Comments

EMPLOYEE DRIVEN HEALTH CARE: HEALTH SAVINGS ACCOUNTS, MORE HARM THAN GOOD

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I. INTRODUCTION

Pam Wimbish, a 54 year old furniture sales representative from Aurora, Illinois, was the first American to open a health savings account (HSA).[1] Ms. Wimbish, accustomed to relatively good health, needed to buy her own health insurance because of a job change.[2] She chose a health insurance plan with a high deductible and a low monthly premium, allowing her to open an HSA.[3] When Ms. Wimbish later faced her most costly medical situation in years, which required surgery, she carefully reviewed her treatment options and successfully negotiated down the price of treatment.[4] Ms. Wimbish's HSA effectively empowered her to control her own health care decisions, thus motivating her to reduce the cost of her treatment. After her surgery, Ms. Wimbish was prescribed antibiotics and painkillers, but she only filled the prescription for the antibiotics, explaining, "In the past, my attitude would have been, 'Just have all the prescriptions filled because insurance was paying for it, whether I need them or not.'"[5]

President Bush strongly supports HSAs, praising them for giving individuals control of their own health care choices.[6] In a set of remarks by

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1. Sarah Lueck, *Decisions, Decisions: Health Savings Accounts Give Consumers More Incentive to Manage Their Health Care Costs. But Will They Have the Knowledge?* WALL ST. J., Oct. 11, 2004, at R5.

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. President George W. Bush, Remarks by the President in a Conversation on Health

the President issued by the White House, President Bush remarked that "inherent in the health savings accounts are savings, savings for employers, savings for employees."[7] President Bush also explained how he expected HSAs to work.

> [O]ne of the great elements about health savings accounts is that all of a sudden the consumer starts being more in charge of the decision making process. . . . [T]he consumer can make choices. And when consumers make choices, it then encourages them to start making healthy choices, particularly when you get to save money, when it's like your money on the line.[8]

This assessment of HSAs is overly optimistic. While HSAs can and do, as in the case of Ms. Wimbish, empower consumers to lower their health care cost, they are not a comprehensive solution to the health care financing problems facing the United States. HSAs change the traditional model of employment based health benefits in ways that could ultimately be harmful to employees, decreasing their overall compensation and increasing their health care related costs. However, for small businesses and the self employed, HSAs provide an opportunity to take advantage of tax benefits (similar to those provided to employers when they help finance traditional health insurance for their employees) in order to better manage their health care costs. Thus, HSAs, while not a solution to the health care problems facing the United States, have the potential to be a good first step towards meaningful health care reform.

In this Comment I will argue that the potential benefits of HSAs are outweighed by their costs in the context of employment based health care benefits. In Part II, I review the history and tax status of employment based health care benefits. Next, in Part III, I discuss the purpose, details, general benefits and general costs of HSAs. Finally, in Part IV, I discuss the impact of HSAs on employment based benefits, focusing on the benefits of HSAs to employers and the tendency of HSAs to shift the costs of health care from employers to employees.

II. EMPLOYMENT BASED HEALTH BENEFITS

Employers are the dominant source of health care benefits in the United States. Employment based health care benefits cover approximately 60% of the population.[9] Of those Americans privately insured, over 80%

Access (March 16, 2004), http://whitehouse.gov/news/releases/2004/03/20040316-5.html.

7. *Id.*

8. *Id.*

9. Carolyn V. Juárez, *Liberty, Justice, and Insurance for All: Re-Imagining the Employment Based Health Insurance System*, 37 U. MICH. J.L. REFORM 881, 884 (2004).

get their insurance through their employer. [10] Employers began offering benefits on a large scale during the Great Depression. [11] The employment based benefit system then expanded dramatically during the Second World War as an alternative source of compensation in light of wage freezes.[12] Finally, in 1954, employer payments for health care coverage became exempt from corporate, payroll, and income taxes.[13] This effectively cemented the role that employer based benefits now play in the American health care system.

A. Tax Status of Employment Based Benefits

The tax exempt status of employer provided health insurance begins to explain why it has become the dominant source of private health care financing in the United States. "Because each premium dollar of employer-sponsored health insurance results in a reduction of taxes collected, the federal government is in essence subsidizing employer sponsored health insurance."[14] This government subsidy essentially pays a large portion of the American health care bill. In 2004, the federal and state estimated tax expenditure on the tax favored status of employment based benefits was projected to be $209.9 billion.[15] The federal government alone spent more that $122 billion on the tax favored treatment of employer based health plans.[16]

The tax favored status of employment based benefits does not completely explain why so many employers provide their employees with health care benefits. Employers offer health insurance benefits to their employees for a number of additional reasons, including: to improve recruitment and retention, to remain competitive within their industry or region, to improve employee morale and performance, to increase employee loyalty, and to keep employees healthy, thereby decreasing absenteeism and increasing overall productivity.[17] The longstanding tradition of employers providing their employees with health benefits may also create an expectation on the part of employees that their employers will provide them with such benefits.

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10. Sherry A. Glied & Phyllis C. Borzi, *The Current State of Employment-Based Health Coverage*, 32 J.L. MED. & ETHICS 404, 405 (2004).

11. *Id.* at 404.

12. *Id.*

13. *Id.*

14. Thomas Bodenheimer & Kevin Grumbach, *Paying for Health Care*, *in* HEALTH CARE LAW AND ETHICS 894, 897 (Mark A. Hall et al. eds., Aspen Publishers, 6th ed. 2003).

15. Glied & Borzi, *supra* note 10, at 405.

16. *Id.*

17. *Id.*

B. *Availability of Employment Based Benefits*

While the convention of employers providing employees and their families with health insurance can be credited as a major benefit to society, the provision of such benefits is not uniform. "Employment-based coverage is much less available to those who work in certain industries (e.g., agriculture, retail, and food service), temporary and part-time employees, and those who work for small businesses."[18] In fact, the availability of health insurance to employees is directly linked to the size of the firm for which they work.

> Workers in nearly all midsize and large businesses are offered health benefits by their employer (95% of workers in firms with more than 100 employees); however, only about half (54%) of workers in firms with less than ten employees, and 72 percent of workers in firms with 10 to 24 employees, are offered coverage.[19]

Not only does employment not automatically lead to health benefits, "[t]he large majority of the uninsured come from families with at least one member who is working outside the home."[20] The lack of universal availability is just one of the many problems facing the employment based system.

Even employees who are offered insurance through their employer may not obtain such insurance because of its cost.[21] The required employee contributions to insurance premiums make even employer subsidized insurance unaffordable to many.[22] However, while participation in employer sponsored health plans does vary across family income level, it does not do so dramatically.[23] Family income can also affect access to employer based insurance; "the poor and near-poor have the greatest risk of being uninsured."[24] Families whose income is less than 200% of the poverty level have less access to job based insurance.[25]

There are also concerns that the availability of health insurance for

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18. David A. Hyman & Mark Hall, *Two Cheers for Employment Based Health Insurance*, 2 YALE J. HEALTH POL'Y L. & ETHICS 23, 26 (2001) (citing CATHY SCHOEN & KAREN DAVIS, THE COMMONWEALTH FUND ISSUE BRIEF: EROSION OF EMPLOYER-SPONSORED HEALTH INSURANCE COVERAGE (1998), http://www.cmwf.org/programs/insurance/schoen_erosion_ib_297.asp.).

19. Catherine Hoffman, Diane Rowland & Alicia L. Carbaugh, *Holes in the Health Insurance System—Who Lacks Coverage and Why*, 32 J.L. MED. & ETHICS 390, 391 (2004).

20. *Id.* at 394.

21. Glied & Borzi, *supra* note 10, at 406.

22. Hoffman, Rowland & Carbaugh, *supra* note 19, at 391.

23. *Id.* Eighty-seven percent of workers in poor families participate in employer based plans, while ninety-six percent of workers from families making at or above 400% of the poverty level participate.

24. *Id.* at 394.

25. *Id.* at 391.

employees could lead to decreases in salary. Employer contributions to health plans are essentially a form of compensation, despite their exclusion from gross income for tax purposes.[26] Thus, employers could choose to provide benefits in lieu of appropriate cash compensation instead of in addition to it.

Employer provided health benefits can also diminish employees' job mobility by discouraging employees from leaving jobs for fear of losing benefits and by limiting employees' choices regarding insurance carriers.[27] Another concern attributed to employment based health insurance is that an employer's decision to switch coverage options may affect employees' existing relationships with their doctors by changing the doctors that are covered by insurance.[28]

One perspective on this is that "[m]ost of the difficulties with employment based insurance stem from the fact that someone other than the ultimate consumer of health care is making most of the decisions about what coverage to purchase and how much to pay."[29] Congress has attempted to address this concern with the creation of health savings accounts.

Despite all of the problems and concerns with employment based health insurance discussed above, "[s]urveys show that employees are generally satisfied with their employment-based coverage."[30]

III. HEALTH SAVINGS ACCOUNTS

A. The Purpose of HSAs

Health expenses in the United States are paid primarily through a third party payor system. Under this system, individuals purchase health insurance and insurers pay most point of service costs directly to doctors and hospitals. There is concern that if patients do not manage and treat the dollars that go towards their health care as their own, any attempt to curb medical inflation will be elusive because patients have no incentive to reduce their use of medical services.[31] Health savings accounts were created to "reflect the need for individuals to accumulate assets for future health care costs and to make cost-conscious spending decisions about health care expenses to help reduce the rising cost of health care."[32] These

26. Juárez, *supra* note 9, at 897.
27. Glied & Borzi, *supra* note 10, at 406.
28. *Id.*
29. Hyman & Hall, *supra* note 18, at 26–27.
30. Juárez, *supra* note 9, at 894.
31. Stephen J. Warrell, *Update of Health Savings Accounts: An Affordable Alternative to Health Insurance*, 12 NEV. LAW. 10, 10 (April 2004).
32. Health Savings Account Availability Act, H.R. REP. NO. 108-177, at 9–10 (2003).

accounts "are meant to help reduce wasteful spending by involving consumers more directly in weighing the costs of alternative types of care."[33]

Former Treasury Secretary John Snow has suggested that HSAs are useful to consumers because it gives them "greater control over their health purchasing decisions and the opportunity to budget for health expenses over many years through rollovers of account balances from year to year—'something that makes a lot of sense and will prove to be empowering for consumers.'"[34] Former Secretary Snow also advocated the widespread use of HSAs, noting that "[a]t a time when health care costs are rising rapidly and individuals, families and employers are struggling to find lower-cost alternatives, HSAs are a terrific option that I think every American ought to consider."[35]

B. What is an HSA?

An HSA is a savings account to which eligible individuals can contribute tax-free in order to fund medical expenditures.[36] HSAs were created "exclusively for the purpose of paying the qualified medical expenses of the account beneficiary."[37] Medical expenses are amounts paid by an account beneficiary for medical care,[38] primarily the costs "for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body."[39] This includes doctor's office visits, hospital, dental, and vision care, prescription drugs, and over-the-counter medications.[40]

Among those expenses which can not be paid for with tax free HSA funds are: commuting expenses for the disabled; health programs at resorts, health clubs, and gyms; illegal operations, treatments, or drugs; premiums for life, disability, or other accident insurance; and travel for general health improvement.[41] Notably, health insurance may not be

33. Milt Freudenheim, *Bush Health Savings Accounts Slow to Gain Acceptance*, N.Y. TIMES, Oct. 13, 2004, at C1.

34. *IRS Releases Model HSA Trustee Forms; Snow Touts Benefits for Small Businesses*, 9 BNA'S HEALTH CARE DAILY REPORT (June 28, 2004) [hereinafter *Model*].

35. Press Release, Office of Pub. Affairs, Dep't of the Treasury, Treasury Issues Comprehensive Health Savings Account Guidance (July 23, 2004) *available at* http://www.treas.gov/press/releases/js1812.htm.

36. 26 U.S.C. § 223(e) (2004).

37. 26 U.S.C. § 223(d)(1) (2004).

38. 26 U.S.C. § 223(d)(2)(A) (2004).

39. 26 U.S.C. § 213(d)(1)(A) (2004). *See also* I.R.S. Pub. 502, 3 (2004), *available at* http://www.irs.gov/publications/p502/ar03.html.

40. *Id. See also Guide to Health Savings Accounts*, HSADECISIONS.ORG (Am. Health Ins. Plans) Jan. 2005 at 1, 3 [hereinafter *Guide to HSAs*].

41. DAN PERRIN, HSA ROAD RULES: FOR CONSUMERS, EMPLOYERS, INSURERS, BANKS,

purchased using an HSA unless the funds are being used: for purchasing COBRA continuation coverage or long-term care insurance; by an individual receiving unemployment compensation; or by an individual who is age sixty-five or older (however, this exception does not apply to the purchase of Medicare supplemental policies).[42] If money in an HSA is spent on something that is not a qualified medical expense, that amount is includable in the account beneficiary's gross income and therefore taxable.[43] Addi-tionally, the beneficiary's HSA ceases to be an HSA as a result of the non-qualified distribution.[44]

In order to be eligible for an HSA, an individual must be covered by a high deductible health plan (HDHP).[45] The individual cannot be covered by a non-high deductible insurance plan which covers any benefit which is covered under the HDHP.[46] To qualify as a high deductible plan, a plan must have a minimum deductible of $1,000 for self coverage and $2,000 for family coverage.[47] Additionally, the sum of the annual deductible and out of pocket expenses (not including premiums), cannot exceed $5,000 for self coverage or $10,000 for family coverage.[48] A person is not eligible for an HSA if she is deducted by another tax payer as a dependent, or receives Medicare benefits.[49]

Generally, contributions to an HSA cannot exceed the annual deductible of the beneficiaries HDHP, or $2,250 a year for self coverage or $4,500 a year for family coverage.[50] Any person (including an employer or family member) can make a contribution to an eligible individual's HSA[51]

CREDIT UNIONS AND ADMINISTRATORS, 19 tbl.E (The HSA Coalition 2004).

42. *Guide to HSAs*, *supra* note 40, at 3.; Greta E. Cowart, *Employer Sponsored Group Health Plan Changes in the Medicare Prescription Drug Improvement and Modernization Act of 2003*, SJ072 A.L.I.-A.B.A. 595, 609 (Feb. 12–14, 2004).

43. 26 U.S.C. § 223(f)(1)-(2) (2004); Cowart, *supra* note 42, at 610.

44. 26 U.S.C. § 223(e)(2) (2004); Cowart, *supra* note 42, at 610.

45. 26 U.S.C. § 223(c)(1)(A)(i) (2004).

46. 26 U.S.C. § 223(c)(1)(A)(ii) (2004).

47. 26 U.S.C. § 223(c)(2)(A)(i) (2004). These figures are adjusted annually for inflation. 26 U.S.C. § 223(g) (2004).

48. *Id.*

49. 26 U.S.C. § 223(b)(6)–(7) (2004). While section 223(b)(7) specifies that an individual is ineligible if "such individual is entitled to benefits" under Medicare, this language means both eligibility and enrollment. "Thus, an otherwise eligible individual under section 223(c)(1) who is not actually enrolled in Medicare Part A or Part B may contribute to an HSA until the month that individual is enrolled in Medicare." *Health Savings Accounts—Additional Qs&As*, I.R.S. Notice 2004-50, 2004-33 I.R.B. (Aug. 16, 2004), at Ans. 2, *available at* http://www.irs.gov/irb/2004-33_IRB/ar08.html.

50. 26 U.S.C. § 223(b) (2004). These figures are adjusted annually for inflation. 26 U.S.C. § 223(g) (2004).

51. *Health Savings Accounts—Additional Qs&As*, I.R.S. Notice 2004-50, 2004-33 I.R.B. (Aug. 16, 2004) at Ans. 28, *available at* http://www.irs.gov/irb/200433_IRB/ar08.html.

and this money is exempt from taxation.[52] "Any amount paid or distributed out of a health savings account which is used exclusively to pay qualified medical expenses of any account beneficiary" is not included as a part of the recipient's gross income.[53] Additionally, earnings on an HSA are not taxable as a part of gross income so long as they are held in the HSA.[54] However, if money from an HSA is used for a non-qualifying expense, the beneficiary must pay income tax on that money as well as a 10% excise tax.[55]

Individuals can set up HSAs through health insurance plans, which administer HSAs and provide the HDHPs they require, or through any organization approved by the IRS to serve as a trustee (such as a bank or credit union).[56] As of September 2004, approximately twenty financial institutions and fifty insurers were offering services for individuals wishing to establish HSAs.[57] Once a beneficiary has established an HSA, he can decide how much of it to spend, which qualified medical expenses to spend it on, and whether or how those funds should be invested.[58] HSA funds are also portable: they can be carried over from year to year and beneficiaries retain the account when they change jobs.[59]

C. *Other Similar Programs*

Prior to the enactment of the Medicare Prescription Drug Improvement and Modernization Act of 2003, two types of accounts similar to HSAs existed, flexible spending accounts (FSAs), and health reimbursement arrangements (HRAs). These arrangements are employment based and can be used to reimburse the medical expenses of employees by excluding amounts paid for medical expenses from gross income and wages for employment tax purposes.[60] "FSAs allow people to set aside pretax money from their paychecks to pay for almost any medical expenses insurance doesn't cover."[61] However, balances in FSAs cannot be

52. 26 U.S.C. § 223(e)(1) (2004).

53. 26 U.S.C. § 223(f)(1) (2004).

54. 26 U.S.C. § 223(e). *See also Health Savings Accounts (HSAs)*, I.R.S. Notice 2004-2, 2004-2 I.R.B. (Jan. 12, 2004), at Q&A 20, *available at* http://www.irs.gov/irb/2004-02_IRB/ar09.html.

55. 26 U.S.C. § 223(f)(4)(A) (2004).

56. *Guide to HSAs*, *supra* note 40, at 3.

57. Louise Story, *Health-Savings Accounts Gain Momentum*, WALL ST. J., Sept. 9, 2004, at D2.

58. *Id.*

59. *Id.*

60. Health Savings Account Availability Act, H.R. REP. NO. 108-177, 10 (2003).

61. Ron Lieber, *The Annual Race to Binge on Health Care: Drugstores Offer New Tools As Deadline Looms for Using Money in Pretax Medical Accounts*, WALL ST. J. Nov. 17, 2004, at D1.

carried over from year to year.[62] Any excess money in an FSA at the end of the year reverts back to the employer that administers the plan.[63] FSAs cannot be used to reimburse employees for premiums paid for other health insurance coverage. [64]

Alternatively, HRAs are employer funded notional health care accounts provided by employers in addition to health insurance.[65] HRAs allow for the carry over of unused amounts from year to year and can be used to reimburse employees for the purchase of health insurance.[66] "The primary requirements for an HRA are that (1) the plan must be funded solely by the employer and cannot be funded by salary reduction, and (2) the plan may only provide benefits for substantiated medical expenses."[67]

There are several key distinctions betweens HSAs and FSAs/HRAs. Most notably, FSAs and HRAs do not require beneficiaries to be enrolled in HDHPs.[68] Unlike FSAs, excess funds in HSAs can be carried over from year to year. The beneficiaries of HSAs are responsible for determining if individual expenditures are qualified, whereas the plan is responsible for making that determination regarding FSAs and HRAs.[69] There is also concern that employees may use health care services unnecessarily when they have an HRA because they view the money in the account as their employer's rather than their own.[70] This is not a problem with HSAs because the funds in HSAs belong to employees and employees can take the funds with them from job to job.[71] Finally, unlike FSAs and HRAs, HSAs can be designed to avoid being subject to the Employment Retirement Income Security Act (ERISA).[72]

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62. Anne E. Bourdine & David L. Raish, *Health Savings Accounts and Other Health Plan Structures: What Practioners Need to Know*, 29 A.L.I.-A.B.A. BUS. L. COURSE MATERIALS J., 43, 59 (2004).

63. Lieber, *supra* note 61.

64. *Id.*

65. *HSA Proponents May Seek Changes From Congress to Further Promote HSAs*, 9 BNA'S HEALTH CARE DAILY REPORT 156 (Aug. 13, 2004) [hereinafter *Proponents*].

66. Press Release, Office of Pub. Affairs, Dep't of the Treasury, Treasury and IRS Issue Guidance on Health Reimbursement Accounts (June 26, 2002), *available at* http://www.ustreas.gov/press/releases/po3204.htm.

67. *Id.*

68. Bourdine & Raish, *supra* note 62.

69. *Id.*

70. *EBRI Report Questions Impact of HSAs in Slowing Increases in Health Care Spending*, 9 BNA'S HEALTH CARE DAILY REPORT 170 (Sept. 2, 2004) [hereinafter *Impact*].

71. *Id.*

72. Bourdine & Raish, *supra* note 62.

> HSAs do not create an ERISA plan if: a) The employer does not contribute, employee participation is voluntary, there is no employer endorsement, and the employer is paid only reasonable payroll deduction expenses; or b) There are employer contributions, but the employer does not limit the ability of employees to move funds, make or influence investment decisions, represent the HSA as a

HSAs are also nearly identical to Archer Medical Savings Accounts ("MSAs"), which are tax exempt savings accounts for qualified medical expenses.[73] MSAs were created as a part of the Health Insurance Portability and Accountability Act of 1996 on a pilot basis.[74] However, "Archer MSAs are available only to employees of a small employer who are covered under an employer-sponsored high deductible health plan and to self-employed individuals covered under a high deductible health plan."[75] Additionally, the number of taxpayers who could benefit annually from an Archer MSA contribution was limited to a threshold level of about 750,000.[76] MSAs were created as a temporary program, and have been obsolete since 2003.[77] Despite the limitations placed on MSAs, functionally, they are analogous to HSAs.

D. Benefits of HSAs

1. The Affluent

HSAs have the largest benefit for affluent people. Insurance brokers have noted "the accounts appeal primarily to lawyers, doctors and partners in small businesses who may welcome tax-free savings accounts for themselves."[78] HSAs are particularly helpful for the richest people in our society because of the progressive tax system. The tax free dollars placed in an HSA by an individual would otherwise be taxed at that individual's marginal tax rate. Thus, if a single individual who makes $100,000 a year placed $100 into an HSA they would save $28.[79] If the same individual only made $50,000 per year their savings would drop to $25, if they made only $25,000 per year the savings would be $15.[80]

HSAs benefit people who likely do not face major difficulty paying for their health expenses now. Massachusetts Institute of Technology (MIT) economist Jonathan Gruber estimates that 87% of HSAs will be purchased by people who already have traditional health insurance.[81] The typical employee who selects an HDHP earns more than $50,000, has

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plan, or receive any compensation in connection with the HSA.

DOL Field Assistance Bulletin 2004-1 (Apr. 7, 2004).

73. H.R. REP. NO. 108-177, at 10 (2003). *See also* 22 U.S.C. § 220.

74. Barry Kozak, *Young Lawyers Journal: New Health Savings Accounts Promote Consumer Driven Health Care*, 18 C.B.A. 58, 59 (April 2004).

75. H.R. REP NO. 108-177, at 12 (2003).

76. *Id.* at 13.

77. Kozak, *supra* note 74, at 59.

78. Freudenheim, *supra* note 33, at C15.

79. Rev Proc. 2003-85, 2003-49 I.R.B. 1184 at § 3, tbl. 3 (2004).

80. *Id.*

81. Jonathan Chait, *Up and Away*, NEW REPUBLIC, Sept. 13, 2004, at 21.

predictable health care cost and can afford to fully fund their HSA and cover their out of pocket expenses.[82] If they are acting rationally, individuals who choose to have HSAs "also have the ability to pay medical costs during periods of multiple doctor visits";[83] otherwise it seems unlikely they would choose to abandon traditional insurance which covers the bulk of this expense. Thus, HSAs seem to be a good choice for middle to upper class families with no major medical expenses, "particularly considering the $2,170 that is left over for future expenses."[84]

2. Shift to the Fee for Service Model

The greatest advantage of HSAs, and in fact, the reason they were created, is that they begin to shift the health care system back toward a fee for service model under which the patient simply pays health care providers for services rendered. Under such a model, market forces would presumably push health care costs to the socially optimal level. The system could also reduce the number of health care expenditures that are based on emotion rather than cost/benefit analysis.[85] Additionally, the HSA model may leave many individuals who were previously covered under the managed care system with many more choices regarding the details of their health care.

E. Problems With HSAs

1. Ineffectiveness for the Chronically Ill

The potential problems with HSAs outweigh the benefits. One of the most vivid problems is their ineffectiveness for individuals with chronic illnesses who face consistently high health care costs. A report by the Employee Benefit Research Institute notes that 25% of the United States population accounts for 80% of the country's health care spending.[86] The report went on to suggest that the theory behind HSAs, that giving consumers control over their health care spending will lower the overall cost of health care, may not hold true. "Even if many high users of health care services [who opt for high-deductible health plans] were able to change the way they used health care services because they have more

82. Rob Corrigan, *Preventing Adverse Selection of Health Plans*, BUS. INS., Nov. 22, 2004, at 10.

83. Kevin J. Delaere, *Healthy Advice: Properly Used and Funded, Health Savings Accounts Can Give Clients Another Tax-Deferred Savings Vechicle*, FIN. PLANNING, Jan. 1, 2005, at 1.

84. *Id.*

85. *Id.*

86. *Impact*, *supra* note 70.

'skin in the game,' the change might only delay the time at which they reach the annual deductible, and not mean the individual spends less over the course of a year.'"[87] The report added that, "[u]nless high-deductible plans include incentives to affect the spending patterns of chronically high users of health care services, the total cost of providing health benefits is unlikely to be significantly changed."[88] Because of the high cost of treating chronic conditions, a chronically ill patient with an HDHP and HSA "ends up paying the maximum deductible for an extended time period as well as being shut out of traditional insurance in the future because of a pre-existing health condition."[89] One article on HSAs went so far as to suggest "if you are a poor saver and have chronic health problems, the new account may be an expensive shell game that mocks the claim of the White House and lawmakers who say it's the bright future of U.S. health care."[90]

2. Adverse Selection

There are also concerns that HSAs will be most "attractive to younger, healthier and wealthier subscribers,"[91] pulling those individuals out of more comprehensive insurance plans and making membership in comprehensive plans increasingly more difficult for those who opt against opening HSAs.[92] If an HDHP "is not properly designed, adverse selection will proliferate."[93] With healthier patients fleeing to HDHPs, the average cost of insuring any given risk pool will increase, likely causing both premiums and overall health care expenditures to rise dramatically. Additionally, most medical spending occurs at levels that would exceed the deductible of HDHPs,[94] so that even absent adverse selection, insurance should continue paying the majority of health care costs. It seems likely that any positive effects that HSAs coupled with HDHPs might have on overall health care expenditures would be negated by the increased expenditures on the part of those most in need of health care.

3. Questions of Effectiveness

It is also questionable whether giving patients more control over their health care expenditures will decrease individuals' spending. It seems

87. *Id.*
88. *Id.*
89. Delaere, *supra* note 83.
90. John Wasik, *New Health Savings Accounts Only Favor Savers*, BLOOMBERG, Sept. 27, 2004, *available at* http://www.bloomberg.com.
91. HEALTH CARE LAW AND ETHICS 910 (Mark A. Hall et al. eds, 6th ed. 2003).
92. *Id.*; Chait, *supra* note 81.
93. Corrigan, *supra* note 82.
94. Chait, *supra* note 81.

unlikely that most patients will be able to engage in the same sort of cost/benefit analysis they use when purchasing consumer goods in a setting involving their health. "Most people follow their physicians' advice about what care they need, and physicians are motivated to recommend all care that will produce any benefit, pretty much regardless of the cost."[95] On the topic of consumer driven health care, one physician remarked, "asking consumers to 'drive their health plans' is like asking blind people to become NASCAR drivers."[96] This suggests that the underlying rationale behind HSAs is flawed.

HDHPs may also have an adverse effect on patient health because of the "cost saving" choices that patients make. A 1970s study by the RAND Corporation showed that:

> A catastrophic insurance plan that required the patient to pay 95 percent of the first $1,000 successfully reduced expenditures 31 percent relative to zero out-of-pocket costs, with no discernible differences in health status for most patients. But the lowest-income participants under the cost-sharing plan scored noticeably worse on several measures of health status than did low income participants under the free plan. Further analysis revealed that most of the cost savings came from patients' reducing their initial visits to their doctors, and that most of the patients cut back on necessary and unnecessary visits.[97]

This study suggests that individuals with HSAs may choose to "save" money in a manner that could lead to significantly higher medical costs in the future. This has the potential to perpetuate the already serious problem of Americans failing to get cheap preventative care leading to more costly medical problems later on.[98]

There is no legal requirement that individuals with HSAs put the money they save on health insurance by purchasing a HDHP into their HSAs.[99] Ira S. Loss, a health policy expert with the business consulting firm Washington Analysis remarked, "'It's hard to imagine that a guy who makes $50,000 a year is going to have $2,000 for him and his family to

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95. HEALTH CARE LAW AND ETHICS 910–911 (Mark A. Hall et al. eds., 6th ed. 2003). *See also* Regina T. Jefferson, *Medical Savings Accounts: Windfalls for the Healthy, Wealthy & Wise*, 48 CATH. U.L. REV. 685, 712 (1999).

96. Vicki Rackner, *Health Savings Accounts: What the Physician Sees*, NAT'L UNDERWRITER, Jan. 10-17, 2005, at 30.

97. HEALTH CARE LAW AND ETHICS, *supra* note 95, at 911.

98. Amy Feldman, *The Health-Care IRA. Are You Ready?*, MONEY, Oct., 2004, at 45. *See also* Thomas S. Brown, *Residents Appreciate Health Saving Account Plans*, DAYTONA BEACH NEWS J. ONLINE, Nov. 6, 2004, *available at* http://homeequityloandirect.com/news-residents-appreciate-health.html.

99. Story, *supra* note 57.

stick in this plan.'"[100] Failing to fully fund an HSA could lead to an individual not having enough money to cover her medical expenses at all if those expenses exceed her account balance but are less than their deductible.[101] There is also a risk of an individual having a cash flow crisis in the case of a catastrophic health situation.[102] There is a significant risk that an individual could switch from a traditional insurance plan to an HSA and fail to use her HSA as it was intended to be used, ending up unable to pay for any unanticipated health expenses. Thus, the introduction of the HSA into the American health care landscape could compound the health care financing crisis in the United States by funneling money which would otherwise have gone towards health insurance premiums into other sectors of the economy.

It has also been suggested that HSAs are a tool for the funding of medical care, but fail to address the more general issues presented by rising health care costs.[103] This is not necessarily the case, because it is possible that HSA holders will reduce their medical spending as a consequence of being more directly responsible for paying for their medical expenses. However, it is clear that HSAs "do little to make health care coverage available for the 45 million who have no health insurance."[104]

IV. HEALTH SAVINGS ACCOUNTS IN THE CONTEXT OF EMPLOYMENT BASED BENEFITS

A. Tax Status of HSAs in the Employment Context

Employer contributions to HSAs, like their contributions towards many other employee benefits, have a tax preferred status. An employer can contribute to its employee's HSA, and as long as those contributions do not exceed the limit for the employee's tax deduction, they are excludable from the employee's income under Code section 106(d).[105] However, if an employer makes contributions to an employee's HSA, he must make comparable contributions, either in the same amount, or the same percentage as the applicable health plans deductible, into the accounts of all comparable participating employees.[106] Health savings account contributions are also "excluded from unemployment tax, railroad retirement tax, and income tax withholding under section 3401 of the

100. Freudenheim, *supra* note 33.
101. Wasik, *supra* note 90.
102. Delaere, *supra* note 83.
103. Wasik, *supra* note 90.
104. *Id.*
105. 26 U.S.C. § 223(f)(3)(B) (2004); Cowart, *supra* note 42, at 612.
106. Cowart, *supra* note 42, at 612.

Code."[107]

Despite the fact that HSAs have tax benefits similar to other employee benefits, "[s]o far, most of the action has been at the individual level. Most enrollees are either self-employed, early retirees or people . . . who had to arrange [their] own health insurance after moving to a company that didn't offer benefits."[108] This may be the case simply because of a delay in guidance from the Treasury Department. [109] But it could also be attributed to concern among large employers about how employees "with chronic conditions . . . would fare." [110]

B. Shifting Health Care Expenses to Employees

HSAs provide several benefits for all employers. The biggest benefit is that "[w]hen paired with a health savings account or health reimbursement account, an HDHP permits significant cost savings for companies while making employees more conscious of their health care spending, a critical element in long-term cost management."[111] Much of this cost savings comes from reduced insurance premiums, since the employee would no longer be able to maintain a traditional lower deductible health insurance plan. Additionally, employers are not responsible for verifying that employees use HSA distributions for qualifying medical expenses.[112] This could save employers significant administrative fees.

The shift of health care expenses from employers to employees is one major problem which could result from the adoption of HSAs by large employers. HSAs "achieve savings by shifting more health expenses to consumers."[113] In doing so, HSAs provide an opportunity for employers to shift health care expenses to employees. "[E]mployers will gladly replace their current low deductible health plans with High Deductible Health Plans in order to save money, but might not make appropriate contributions to HSAs, shifting the overall cost of health care to employees."[114] The top two reasons companies have for offering HSAs are "to promote employee

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107. *Id.*

108. Thomas S. Brown, *Investing in a Healthy Future; Some Area Residents See Wise Choice in Health Savings Accounts*, DAYTONA BEACH NEWS J., Nov. 6, 2004, at B1.

109. *See* Ron Lieber, *The Health Savings Plan You Can't Get*, WALL ST. J., Nov. 3, 2004, at D1.

110. *Id.*

111. Corrigan, *supra* note 82.

112. *Proponents*, *supra* note 65. Employers are responsible for this under FSA and HRA accounts. Bourdine and Raish, *supra* note 62.

113. Fred Brock, *Weighing the Risks in a Health Savings Account*, N.Y. TIMES, Sept. 21, 2004, at G3.

114. Kozak, *supra* note 74.

involvement and accountability in purchasing health-care services . . . and to reduce or control the organization's spending on health-care benefits."[115] The existence of HSAs could lead to some businesses scaling back or dropping health insurance for employees. John Gruber of MIT estimates that the introduction of HSAs could lead to 350,000 people actually losing their insurance.[116]

Some companies use the money saved by purchasing HDHPs to make contributions to employees' HSAs.[117] However, there is no requirement that they do so. If an employer fails to contribute this savings to the employee's HSA, the transition to an HSA/HDHP essentially constitutes a reduction in compensation. This practice uses the guise of health care reform to redistribute wealth from employees to those large companies which employ the most people. While there is not a universal legal requirement that employers offset employees' health care costs, the practice is critical to the overall financing of health care in the United States. If large companies encourage employees to open HSAs and provide those employees with only the premiums or a part of the premiums for a HDHP, failing to give the employee any form of increased compensation to offset the company's savings, HSAs will ultimately worsen the problem of health care financing in the United States.

C. *Benefits to Small Businesses and the Self Employed*

Despite the problems HSAs present in the context of large employers, HSAs are a very useful tool for small businesses and the self employed.

> [S]mall employers are too often confronted with situations in which there is a strong incentive to choose one or a combination of three options: 1) avoid hiring or retaining employees who have high health care costs, 2) create insurance plans with low coverage limits or caps, or 3) offer no health insurance coverage, instead leaving employees to seek their own coverage in the private market. These alternatives are all unsatisfactory, both for persons with health concerns who work for, or would like to work for, those companies, and for the companies themselves.[118]

HSAs provide small employers with an additional option. They can help finance HDHPs for their employees without having to outlay nearly as

115. Stephen Taub, *Employers Embracing Health Savings Accounts: Many Say They're Likely to Offer the Vehicles, Which Resemble Individual Retirement Accounts.*, CFO.COM, Apr. 30, 2004, http://www.cfo.com/printable/article.cfm/3013583?f=options.

116. Chait, *supra* note 81.

117. Brock, *supra* note 113.

118. Ann Hilton Fisher, *Small Employers and the Health Insurance Needs of Employees With High Health Care Costs: A Need for Better Models*, 8 EMP. RTS. & EMP. POL'Y J. 53, 62 (2004).

much cash as would be necessary to provide traditional health insurance. On June 25, 2004, former Treasury Secretary John Snow pointed out the advantages of HSAs to small business by allowing individuals and employers to contribute in a flexible manner "that is helpful 'for a small group struggling to keep costs reasonable for both parties.'"[119] One small businessman, Rich Phillips of Austin, Texas, does not provide his five employees with health insurance, but plans to add coverage for his employees and their families through the use of HSAs coupled with HDHPs.[120] Mr. Philips spoke positively about HSAs saying, "'The scary thing for a lot of people with these policies is the high deductible,'" but he added that he sees the plans as "'a great way to make [him] vigilant about [his] health cost.'"[121]

HSAs are also a good option for the self employed. An article in *Money* magazine explains, "[i]f you're self-employed or your employer does not offer health benefits, an HSA may be a no-brainer since it offers affordable access to catastrophic medical coverage with a tax-planning sweetener."[122] Wayne Modungo, a self employed construction manager and California father of seven, opened an HSA for his family.[123] Modungo praised the HSA's flexibility: "'It's a fairly long list of things that [an HSA account] can be used for,' said Modugno. 'It's easy to keep track of . . . Before, it was really hard to keep your records straight.'"[124] While Modungo had overwhelmingly positive things to say about his HSA, it is important to note that no one in his family has a chronic health condition.[125] Modugno used most of the HSA money this year for "braces for three of his children and a hernia operation for his 1-year-old."[126] Notably, it does not appear that Mr. Modugno saved a significant amount of money for future health care costs.

V. CONCLUSION

HSAs are not a panacea for all that ails the American health care system. In the employment context they present the risk of undermining the system of employment based health benefits which has dominated the health care landscape for more than fifty years by shifting the system back towards a fee for service model. HSAs are most helpful for the affluent

119. *Model*, *supra* note 34.
120. Brock, *supra* note 113.
121. *Id.*
122. Feldman, *supra* note 98, at 47.
123. January W. Payne, *Early Users of Health Savings Accounts Say So Far, So-So*, WASH. POST, Oct. 26, 2004, at F9.
124. *Id.*
125. *Id.*
126. *Id.*

and self employed, but do little to address the problem of providing health care to the poor and unemployed. HSAs also present a heightened risk that healthier patients will leave traditional health insurance plans, leading to increased premiums for those who remain in those plans. Finally, adopting consumer driven health care plans may not lead to a decrease in health care costs both because health care is not a traditional consumer good, and because it may motivate consumers to skip low cost preventative care leading to significantly larger future expenditures to treat avoidable illnesses.

HSAs also present employers with an occasion to shift health care expenses to employees. However, it is not certain that employers will abuse the opportunity to decrease employee compensation by lowering their contributions towards health benefits. "Many employers would like to give enhanced coverage to people with [chronic conditions], paying for care and drugs related to certain conditions before the employee has hit the deductible."[127] Others "want to change the law to allow firms to provide prescription drug coverage on a first-dollar basis in conjunction with HSAs."[128] Undoubtedly, some employers will not reduce their expenditures on employees who switch to a HSA/HDHP, but others will.

HSAs are unlikely to improve the health care situation of employees of large corporations. Nor will HSAs help the unemployed or poor. However, HSAs may become an extremely useful tool for the self employed and employees of small businesses who can afford health care, but cannot afford traditional health insurance. Thus, HSAs are a step in the direction of meaningful health care reform. If seen as such, they could become a significant step. However, if treated as a solution to the problems facing the American health care system, they will only compound those problems.

127. Lieber, *supra* note 109.

128. *Proponents*, *supra* note 65.