Moneys in the account shall be taxed as Hawaii adjusted gross income when moneys are withdrawn for purposes other than the payment of eligible medical expenses.

**EFFECTIVE DATE:** July 1, 2009 applicable to tax years beginning after December 31, 2009

**STAFF COMMENTS:** The Health Insurance Portability and Accountability Act (HIPAA), enacted in 1996, established a national test of MSAs in the private health insurance market. Effective January 1, 1997, MSA plans were available to individuals and families eligible for such coverage under the terms of the HIPAA. It should be noted that IRC section 220 (with respect to medical savings accounts) is operable for Hawaii income tax purposes if such accounts have been approved by the secretary of the treasury of the United States. Since Hawaii recognizes the federal provisions relating to the establishment of MSAs, the adoption of this measure would appear to be unnecessary.

Digested 2/5/09

# Health Savings Account

A Health Savings Account (HSA) is a tax-favored<sup>1</sup> account set up exclusively to pay certain medical expenses of the account owner, spouse, and dependents. Health insurance coverage must be provided under a high-deductible health plan. Qualified contributions by the account owner are deductible from gross income and growth inside the account is not taxed. Distributions to pay for qualified medical expenses are received income tax-free. Funds not used during one year can be held over and used to pay qualified medical expenses in a later year even if no further contributions are permitted.



Similar in nature to an Individual Retirement Account (IRA) or Archer Medical Savings Account (Archer MSA), an HSA is owned by an individual and is thus portable. If an individual changes employers, the HSA moves with the individual and does not stay with the former employer even though that employer may have contributed to the HSA.

## Key Concepts

There are a number of key concepts involved in understanding HSAs:

- **Eligible individual:** Only an “eligible individual” may establish, and then contribute to, an HSA. This is someone who on the first day of any month: (1) is covered by a high-deductible health plan (HDHP); (2) is not also covered by another health plan that is not a HDHP<sup>2</sup>; (3) is not enrolled in Medicare (generally, under age 65); and (4) may not be claimed as a dependent on someone else’s tax return.
- **High-deductible health plan:** A health plan that meets certain requirements (adjusted annually for inflation) regarding deductibles and out-of-pocket expenses:

| Coverage Type | 2009 Minimum Deductible | 2009 Maximum Out-of-Pocket |
|---------------|-------------------------|----------------------------|
| Self-Only     | \$1,150                 | \$5,800                    |
| Family        | 2,300                   | 11,600                     |

As a general rule, the HDHP may not provide benefits (except for certain preventive care) until the minimum deductible for the year has been met.

- **Permitted insurance:** An individual is considered to be “eligible” without regard to any coverage he or she may have under certain “permitted” insurance such as worker’s compensation, tort liability, or liability arising from the use or ownership of property (e.g. auto insurance). Also disregarded is insurance for a specific illness or disease or that pays a fixed amount (per day or other period) for hospitalization. Coverage for accidents, disability, dental care, vision care, and long-term care is also disregarded. Flexible Spending accounts are permitted only if they are limited to dental or vision care and/or meet the minimum deductible requirement.

<sup>1</sup> The rules discussed here concern federal income tax law. State or local law may differ.

<sup>2</sup> Certain limited exceptions apply.

*Continued...*

# Health Savings Account

- **A trust or custodial account:** An HSA must be in the form of a trust or custodial account, established with a qualified trustee or custodian, such as an insurance company, bank, or similar financial institution.

## Contributions To An HSA

Contributions to an HSA generally must be in cash:

- **Annual contribution limit:** For 2008 and 2009, the maximum deductible contribution to an HSA is as follows:

| Coverage Type | 2008 Specified Maximum | 2009 Specified Maximum |
|---------------|------------------------|------------------------|
| Self-Only     | \$2,900                | \$3,000                |
| Family        | 5,800                  | 5,950                  |

Federal law allows an individual who becomes covered under a high-deductible plan in a month other than January to make a full, deductible HSA contribution for the year; certain restrictions and limitations apply. Individuals over age 55 may also make “catch-up” contributions of \$900 per year in 2008 and \$1,000 per year thereafter.

- **Individuals who may contribute:** Contributions may be made by an eligible individual, either directly or through a cafeteria plan, or by the individual’s employer. Any person, including family members, may also contribute on behalf of an eligible individual.
- **Deadline for making contributions:** Contributions may be made in one or more payments and must be made no later than the due date for filing the eligible individual’s federal income tax return for the year, generally April 15 of the following year. Contributions may not be made before the first day of the year to which they apply.
- **Income tax treatment of contributions:** Qualified contributions (including contributions by family members) to the HSA by an eligible individual are deductible from the eligible individual’s gross income. Employer contributions to an HSA are excludable from an employee’s income and are not subject to withholding for federal income taxes or for federal payroll taxes.<sup>1</sup> Growth or earnings on the contributions are not taxable while held inside the account. Excess contributions may be subject to a 6% excise tax.
- **Other:** Rollover contributions from an Archer MSA (or another HSA) to a HSA are permitted and need not be made in cash.

<sup>1</sup> Such as the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax (FUTA), or the Railroad Retirement Act (RRA).

Continued...

# Health Savings Account

## Distributions From a HSA

Distributions from an HSA may be made at any time. Distributions used solely to pay for qualified medical expenses for the account owner, spouse, and dependents are excludable from gross income (i.e. tax-free).

- **Qualified medical expenses:** Qualified medical expenses are expenses (incurred after the HSA has been established) for “medical care” as that term is used in IRC Sec. 213(d). Generally, this includes amounts spent for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, to the extent not reimbursed by insurance. Qualified medical expenses do not generally include health insurance premiums.<sup>1</sup>
- **Taxation of amounts not used for qualified medical expenses taxed:** Any distribution from an HSA that is not used for qualified medical expenses is included in the income of the account owner and a 10% penalty is added. The 10% penalty does not apply if a distribution is made because of an account owner’s death, disability, or reaching age 65.
- **No longer an eligible individual:** If an account owner is no longer an “eligible individual” (for example, becoming enrolled in Medicare or no longer being covered by a HDHP), the HSA account may continue to be used. Distributions used solely to pay for qualified medical expenses continue to be received income tax-free.
- **Death of the account owner:** At death, funds in an HSA pass to a named beneficiary. If the beneficiary is a surviving spouse, the account becomes the HSA of the surviving spouse, subject to the normal rules that apply to all HSAs. If the funds in an HSA pass to a non-spousal beneficiary, the account ceases to be an HSA as of the date of death, and the non-spousal beneficiary must include in taxable income the value of HSA assets as of the date of death.<sup>2</sup>

## Tax Relief and Health Care Act of 2006

The Tax Relief and Health Care Act of 2006 (TRHCA 2006) contained a number of provisions designed to promote the use of HSAs. Among these new provisions are:

- **Rollovers from Health FSAs and HRAs into HSAs:** This provision allows certain amounts in a health Flexible Spending Account (FSA) or Health Reimbursement Arrangement (HRA), to be contributed to an HSA in a direct transfer. The amount that may be transferred cannot exceed the lesser of (i) the balance in the FSA or HRA as of September 21, 2006, or (ii) the amount in the FSA or HRA as of the date of transfer. The amount transferred is not deductible, is not taken into account in applying the maximum deduction limitation for other HSA contributions, and is excludable from income. An individual may make only one such distribution from each FSA or HRA.

<sup>1</sup> Certain exceptions apply to qualified long-term care insurance, COBRA health continuation coverage, and health insurance premiums paid by an individual while receiving unemployment compensation. For those over age 65, premiums paid for Medicare Part A, Part B, Part D, a Medicare HMO, or premiums paid under an employer-sponsored health insurance plan also qualify.

<sup>2</sup> Less any qualified medical expenses of the deceased account owner, paid within one year after death.

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# Health Savings Account

An individual who makes such a transfer must remain an eligible individual during a 12 month “testing” period, beginning with the month of the contribution and ending on the last day of the 12<sup>th</sup> month following that month. If the individual does not remain an eligible individual during this testing period, any amounts transferred are included in income and a 10% penalty tax applies.<sup>1</sup> This provision is effective for distributions on or after the date of enactment and before January 1, 2012.

- **Full contribution for months preceding becoming an “eligible” individual:**  
An individual who becomes an “eligible” individual during a month other than January is allowed to make contributions for the months in the year preceding the month he or she enrolls in a HDHP. If an individual makes contributions under this provision, he or she must remain an eligible individual for a “testing period.” The testing period is the period beginning with the last month of the taxable year and ending on the 12<sup>th</sup> month following such month. If an individual makes deductible contributions under this provision and does not remain an eligible individual during the testing period,<sup>1</sup> the amount of contributions made for the months preceding the month the individual became eligible are included in income and a 10% additional tax applies.
- **One time rollovers from IRAs:** This provision allows for a once-in-a-lifetime distribution of amounts from an IRA (either a Traditional IRA or a Roth IRA), in a direct trustee-to-trustee transfer. Amounts distributed under this provision are not includible in income to the extent that they would otherwise be includible in income, and they are not subject to the 10% penalty tax on early distributions. The maximum amount that may be distributed from the IRA and contributed to the HSA is limited to the otherwise maximum deductible contribution amount to the HSA. No deduction is allowed for amount contributed from an IRA to an HSA.

An individual who makes such a transfer must remain an eligible individual during a 12 month “testing” period, beginning with the month of the contribution and ending on the last day of the 12<sup>th</sup> month following that month. If the individual does not remain an eligible individual during this testing period, any amounts transferred are included in income and a 10% additional tax applies.<sup>1</sup> This provision is effective for taxable years beginning after December 31, 2006.

## Seek Professional Guidance

Health Savings Accounts provide a tax favored means to accumulate funds to pay for qualified health care expenses. Because of the complexity of such accounts, the advice and guidance of trained tax and financial professionals is strongly recommended.

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<sup>1</sup> An exception applies for death or disability.



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**From:** Malia Zimmerman [malia@hawaiiireporter.com]  
**Sent:** Thursday, February 05, 2009 8:33 PM  
**To:** HTHTestimony  
**Subject:** testimony in Support of SB 340 - please include in testimony at 3 p.m. in Senate health committee room 016

**Hearing in Senate Health Committee set for Friday, Feb 6, 2009 at 3 p.m. in conference room 016 at the Hawaii State Capitol**

From: "Walt Harvey" <reowalt@earthlink.net>

Senator Ige, Senator Green and Senate Health Committee Members,

We are writing in support of SB 340, which establishes Medical Savings Accounts in Hawaii.

We actually use Medical Savings Accounts (MSAs) already. We love it because our premiums are lower because we have catastrophic coverage with a high deductible. We put the savings in premium cost into the MSA (it's like an IRA) that earns interest and we can cover our deductible when necessary. Last year when Arla fell and broke her ankle, we were covered. We pay our deductible or office bills with a debit card and get a 40% discount! We have a choice of providers! We can negotiate the cost of the health care! We have freedom!

MSAs may not be for people that are sick a lot or need a lot of medications. Thankfully, (except for last year), we don't get sick much. As independent contractors with no employer paid benefits and no 'sick days', we have no incentive to be sick. Sick days are lost opportunity time for us so we tend to stay well.

We feel that MSAs would lower health care costs by cutting the premium costs, reducing the paperwork and allowing the consumer to shop for medical providers. In our view, that's called a "Win-Win-Win"!

Aloha, Walt & Arla Harvey

Walt Harvey (R) Broker-Associate

ABR, CIPS, CRB, CRS, GRI, SRES, AHWD, ePRO, RSPS, TRC, CHNS, QSC, RCC

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and

Arla Harvey (R) Broker-Associate

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LATE

February 6, 2009

To: Senate Committee on Health  
Senator David Y. Ige, Chair  
Senator Josh Green, M.D., Vice Chair

By: Hawaii Medical Association  
April Troutman Donahue, Executive Director  
Richard C. Botti, Government Affairs  
Lauren Zirbel, Government Affairs

Re: 340 RELATING TO MEDICAL SAVINGS ACCOUNTS (MSA)  
380 RELATING TO TAXATION (MSAs)

Chairs & Committee Members:

HMA supports SB 340 and SB 380. MSAs will provide an option that is already available under Federal Law, and can provide the following benefits:

- Can reduce monthly medical premiums;
- Puts the individual in charge of their medical spending;
- Contributions would be tax-deductible at both State & Federal levels;
- Participants pay for medical expenses with pre-tax dollars.
- Interest earned on the account is tax-free.
- Withdrawals for qualified medical expenses are tax-free.
- Unused funds and interest are carried over, without limit, from year to year.
- Participants of the HSA get to take the savings with them when they change plans or retire;
- The plan is administered by a trustee/custodian.
- Can build a reserve that can be used as Long Term Care.

It's a win win for everyone, including government, since without the MSA, government may get stuck with the bills.

We do suggest that anything considered should parallel the federal law for continuity and to reduce confusion.

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**From:** mailinglist@capitol.hawaii.gov  
**Sent:** Friday, February 06, 2009 3:17 PM  
**To:** HTHTestimony  
**Cc:** phahn86@gmail.com  
**Subject:** Testimony for SB340 on 2/6/2009 3:00:00 PM

LATE

**Categories:** Blue Category

Testimony for HTH 2/6/2009 3:00:00 PM SB340

Conference room: 016  
Testifier position: support  
Testifier will be present: Yes  
Submitted by: Pearl Hahn  
Organization: Individual  
Address: 1314 S. King Street Suite 1163 Honolulu, HI  
Phone: 9086425832  
E-mail: [phahn86@gmail.com](mailto:phahn86@gmail.com)  
Submitted on: 2/6/2009

**Comments:**

I respectfully express strong support for this bill and its intentions. Medical savings accounts are a crucial step to lowering the costs of health care and empowering consumers in the confusing health care marketplace. MSAs will allow patients to use funds in their special accounts for routine medical expenses as they please instead of only being allowed to use services prescribed by government officials. MSAs also expand access to a wide variety of services and reduce paperwork burden often involved in federal and state programs. Thank you for the opportunity to testify.