820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

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Roth HSAs in Cassidy-Collins Plan: Little for Most Workers, Tax Shelters for the Top

By Edwin Park, Chuck Marr, Brandon DeBot, and Chye-Ching Huang

Legislation from Senators Bill Cassidy and Susan Collins to replace the Affordable Care Act (ACA)[1] would rely heavily on a new type of Health Savings Account (HSA) that people could draw upon to purchase health insurance or pay out-of-pocket costs. The HSAs that their bill proposes, however, would do little to help low- and moderate-income people afford adequate health insurance while greatly expanding tax-sheltering opportunities for high-income people.[2]

Currently, anyone with a high-deductible health plan can set up an HSA, make tax-free contributions to it every year, and then use the funds to pay out-of-pocket health expenses. HSAs disproportionately benefit high-income households because they don't restrict eligibility by income and provide the largest tax breaks to households high on the income scale, and because people at the top are those most likely to have the disposable income to set up and make substantial contributions to these accounts.[3]

The Cassidy-Collins legislation would convert current HSAs into "Roth HSAs" — so-called because they'd resemble Roth Individual Retirement Accounts, which are known as "Roth IRAs." Under the bill, states could: 1) retain key features of the ACA but with reduced funding; 2) reject all ACA-related federal assistance to help their residents afford health insurance in the individual market; or 3) move to a new structure (which the bill calls the "alternative option") under which the ACA's subsidies to help people buy insurance would be replaced by smaller subsidies that would go into people's Roth HSAs. Roth HSA account holders then could withdraw funds to pay their

[1] "Patient Freedom Act of 2017" legislative text, available at: http://www.cassidy.senate.gov/imo/media/doc/PFA%20Bill%20Text.pdf.

[2] Sarah Lueck, "Senators' ACA Replacement Won't Likely Give States, Patients the Choices They Seek," Center on Budget and Policy Priorities, updated January 24, 2017, http://www.cbpp.org/blog/senators-aca-replacement-wont-likely-give-states-patients-the-choices-they-seek.

[3] Edwin Park, "Ways and Means Bill Would Dramatically Expand Health Tax Shelters for High-Income Earners," Center on Budget and Policy Priorities, June 20, 2016, http://www.cbpp.org/blog/ways-and-means-bill-would-dramatically-expand-health-tax-shelters-for-high-income-earners.

insurance premiums and other out-of-pocket health costs. States that didn't explicitly choose among the three options would default to the third.[4]

Cassidy-Collins would enable anyone in any state to create a Roth HSA, no matter which option a state chose and, consequently, no matter whether the individual is eligible for subsidies under the third option. In addition, the bill would allow anyone with health coverage to set up a Roth HSA, not just those with high-deductible plans — and that would dramatically expand eligibility for HSAs. Moreover, the bill would sharply increase the amounts that people could contribute to HSAs each year, including high-income people who are most able to contribute the maximum amounts to HSAs today.

The expanded eligibility for Roth HSAs, coupled with the increased contribution limits, would provide major new tax-sheltering opportunities for high-income people. They could make large contributions to these tax-favored accounts year after year and let their savings grow tax-free over time, securing a substantial new tax break.

By contrast, Roth HSAs would do little to help low- and moderate-income people afford decent-quality health coverage because they wouldn't get much of a tax benefit from the Roth HSAs and they'd receive significantly smaller subsidies to help them afford coverage. That would make coverage for them less affordable, not more.

Proposal Would Combine Elements of HSAs and Roth IRAs

Health Savings Accounts are tax-advantaged accounts in which individuals can save money to pay out-of-pocket health expenses. Under current law, an individual wishing to establish or make contributions to an HSA must be enrolled in a high-deductible health plan — a plan with a deductible of at least $1,300 for individuals and $2,600 for family coverage — that also meets other federal requirements.[5] The Cassidy-Collins plan would convert the current HSAs into so-called "Roth HSAs," combining elements of current HSAs and Roth Individual Retirement Accounts (known as "Roth IRAs"). Under the proposal:

- Contributions to Roth HSAs would not be tax-deductible, unlike contributions to current HSAs, which are deductible. But earnings on the funds in an HSA, and withdrawals used for health expenses, would be entirely tax-free, similar to the rules governing Roth IRAs (and current HSAs).
- The availability of HSAs would be dramatically expanded: Roth HSAs would be available to *all* people with health coverage who aren't eligible for Medicare. Currently, only people with high-deductible health plans can establish or contribute to an HSA (and therefore receive HSA tax breaks).[6] This would likely greatly increase high-income people's attraction to HSAs.

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[4] Residents of any state would be able to contribute to Roth HSAs, but federal subsidies would be provided and deposited in HSAs only in states choosing the "alternative option."

[5] For more background on HSAs, see Center on Budget and Policy Priorities, "What Is a Health Savings Account?" January 25, 2017, http://www.cbpp.org/research/health/what-is-a-health-savings-account.

[6] Many more people would be eligible for HSAs than are eligible today. For example, in 2016, only 24 percent of employers offered plans that were HSA-eligible, and only 19 percent of all workers with employer-sponsored insurance were enrolled in HSA-eligible health plans, according to the Kaiser Family Foundation. See Kaiser Family Foundation

Such individuals would be able to make substantial contributions to the accounts and secure large tax breaks over time by doing so.

- In addition, unlike with current HSAs, withdrawals from the new Roth HSAs could be used to pay for health insurance *premiums* (as well as for deductibles and other out-of-pocket health expenses). This would be particularly attractive to high-income individuals who now purchase health coverage in the individual market and generally don't receive tax breaks for their premium costs.[7]
- Of particular note, the maximum amounts that individuals could contribute to the Roth HSAs would be set much higher than current HSAs allow. The maximum allowable contribution to an HSA is now $3,400 a year for individuals and $6,750 for a family, levels that already exceed what most Americans can afford to contribute. That's why households with incomes over $100,000 make up a majority of all households contributing to HSAs and account for 70 percent of all HSA contributions.[8] Nevertheless, the Cassidy-Collins bill would substantially increase the HSA contribution limits to $5,000 per family member. That would enable wealthy families of four to sock away $20,000 each year in these tax-advantaged accounts.
- Moreover, as under current HSAs, there would be *no limit* on how high a tax filer's income can be to put money in an HSA. This aspect of the proposed Roth *HSAs* differs sharply from the rules governing Roth *IRAs*. Eligibility to contribute to Roth IRAs is limited to people with incomes below $133,000 for individuals and $196,000 for couples.

The Cassidy-Collins proposal thus would essentially enable people with incomes too high to qualify for Roth IRA tax breaks to circumvent the Roth IRA income limits and accumulate large sums over time in tax-advantaged Roth HSAs, allowing the new HSAs to become a major new tax shelter for high-income households. (See Table 1 for a comparison of current-law HSAs, Roth IRAs, and Roth HSAs under the Cassidy-Collins plan.)

TABLE 1

	Current Law *HSAs*	Current Law Roth *IRAs*	Roth *HSAs* Under Cassidy-Collins Plan
Initial contributions tax deductible?	Yes	No	No
Maximum contribution, 2017	$3,400 for individuals; $6,750 for families; $1,000 additional contribution for people age 55 or older	$5,500; $1,000 additional contribution for people age 50 or older	$5,000 per person; $1,000 additional contribution for people age 55 or older
Income limit on contributions, 2017	None	Individuals making more than $133,000 and couples making more than $196,000 ineligible to contribute	None

and Health Educational Research Trust, "Employer Health Benefits: 2016," September 14, 2016, http://kff.org/report-section/ehbs-2016-section-eight-high-deductible-health-plans-with-savings-option/.

[7] Self-insured individuals can deduct the premium costs of their individual market plans.

[8] Park, *op cit*.

TABLE 1

	Current Law *HSAs*	Current Law Roth *IRAs*	Roth *HSAs* Under Cassidy-Collins Plan
Earnings and withdrawals tax-free?	Yes, if used for qualified expenses	Yes	Yes, if used for qualified expenses
Limitation on use of withdrawals to avoid penalties?	Withdrawals can be used for deductibles and other out-of-pocket health expenses	No limitation after age 59 ½	Withdrawals can be used for premiums, deductibles, and other out-of-pocket health expenses
Health coverage required to contribute?	Yes, must have a high-deductible health plan and not be eligible for Medicare	No	Yes, must have health coverage and not be eligible for Medicare
Subsidies for health care coverage through accounts?	None	None	Yes, for people with incomes up to the eligibility limit in states that choose the bill's "alternative" option

Roth HSAs an Inadequate Way to Help People Afford Health Coverage

Despite providing lucrative new tax breaks for high-income households, the Roth HSAs, coupled with the limited health insurance subsidies the Cassidy-Collins bill would provide, would be inadequate to help many people with modest incomes afford decent-quality health coverage and access needed care.

- Tax-advantaged savings accounts are largely ineffective as a way to help low- and moderate-income people afford insurance premiums and out-of-pocket medical expenses. Although some HSA proponents envision workers' HSA contributions accumulating over time as new contributions are made to their accounts each year, most low- and moderate-income workers likely would not be able to afford to contribute large amounts to the accounts. To be sure, under the bill, the federal government would make deposits into the HSAs of people eligible for subsidies in states with the "alternative option." These people would receive their subsidy in the form of a tax credit that would be deposited into their HSA. But as explained below, these new tax credit subsidies would be significantly smaller than the ACA premium subsidies they would replace. As a result, most consumers would have to use the modest subsidy amounts deposited in their HSAs as their primary means of paying premiums and related health costs, and they likely would exhaust their HSA contributions relatively quickly. They consequently would benefit little, if at all, from the tax breaks the HSAs would provide for affluent people, who could amass large sums in their accounts over time and shelter from taxation the earnings on the investments they made with their hefty HSA balances.

  More specifically, in states taking the "alternative option," the total amount of resources allotted to a state for subsidies for its residents would equal 95 percent of the funds the ACA would have provided for subsidies in the state. (It isn't clear how this capped amount, which the Secretary of Health and Human Services would set, would be adjusted over time, especially if a state experienced higher-than-expected enrollment or premium growth. As a result, the actual reduction in funding could grow considerably larger over time.)

Yet despite this reduction in the overall resources for subsidies, the subsidies would have to *spread across a much larger group of people*, because Cassidy-Collins would make the subsidies available to people with incomes up to $190,000 a year for individuals and $250,000 for couples[9] — far above the income limits for ACA subsidies. Furthermore, the subsidies would also be made available to people with access to employer-based coverage. *Spreading a smaller total amount of resources for premium subsidies over a much larger number of people would make the level of the subsidies that near-poor and working-class people receive considerably smaller than the subsidies for which they qualify now under the ACA.*[10]

Exacerbating this problem, the subsidies would *not* begin to be scaled by income until $90,000 for individuals and $150,000 for couples, phasing down slowly at one percentage point per $1,000 of income after that. In other words, a couple with a $25,000 income would get the same subsidy as a couple with a $150,000 income. That would further depress the subsidy levels for near-poor and modest-income households, relative to the ACA subsidies and prevent the bill from providing bigger benefits to those who need the most assistance to afford decent-quality health coverage.

Finally, the bill would count the tax-credit subsidies as taxable income. This would effectively reduce the assistance available under the subsidies for many working-class families, by raising their income taxes and reducing (or in some cases, eliminating) their Earned Income Tax Credit.

- High-income filers, by contrast, would benefit handsomely. They would be the people who would amass the largest HSA accumulations. And because they face the highest marginal tax rates, they would benefit the most from the HSA features that shield HSA earnings and withdrawals from taxation. The tax breaks for high-income households would be worth considerably more per dollar in an HSA than for ordinary workers.

The plan thus would give modest-income working families considerably less help in affording decent-quality health plans than they can receive today, with the result that many people could find adequate coverage difficult to afford.

Tax-Sheltering Opportunities for Top Earners

As noted, while individuals earning more than $133,000 and couples making more than $196,000 in 2017 are ineligible to contribute to Roth IRAs, there would be no income limits for contributions to the greatly expanded Roth HSAs. A high-income family of four could contribute $20,000 every year to a Roth HSA, about triple the current HSA contribution limit.

The evidence is strong that high-income people would indeed constitute the great bulk of those who would make the maximum contribution. With high-income households ineligible for Roth IRAs, few people make the maximum allowable IRA contribution of $5,500 a year ($6,500 for people aged 50 or older). Less than 2 percent of workers max out on Roth IRA contributions,

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[9] According to the plan, the tax subsidies would be available up to those income levels. States could opt to increase subsidy amounts for those who qualify for ACA's marketplace subsidies today. But such increases would have to be budget neutral to the federal government, thus likely making this option infeasible for states.

[10] By increasing taxpayers' taxable income, the new Roth HSA deposits could reduce the EITC for taxpayers in the EITC's "phase-out" range (and could push some taxpayers out of that range and make them ineligible for the EITC).

based on Internal Revenue Service (IRS) and the Congressional Budget Office (CBO) data.[11] This underscores the point that the people who could afford to make very large contributions to the proposed Roth HSAs would overwhelmingly be those with high incomes.

In short, wealthy people could maximize contributions to these tax-favored savings accounts, let substantial funds accumulate in the accounts over time, and reap hefty tax-free gains on the HSA balances they amassed. Indeed, the budgetary costs of the proposal would likely mount over time as affluent people built up the assets in their HSAs (the earnings on which would be tax-free), and as many of these people later made tax-free withdrawals from the accounts in retirement to pay for medical and long-term costs *in lieu of* sources that are taxable, such as withdrawals from 401(k) accounts.[12]

Conclusion

The Cassidy-Collins Roth HSA proposal is poorly designed to meet low- and moderate-income people's health coverage needs and a faulty replacement for the ACA's premium and cost-sharing subsidies. Rather than helping people with modest incomes afford to maintain decent-quality coverage, it would offer lucrative new benefits to high-income people and create an attractive tax sheltering opportunity for them, even as subsidies for modest-income working families were being cut back. The proposal thus would transfer resources up the income scale in reverse Robin Hood-fashion and likely would leave millions of Americans underinsured or uninsured.

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[11] Based on IRS data, we estimate that in 2014, roughly 1.4 percent of all tax filers contributed the maximum amount to Roth IRAs. Similarly, in 2011 CBO published a comprehensive study estimating that about 1.6 percent of all workers contributed the maximum amount to Roth IRAs in 2006. See: Internal Revenue Service Statistics of Income, "Table 6: Taxpayers with Roth IRA Plans, by Size of Contribution and Age of Taxpayer," https://www.irs.gov/uac/soi-tax-stats-special-studies-on-individual-tax-return-data and Congressional Budget Office, "Use of Tax Incentives for Retirement Saving in 2006," October 2011, https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/2011-10-14-TaxIncentives.pdf.

[12] The Roth HSA proposal may initially appear to produce savings by making contributions to HSAs non-deductible. However, the proposal would likely lose considerable revenue over time because the expanded eligibility for HSAs and increased contribution limits would lead to larger tax breaks on investment gains over time. These costs would be even greater if the upfront savings from the Roth HSA proposal were used to finance other proposals with permanent costs. For analysis of similar timing gimmicks with Roth IRAs, see Nathaniel Frentz and Chye-Ching Huang, "Four Timing Gimmicks That Could Disguise Fiscally Irresponsible Individual Tax Reform," Center on Budget and Policy Priorities, October 30, 2013, http://www.cbpp.org/research/four-timing-gimmicks-that-could-disguise-fiscally-irresponsible-individual-tax-reform?fa=view&id=4041.