Alert
Significant Regulatory Developments in Human Resources, Benefits and Compensation
UNITED STATES

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Congress Passes Improvements for HSAs and FSAs

As part of the final legislative package of the 109th Congress, both the House and Senate this weekend approved a measure that would significantly enhance several rules pertaining to health savings accounts (HSAs). The President is expected to sign the bill, HR 6111, shortly. Most importantly, the new law will increase (under some circumstances) the amount that can be contributed to an HSA starting next year. The measure also will permit certain employees to contribute to an HSA during the "grace period," the 2½ month period after the end of the plan year during which individuals are permitted to spend down amounts remaining in their health flexible spending accounts (FSAs) from the previous year.

These changes are good news for employers and employees. Next year, employees will be able to save more pretax money in an HSA, making these accounts and the accompanying high-deductible health plans more attractive to employees and helping to increase participation in these plans.

Major HSA/FSA Changes

Transfer of HRA/FSA balances to HSA: Allows the transfer of amounts in an existing health reimbursement account (HRA) or health FSA to an HSA before January 1, 2012. The amount contributed to the HSA may not exceed the amount in the HRA or FSA on September 21, 2006 (or the amount on the date of distribution, if less.) Individuals will be limited to one distribution from each type of account. Transferred amounts will become taxable income to the individual and a 10% penalty will be imposed if the individual fails to maintain eligibility to make HSA contributions for the 12 months following the transfer.

***Effective date*:** Distributions on or after the date of enactment

FSA grace period: Permits an employee to contribute to an HSA during the FSA post-year-end grace period, provided that either the balance in the individual's FSA at the previous year's end is zero, or any remaining funds in the FSA are transferred to the individual's HSA (in accordance with the rules in the preceding paragraph).

***Effective date*:** Date of enactment

Higher contribution limits: Allows individuals and families to contribute annually to their HSAs an indexed amount ($2,850 in 2007 for single coverage and $5,650 for families), regardless of the plan deductible (i.e., of the accompanying high-deductible health plan).

***Effective date*:** Taxable years beginning after December 31, 2006

Transfer from IRA: Permits a one-time trustee-to-trustee transfer (not to exceed the HSA contribution limit for the year of the transfer) from an IRA to an HSA. Transferred amounts will become taxable income to the individual and a 10% penalty will be imposed if the individual fails to maintain eligibility to make HSA contributions for the 12 months following the transfer.

***Effective date*:** Taxable years beginning after December 31, 2006

Higher contributions for non-highly compensated employees: Allows an employer to make higher HSA contributions for non-highly compensated employees than for highly compensated employees.

***Effective date*:** Taxable years beginning after December 31, 2006

Mid-year enrollment: Permits an individual who enrolls mid-year in an HSA to contribute up to the full contribution limit for the year rather than a prorated amount based on the month of enrollment. The non-prorated amounts will become taxable income to the individual and a 10% penalty will be imposed if the individual fails to maintain eligibility to make HSA contributions for the 12 months following their enrollment.

***Effective date*:** Taxable years beginning after December 31, 2006

Earlier indexing: Requires that the Treasury Department report the annual inflation indexing of certain statutorily prescribed HSA limits for a taxable year by June 1 of the previous year.

***Effective date*:** Will apply to indexing in taxable years beginning after 2007 (which thus will first be reportable in 2007)

Immediate Action

Employers sponsoring both an HSA and an FSA with a grace period may wish to offer employees some flexibility during the grace period, i.e., to contribute to an HSA during the 2½ month grace period if they have reduced any FSA funds to zero by the end of the plan year or if they agree to transfer any remaining prior-year FSA balance to their HSA.

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