



Next Generation Healthcare™

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The House and Senate passed a package of tax extenders that included modifications to health savings accounts (HSAs) and a rollback of Medicare physician payment cuts. This package, "Tax Relief and Health Care Act of 2006" (HR 6111) is now going to the President for his official signature, which is expected and will make it law.

Expands Funding Sources for HSAs

The bill allows an employee a one-time opportunity to roll over unused funds from an existing flexible spending account (FSA) and/or health reimbursement arrangement (HRA) into their HSA. Determining the amount that can be rolled over is somewhat convoluted. The amount that can be distributed from a health FSA or HRA and contributed to an HSA may not exceed an amount equal to the lesser of: 1) the balance in the health FSA or HRA as of September 21, 2006, or 2) the balance in the health FSA or HRA as of the date of distribution. Amounts contributed to an HSA under this provision are excludable from gross income and wages for employment tax purposes; they are not taken into account in applying the maximum deduction limitation for other HSA contributions. Contributions must be made directly to the HSA before January 1, 2012. The provision is limited to one distribution with respect to each health FSA or HRA of the individual. This provision is effective for distributions and contributions on or after the bill's enactment and before January 1, 2012.

Note: The present law stating that an individual is not an HSA eligible individual if the individual has coverage under a general purpose health FSA or HRA continues to apply. For example, if the health FSA or HRA from which the contribution is made is a general purpose health FSA or HRA and the individual remains eligible under such arrangement after the distribution, the individual is not an HSA eligible individual.

The bill also allows one-time transfers from individual retirement accounts (IRAs) to HSAs. The roll-over amount may not exceed the HSA contribution limit for the year. This provision is effective for taxable years beginning after December 31, 2006.

Expands the Annual Limits on HSA Contributions

Repeals the annual plan deductible limitation on HSA contributions for taxable years beginning after December 31, 2006. The maximum deductible contribution is not limited to the annual deductible under the high deductible health plan. The maximum aggregate annual contribution that can be made to the HSA of an HSA eligible individual is \$2850 (for 2007) in the case of self-only coverage and \$5,650 (for 2007) in the case of family coverage.

Allows full-year contributions for part-year coverage. The provision permits individuals who become covered under a high deductible plan in a month other than January to make the full deductible HSA contribution for the year. An individual who is an eligible individual during the last month of a taxable year is treated as having been an eligible individual during every month during the taxable year for purposes of computing the amount that may



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be contributed to the HSA for the year. An individual is allowed to make contributions for months before the individual was enrolled in a high deductible health plan. However, individuals would be required to maintain a high deductible health plan for the subsequent 12-month period, or pay tax on the contribution and a 10 percent penalty tax. Effective for taxable years beginning after December 31, 2006.

Certain FSA Grace Period Coverage Disregarded

For taxable years beginning after December 31, 2006, FSA "grace period" coverage may be disregarded for purposes of determining HSA eligibility if: 1) the balance in the health FSA at the end of the plan year is zero, or 2) in accordance with rules prescribed by the Secretary of Treasury, the entire remaining balance in the health FSA at the end of the plan year is contributed to an HSA.

Flexibility to Help Lower Paid Workers

The bill allows employers to make additional contributions to lower-paid workers. The bill provides an exception to the current "comparability rules" that require companies to make equal dollar contributions to all HSA-eligible employees with similar coverage (single or family) and work status (full-time or part-time). Under this provision, employers will be able to make a greater contribution to all similarly situated non-highly compensated employees than to the HSAs of highly compensated employees. For example, an employer is permitted to make a \$1,000 contribution to the HSAs of non-highly compensated employees for a year without making contributions to the HSAs of highly compensated employees. This provision is effective for taxable years beginning after December 31, 2006.

Earlier Indexing of HSA COLA

The bill requires the Secretary of Treasury to announce the cost of living adjustments to HSA contribution limits, minimum deductibles, out-of-pocket limits by June 1st each year rather than in Autumn.