

New Health Savings Account Legislation/Recent DOL Health Savings Account Guidance

December 20, 2006

In what may represent a high-water mark for favorable health savings account (HSA) legislation, Congress passed and President Bush signed into law today HSA legislation increasing HSA contribution limits and permitting rollovers to HSAs from health reimbursement arrangements (HRAs), flexible spending accounts (FSAs), and individual retirement accounts (IRAs).

Further, recent DOL guidance clarifies the steps that employers can take to create HSAs or offer HSA-linked credit cards without triggering ERISA concerns.

As a result of these two actions, employers have greater flexibility to establish HSAs, and HSAs are even more favorable to participants.

HSA Legislation

The surprise passage of HSA legislation was a parting gift delivered during the final hours of the 109th Congress.

The new HSA legislation, part of the Tax Relief and Health Care Act of 2006, resurrects earlier HSA proposals and allows:

- Immediate rollovers of HRA and/or FSA balances (limited only to the lesser of the current balance or the balance on September 21, 2006) to HSAs, subject to a 12-month clawback provision (see below) and an end date of December 31, 2011;
- Disregarding some FSA 2½-month grace period issues when determining HSA eligibility in 2007 and beyond;
- Contributions up to annual single (\$2,850) or family (\$5,650) HSA statutory maximums in 2007 and beyond, regardless of the annual deductible limit in a related high-deductible health plan;
- Earlier indexing of HSA limits (which will ease timing concerns related to annual enrollment communications) starting in 2008;

- Full annual HSA contributions starting in 2007 if an individual enters a high-deductible health plan after the start of a year, subject to a 12-month clawback provision (see below);
- Greater employer HSA contributions for nonhighly paid employees than for highly paid employees in 2007 and beyond; and
- One-time rollovers from IRAs to HSAs beginning January 1, 2007, subject to annual HSA contribution limits and also subject to a 12-month clawback provision (see below).

While many of these provisions will make it easier to participate in an HSA and will increase the amount of permissible HSA contributions, the rollover and full annual contribution rules each contain a 12-month clawback provision. The clawback provisions negate the rollover or increased contribution opportunity and add an additional tax unless the participant remains an eligible HSA participant for a subsequent 12 months (unless participation ends due to death or disability). These provisions reflect the objective of permitting increased contributions or rollovers from terminating HRA or FSA arrangements to ongoing rather than transitory HSAs. Notably, while IRA rollovers are limited to the annual HSA contribution limit, unlimited HRA or FSA amounts can roll over to an HSA. This provision will be particularly useful for employers who have an established HRA program with large balances and who want to transition to a high-deductible health plan/HSA design structure.

Additionally, while the new rules disregarding the 2½-month FSA grace period in some circumstances appear to go a long way toward solving the HSA contribution problems posed by the grace period, the rules are only truly effective for individuals who have no FSA balance on December 31 or transfer their FSA balance to an HSA. As such, it initially appears that (1) an individual who has an FSA balance at year-end and enrolls in a high-deductible health plan at the start of the next year will still be prevented from making HSA contributions until April and (2) the individual will not be able to make a full annual contribution to the HSA.

Finally, while most of the HSA rules are effective today or in a few short weeks, guidance will be necessary to round out some of the provisions. However, given the simplicity of the increased contribution limits, employers should quickly communicate the new limits to participants so that participants can decide whether to increase their 2007 HSA contributions.

DOL HSA Guidance

Additional DOL guidance issued in late October further clarifies the boundaries regarding when employer involvement with an HSA will not cause the HSA to be subject to ERISA.

As a result of Field Assistance Bulletin 2006-02, employers can now, without causing ERISA to apply to an HSA:

- Open an HSA and deposit funds without an employee's affirmative consent;
- Limit marketing to a single HSA provider and only agree to forward contributions to a single HSA provider;
- Select HSA providers whose investment funds mirror some or all of the employer's 401(k) plan investment funds;

- Enjoy Social Security (FICA) tax savings on pretax employee HSA contributions;
- Pay HSA fees on behalf of employees; and
- Offer their own HSA products to their employees (if, for example, the employer is a bank that markets HSAs to the general public).

Further, HSA vendors cannot provide a discount to employers on other products in return for HSA business, but HSA vendors can offer cash incentives to HSA holders for opening an HSA, as long as the cash incentive is deposited into the HSA.

Also, HSAs are subject to the Internal Revenue Code prohibited transaction rules, which, in particular, will force employers to timely transmit employee contributions to an HSA (much like the timely transmittal rules applicable to 401(k) plans).

Finally, the Field Assistance Bulletin gives a critical boost to the growing field of credit cards or lines of credit that are linked to, and repaid by, HSA balances. Now, as long as the HSA is not actually pledged as an asset to repay the credit card, it is not a prohibited transaction to voluntarily direct the payment of HSA funds to the credit card vendor to reimburse expenses previously paid with the credit card. This clarification should significantly increase usage of credit cards linked to HSAs and should allow individuals who do not have a large HSA balance to pay for medical expenses through their HSA-linked credit card and repay the credit advance through additional HSA contributions.

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