



# Compliance Alert

February 12, 2007

***Compliance Alert, provided by Group Benefit Services, gives you the most up to date information regarding industry news as well as legislation and regulatory activities affecting your health plan.***

## **Topic: H.R. 6111 – The Tax Relief and Health Care Act of 2006, Passed Saturday December 9, 2006.**

H.R. 6111 (the “Act”) was passed on December 9, 2006 and includes improvements to the Health Savings Account (HSA) rules. Most of the provisions are effective January 1, 2007. Below are the 7 improvements as well as a description of prior guidance associated with each change.

1. The Act now allows an employee to a one-time, tax-free rollover of funds from a Flexible Spending Account (FSA) or Health Reimbursement Arrangement (HRA). This provision will allow the one-time, tax-free rollover to the individual’s HSA prior to January 2012.

**Prior to H.R. 6111**, excess funds in the FSAs were forfeited at the end of each year and balances in HRAs were employer contributions only , therefore belonged to the employer.

2. The Act eliminates the “lesser of” deductible or statutory limit contribution rule. This is simplified by allowing HSA contributions up to the full statutory maximum (based on single or family coverage) without regard to the individual’s High Deductible Health Plan deductible amount. The contribution limit for 2007 is \$2,850 for single coverage and \$5,650 for family coverage.

**Prior to H.R. 6111**, individuals were only allowed an HSA contribution equal to the “lesser of” the amount of the deductible for the high deductible coverage they are enrolled in or the annual maximum contribution limit.

3. The Act modifies HSA Contribution Rules for Mid-Year Enrollees. This provision will allow a full-year’s contribution for individuals that enroll in a High Deductible Health Plan mid-year provided certain conditions are satisfied.

**Prior to H.R. 6111**, if an individual had enrolled in the High Deductible Health Plan with an HSA after the start of the year, the amount they could contribute was prorated by the number of months remaining in the year, although the deductible was not similarly adjusted. This limitation made the HSA and the High Deductible Health Plan unattractive to those individuals.

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4. The Act now allows employers to contribute more money into the health savings accounts of non-highly compensated employees. Higher contributions can be made to the accounts of lower-wage workers.

**Prior to H.R. 6111**, employers who contributed to their employees' accounts were required to make "comparable contributions" to each account or could be penalized for discrimination.

5. The Act now allows a one-time tax-free withdrawal from IRA funds to transfer those funds to an HSA up to the annual contribution limit. This transfer is penalty free and the individual does not have to claim the money being withdrawn as income.

**Prior to H.R. 6111**, individuals with IRAs were not permitted to make tax-free withdrawals from their IRAs before age 59 ½ without paying a 10% penalty. The amount withdrawn had to also be claimed as income on income tax returns.

6. The Act requires the Treasury Department to publish the cost of living adjustments (COLA) for HSAs no later than June 1 of the preceding year. This will allow employers and health plans to make appropriate benefit design changes to plans in time for their annual enrollment sessions.

**Prior to H.R. 6111**, Treasury could wait until as late as November 1<sup>st</sup> to issue indexed amounts. The late deadline would prohibit employers from communicating new amounts into plan designs for the upcoming plan year.

7. The Act allows individuals that participate in FSAs with a "Grace Period" to contribute to HSAs at the start of the year. Contributions are allowed even if the individuals were enrolled for the previous year in an FSA with a 2 ½ month grace period provided the FSA balance is zero before the start of the grace period or any remaining FSA funds are transferred to the new HSA.

**Prior to H.R. 6111**, individuals could not begin contributing to an HSA until late March if they were previously participating in a Flexible Spending Arrangement with an "end of year" grace period.

We have attached the "Summary of Health Savings Account Changes in H.R. 6111", published by Davis & Harman LLP, to provide you with more information on the provisions.

You can also read more about HSAs at the following website:

<http://www.ustreas.gov/offices/public-affairs/hsa/>

*This communication is not intended to be legal advice and should not be construed as legal advice. If you have any legal questions or concerns about your plan, GBS recommends seeking counsel from an ERISA attorney.*

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## SUMMARY OF HEALTH SAVINGS ACCOUNT (HSA) CHANGES IN H.R. 6111\*

| ITEM  | CURRENT LAW   | BILL  | COMMENTS  |
|---|---|---|---|
| <b>INCREASED HSA CONTRIBUTION LIMITS FOR ALL INDIVIDUALS</b>            | The contribution limit to a health savings account (HSA) is the <u>lesser</u> of (i) 100 percent of the annual deductible (not including any deductible for out-of-network services) of the accountholder's qualifying high deductible health plan ("HDHP"), or (ii) \$2,700 for individual coverage or \$5,450 for family coverage. For 2006, the annual deductible in an HDHP cannot be less than \$1,050 for individual coverage or \$2,100 for family coverage, but the annual out-of-pocket maximums may be as high as \$5,250 for individual coverage and \$10,500 for family coverage. | Eliminates the "lesser of" rule so that the contribution limit for anyone with HDHP coverage is the statutory dollar maximum ( <i>i.e.</i> , \$2,700 for individual coverage and \$5,450 for family coverage), regardless of the deductible amount under the HDHP.  | This change increases the contribution limits and, therefore, will help reduce the risk that a person will exhaust his or her current-year HSA dollars before the out-of-pocket expense maximum is reached under the HDHP.<br><br><i>Effective date: 2007</i>   |
| <b>NO CONTRIBUTION REDUCTION FOR PERSONS WHO JOIN THE HDHP MID-YEAR</b> | The contribution limits to an HSA are based upon eligibility to make contributions ( <i>e.g.</i> , HDHP coverage) in each calendar month. Thus, to be eligible for the full-year's HSA contribution, a person must be enrolled in the HDHP in each month of the calendar year even though the HDHP deductible is not limited for partial-year coverage.   | Provides for a full-year contribution to the HSA for a person who joins the HDHP mid-year, provided that he or she continues to be eligible for HSA contributions ( <i>e.g.</i> , enrolled in HDHP coverage) for a full 12 months. Failure to maintain such coverage would result in income tax and a 10-percent penalty on contributions made. | Individuals that enroll in HDHP coverage after the start of the year, either as part of employer-sponsored group coverage or on the individual market, remain subject to the full annual deductible under the HDHP. For such individuals, current law limits HSA contributions to only those months in which they have qualifying HDHP coverage even though they are subject to the full year plan deductible. H.R. 6111 provides an important "fix" by allowing individuals that enroll in an HDHP mid-year to make contributions up to the full annual HSA contribution limit.<br><br><i>Effective date: 2007</i> |

\* H.R. 6111, the Tax Relief and Health Care Act of 2006, was passed by the House on December 8, 2006, and is expected to be considered by the Senate. The provisions relating to HSAs contained in Title III of H.R. 6111 are the same as the provisions in H.R. 6134, which was reported by the Committee on Ways and Means on September 29, 2006.

| ITEM  | CURRENT LAW   | BILL  | COMMENTS   |
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| <p><b>CONSOLIDATION OF EXISTING HRA AND FSA FUNDS INTO HSAs</b></p> | <p>An flexible spending arrangement (“FSA”) or a health reimbursement arrangement (“HRA”) for employees that provides for reimbursement of medical expenses before the employee satisfies the deductible under an HDHP disqualifies the employee from making HSA contributions even if the employee participates in an HDHP. Current law provides no mechanism for consolidating health accounts after an employee becomes covered under an HDHP.</p>   | <p>Provides a 5-year window for an employer to make a one-time transfer of FSA or HRA balances to an HSA for employees on a nondiscriminatory basis. The amount transferred cannot exceed the balance in the FSA or HRA as of September 21, 2006. If the employee fails to continue to be covered by the HDHP for a 12-month period after the transfer (or otherwise fails to be eligible for HSA contributions during that period), then the employee would incur income tax plus a 10-percent penalty on the transferred amounts.</p> | <p>The consolidation of employer-sponsored health accounts in an HSA eliminates inequities for employees who have elected to participate in an HDHP but are precluded from making current HSA contributions because a pre-existing employer health account constitutes disqualifying “other health coverage.” The requirement that the transfer not exceed the balance in the account on the statutory date limits the relief to pre-existing accounts.</p> <p>The one-time rollover of existing HRA or FSA funds will assist employers that seek to transition employees to HDHP coverage; this is especially so where an employer’s workforce includes employees that are likely to incur immediate claims under the HDHP, such as with chronically ill employees. The one-time rollover will help ensure that employees have HSA funds available to them from the start of HDHP coverage to meet initial out-of-pocket costs under the HDHP.</p> <p><i>Effective date: Date of enactment and sunsets December 31, 2011.</i></p> |
| <p><b>ELIMINATION OF FSA “2-1/2 MONTH” FICTION</b></p>              | <p>Under recent IRS administrative guidance, an employer may provide that FSA funds be available for health reimbursements during an additional 2-1/2 month grace period. An employee who has drawn down on all funds from the FSA prior to the 2-1/2 month grace period, and thus has a “zero balance” in his or her FSA during the 2-1/2 month grace period, is nonetheless treated as having disqualifying coverage that precludes HSA contributions during the 2-1/2 month period. Administrative guidance in IRS Notice 2005-86 does not allow an employer to eliminate the 2-1/2 month grace period only for employees who elect HDHP coverage.</p> | <p>Provides that an employee with a “zero balance” in the FSA is not disqualified from HSA contributions during the 2-1/2 month FSA grace period or if the employer is otherwise making a qualifying transfer to consolidate the FSA balance in an HSA, as discussed above.</p>   | <p>This provision effectively overrides the result in Notice 2005-86. Employers that had considered eliminating the 2-1/2 month grace period from their FSAs because of the negative interaction with the HSA rules now may be more inclined to continue the feature.</p> <p><i>Effective date: 2007.</i> An employee who has elected HDHP coverage for January 2007 and who is a participant in a calendar-year FSA that utilizes the grace period would need to spend down the FSA by December 31, 2006, or the employer would need to make the one-time rollover of the FSA dollars to the HSA (as discussed above).</p>  |

| ITEM   | CURRENT LAW   | BILL   | COMMENTS   |
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| <b>EARLIER COST-OF-LIVING ADJUSTMENTS FOR HSA LIMITS</b>   | HSA contribution limits and HDHP out-of-pocket limits are subject to a COLA that cannot be calculated and published by the Treasury Department until late in the year.  | Amends Code section 223 to require that the Secretary of Treasury complete the indexing of the applicable limits by June 1.  | Ensures that employers and providers have sufficient time to produce communication materials using the correct contribution amounts for programs that take effect in the next calendar year.<br><br><i>Effective date: 2008</i>  |
| <b>ROLLOVERS OF EXISTING IRA FUNDS INTO HSAS</b>           | Rollovers are not permitted into an HSA from a qualified retirement plan, including an individual retirement account (“IRA”).   | Permits a one-time tax-free irrevocable rollover from an IRA into an HSA. The amount of the rollover cannot exceed the applicable annual HSA contribution limit (which would vary depending on whether the person has individual or family HDHP coverage). Failure to maintain eligibility for HSA contributions for a period of 12 months following the IRA transfer would result in income tax and a 10-percent penalty on the transfer. | Gives individuals access to IRA funds for HSA contributions. Because the amount of the rollover cannot exceed the annual contribution limit to the HSA, the rollover of IRA funds does not increase the HSA contribution.<br><br>This provision is likely to benefit individuals that opt into an HDHP and incur out-of-pocket costs during the early part of the year or before they are otherwise able to “fund up” their HSA through payroll deductions or non-rollover contributions.<br><br><i>Effective date: 2007</i> |
| <b>HIGHER CONTRIBUTION LIMITS FOR LOWER-PAID EMPLOYEES</b> | Employer contributions to an HSA (other than through a cafeteria plan) must be “comparable” for all participants; therefore, contributions cannot differ based upon compensation or job status even where such differing contributions would favor nonhighly compensated employees. | Eliminates the requirement that disallows higher contribution limits for nonhighly compensated employees.  | Allows employers to provide higher HSA contributions – up to the statutory maximums – to nonhighly compensated employees. Because employer contributions made through a cafeteria plan are subject to more flexible rules than the general comparability rules governing HSAs, this provision is likely to be useful primarily for small businesses that do not sponsor cafeteria plans.<br><br><i>Effective date: 2007</i>  |

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