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BULLETIN 23-03

To: Consumers, Employers, Health Carriers, and Health Maintenance Organizations

From: Carter Lawrence, Commissioner
Carter Lawrence (May 10, 2023 16:34 CDT)

Date: May 10, 2023

RE: Potential Unintended Tax Consequences for Individuals with High-Deductible Health Plans and Health Savings Accounts

The Tennessee Department of Commerce and Insurance (the "Department") issues this bulletin to address the potential unintended tax consequences for Tennessee policyholders who have high-deductible health plans (HDHPs) and health savings accounts (HSA).

Section 223 of the Internal Revenue Code allows eligible individuals to deduct contributions to HSAs. One of the requirements for this deduction is that the individual must be covered by an HDHP. HDHPs must meet certain requirements outlined in federal law, including minimum deductibles and maximum out-of-pocket expenses. Generally, under Section 223(c)(2)(A), an HDHP may not provide benefits for any year until the minimum deductible for that year is satisfied. This restriction does not apply to third-party payments made toward preventative care or any cost-sharing occurring after the annual deductible has been reached. If third-party payments are applied before the individual's HDHP annual deductible is met, with the exception of third-party payments made toward preventative care, the tax benefits provided by the HSA could be lost and potentially create a serious tax event for the individual.

Tenn. Code Ann. § 56-7-3205(a) requires insurers to apply cost sharing amounts paid by the enrollee, or on behalf of the enrollee by another person, toward the enrollee's contribution to an applicable cost sharing requirement. These cost sharing amounts include copayments, coinsurance, deductibles, or other similar annual limitations on cost sharing.

The Department cautions Tennesseans who are enrolled in an HDHP with an HSA to carefully apply cost sharing amounts toward their annual deductible to avoid losing the tax benefits of an HSA, while also taking advantage of the benefit provided in Tenn. Code Ann. § 56-7-3205(a). The Department encourages Tennesseans to review the guidance in IRS Notice 2004-50, 2004-33 I.R.B. 196, Q&A-9, which provides that an individual covered by an HDHP, who also has a discount card for health care services or products, may still contribute to an HSA, provided that the individual is required to pay the costs of the covered health care until the minimum annual deductible for the HDHP is satisfied. In other words, the minimum annual deductible may only be satisfied by actual medical expenses the covered individual incurred. For example, if a covered individual is prescribed a drug that costs $1,000, but a discount from the drug manufacturer reduces the cost to the individual to $600, the amount that may be credited towards satisfying the deductible is $600, not $1,000. This same principle also applies to a third-party payment, such as a rebate or coupon, that has the same effect as a discount.

The Department encourages employers offering HDHPs to notify employees and all insurance issuers providing HDHP products in Tennessee to notify insureds of these circumstances.

This bulletin has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for tax, legal, or accounting advice. You should consult your own tax, legal, or accounting advisors before engaging in any transaction.

Please contact the Department at ask.tdci@tn.gov if you have any questions or if you need additional information.