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## **NEW FEDERAL LAW BRINGS SIGNIFICANT CHANGES TO HEALTH SAVINGS ACCOUNTS FOR 2007 AND BEYOND**

Congress has provided an early Christmas present for employers and individuals thinking of making available or setting up Health Savings Accounts (“HSAs”) beginning in 2007 by significantly liberalizing many of the HSA funding rules.

On December 9, 2006, Congress passed the Tax Relief and Health Care Act of 2006. Among numerous smaller subdivisions of this wide-ranging tax law is the Health Opportunity Patient Empowerment Act (HOPE Act), which makes a number of important changes regarding contributions to HSAs. President Bush signed the law into effect on December 20, and its provisions become effective beginning January 1, 2007.

### *TO REFRESH MY MEMORY, WHAT IS AN HSA AGAIN?*

At their most basic level, HSAs are individual tax-advantaged savings accounts designed to help pay for present or future medical costs. HSAs were initially created beginning in 2004, and are governed primarily by Section 223 of the Income Tax Code. In essence, an HSA is like an Individual Retirement Account (IRA), but for health care. It is owned by the beneficiary, funded with real dollars, and is completely portable. Unlike IRAs, however, not everybody can establish an HSA. In order to establish an HSA or to make ongoing contributions, one needs to be an “eligible individual” with a Qualifying High Deductible Health Plan (“HDHP”).

### *WHAT HAS CHANGED UNDER THE NEW LAW?*

While the vast majority of HSA rules and requirements have not changed, and while the fundamental purpose of HSAs has stayed the same, the HOPE Act did make significant changes regarding how HSAs can be funded, and how much money may be contributed. Specifically, the new law:

- Allows an employer to transfer pre-existing health FSA (Flexible Spending Accounts) and HRA (Health Reimbursement Arrangement) balances (with certain limits) to an HSA for employees switching coverage to an HDHP.
- De-couples the annual HSA contribution limit from the HDHP deductible. Beginning in 2007, all HSA eligible individuals can contribute the maximum amount (for 2007, \$2,850 for an individual with self-only coverage, and \$5,650 for family) even if their deductibles are not that high.

- Allows full year contributions even for persons covered for only part of the year, provided, however, that the individual stay in an HDHP for at least 12 months (income and excise taxes can apply if not).
- Allows individuals to make a one-time direct trustee to trustee transfer of up to a year's funding limit from any personal IRA. While there is generally no tax advantage in this transfer, it does allow for full instant funding of the HSA, and essentially permits tax-free withdrawal of some IRA funds to use to cover health costs.
- Provides an exception to HSA eligibility rules where an individual is technically still covered under a FSA, but that account has no remaining funds.
- Allows employers to contribute higher amounts to HSAs of rank-and-file employees than they do to officers or other "highly compensated employees".

### *WHAT HAS NOT CHANGED?*

Other than funding rules, and one very minor eligibility rule, the HOPE Act did not make changes in any other aspects of HSAs. The initial eligibility rules have not changed, nor have distribution rules. One still needs to have coverage under a qualified HDHP to make contributions, and one still needs to pay income taxes and possibly more on amounts withdrawn (distributed) prior to age 65 for reasons other than health care. Similarly, reporting requirements have not changed. One still needs to file annual statements with the IRS (done in conjunction with each individual's annual income tax return). Finally, rules taxes, permitted coverages and other aspects of HSAs other than funding as described above have not changed.

### *HOW WILL THE NEW LAW IMPACT ME AND WHAT SHOULD I DO?*

If you are an employer thinking of making HDHPs an option for your employees, but held off because of concerns about whether employees would be able to compile enough money in their HSA to cover a large expense early in a plan year, or you have a mid-year insurance renewal and were concerned because the full deductible amount applied immediately, while employees were only able to fund a pro-rata HSA contribution for that year, then you may wish to contact us to see if an HDHP / HSA option now makes sense.

If your company is already sponsoring a HDHP allowing your employees to open HSAs, you may want to review whether your HDHP's deductible limit still serves your goals.

As always, if you have any questions regarding this or any other benefits issues, please contact:

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