



IRS Proposes Regulations for Employer Comparable Contributions to Health Savings Accounts

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On August 26, the Internal Revenue Service (IRS) issued proposed regulations for employer comparable contributions to health savings accounts (HSAs). The proposed regulations clarify and expand earlier guidance in Notice 2004-2 and Notice 2004-50, and generally outline the permissible circumstances under which employers can make contributions to HSAs without triggering an excise tax applicable to noncomparable contributions. The regulations will only apply to employer contributions made on or after the date the regulations are published in final form, but employers may rely on the proposed regulations in the interim.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 allows individuals who are participating in a high deductible health plan (HDHP) to establish a health savings account. Both employees and employers can contribute to an employee's HSA (up to specific limits), and HSA funds can be used to pay, on a tax-free basis, medical expenses incurred by the employee or the employee's dependents. Unused HSA funds carry over to subsequent years.

While employers are not required to make contributions to HSAs, any employer who chooses to make HSA contributions must ensure that the contributions are comparable for all comparable participating employees. Failure to follow the comparability rules will result in an excise tax equivalent to 35% of the aggregate amount contributed by the employer to all HSAs for that calendar year.

Comparable Contributions in General

Similar to earlier guidance, the proposed regulations begin with the premise that employers who choose to contribute to HSAs will have very little flexibility to make varying HSA contributions for different groups of employees. Unlike other employee benefits provisions, the proposed regulations provide that employers cannot vary HSA contributions between union and nonunion employees or management and non-management employees. Further, employer HSA contributions cannot:

- take the form of matching contributions;
- be based on wellness, disease management, or health assessment program participation;
- reflect age or year of service factors; or
- be predicated on qualification for HSA catch-up contributions.

Thus, with the notable exception of HSA contributions made through cafeteria plans (discussed later), employer contributions to HSAs must be carefully structured to avoid the 35% excise tax on noncomparable contributions.

The proposed regulations provide that employer contributions to HSAs are comparable if they are either the same amount or the same percentage of the deductible for employees who are eligible individuals with the same category of HDHP coverage. The only two permissible categories of HDHP coverage are self-only HDHP coverage and family HDHP coverage. Thus, an employer can make HSA contributions to eligible individuals with self-only HDHP coverage while not making any contributions to eligible individuals with family HDHP coverage (or vice versa).

For example, an employer can choose to make a \$1,000 HSA contribution to eligible individuals with self-only HDHP coverage, and a \$2,000 HSA contribution for eligible individuals with family HDHP coverage. Employer HSA contributions would still be comparable if the dollar amounts were reversed, or if the employer only made a \$1,000 contribution to eligible individuals with family coverage.

Employers can further vary HSA contributions among different categories of employees who have self-only or family HDHP coverage. These exclusive categories are full-time employees (who are customarily employed for 30 or more hours per week), part-time employees, and former employees. Thus, an employer can make HSA contributions of the same amount or the same percentage of the deductible to all full-time employees who have the same category of HDHP coverage while not making any HSA contributions to part-time or former employees who have identical HDHP coverage. Further, under a special rule, employers can make HSA contributions to former employees without having to make HSA contributions to former employees electing HDHP coverage under the terms of COBRA.

Despite the limited flexibility provided by the ability to vary employer HSA contributions between different categories of coverage and categories of employees, if an employer makes HSA contributions for any employee in a category, comparable contributions must be made to all other comparable participating employees in that category.

The proposed regulations also provide additional rules permitting (but not requiring) multiple employer HSA contributions among a single category of coverage as long as the contributions represent the same percentage of any multiple deductibles in that same category. For example, if a HDHP had a deductible of \$3,800 for self plus spouse and \$4,000 for self plus two or more dependents, the employer HSA contributions for eligible individuals in those coverage categories can vary in amount as long as they represent the same percentage of the underlying varying deductible. In this example, employer HSA contributions of \$950 for self plus spouse coverage and \$1,000 for self plus two or more dependents would be comparable because they both represent 25% of the deductible for employees with HDHP family coverage.

Finally, an employer may choose to limit its HSA contributions to individuals who are participating in the employer's HDHP. However, if an employer makes HSA contributions to any individuals covered under another HDHP (such as a HDHP maintained by a spouse's employer), then the employer must make comparable HSA contributions to all comparable participating employees. Special rules for coworker spouses also come into play when an employer chooses to make contributions to individuals covered under another HDHP.

Procedures for Making Comparable Contributions

In order to determine whether employer HSA contributions are comparable, an employer must take into account all full-time, part-time, and former employees who were eligible individuals for any month in a calendar year. Comparability testing must be performed across an employer's controlled group.

Employers can make HSA contributions on a pre-funded basis at the start of the year, on a pay-as-you-go basis, or on a look-back basis by April 15 of the following year, as long as all employees are treated the same. There are special rules and exceptions that deal with employees who begin or terminate employment during the course of a year or move between self-only or family HDHP coverage. Other proposed rules address employees who have not established a HSA, and relieve an employer of any obligation to make a comparable contribution if the employee fails to establish a HSA by December 31 of that calendar year. Last, if an employer determines that it has not satisfied the comparability rules, it cannot recoup any portion of its contribution from an employee's HSA. Instead, it must make additional HSA contributions (plus reasonable interest) by April 15 of the following calendar year, or be faced with the 35% excise tax on all HSA contributions.

Under the proposed regulations, the HSA comparability rules do not apply to: rollovers from Archer MSAs or from an employee's prior HSA; after tax contributions forwarded by the employer to an HSA; or to HSA contributions to independent contractors, sole proprietors, or partners.

Finally, the regulations recognize that certain individuals are ineligible to receive HSA contributions because they are participating in a FSA of the employer or a spouse's employer, or because they are enrolled in Medicare. Such individuals are excluded from comparability testing.

Exception for Cafeteria Plans

As provided in the legislative history of the Medicare Act, the comparability rules in the proposed regulations do not apply to contributions that an employer makes through a cafeteria plan. However, in order for an employer HSA contribution to be made under a cafeteria plan, the proposed regulations state that the employee must have the option to receive cash or other taxable benefits in lieu of the HSA contribution. Whether this requirement will be satisfied merely by the existence of other cashable credits or taxable benefits in the cafeteria plan, or whether it will actually require the option to receive the full HSA contribution in cash will undoubtedly be the subject to comments on the proposed regulations. Finally, any employer contributions provided through a cafeteria plan will be subject to the full range of section 125 nondiscrimination rules.

Waiver of Excise Tax

While the 35% excise tax applies to the aggregate amount of employer HSA contributions for a year, the proposed regulations do recognize the opportunity to waive all or part of the tax. Specifically, in the case of a failure due to reasonable cause and not due to willful neglect, all or a portion of the tax may be waived to the extent that the tax would be excessive relevant to the failure involved.

Additional Information

Comments on the proposed regulations and requests for a public hearing must be submitted to the IRS by November 25, 2005. Although these regulations will not be finalized for some time, many of the concepts in the proposed regulations have already appeared in prior guidance. Thus, as employers prepare for the 2006 health plan enrollment season, they should carefully evaluate any employer HSA contributions to be certain that they meet the spirit, if not the letter, of the proposed regulations.

If you would like further information regarding the issues raised in this Morgan Lewis LawFlash, please contact any of the following Morgan Lewis attorneys:

Chicago

David Ackerman	312.324.1170	dackerman@morganlewis.com
Andy R. Anderson	312.324.1177	aanderson@morganlewis.com
Brian D. Hector	312.324.1160	bhector@morganlewis.com

Dallas

Riva T. Johnson	214.438.1557	riva.johnson@morganlewis.com
John A. Kober	214.438.1552	jkober@morganlewis.com
Erin Turley	214.438.1558	eturley@morganlewis.com

New York

Craig A. Bitman	212.309.7190	cbitman@morganlewis.com
Gary S. Rothstein	212.309.6360	grothstein@morganlewis.com

Philadelphia

Robert L. Abramowitz	215.963.4811	rabramowitz@morganlewis.com
Brian J. Dougherty	215.963.4833	bdougherty@morganlewis.com
I. Lee Falk	215.963.5616	ilfalk@morganlewis.com
Robert J. Lichtenstein	215.963.5726	rlichtenstein@morganlewis.com
Vivian S. McCardell	215.963.5810	vmccardell@morganlewis.com
Joseph E. Ronan, Jr.	215.963.5793	jronan@morganlewis.com
Mims Maynard Zabriskie	215.963.5036	mzabriskie@morganlewis.com

Pittsburgh

John G. Ferreira	412.560.3350	jferreira@morganlewis.com
R. Randall Tracht	412.560.3352	rtracht@morganlewis.com

San Francisco

Mark H. Boxer	415.442.1695	mboxer@morganlewis.com
Eva P. McComas	415.442.1249	emccomas@morganlewis.com

