

THE IRS GIVETH AND THE IRS TAKETH AWAY

A new law will enhance several rules pertaining to Health Savings Accounts (HSAs). The President has signed into law, the HR 6111 bill (the Tax Relief and Health Care Act of 2006). The bill improves existing HSA rules in the following ways:

THE IRS GIVETH –

Provision repealing the annual plan limitation on the HSA contribution is effective for taxable years beginning after 12/31/06. The provision allows HSA contributions up to the full statutory maximum without regard to the individual's HDHP deductible amount. The maximum annual contribution that can be made to an HSA is \$2,850 for self only coverage and \$5,650 for family coverage for 2007.

Provision for one time rollover from Health FSA or HRA to HSA effective for taxable years beginning after 12/31/06. The one time distribution from FSA or HRA can be for the lesser of the account balance on September 21, 2006 or the balance in the account on the date of the distribution (excluding incurred but not yet reimbursed claims). Debit Card Pending Swipes were not taken into consideration although the bill did state that it is expected that the Secretary will provide guidance with respect to timing of health FSA distributions contributed to an HSA. Rollovers from FSA or HRA to HSA do not count towards the annual maximum contribution limit.

The rule only applies to participants who have an HRA or health FSA on September 21, 2006.

Provision disregarding certain FSAs coverage is effective for taxable years beginning after 12/31/06. Coverage under a health FSA during the "grace period" immediately following the end of a plan year is disregarded when considering eligibility of the individual for an HSA, if the balance in the health FSA at the end of the plan year is zero or the entire remaining balance in the health FSA at the end of the plan year is contributed to an HSA.

However, participants whose plan year ending balance is greater than the Health FSA balance on September 21, 2006, and are therefore unable to rollover the entire balance to an HSA and who do not incur enough expenses prior to the end of the plan year equal to the ending balance will continue to be ineligible for an HSA until the end of the grace period.

Provision for earlier cost-of-living adjustments is effective for taxable years beginning after 2007. Cost of living adjustments will be determined as of the close of the 12-month period ending March 31 rather than August 31 and must be published no later than June 1st.

Provision allowing contributions for months preceding the month that the taxpayer is eligible individual is effective for taxable years beginning after 12/31/06.

Individuals who are eligible individuals anytime on or before the first day of December

are treated as having been an eligible individual for every month during the taxable year for purposes of computing the amount that may be contributed to the HSA.

Per each taxable year –“If an individual is treated as an individual solely on the basis of this provision, the individual is treated as having been enrolled in the same HDHP in which the individual was enrolled in during the last month of the taxable year”.

Example: Employee was eligible all for tax year 2007, then changes to an ineligible health plan on 1/1/08, but still has an HSA account. The employee enrolls in a qualified HDHP effective 2/1/08, they can contribute for all of 2008. Also the amount they can contribute for January of 2008 is based on the maximum allowed for the tier(single or family) that they were enrolled in for the month of December 2007.

Example: An employee is hired November 15, 2007 and has enrolled in HDHP family coverage effective December 1, 2007 and is therefore eligible for HSA on December 1, 2007. The employee will be allowed to contribute the maximum allowed for family coverage for the entire taxable year of \$5,650.

Note: The amount an individual can contribute under this provision can be complicated.

Example: suppose an individual had a non-HDHP self only coverage January 1, 2007 through April 30, 2007, then HDHP self only coverage May 1, 2007 through October 31, 2007. On November 1, 2007 the individual switched to HDHP family coverage for the remainder of the year.

The individual's HSA contributions for May through October 2007 likely will be based on the HDHP self only coverage maximum of \$2,850 ($\$2,850/12*6=\$1,425$). The individual's HSA contributions for November and December likely will be based on the HDHP family coverage maximum of \$5,650 ($\$5,650/12*2=941.67$). The individual's contribution limitation for his or her January through April coverage is apparently based on the HDHP family maximum of \$5,650 ($\$5,650/12*4=1883.32$), even though the individual had self only coverage during that time period and then immediately switched into another self only coverage.

Also, note that the varying contribution amount can create administrative issues for the cafeteria plan administrators because the amount contributed can vary so often.

Provision modifying comparability rules for non-highly compensated employees is effective for taxable years beginning after 12/31/06. Allows employers to make larger HSA contributions for non-highly compensated individuals than for highly compensated individuals. However, comparability rules apply for all non-highly compensated individuals.

Provision for one time rollover from IRAs to HSAs effective for taxable years beginning after 12/31/06. The amount that can be contributed to the HSA for the year

are reduced by amount distributed from an IRA and contributed to an HSA. Only one distribution per lifetime of the individual.

AND THEN THE IRS TAKETH AWAY -

Take back provision on one time rollover from Health FSA or HRA to HSA. If an individual becomes ineligible any time during the testing period (beginning with the month the distribution is made and ending on the last day of the 12th month following such month. (rolling 12 month period) then the amount contributed to HSA from FSA will be included in gross income in the taxable year the individual is no longer eligible for HSA and an additional 10 % tax applies. Taxable in year they become ineligible.

A modified comparability rules applies with respect to the FSA or HRA rollover. If the employer allows any employee the ability to make contributions to the HSA from distributions from a health FSA or HRA, then all employees who are covered under a HDHP must be allowed to make such a distribution.

Take back provision on allowing contributions for months preceding the month that the taxpayer is eligible individual. If an individual becomes ineligible during the testing period beginning with the last month of the taxable year and ending on the last day of the 12th month following such month (12 month calendar year), the amount of contributions attributed to months preceding the month in which the individual was an eligible individual will be includable in taxable income and an additional 10% tax applies. Taxable in year they become ineligible.

Take back provision on one time rollover from IRAs to HSAs. If an individual becomes in eligible during the testing period beginning with the last month of the taxable year and ending on the last day of the 12th month following such month (12 month calendar year), the amount of contributions attributed to months preceding the month in which the individual was an eligible individual will be includable in taxable income and an additional 10% tax applies. Taxable in year they become ineligible.

Further guidance is needed on:

- Whether an employer has discretion over making Qualified HSA distributions available.
- Must employers make HSA distributions available until January 1, 2012?
- May employers force employees to make Qualified HSA distributions if the employer wishes to establish an HSA on behalf of the employee without the employee's consent?

Click on link below for text of bill.

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:h6111eah.txt.pdf