

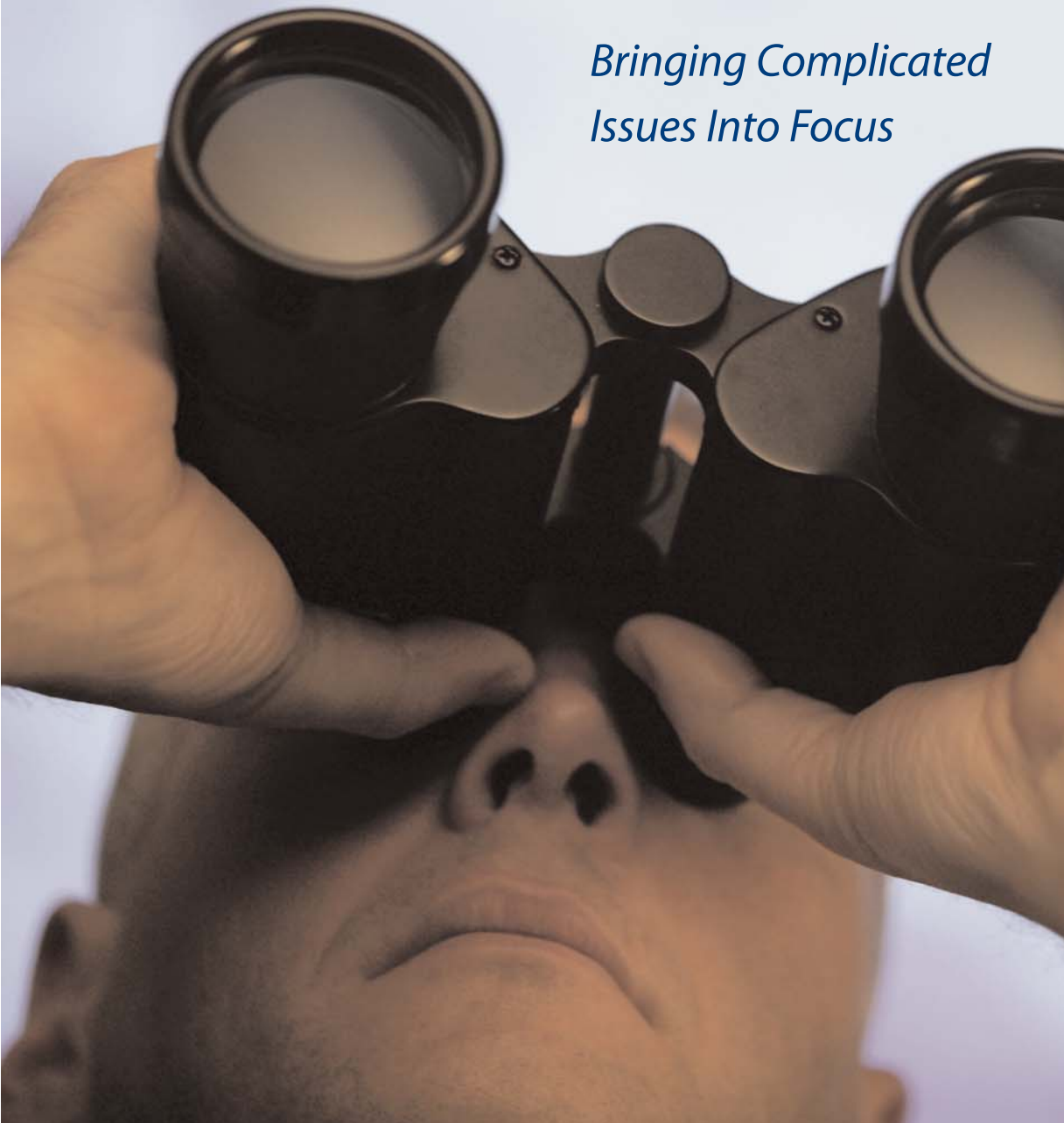
Overview of Health Savings Accounts



BlueCross
BlueShield
of Georgia

The Power of BlueSM Working for You

*Bringing Complicated
Issues Into Focus*



Introduction

This overview is provided as a high-level orientation on Health Savings Accounts (HSAs) in general. It will help you understand the concept of an HSA, as well as its advantages and administration.

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Employers and employees should consult their tax advisors for guidance and comprehensive information about HSAs and other tax-related issues as well as eligibility requirements, definitions of qualified medical expenses, and mid-year contribution amounts. BCBSGA does not provide tax advice, and does not administer employee HSA accounts.

Background

The Medicare Prescription Drug, Improvement and Modernization Act, signed into law in December 2003, established HSAs. This legislation allows eligible individuals, employers or employees to contribute to Health Savings Accounts (HSAs) to cover qualified medical and retiree health expenses on a tax-free basis. The HSA is an individually-owned account that must be paired with an HSA-compatible high-deductible health plan (HDHP).

HSA Advantages

The HSA is designed to empower consumers by giving them more control over how they save for and manage their health care expenses. The advantages of an HSA can be broken down into two areas - savings benefits and tax benefits:

Savings Benefits

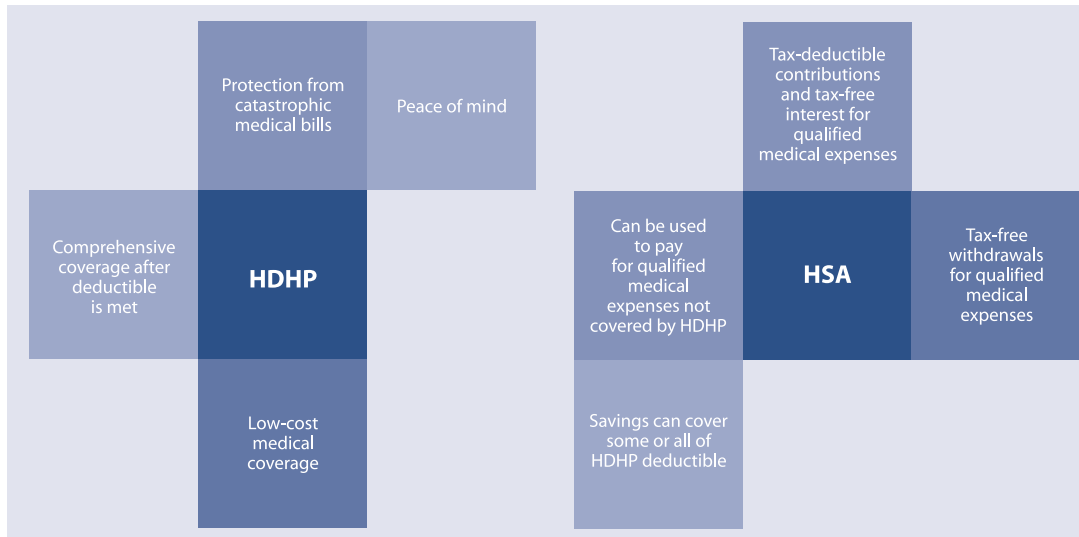
- HSA funds can be used to pay for qualified medical expenses not covered by the HDHP
- Money not spent rolls over to the following year
- Potential exists to build significant balances after years of tax-free contributions and interest growth

Tax Benefits (subject to IRS Rules)

- Individual/employee HSA contributions are tax-deductible up to the IRS maximum
- Employer contributions are exempt from federal employment taxes
- Interest earned on HSA funds is tax-advantaged
- HSA withdrawals are tax-free for qualified medical expenses

How HDHPs and HSAs Work Together

HDHPs and HSAs work hand-in-hand to provide consumers with the medical coverage they need and an account to help them pay for what's not covered. Enrollment in a qualified HDHP is required to establish an HSA.



What Kind of Tax Savings are Possible with an HSA?

The following scenario illustrates potential federal tax savings for an individual who makes the maximum amount of contributions to a qualified HSA plan in 2005, when income tax is paid at various rates.

Total Yearly HSA Contributions		Tax Rate		Potential Federal Income Tax Savings
\$2,650	X	35%	=	\$927.50
		33%		\$874.50
		28%		\$742.00
		25%		\$662.50
		15%		\$397.50

Important: This is just an illustration; Blue Cross and Blue Shield of Georgia does not provide tax advice and urges all individuals to seek guidance from a qualified tax advisor to determine their specific savings potential.

Employers and employees should consult their tax advisors for guidance and comprehensive information about HSAs and other tax-related issues as well as eligibility requirements, definitions of qualified medical expenses, and mid-year contribution amounts. BCBSGA does not provide tax advice, and does not administer employee HSA accounts.

Step by Step: How HSAs Work

- 1. Application/Enrollment:** An individual applies for an HSA-compatible HDHP. Or, an employer offers their employees the option of enrolling in an HSA-compatible HDHP. The individual/employee enrolls in the HDHP.
- 2. Open HSA:** The individual/employee opens an HSA at a qualified bank or financial institution. BCBSGA does not administer the HSA.
- 3. Contributions:** The individual/employee and/or the employer contributes up to the annual maximum. See question 10 in the Q&A for details. Employee contributions are tax-deductible on their annual return and employer contributions are exempt from federal employment taxes (e.g., income, FICA, FUTA).
- 4. Pay for expenses:** The individual/employee withdraws money from the account to pay for qualified medical expenses, such as plan deductibles and necessary medical services not covered by the plan.
- 5. Unused balances:** At the end of the year, unused HSA funds roll over to the following year. In the event that the individual/employee terminates his/her HDHP, funds in the HSA remain the sole property of the individual/employee. Contributions to the HSA are not permitted when there is no qualified HDHP coverage, but funds can still be withdrawn from the HSA tax-free for qualified expenses.



Questions and Answers

Q1. What is the new HSA regulation?

Section 1201 of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 added Section 223 to the Internal Revenue Code to permit eligible individuals to establish HSAs for taxable years beginning after December 31, 2003.

Q2. What is a Health Savings Account (HSA)?

HSAs were created to help eligible individuals save for qualified medical and retiree health expenses on a tax-advantaged basis. HSA contributions are tax-deductible and withdrawals are tax-free, provided they are used to pay for current and future “qualified medical expenses.”

Q3. What is an HSA-compatible high-deductible health plan (HDHP)?

Individuals/employees must first be enrolled in an HSA-compatible HDHP before they can set up an HSA. To qualify as an HSA-compatible HDHP for 2005, the plan must:*

- Have a minimum deductible of \$1,000 and annual out-of-pocket maximum (including deductibles, coinsurance, copayments, but not premiums) not exceeding \$5,100 for individuals
- Have a minimum deductible of \$2,000 and annual out-of-pocket maximum not exceeding \$10,200 for family coverage
- Apply costs for doctor visit and prescription drugs to the annual medical deductible
- Not provide benefits (except for certain preventive care benefits) until the deductible for that year has been met

Q4. Who owns the HSA?

The individual/employee. It is a personal, portable account that remains theirs if they are no longer enrolled in an HDHP. If an employee changes jobs, their HSA follows them.

Q5. Who administers an HSA?

HSAs are opened and maintained at an HSA-qualified bank or financial institution.

Q6. How does an eligible individual establish an HSA?

1. First, the individual/employee must be enrolled in an HDHP.
2. Then, the individual or employee is responsible for setting up the HSA at a qualified bank or financial institution.
3. Each year, money can be contributed to the HSA, subject to a maximum annual contribution (see question 10). The money in the HSA can be used to pay their deductible and qualified medical expenses. Once the deductible is met, the health plan pays for covered medical expenses.
4. Any money remaining in the HSA at the end of the year rolls over to the next year. Any eligible individual can establish an HSA with a qualified HSA trustee or custodian, in much the same way that individuals establish IRAs with qualified IRA trustees or custodians. No permission or authorization from the IRS is necessary to establish an HSA.

* These amounts may be indexed annually for cost of living adjustments by the U.S. Treasury Department.

Employers and employees should consult their tax advisors for guidance and comprehensive information about HSAs and other tax-related issues as well as eligibility requirements, definitions of qualified medical expenses, and mid-year contribution amounts. BCBSGA does not provide tax advice, and does not administer employee HSA accounts.

Q7. Who is eligible for an HSA?

An eligible individual is anyone who:

- Is covered under a high-deductible health plan on the first day of the qualifying month
- Does not have coverage through an additional plan that is not a qualified HDHP
- Is not enrolled in Medicare
- May not be claimed as a dependent on another person's tax return

Individuals are still eligible for an HSA if they have coverage for accidents, disability, dental care, vision care or long-term care, in addition to a qualified HDHP.

Q8. Who may contribute to the HSA?

Any eligible individual/employee or employer may contribute to an HSA. Individual contributions are tax deductible from gross income. Employer contributions are exempt from federal employment taxes (e.g., income, FICA and FUTA).

Q9. Who else can contribute to an HSA?

Any individual can make a contribution to an HSA on behalf of an eligible individual, subject to the maximum annual contribution.

Q10. How much may be contributed to an HSA?

Contribution guidelines vary for singles and families:

- **Singles:** In 2005, the annual contribution maximum for members enrolled in an eligible HDHP for the full 12 months is \$2,650 or the full amount of the HDHP deductible, whichever is less. For members enrolled less than 12 months, their annual maximum contribution is a prorated portion of their deductible, depending on the number of full months they have been enrolled in the eligible HDHP that year.
- **Families:** In 2005, the annual contribution maximum for members enrolled in an eligible HDHP for the full 12 months is \$5,250 or the full amount of the HDHP deductible, whichever is less. For members enrolled less than 12 months, their annual maximum contribution is a prorated portion of their deductible, depending on the number of full months they have been enrolled in the eligible HDHP that year.
- Participants who are 55-65 can make additional catch-up contributions of \$600 in 2005, increasing \$100 per year until 2009 when it becomes \$1,000.

Q11. When can a member contribute to an HSA?

The IRS has determined that a member cannot contribute to his/her HSA unless their HDHP is in effect at the beginning of that month. For example:

- A member with an HDHP in effect on September 1 may begin contributing to their HSA on September 1
- A member with an HDHP in effect on September 2 or later in the month may not begin contributing to their HSA until October 1

Contributions for the current year must be made by April 15 of the following year. For example, all contributions for 2005 must be made by April 15, 2006.

Questions and Answers

Q12. When is an individual permitted to withdraw funds from an HSA?

Individuals are permitted to withdraw money from an HSA any time after the HSA is established, even if they are not currently enrolled in a qualified HDHP.

Q13. What are “qualified medical expenses” that are eligible for tax-free distribution?

A qualified medical expense is any health care cost as defined in the Internal Revenue Code (IRC Section 213 [d]), but only to the extent the expenses are not covered by the HDHP. For examples of qualified medical expenses, see Appendix A - Examples of Qualified Medical Expenses. The qualified medical expenses must be incurred after the HSA has been established. The individual account holder is responsible for determining whether expenditures are for qualified medical expenses.

Q14. Are health insurance premiums qualified expenses?

Generally, no, except in the following instances:

- Qualified long-term care insurance
- COBRA health care continuation coverage
- Health care coverage while an individual is receiving unemployment compensation

Q15. Can HSA funds be used for non-medical expenses?

Non-medical distributions from an HSA are included in gross income and are therefore taxed, as well as subject to a 10 percent penalty.

Q16. Who will determine whether something is a qualified medical expense?

It is the member's responsibility to ensure that the funds from the account are being used for qualified medical expenses. On annual tax returns or in the event of an audit, it will be the member's responsibility to document and demonstrate the appropriate use of these funds for the IRS. The bank or financial institution administering the HSA will not determine if the funds are being used for qualified medical expenses.

Q17. Can IRA, HRA or FSA funds be rolled into an HSA?

Rollovers from an IRA, a health reimbursement account (HRA) or flexible spending account (FSA) to an HSA are **not** permitted.

Q18. Does the HSA replace the Archer Medical Savings Account (MSA)?

Yes. The U.S. Treasury Department is replacing Archer MSAs with HSAs. Funds in an existing MSA may be rolled-over to an HSA without penalty. Tax-free rollovers from Archer MSAs to HSAs are permitted, however subscribers who already have Archer MSAs may keep them.

Employers and employees should consult their tax advisors for guidance and comprehensive information about HSAs and other tax-related issues as well as eligibility requirements, definitions of qualified medical expenses, and mid-year contribution amounts. BCBSGA does not provide tax advice, and does not administer employee HSA accounts.

Q19. What are the tax benefits of an HSA?

The tax benefits (if all IRS requirements are met) include:

- Individual/employee HSA contributions are tax-deductible
- Employer contributions are exempt from federal employment taxes
- Interest earned on HSA funds is tax-free if used for qualified medical expenses
- HSA withdrawals are tax-free if used for qualified medical expenses

Q20. What are the savings advantages of an HSA?

The savings benefits include:

- HSA funds can be used to pay for current and future qualified medical expenses
- Balance is rolled over to the following year
- An opportunity exists to build significant balances after years of tax free contributions and interest

Q 21. What happens to the HSA if a member terminates employment?

If a member's HDHP is terminated along with employment, the member is no longer eligible to contribute to their HSA until a qualified HDHP is once again in effect.

Upon HDHP termination, the member has several options for the funds already in the HSA, including:

- Leave the funds in the HSA where they will continue to earn interest
- Rollover the funds to another financial institution that is a qualified HSA custodian
- Withdraw any amount of the funds for qualified medical expenses on a tax-free basis as they would normally
- Withdraw any amount of the funds for non-qualified medical expenses, in which case the entire amount of the withdrawal will be taxed and penalized 10% by the IRS

Appendix A

Examples of Qualified Medical Expenses

- Prescription drugs, including birth control pills
- Doctor visits, lab, X-ray and other diagnostic and treatment services
- Car controls for the physically challenged
- Christian Science practitioner services
- Coinsurance costs for health care, prescription drug and dental plans
- Dental X-ray, fillings, extraction and dentures
- Orthodontia (such as braces)
- Specially installed equipment if primary purpose is health care
- Eyeglasses, contact lenses, and solution
- Guide dog or other animal, including its maintenance
- Hearing aids and batteries
- In-vitro fertilization
- Remedial reading lessons for a child with a severe learning disability
- Laser eye surgery
- Routine physical exams
- Stop-smoking programs

Employers and employees should consult their tax advisors for guidance and comprehensive information about HSAs and other tax-related issues as well as eligibility requirements, definitions of qualified medical expenses, and mid-year contribution amounts. BCBSGA does not provide tax advice, and does not administer employee HSA accounts.

- Special school costs, including tutoring fees and tuition, for physically challenged or mentally impaired
- Transportation to and from health care providers
- Vitamin and mineral supplements that can be obtained only by prescription
- Qualified long-term care services and long-term care insurance
- Medicare Part A and B premiums, Medicare HMO or Medicare Advantage premiums
- Retiree health expenses for those 65 and older
- COBRA premiums and health insurance for those on unemployment compensation

Please note these are examples only and may be subject to change. Please refer to the Qualified Medical Expenses as defined in the Internal Revenue Code (IRC Section 213 [d]).

Appendix B AAHP-HIAA Comparison of Tax-Advantaged Health Care Spending Accounts

Feature	Archer Medical Savings Accounts (MSAs) ¹	Health Savings Accounts (HSAs) (as approved in the new Medicare legislation)
Overview	A tax-exempt trust or custodial account with a financial institution in which account holders can save money exclusively for future qualified medical expenses (Authorized under 26 USC 220.)	A tax-exempt trust or custodial account created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse or dependents.
Who is eligible to set up an account?	An employee (or the spouse of an employee) of a small employer (50 or fewer employees) covered by an individual or family high deductible health plan (HDHP), and a self-employed person (or the spouse of a self-employed person) who maintains an individual or family HDHP.	Individuals and families covered by <i>qualified high-deductible health plan</i> . Individuals and families cannot be covered by any other health plan that covers the same benefits as the high deductible health plan. ³
What are the requirements for the corresponding health plan?	<p><i>High deductible health plan:</i></p> <p>For 2003, self-only deductible must be between \$1,700 and \$2,500, with an out-of-pocket maximum of not more than \$3,350; family deductible must be between \$3,350 and \$5,050, with an out-of-pocket maximum of \$6,150.</p> <p>Plan can provide first-dollar coverage of preventive care and still be qualified.</p>	<p><i>Qualified high-deductible health insurance:</i></p> <p>For 2005, self-only deductible must be at least \$1,000 for self-only coverage; \$2,000 for family coverage.⁴ The maximum of the deductible and annual out-of-pocket expenses required to be paid under the plan (i.e. co-payments and coinsurance, not premiums) is \$5,100 for self only; \$10,200 for family. These limits are indexed to the CPI.</p> <p>Plan can provide first-dollar coverage of preventive care and still be qualified.</p> <p>For PPO's, deductible and out-of-pocket amounts apply only to in-network services.</p>
Who may contribute to the account?	Either the employee or the employer, but an employee and an employer may not both make contributions to the MSA in the same year.	Either the account holder or the employer or both.
What are the limits on contributions?	<p>75% of the amount of the annual health plan deductible for family coverage; 65% of deductible for self-only coverage, subject to an income limit.</p> <p>Contributions cannot exceed the amount earned for the year from one's employer or, if self-employed, net self-employment income.</p>	Up to 100% of the deductible amount of the accompanying high-deductible health insurance policy, up to a maximum in 2005 of \$2,650 for a self-only account, \$5,250 for a family account. Future year limits indexed to the CPI.

¹ MSAs were authorized as a demonstration program under the Health Insurance Portability and Accountability Act of 1996 (HIPAA). The program, which has been reauthorized in the past, expired at the end of 2003. The House has passed a bill (H.R. 3521) extending the sunset date for Archer MSAs from 2003 to 2004. A companion Senate bill (S. 1896) has not yet been passed.

² Cafeteria plans are plans under which participants may choose among 2 or more benefits consisting of cash and qualified benefits.

Flexible Spending Arrangements (FSAs)	Health Reimbursement Arrangements (HRAs)
<p>A type of cafeteria plan authorized under Section 125 of the Internal Revenue Code.² Separate FSAs can be set up to cover each of the following types of expenses:</p> <ol style="list-style-type: none"> 1. Health insurance premiums (known as “premium-only plan”); 2. Qualified medical expenses; 3. Dependent care expenses. 	<p>An employer funded account that reimburses employees for qualified medical care expenses, typically combined with a high-deductible health plan.</p>
<p>An employee whose employer offers an FSA option. Employees may also set up a Dependent Care Account for qualifying dependents:</p> <ul style="list-style-type: none"> - A child under 13 claimed as a dependent for income taxes; - A spouse incapable of self-care; - A child 13 or older, parent, sibling, in-law incapable of self-care and claimed as a dependent for income taxes. 	<p>An employee whose employer offers an HRA.</p>
<p>No health plan requirements.</p>	<p>No health plan requirements.</p>
<p>The employee, employer, or both. Usually funded by employees, who choose to set aside a certain amount of their pay in an FSA account.</p>	<p>Solely the employer.</p>
<p>No limits under federal income tax law for FSAs set up to pay for qualified medical expenses or health insurance premiums; employers typically set limits.⁵</p>	<p>No federal income tax law limits. Employers typically set limits, usually equal to or less than the amount of the deductible of employees’ health plan.</p>

³ An outstanding question is whether HRAs or FSAs would be considered another health plan, or acceptable complementary arrangements.

⁴ The family deductible applies to the entire family as a unit, not to individuals as is more commonly the case in most health insurance policies.

⁵ Limit for Dependent Care Accounts is \$5,000 per family per calendar year for single taxpayers with dependents, or for married taxpayers who file a joint income tax return.

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Appendix B AAHP-HIAA Comparison of Tax-Advantaged Health Care Spending Accounts

Feature	Archer Medical Savings Accounts (MSAs)¹	Health Savings Accounts (HSAs) (as approved in the new Medicare legislation)
What are qualified medical expenses?	<p>Unreimbursed, qualified medical expenses as defined in Section 213(d) of the Internal Revenue Code, except (in general) for health insurance premiums: e.g., amounts paid for doctors' fees, prescription medicines, and necessary medical services not paid for by insurance (including many over-the-counter medications).</p> <p>MSA funds generally cannot be used to pay health insurance premiums; however, there are certain exceptions. See below ("When can funds be used to pay health insurance premiums?").</p>	Same as Archer MSAs.
When can funds be used to pay health insurance premiums?	<ol style="list-style-type: none"> 1. While receiving unemployment benefits. 2. While receiving COBRA continuation benefits. 	<ol style="list-style-type: none"> 1. While receiving unemployment benefits. 2. While receiving COBRA continuation benefits. 3. When age 65 or over for any health insurance except Medicare supplemental policies.
Can funds be used to pay for long-term coverage?	Yes, premiums for long-term care insurance are reimbursable.	Same as Archer MSAs.
Are withdrawals for non-medical expenses allowed?	Yes, but distributions not used exclusively to pay "qualified medical expenses" are included in income and are subject to a 15% additional tax – except when the individual is age 65 or older, disabled, has died during the year.	Same as Archer MSAs, except the additional tax penalty is 10%.
What is the tax treatment of contributions?	Employee contributions are tax deductible. Employer contributions are excludable from gross income and not subject to employment taxes (e.g. FICA).	Same as Archer MSAs.
Can funds be carried over from one year to the next?	Yes. MSA funds may be carried over indefinitely during a participant's lifetime. Upon a participant's death, an MSA may be passed on to a surviving spouse without federal tax liability.	<p>Same as Archer MSAs.</p> <p>In addition, unspent funds from an Archer MSA may be rolled over into an HSA.</p>
Are accounts portable?	Yes. Employees may take funds with them when they leave or change jobs.	Same as Archer MSAs.
Does interest accrue on funds deposited in the account?	Yes. Interest accrues tax-free.	Same as Archer MSAs.

Flexible Spending Arrangements (FSAs)	Health Reimbursement Arrangements (HRAs)
Same as Archer MSAs.	Unreimbursed qualified medical expenses as defined in Section 213(d) of the Internal Revenue Code, including health insurance premiums.
A separate FSA (“premium only plan”) can be set up to pay the employee’s contribution toward the monthly cost of health insurance. Under a salary reduction agreement, the employee agrees to contribute a portion of salary on a pre-tax basis to pay for qualified benefits.	In general, funds can be used to pay for premiums under: 1. The employee’s health plan 3. The employer’s retiree health plan 2. A spouses’s health plan 4. COBRA continuation coverage. However, premiums that may be paid by salary reduction may not be paid from an HRA.
No, the Internal Revenue Service code specifically excludes long term care insurance as a qualified benefit under a cafeteria plan; so long term care insurance premiums are not reimbursable under an FSA.	Same as Archer MSAs.
No.	No.
Employees pay no federal, Social Security or (in most states) state taxes on FSA contributions. Employers pay no FICA tax or federal or state unemployment taxes on FSA contributions.	Employer contributions are generally excludable from employee’s gross income. However, an arrangement that distributes the unused HRA amount at termination either as a death benefit or as a severance payment will not qualify as an HRA. Employers receive expense deductions for payments.
No. Unused FSA balances are forfeited at the end of the year.	Yes. Unused amounts in an HRA may be carried over, subject to any limits set by the employer.
No. Unused FSA balances are forfeited if the employee leaves or changes jobs.	Yes, but only at discretion of the employer.
No. Interest is not accrued.	There is no requirement that interest accrue but employers have discretion to credit interest to the HRA accounts.

Read the Contract Carefully.

This summary of benefits provides only a brief description of the important features of plans for your clients and their employees. This is not the insurance contract and only the actual policy will control. The contract sets forth in detail the rights and obligations of the employee and Blue Cross and Blue Shield of Georgia. It is, therefore, important that everyone READ THE CONTRACT CAREFULLY.

Other Insurance Plans

An individual or employee cannot be enrolled in any other medical plan that is not a high-deductible health plan (HDHP) to be eligible for a health savings account (HSA).

Regarding BCBSGA HDHPs: U.S. Treasury regulations require conformity of state laws with federal regulations and statutes by January 1, 2006 for continued approval and tax-exempt status. Consultation with a tax advisor is recommended.

This brochure provides general information only and is not intended to be a substitute for the advice of a qualified tax professional. If you are considering an HSA, you should consult a qualified tax advisor who can evaluate your particular needs and circumstances. A high-deductible health plan is not an MSA or HSA. An MSA or HSA, which must be established for tax-advantaged treatment, is a separate arrangement between the individual and a bank or other qualified institution. One must be an eligible individual under IRS regulations to receive the MSA or HSA tax benefits. Consultation with a tax advisor is recommended.

HSA administration provided through Chase.



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