



On December 20, 2006 President Bush signed the Tax Relief and Health Care Act of 2006 into law. The key provisions of this Act include the following and should be beneficial to Health Savings Account (HSA) participants.

Effective January 1, 2007, the amount of money an HSA participant may contribute to an HSA is \$2,850 for a person with individual High Deductible Health Plan (HDHP) coverage, and \$5,650 for a person with family HDHP coverage. This amount is no longer linked to the annual deductible a person has selected with a HDHP.

For participants over 55 years of age the catch up amount of \$800 for 2007 still applies and will, as before, increase each year in the future.

Anyone who enrolls in a qualifying HDHP beginning January 1 through December 1 of the current tax year will be able to make a full year's contribution to an HSA, and will no longer be subjected to the pro-rated limitations. Prior to this new guidance, if a person opened an HSA account in July, only half of the annual contribution maximum was allowed. A participant must have coverage under a qualified HDHP and remain eligible for 12 months after the end of the calendar year in which the participant enrolled in an HDHP. If a participant is not covered by an HDHP for 12 months after the end of the calendar year in which (s)he enrolled in an HDHP the participant will be subject to income tax and a 10 percent excise tax on HSA contributions for months not covered by an HDHP.

This will allow employees to enroll in HSAs any time of year and still be able to contribute the full annual amount.

The Act permits (but does not require) employers to allow a one-time tax free distribution from a flexible spending account (FSA) or health reimbursement arrangement (HRA) to an HSA. This provision allows employers to roll over certain amounts of unused Medical FSA or HRA balances to their employees' HSAs under specified conditions.



These roll-overs will not be subject to the maximum annual HSA contribution limits. Employees must be covered by an HDHP and remain HSA eligible for 12 months after the FSA or HRA transfer. If not, the funds transferred will be treated as taxable income and subject to a 10 percent excise tax.

The new rules allow for a one-time contribution to an HSA of amounts distributed from an Individual Retirement Arrangement (IRA). The contribution must be made in a direct trustee-to-trustee transfer. The IRA transfer will not be included in income or subject to the early withdrawal additional tax. The transfer is limited to the maximum HSA contribution for the year, and the amount contributed is not allowed as a deduction. Generally, only one transfer may be made during the lifetime of an individual. If an individual electing the one-time transfer does not remain an HSA eligible individual for

the 12 months following the month of the contribution, the transferred amount is included in income and subject to a 10 percent additional tax.

Under previous law, if an FSA had a grace period following the end of the plan year allowing participants to incur additional reimbursable expenses, participants were treated as having disqualifying coverage, reducing their HSA contribution for that year, even though they had switched to HSA-eligible coverage at the first of the year. The new rules treat certain FSA coverage during a grace period as disregarded coverage, eliminating any resulting reduction in the HSA contribution for the year. First, the coverage is disregarded if the balance in the health FSA at the end of the plan year is zero. Second, the coverage is disregarded if the year-end balance is transferred directly to an HSA from the FSA, as noted above.



The Department of the Treasury will be required to publish their annual cost of living adjustments (COLA) based on the Consumer Price Index by June 1st of each year, for the next year.

For employers who make contributions to employees' HSAs outside a cafeteria plan, the new rules allow greater employer contributions for lower-paid employees. (Remember, these comparability rules do not apply to contributions made through a cafeteria plan.) Previously, employer contributions under the comparability rules had to be the same amount or percentage of the deductible for all employees with the same category of coverage. Consequently, employers could not contribute higher amounts to lower-paid employees. The new rules provide an exception to the comparability rules allowing employers to contribute more to the HSAs of non-highly compensated individuals. For this purpose, the definition of "highly compensated employee" is based on same definition used for qualified retirement plans.