



## The Vita Viewpoint Important Information for Decision Makers

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### HSA Reform Bill Passed . . . Awaiting Presidential Signature

#### **Overview**

Earlier this week the Senate passed the Tax Relief and Health Care Act of 2006, a last minute piece of House-initiated legislation that includes changes to the Health Savings Account landscape. The President is expected to sign the bill. Following is an overview of the law as passed by Congress.

#### **Eliminate Tie Between Annual Deductible and HSA Contribution Amount**

Current law restricts HSA contributions to the amount of the annual plan deductible. Beginning in 2007, the monthly contribution maximum for an HSA-eligible employee is simply 1/12<sup>th</sup> of the statutory annual maximum contribution (\$2,850 for single coverage and \$5,650 for family coverage) even if the HDHP's deductible is less.

#### **Catch-up Contribution**

The current law allows for a "catch-up contribution" for employees and covered spouses who have attained age 55 by the end of the plan year. For 2006, that amount is \$700 and increases by \$100 for the coming years until it caps out at \$1,000 in year 2009 and thereafter. There is no change to this provision.

#### **Individuals with Partial Year HDHP Coverage May Contribute Full Annual Maximum**

Current law restricts HSA contributions to 1/12 of the annual deductible for months where coverage was actually in force. The new law eliminates this restriction and allows for the full annual deductible to be contributed to an HSA account regardless of the number of months that qualifying HDHP coverage was actually in place. This allows new HSA owners to take the full annual deduction in their first year of HSA ownership. However, when this is done, the person must remain eligible to make HSA contributions during the *next* full 12 month period, otherwise the contributions will be taxed and an excise tax will also be levied. There are exceptions to this if the person dies or becomes disabled.

#### **Allow Rollovers from FSAs and HRAs into HSAs**

The law allows for a one-time qualifying transfer to an individual HSA of a residual balance from an HRA or health FSA. The transfer may be made on or after the date the law is signed but not later than December 31, 2011. The transfer is treated as a "rollover" contribution to the HSA and therefore does not reduce the HSA account holder's maximum contribution for that year. However if a rollover is made, the individual must remain HSA eligible for the following 12 months or the rollover will be included in gross income and subject to a 10% penalty tax.

#### **Allow Rollovers from IRAs into HSAs**

Individuals may make a one-time transfer to an HSA from an IRA other than a SEP. This type of transfer differs in significant ways from the HRA and FSA transfers described above. The amount of the transfer is limited to the HSA maximum contribution then in effect for the type of coverage (that is, single or family coverage) that the person has under an HDHP at the time of the transfer. This transfer from an IRA reduces dollar for dollar the contributions an individual could otherwise make to his HSA for the year. However, as with the HRA and FSA transfers, if the individual does not remain eligible to make HSA contributions for at least 12 months following the transfer, it becomes taxable as ordinary income and subject to a 10% excise tax penalty.

### ***Annual Cost of Living Increases***

One of the great hassles faced by plan sponsors of HDHPs has been the guesswork associated with setting deductibles and contribution maximums for the coming year. Under the old law, deductible and contribution maximums were based on CPI as of August 31<sup>st</sup> of each year. This restricted the timing on when updates could be released. Under the new law, the updates will be based on the CPI as of March 31<sup>st</sup>, therefore, the Treasury Department will be able to release them much earlier in the year. The Treasury Department will be required to publish the COLA changes for HSA contribution and deductible amounts by June 1<sup>st</sup> (rather than in October or early November). This is a welcome change for employers so they can make appropriate plan changes for the following year and get communication materials printed for open enrollment.

### ***Employers Can Make Higher HSA Contributions for NHCEs***

Under current law, employers who make contributions to the HSA of any employee are required to make “comparable” contributions to the HSAs of comparable employees. There will now be a statutory exception, effective for 2007 and beyond, that allows an employer to ignore HCEs when determining comparable employees, thus employers would be allowed to contribute more to HSAs for their lesser-paid employees. (Many employers have indicated that they want to introduce the plans but can’t subject their lower-wage employees to the full deductible without making a bigger deposit to an HSA than current law allows, to help employees with the routine expenses.)

### ***FSA Grace Period Doesn’t Disqualify Some HSA-Eligible Employees***

In 2005 the IRS authorized FSAs to offer a 2½ month “grace period” after the end of the plan year, to allow employees with residual year end balances to consume those balances by incurring additional claims during the grace period. The problem is that until now the existence of the grace period technically disqualified employees from making HSA contributions for the three months touched by the grace period. The new law would change those restrictions to allow a person whose only disqualifying reason is the existence of the FSA grace period to make the normal HSA contribution if one of the following two circumstances exist:

1. If the FSA balance is zero at the end of the year, or
2. If the person transfers the residual year-end balance from the FSA into his HSA.

***For questions or additional information, please contact  
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