

## FBMC BENEFITS ALERT 2007-02

To	All Clients & Friends of FBMC	Date	02/19/07
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Re	<b>Transition Relief for General Purpose Health FSA and HRA Rollovers Before 03/15/07</b>		

In our Benefits Alert No. 2006-08, FBMC shared with you that on December 20, 2006, President Bush signed into law the Tax Relief and Health Care Act of 2006 (the "Act"). The Act made important changes to HSA contribution limits, HRA and health FSA interaction, and much more. However, because the law was enacted so late in 2006, many calendar-plan year Employers did not have enough time to amend their written plans by 12/31/06 to permit qualified HSA distributions.

On February 15, 2007, the IRS and Treasury released IRS Notice 2007-22 to provide transition relief and further guidance on how employers can rollover their health Flexible Spending Arrangements (health FSAs) and Health Reimbursement Arrangements (HRAs) to Health Savings Accounts (HSAs) for their employees. For a copy, go to: <http://www.irs.gov/pub/irs-drop/n-07-22.pdf>.

**Transition Relief In Notice.** Participants who had a year-end balance in a general purpose health FSA with a grace period or in a general purpose HRA after December 31, 2006, may still be an eligible individual for HSA purposes before April 1, 2007, if all of the following requirements in the Notice are met and quickly:

- The Employer amends the general purpose health FSA or HRA written plan to permit qualified HSA distributions effective **on or before March 15, 2007**.
- The employee has HDHP coverage as of the 1<sup>st</sup> day of the month during which the qualified HSA distribution occurs, and is otherwise an eligible individual.
- The employee elects **on or before March 15, 2007** to have the Employer make a qualified HSA distribution from his or her health FSA or HRA to an HSA.
- A qualified HSA distribution from the general purpose health FSA or HRA has not been previously made on behalf of the employee with respect to that particular health FSA or HRA.
- The qualified HSA distribution from the employee's general purpose health FSA or HRA does not exceed the *lesser* of the balance of the respective health FSA or HRA on (i) September 21, 2006, or(ii) the date of the distribution that must occur on or before March 15, 2007.
- After an employee becomes HSA-eligible, his or her Employer must make the qualified HSA distribution directly to the HSA trustee **by March 15, 2007**.
- After the qualified HSA distribution, there must be a \$0 balance in the general purpose health FSA or HRA and the employee is no longer a plan participant; or, effective on or before the date of the 1<sup>st</sup> qualified HSA distribution, the Employer converted the general purpose health FSA or HRA written plan to an HSA-compatible health FSA or HRA, as described in Rev. Rul. 2004-45, for all participants.

**Note:** During the transition relief period, reimbursements from the general purpose health FSA or HRA can be made after December 31, 2006; however, the distribution balance must still be calculated on a cash basis. "Cash basis" means the balance as of any date, without taking into account expenses incurred that have not

been reimbursed as of that date.

The Notice provides several helpful examples, including the two repeated below from Example 9:

“For 2006, Employer S has a calendar year general purpose health FSA with a grace period ending on March 15, 2007. Employer S offers employees the option of electing HDHP coverage for the plan year beginning January 1, 2007. Employer S amends the health FSA to allow for qualified HSA distributions. The amended plan allows an employee electing HDHP coverage to also elect to have any health FSA balance at year-end, determined on a cash basis, contributed directly to an HSA trustee for the employee. For this purpose, the year-end balance is the balance of the health FSA without regard to any expenses incurred but not paid. During the period from January 1, 2007 to March 15, 2007, an employee electing HDHP coverage for 2007 may elect a qualified HSA distribution of the health FSA balance. The amount of qualified HSA distribution is determined on a cash basis on the date of the distribution.”

“Employee O has a balance of \$300 in the health FSA on September 21, 2006, and a balance of \$175 on December 31, 2006. On or before 12/31/06, O elects HDHP coverage for 2007. On or before March 15, 2007, O also elects to have a qualified HSA distribution of the \$175 remaining in the health FSA on December 31, 2006. Employer S contributes \$175 to an HSA on behalf of O on or before March 15, 2007. O is otherwise an eligible individual as of January 1, 2007.”

Reporting. The Notice also provides reporting guidance as follows:

- Amounts transferred through a qualified HSA distribution are not reported in box 12 of Form W-2.
- Employers are not responsible for reporting whether an employee receiving a qualified HSA distribution remains an eligible individual during the testing period.
- Employers must report qualified HSA distributions as rollover contributions to the HSA trustee, and the HSA trustee must report the qualified HSA distribution as a rollover contribution on Form 5498-SA.

Further Guidance. The Notice clarifies some points under the Act (not related to the transition relief), including:

- Health FSA and HRA balances are determined on a cash basis and do not take into account pending claims, claims submitted, claims received or claims under review that have not been paid as of a date.
- An employee who begins HDHP coverage *after* the 1<sup>st</sup> day of the month is not eligible to take HSA-distributions until the 1<sup>st</sup> day of the next month.
- An individual with a zero balance (as determined on a cash basis) in a general purpose HRA, on the last day of the HRA plan year, may be an eligible individual on the 1<sup>st</sup> day of the immediately following HRA plan year, if (i) effective the 1<sup>st</sup> day of such plan year, the employee elects to waive participation in the HRA, or (ii) effective on or before the 1<sup>st</sup> day of such plan year, the Employer terminates the general purpose HRA with respect to all employees, or (iii) effective on or before the 1<sup>st</sup> day of such plan year, with respect to all employees, the Employer converted the general purpose HRA to an HSA-compatible HRA, as described in Rev. Rul. 2004-45.

### **Additional Information**

Please contact your Account Manager or the undersigned.