

Congress Enacts Health Savings Account (HSA) Reform Package to Expand HSA Enrollment

On December 9, 2006, Congress passed the Tax Relief and Health Care Act of 2006 (H.R. 6111), which President Bush signed into law on December 20, 2006 (Public Law 109-432). The Act includes an expansion of Health Savings Accounts (HSAs) that will make them more attractive to individuals and employers. (The [box on page 2](#) summarizes the changes to HSAs.) This *Spotlight* discusses the implications of the HSA expansion and what employers may want to do in response.

WHAT ARE THE IMPLICATIONS?

The implications of the Act's HSA provisions include the following:

- Because HSA contribution limits will be increased to the statutory maximum, instead of being limited to the amount of the deductible in the High-Deductible Health Plan (HDHP), HSAs are likely to become more attractive as a health care savings tool. In addition, as long as the HDHP deductible is more than the statutorily required minimum (\$1,100 single, \$2,200 family in 2007), employers no longer have to take the amount of the deductible into account when deciding whether to fund the HSA, and in what amount.
- As HSAs become more attractive and flexible, employers with other individual account plans, such as Health Reimbursement Arrangements (HRAs), may be more interested in transitioning into an HSA environment. However, if an employer intends to allow employees to roll HRA funds into an HSA, it should stop to consider that the HRA, which can be a paper account, would have to be fully funded in order for the funds to be transferred into an HSA, which is a funded, trustee arrangement. This would effectively convert an HRA from a notional promise to pay into a funded account.
- Earlier release of HSA and HDHP annual limits will allow employers more time to plan for HSA implementation as part of open enrollment.
- With new comparable contributions that allow greater employer contributions for non-highly compensated employees, employers may look at plan designs that take advantage of a HDHP and provide employer contributions targeted to lower income employees.

WHAT RESPONSE, IF ANY, IS REQUIRED?

Employers that offered an HSA-related option for 2006 should immediately review the new law to decide whether any changes are required or desired to their existing HDHP/HSA plan option. Some possible action items include:

- If FSA grace periods have presented a problem for the first quarter of 2007, review the new rules and see whether the new rules adequately address any concerns.
- Notify employees about the new higher contribution limit and how it will affect their HSA.
- If an employer contribution is made, either through a cafeteria plan or after-tax, review whether they wish to modify their contribution. Keep in mind modifications to the comparable contribution rule that permit employers to favor non-highly compensated employees. Also, think about how much employer contributions should be made for new hires, in light of the new rule allowing mid-year hires to contribute for the full year.

- Assure that payroll systems are modified in light of the new rules.

Employers may also want to consider asking the FSA or HRA administrator to take a “snapshot” of the account to record the balance as of September 21, 2006. This will assure that if the employer decides to permit a rollover of the balance, an accurate amount will be known.

Employers should keep a careful eye out for fast guidance from the Internal Revenue Service or Treasury Department. Agency representatives have informally announced that they realize guidance is necessary to help employers implement some of these rules, particularly those associated with rollovers between accounts. It is even possible employers may be allowed to re-open their 2006 enrollment in light of the new rules.

Employers considering an HDHP/HSA option for 2008 should review the new law and consult with their benefits advisors as to whether the new flexibility around HSAs, particularly contributions, makes sense for them. Employers that adopted consumer-driven plans with an HDHP/HRA option prior to 2004 should review whether they wish to continue the HRA or provide for a rollover into an HSA.



To discuss the implications of the HSA provisions in the Tax Relief and Health Care Act of 2006 for your organization, contact your Segal/Sibson consultant or the nearest Segal/Sibson office.

THE NEWS IN BRIEF

The HSA provisions include the following, generally effective January 1, 2007:

- **Increased Contribution Maximum** The Act removes the link of the contribution maximum to the annual HDHP deductible. Consequently, for 2007 the maximum contributions are \$2,850 (individual) or \$5,650 (family) regardless of the plan's deductible.
- **Earlier Indexing of Contribution Limits and HDHP deductibles and Out-of-Pocket Maximums:** HSA indexed amounts for a calendar year will be published no later than June 1 of the preceding calendar year. The adjustment will be based on the Consumer Price Index for the 12-month period ending March 31, rather than August 31.
- **Permit Full HSA Contribution for Employees that Join the HSA Mid-Year** The Act allows contributions to be made up to the contribution maximum for individuals who become eligible for an HSA mid-year, as long as the individual continues to be eligible for a full 12 months after the end of the taxable year.
- **Comparable Contribution Rules for Non-Highly Compensated Employees** The Act permits employers to provide lower HSA contributions to highly compensated employees (HCEs) than are provided to non-highly compensated employees.
- **One-Time Rollovers from Individual Retirement Arrangements (IRAs) into HSAs** The Act permits a one-time tax-free distribution of IRA funds into an HSA without penalties, subject to conditions set out in the law.
- **One-Time Distributions from an FSA or HRA into an HSA** Individuals may make a one-time distribution of the amount in their FSA or HRA into an HSA prior to January 1, 2012. The distribution maximum is the lesser of the balance in the FSA or HRA as of the date of distribution or the balance as of September 21, 2006.
- **Relaxation of Grace Period Rule** Under current law, coverage under an FSA during the grace period renders an individual ineligible to make HSA contributions, even if they have no money left in the FSA. Now, FSA coverage will be disregarded as long as certain conditions are met.

(To return to the discussion of the implications and action items, click [here](#).)

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