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Health Savings Account (HSA) Qualified Medical Expenses

Section 223 of the Internal Revenue Code (IRC) allows individuals to establish and contribute to a health savings account (HSA) while they are covered under certain high-deductible health plans (HDHPs). Individuals can withdraw money from their HSA to pay for eligible medical expenses, also known as *qualified medical expenses*, for the account holder, their spouse, or their dependents. These expenses are excluded from gross income for federal income taxes even if the individual no longer has an HSA-qualified HDHP at the time of the withdrawal.

Qualified Medical Expenses for HSAs

For HSA purposes, qualified medical expenses include most items and services that would be considered medical care for the medical and dental expenses itemized deduction, as described in IRC Section 213(d). Qualified medical expenses also include menstrual care products and over-the-counter medications and drugs without a prescription. Premiums generally are not considered a qualifying medical expense, except in limited instances.

Medical Care Under Internal Revenue Code 213(d)

If an expense falls within the definition of medical care under IRC 213(d), it generally would be considered an HSA-eligible medical expense (notwithstanding any HSA-specific rules).

IRC Section 213(d) does not provide an exhaustive list of all items and services that are considered medical care; rather, it provides a broad definition to include amounts paid for "the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body." Treasury regulations and case law further specify that these expenses must be incurred "primarily for the prevention or alleviation of a physical or mental defect or illness." An expense is considered to prevent disease if there is a present existence or an imminent probability of developing a disease, physical defect, mental defect, or illness.

The term *medical care* at IRC Section 213(d) also includes certain transportation and lodging expenditures, qualified long-term-care costs, amounts paid for health insurance, and limited amounts of long-term-care insurance premiums. Although health insurance premiums are included in the definition of medical care at 213(d), HSA-specific rules prevent using HSAs to pay for health insurance premiums except in limited instances.

Regulations provide that costs for hospital services, nursing services, and body scans would fall within the definition of medical care and would be an HSA-eligible expense. Personal expenses that are merely beneficial to the general health of the individual, such as toothpaste, would not be considered medical care and would not be an HSA-eligible expense. Additionally, costs for illegal operations or treatments are not considered eligible medical care.

In certain instances, an item or service that is typically considered a personal expense may be considered medical care under IRC Section 213(d). These instances will depend on the facts and circumstances of the situation in which the item or service is used. For example, the Internal Revenue Service (IRS) has held that the costs of a weight-loss program for the purpose of improvements of appearance, general health, or a sense of well-being would not be considered medical care; however, if the costs of a weight-loss program were for the purpose of treatment of a specific disease diagnosed by a physician (e.g., obesity, hypertension, heart disease), these expenses would constitute medical care.

The IRS suggests using objective factors to determine if a typically personal expense can be considered medical care. These factors include the individual's purpose for the expense, whether a physician diagnosed a medical condition and recommended it, the treatment's relation and effectiveness to the illness, and the timing relative to disease onset or recurrence.

In addition, personal expenses typically are considered a medical expense only if the individual would not have incurred the expense but for their disease or illness.

Internal Revenue Service Resources

The IRS provides guidance on which (and when) specific items and services can be considered medical care for purposes of IRC Section 213(d).

Publication 502, which relates to the medical and dental expenses itemized deduction, offers detailed information about what items and services generally are and are not considered medical care under IRC Section 213(d). As such, the publication also indicates which items and services generally might or might not be considered a qualifying medical expense for HSA purposes, though it does not incorporate any HSA-specific rules. For example, Publication 502 does not take into account the HSA-specific rule generally excluding health insurance premiums from being considered a qualifying medical expense. In another example, even though Publication 502 indicates that over-the-counter medicines are not considered medical care for the medical and dental expenses itemized deduction, such medicines are considered qualifying medical expenses for HSA purposes.

In addition, the IRS has published frequently asked questions (FAQ) that address whether certain costs related

to nutrition, wellness, and general health are considered medical care for purposes of IRC Section 213(d) and, correspondingly, HSAs.

IRS Publication 502 and the FAQ are non-exhaustive lists of medical expenses; the omission of a service or item from such sources does not automatically preclude it from being considered medical care for HSA purposes.

Legislative Approaches to Amending HSA-Qualified Medical Expenses

Congress most recently addressed the types of medical expenses for which HSAs can be used in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136), which expanded the list of HSA-qualified medical expenses to include over-the-counter medicines and menstrual care products. In addition, the CARES Act made similar changes to three other types of health-related, tax-advantaged accounts/arrangements that also rely on the definition of medical care at IRC Section 213(d): health flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), and Archer Medical Savings Accounts (MSAs).

Since then, Congress has introduced other bills that would modify the items and services that can be paid for using an HSA. These bills frequently take one of two approaches:

- Amending the definition of medical care at IRC Section 213(d), or
- Amending IRC Section 223 directly to create or address an HSA-specific rule.

These different approaches could affect different populations.

Amending IRC Section 213(d): This approach could introduce broader changes impacting many tax provisions, compared with solely amending HSA statute. Since FSAs, HRAs, and Archer MSAs also rely on the definition of medical care at IRC Section 213(d), amending this section of the IRC would apply changes to HSAs, other health-related tax-advantaged accounts/arrangements, the medical and dental expenses itemized deduction, and other tax provisions relying on 213(d), barring specific exclusions.

Absent any HSA rules preempting the application to HSAs, additions to the definition of medical care at IRC Section 213(d) would allow individuals to use their HSA to pay for the new expense on a tax-advantaged basis. It also would allow individuals who take the itemized deduction to include the new expense under the medical and dental expenses deduction, although individuals cannot use their HSA for an expense and deduct the same expense for the medical and dental expense deduction. Amending IRC Section 213(d) also could affect other provisions relying on that section of the code, such as the other health-related, tax-advantaged accounts/arrangements.

Examples of bills in the 118th Congress that contain provisions that would amend IRC Section 213(d) directly include the Personalized Care Act of 2023 (H.R. 4803/S. 2621) and the PLAY Act of 2023 (H.R. 5238).

Amending IRC Section 223: This approach would be more limited, as it would make targeted changes to HSA-qualified expenses only, without impacting other provisions that rely on IRC Section 213(d). For example, it would allow individuals to use their HSAs to pay for a new expense on a tax-advantaged basis, but such expense would not be eligible for the medical and dental expenses itemized deduction or for FSAs, HRAs, and Archer MSAs, unless additional changes were made. Some, though not all, legislation that would address HSA-qualified medical expenses by amending IRC Section 223 would make similar changes to FSAs, HRAs, and/or Archer MSAs.

In addition to the CARES Act, examples of bills that would amend Section 223 include the Stay Cool Act (H.R. 4314) and the Dietary Supplements Access Act (H.R. 4794). The Stay Cool Act and the Dietary Supplements Access Act take different approaches with respect to applying similar changes to other tax-advantaged accounts/arrangements. The Stay Cool Act would make changes only to HSAs, whereas the Dietary Supplements Access Act would make changes to HSAs, FSAs, and HRAs.

Policy Considerations

To the extent that Congress modifies the list of HSA-qualified medical expenses, there may be several policy issues to consider in addition to the legislative approach.

Expanding the items and services that are considered HSA-qualified medical expenses could reduce federal revenues. For example, the Congressional Budget Office estimated that the CARES Act expansion of qualified medical expenses for HSAs, FSAs, HRAs, and Archer MSAs to include over-the-counter medicines and menstrual care products would reduce revenues by $9 billion from 2020 to 2030, because people were expected to contribute more to these accounts/arrangements since more types of expenses would be eligible. Policies that would amend IRC Section 213(d) could result in a larger budgetary impact as compared with a similar policy focused on HSAs alone.

When HSAs were established in 2003 (P.L. 108-173), the intent was to provide a "tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses." In the event that legislation would modify the items for which HSAs can be used, Congress may want to consider the extent to which such modification is consistent with the intent that Congress had when it passed legislation establishing HSAs and the extent to which a change to such structure is warranted.

The distinction between the legislative approaches may be less relevant for bills addressing HSA-specific eligible medical expense rules. For example, the Bipartisan HSA Improvement Act of 2023 (H.R. 5688; 118th Congress) would amend the HSA-specific rule that generally prevents the use of HSAs for health insurance premiums by expanding the list of limited exceptions to that rule.

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