



## **Changes to HSA Regulations- Effective January 1, 2007**

President Bush signed the Tax Relief and Healthcare Act of 2006 on December 20, providing some additional flexibility for participants in a health savings account (HSA). Several changes were made to the existing HSA rules, some of which may introduce greater tracking and reporting requirements for employers. The Treasury Department is expected to provide additional guidance on what these changes mean for employers. In the meantime, the lessening of the contribution restrictions will likely be a welcome change for individuals considering a Health Saving Account. The highlights of these changes are summarized below.

### **Contribution Limits Increased**

Starting in 2007, individuals can make HSA contributions up to the statutory maximum amount (\$2850 single/\$5650 family for 2007), regardless of the amount of their high-deductible health plan. Previously, the maximum HSA contribution was the lesser of the deductible of the HSA-eligible plan or the statutory maximum. For example, an individual with a \$1500 high deductible plan can now contribute up to \$2850 to his HSA in 2007, instead of only \$1500.

### **Full Year Contributions Permitted**

The new rules also permit individuals to contribute up to the statutory maximum, even if they are not enrolled in a high deductible plan for the full calendar year. Prior to this recent change, contributions were pro-rated based on the number of months within the calendar year that the individual was covered by a high-deductible plan. For example, if an individual became covered by a high deductible plan in July of 2006, his or her HSA contributions for the 2006 calendar year was pro-rated based on 6 months of high-deductible plan coverage. Based on the new guidance, the full 2007 maximum of \$2850 could be contributed to an HSA, even if the high-deductible plan did not cover the individual for the full calendar year. However, if the individual does not remain covered by an HSA-eligible plan for the next tax year, he or she will pay income tax and a 10% penalty on a portion of the contributions.

### **FSA Grace Period Relief**

When the IRS began to allow a 2 ½ month grace period for Flexible Spending Account (FSA) plans, it caused complications for employers who wanted to offer HSA plans. Under the old HSA rules, if an employee had coverage within the grace period of the prior year's FSA, they were ineligible to contribute to an HSA during the new plan year. Now, Congress has adopted a special HSA eligibility rule concerning FSA grace periods. Starting in 2007, an individual can make an HSA contribution while they are covered under the grace period for the prior year's FSA plan if:

1. They had a zero balance at the end of the prior plan year or
2. They make a one-time transfer of their existing FSA balance to their HSA.

### **FSA and HRA Rollovers**

HSA participants can now make one-time transfers from their Flexible Spending Account (FSA) or Health Reimbursement Arrangement (HRA) to their HSA. Transfers must take place on or before December 31, 2011 and do not reduce the individual's maximum HSA contribution for the applicable year. The amount of the transfer must be the lesser of:

1. The FSA or HRA balance on September 21, 2006 or
2. The balance of the date of the transfer.

Individuals are limited to one transfer per each FSA and HRA and in addition, the individual must remain HSA-eligible for 12 months following the transfer or have the transfer amount be subject to income tax and a 10% penalty.

### **Rollovers from IRA to HSA**

Individuals may now also make a one-time rollover from an Individual Retirement Account (IRA) to their HSA in an amount equal to the maximum contribution for that year. So, in 2007, an individual could make a \$2850 transfer from their IRA to their HSA if they have single coverage or \$5650 if they have family coverage. The transfer from the IRA does not impact the dollar amount that the individual may contribute during that same year, but they must remain HSA-eligible for 12 months following the transfer or the amount transferred from the IRA is taxable and subject to a 10% excise tax.

### **New HSA Limits Published Annually in June**

The new law requires that the IRS publish the cost-of-living adjustments impacting HSAs by June 1 of the preceding year. Accordingly, the 2008 HSA limits will be available in June 2007. In prior years, the IRS has been releasing HSA limits in October or November, making it challenging for employers to respond for plan years beginning in January.

### **Greater Contributions Permitted for Lower Paid Employees**

Finally, the new rules provide an exception to allow employers to contribute more to the HSAs of non-highly compensated employees than to those of the highly compensated employees.

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