



**H.B. 506**

126th General Assembly  
(As Introduced)

**Rep. Blessing**

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**BILL SUMMARY**

- Increases the amount of unreimbursed medical expenses that an individual may deduct in computing Ohio income tax.
- Requires the Public Employees Deferred Compensation Board to contract for a high-deductible medical insurance policy covering state and local government employees, who may elect such coverage to be used in conjunction with health savings accounts opened by such employees.
- Provides an Ohio income tax deduction for employees' annual contributions to qualifying health savings accounts, up to \$2,600 (individual) or \$5,200 (family), adjusted for inflation, or additional "catch-up" amounts for those 55 years of age or older.

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**CONTENT AND OPERATION**

**Income tax deduction for medical expenses**

(R.C. 5747.01(A)(11)(b))

Currently, in computing Ohio income taxes, a taxpayer may deduct unreimbursed medical expenses to the extent those expenses exceed 7.5% of the taxpayer's federal adjusted gross income (FAGI). The kinds of medical expenses that are deductible for Ohio income tax purposes are the same as the kinds that are deductible for federal income tax purposes.

The bill increases the deductible amount by permitting taxpayers to deduct unreimbursed medical expenses to the extent they exceed 5% of FAGI.

### **Public employee health saving accounts**

(R.C. 148.11, 148.12, and 148.13)

The bill requires the state, through the Public Employees Deferred Compensation Board, to offer public employees access to "high-deductible" health benefit plans that employees may use in conjunction with employee-funded, tax-favored "health savings accounts" (HSAs). The high-deductible health plans and the HSAs generally must conform with requirements of federal income tax law that are conditions for favorable federal income tax treatment. Employees who fund an HSA would enjoy Ohio income tax benefits similar to the federal tax benefits.

The bill requires the Public Employees Deferred Compensation Board (hereafter, "Board") to contract with one or more sickness and accident insurers to provide at least two high-deductible health benefit plans to cover full-time employees of the state and political subdivisions, including employees of state or local government boards, bureaus, commissions, councils, committees, authorities, and administrative bodies, and including school employees and employees of public colleges and universities. The high-deductible health plans would be available to these employees as an alternative to any of the other health benefit plans currently available to them.

### **High-deductible health plan**

The high-deductible health benefit plans the Board contracts for must conform with criteria specified in the bill, which are based on the criteria the plans must satisfy in order for the corresponding HSAs to qualify for favorable federal tax treatment. The annual deductible must be at least \$1,000 for an individual plan or \$2,000 for a family plan. The total annual out-of-pocket expenses (deductible plus copayments) must not be more than \$5,000 for individuals or \$10,000 for families.<sup>1</sup> The terms of the plan may not require a covered employee to make any copayment that is greater than the amount the plan insurer will reimburse a health care provider for. The plan may provide for complete "first dollar" coverage for preventive care (including annual physical examinations, screenings, and immunizations).

The Board also may contract for additional high-deductible plans with even higher deductibles as options available to employees.

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<sup>1</sup> *These figures are to be adjusted for inflation by the Department of Administrative Services.*

### *Health savings accounts*

The bill states that a public employee selecting coverage under a high-deductible health plan may open an HSA at a state or federally chartered financial institution and, upon doing so, designate an administrator of the account. The bill states that, to ensure that there are administrators for HSAs available to all participating employees, the Board must contract with at least one administrator qualified under federal law to administer HSAs. An employee may select an account administrator contracting with the Board or any other administrator approved by the Internal Revenue Service. Any administrator is required to manage the HSA in a fiduciary capacity for the benefit of the account holder.

### *Ohio tax treatment*

The bill authorizes a public employee holding an HSA to deduct the amount the employee deposits into the HSA, up to \$5,250 per year if the employee's high-deductible plan provides family coverage, and up to \$2,650 per year if the employee's plan provides individual coverage. (The Tax Commissioner must adjust the maximum deductible amounts annually to reflect inflation.) The deduction is available only if the employee is covered by the high-deductible plan throughout the employee's taxable year. Additional "catch-up" contributions are deductible for employees 55 years of age or older. To be deductible, catch-up contributions cannot exceed the difference between the amount the employee has been eligible to contribute and the amount the employee actually contributed. All deposits are deductible only if they are deductible for federal income tax purposes. (See **COMMENT** 1 and 2.)

Deposits in excess of the deductible amounts (including interest accruing to that amount) are taxable and carry a 6% penalty unless the excess contribution is withdrawn before April 15 of the year after the year the deductible contribution limit applies. The same penalty applies to an employee's deposits to an HSA not opened under the bill's provisions.

Withdrawals from an HSA may be made without restriction, but any amount withdrawn and not used to pay a qualified medical expense becomes taxable, and a 10% penalty is imposed. The penalty does not apply, however, if the account holder is retired from public employment and 65 years of age or older. Neither the tax nor the penalty apply if the account holder dies or is disabled.

The bill states that if its provisions governing the creation and use of high-deductible health plans and HSAs conflict with the federal income tax law governing them, the federal law prevails. (The federal law is summarized below under "*Federal law governing HSAs.*")

### Contracting provisions

(R.C. 148.12 and 148.13)

The bill specifies procedures for soliciting, considering, and awarding contracts for the high-deductible health plans and HSAs the bill provides for.

The Board's contracts for high-deductible health plans and the HSA administrators must be made by competitive sealed proposal in accordance with rules the Board must adopt. Proposals must be solicited through a request for proposals (RFP). The RFP must state the relative importance of the price of the contract, the quality of the plans and HSAs, and other evaluation factors. Notice of the RFP must be given in accordance with rules the Board must adopt.

The bill states that, in order to ensure full understanding of and responsiveness to proposal solicitation requirements, the Board may conduct discussions with "responsible" offerors who submit proposals the Board determines to be "reasonably susceptible of being selected for award." The bill prohibits any disclosure of information derived from proposals of competing offerors while any such discussions are conducted. The Board must accord all offerors "fair and equal treatment with respect to any opportunity for discussion regarding clarification, correction, or revision of proposals."

The bill requires that proposals be opened so as to avoid disclosure of proposal contents to competing offerors. Proposals and related documents are not available for public inspection or copying under the public records law until after the contract being bid for is awarded.

The high-deductible plan and the HSA administrator contracts must be awarded to the offeror whose proposal the Board determines to be most advantageous to the state, taking into account price, quality of the plan or HSA, and the evaluation criteria of the RFP. The contract file is to contain the basis on which the award is made.

The bill requires the Board to award approximately 15% of the estimated dollar value of high-deductible health plan and HSA contracts to minority business enterprises (on a fiscal year basis) unless awarding a contract to a minority business enterprise would cause the Board "to pay an excessive price... or acquire a disproportionately inferior" plan or HSA. To qualify for such consideration, a business enterprise must be certified by the Equal Employment Opportunity Coordinator of the Department of Administrative Services under existing law (R.C. 122.71 and 123.151).

## Federal law governing HSAs

In 2003, Congress authorized the creation of health savings accounts (HSAs) as part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003.<sup>2</sup> An HSA is a tax-exempt trust or custodial account established exclusively for the purpose of paying "qualified medical expenses" of an "eligible individual" and the eligible individual's spouse or dependents.<sup>3</sup>

"Qualified medical expenses" are listed in Internal Revenue Service Publication 502.<sup>4</sup> Examples include amounts paid for doctors' fees, prescription and non-prescription medicines, and necessary hospital expenses not paid for by insurance.<sup>5</sup>

To be an "eligible individual" in any given month, an individual must (1) be covered under a high deductible health plan on the first day of that month, (2) not be covered by any other health plan that is not a high deductible health plan (with certain exceptions for plans providing limited types of coverage), (3) not be enrolled in Medicare, and (4) not be claimed as a dependent on another person's tax return.<sup>6</sup>

In general, a high deductible health plan is a health plan that satisfies certain requirements with respect to deductibles and out-of-pocket expenses. The following table shows the minimum and maximum annual deductible and other out-of-pocket expenses for high deductible health plans for 2005:<sup>7</sup>

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<sup>2</sup> Section 1201 of the Act, 117 Stat. 2469-2476.

<sup>3</sup> Internal Revenue Service. "Notice 2004-2: Questions and Answers on HSAs," (visited Feb. 10, 2006), accessible at <<http://www.irs.gov/pub/irs-drop/n-04-2.pdf>>.

<sup>4</sup> Accessible at <<http://www.irs.gov/pub/irs-pdf/p502.pdf>>.

<sup>5</sup> Internal Revenue Service. "Publication 969," (visited Feb. 10, 2006), accessible at <<http://www.irs.gov/pub/irs-pdf/p969.pdf>>.

<sup>6</sup> Internal Revenue Service, *supra* note 2.

<sup>7</sup> Internal Revenue Service, *supra* note 4.

Health plan coverage	Minimum Annual Deductible	Maximum Annual Deductible and Other Out-of-Pocket Expenses <sup>8</sup>
Individual	\$1,000	\$5,100
Multiple	\$2,000	\$10,200

An eligible individual may establish an HSA with a qualified HSA trustee or custodian and does not need the permission or authorization of the Internal Revenue Service to do so. An eligible individual who is an employee may establish an HSA with or without the involvement of the individual's employer. An eligible individual, the individual's employer, or both may make contributions to the individual's HSA.<sup>9</sup> Because HSAs are portable, employees may take funds in an HSA with them when they leave or change jobs.<sup>10</sup>

Any insurance company or bank (including a similar institution defined in section 408(n) of the Internal Revenue Code) can be an HSA trustee or custodian. Any other person already approved by the IRS to be a trustee or custodian for individual retirement accounts (IRAs) or Archer Medical Savings Accounts is automatically approved to be an HSA trustee or custodian.<sup>11</sup>

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## COMMENT

1. Deposits to any qualifying HSA, and interest on those deposits, appear to be excluded from the Ohio income tax base under current law, and therefore not taxable for Ohio income tax purposes. The federal income tax deduction reduces the income tax base used as the starting point for computing Ohio income tax (federal adjusted gross income or FAGI). The statute defining the Ohio income tax base (R.C. 5747.01) does not provide for the deduction specifically, but the

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<sup>8</sup> *This limit does not apply to deductibles and expenses for out-of-network services if the plan uses a network of providers. Instead, only deductibles and out-of-pocket expenses for services within the network should be used to determine whether the limit applies. Internal Revenue Service, supra note 4.*

<sup>9</sup> *Internal Revenue Service, supra note 2.*

<sup>10</sup> *America's Health Insurance Plans, Center for Policy and Research. "Comparison of Tax-Advantaged Health Care Spending Accounts," (visited Feb. 10, 2006), accessible at <<http://www.ahipresearch.org/pdfs/ChartMSAFSAHRAHSAJan05.pdf>>.*

<sup>11</sup> *Internal Revenue Service, supra note 2.*

federal deduction likely is incorporated into the Ohio tax base because of unrelated amendments made to that statute since the federal deductibility took effect.

2. The bill does not specifically exclude interest on HSA balances from the Ohio income tax, but, for the reason stated in **COMMENT 1**, the interest is not taxable because it is not included in FAGI.

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## **HISTORY**

ACTION	DATE
Introduced	02-07-06

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