

March 2007

IRS GUIDANCE ON FSA & HRA TRANSFERS TO HSAs WITH MARCH 15, 2007 DEADLINE

At the beginning of this year, Moreton & Company informed our clients of some new important legislation affecting Health Savings Account (HSA) plans through the Tax Relief and Health Care Act of 2006. Please see www.moreton.com/HSAinfoJan07.pdf to link to initial HSA doc.

Before the Act, individuals with general-purpose health flexible spending account (FSA) and health reimbursement account (HRA) coverage were not HSA eligible. However, a new rule in the Act allows for individuals with general-purpose health FSA and HRA coverage to become HSA eligible if certain conditions are met, including a \$0 balance in the FSA or HRA. The Act also now allows for health FSA grace periods to be disregarded in determining HSA eligibility if the year-end balance is \$0 or the individual makes a rollover of any year-end balance.

Another key point of the Act allowed for limited health FSA and HRA rollovers into an HSA. Further guidance was needed, however, regarding these rollovers, which the IRS just issued in Notice 2007-22 (the Notice). Please note that additional guidance is likely to be issued on other qualified HSA distribution issues. Some key points of the Notice are below.

Transition Rule for Qualified HSA Distributions Completed by March 15, 2007. Participants who have a balance in a general-purpose health FSA with a grace period or an HRA after December 31, 2006 can still be HSA eligible before April 1, 2007 if all of the following occur:

- The employer amends the health FSA or HRA plan by March 15, 2007 to permit HSA rollovers
- The participant's election occurs by March 15, 2007
- An HSA distribution has not previously been made for the employee from that particular health FSA or HRA
- The participant has high deductible health plan (HDHP) coverage the first day of the month the HSA distribution occurs and is HSA eligible
- The employer makes the HSA rollover directly to the HSA trustee by March 15, 2007, but after the participant is HSA eligible
- The rollover does not exceed the lesser of the health FSA or HRA balance on September 21, 2006 or the date of the rollover
- Either the rollover results in a \$0 balance in the health FSA or HRA and the participant has no other non-HSA compatible coverage; or the health FSA or HRA is converted into an HSA-compatible design

Please note the IRS Notice does not limit the Transition rule to health FSAs with grace periods, but informal IRS comments indicate the intent was to do so, and all examples in the Notice involved health FSAs with grace periods.

Comment: Since the law allowing HSA distributions was enacted so late in 2006, employers that did not have time to amend their calendar-year health FSAs and HRAs before year-end will welcome the transition rule. But fact action is needed, as there are quite a few steps to take between now and March 15th.

Unfortunately, employers hoping for guidance on whether HSA distributions could be used in mid-year transitions, such as a termination of a general-purpose health FSA or HRA or a conversion to an HSA-compatible health FSA or HRA, will need to wait longer as this guidance addresses year-end transfers only. More IRS guidance will hopefully be issued soon addressing the many unanswered questions still lingering.

- ◆ If you would like to discuss amending your Cafeteria Plan document in accordance with the Act, please contact your Moreton & Company Consultant. If you have questions about the legislation, please contact:
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