



Lambert & Carney Benefits Group, LLC
Newsletter Brief

Tax Relief and Health Care Act of 2006

On Wednesday December 20, 2006 President Bush signed into law tax legislation that has a significant impact on health savings accounts.

The Tax Relief and Health Care Act of 2006 has six provisions that will impact HSA programs These include:

- *Allow for contributions that are greater than the deductible*
- *Allow for full contributions even when participant enters a plan after the start of the year*
- *Make a once in a lifetime transfer from an IRA*
- *Allow for a rollover of assets from their FSA into their HSA*
- *Allow for different contributions on behalf of lower paid and higher paid employees*
- *Require the Internal Revenue Service to determine the cost of living adjustments by June of the preceding year.*

The provisions of the Tax Relief and Health Care Act of 2006 will help expand the popularity of Health Savings Accounts and lead to greater funding levels.

In the most significant change, effective January 1, 2007 the maximum annual contribution that can be made to an HSA will be a statutory indexed amount, which in 2007 will be \$2,850 for single coverage and \$5,650 for family coverage. Currently, the maximum contribution is the health plan deductible or the statutory amount, whichever was less.

The new law also will ensure that the maximum contributions can be made to employees' HSAs, regardless of when during a plan year they became eligible for coverage. Previously, contributions had to be pro-rated to reflect when during the year an employee became eligible for HSA coverage. This provision is available provided that they continue in the plan for the entirety of the next plan year. If an individual does not stay in the HSA-eligible plan 12 months following the last month of the year of the first year of eligibility, the amount which could not have been contributed except for this provision will be included in income and subject to a 10% additional 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 eligible individual for the 12 months following the month of the contribution, the transferred amount is included in income and subject to a 10% additional tax.

The new rules also allows for certain amounts in a Health Reimbursement Account or a Flexible Spending Account to be rolled over into the HSA. The rollover amount is limited to the lesser of the balance as of September 21, 2006 or the balance as of the date the balances are distributed to the HSA. Additionally, under previous law, if an FSA took advantage of a grace period allowing participants to incur additional reimbursable expenses after the plan year ended, participants were not eligible to contribute to their HSA during the grace period thus reducing the 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 legislation allows employers to make additional contributions to lower paid workers. Previously contributions had to be comparable between all employees with the same level of coverage (single or family). Under the new provision, effective for tax years after December 31, 2006, employers will be able to make higher contributions to the HSAs of non-highly compensated employees.

The new rules change the base period to the 12-month period ending on March 31, and require that adjusted amounts for a year be published by June 1 of the preceding year. Previously, indexing was based on a 12-month period ending on August 31. This change will provide employers and health plans with more time to design qualifying HSA-eligible plans and individuals with more time to make decisions about their health care for the next year.

The Tax Relief and Health Care Act of 2006 also extends the provisions of the Mental Health Parity provisions that were set to expire at the end of 2006.

The information contained in this newsletter has been compiled from sources we believe are reliable. It is not intended to be legal or tax advice. If you would like further information regarding the issues raised in this News Letter Brief, please contact Paul Lambert at plambert@lcbenefits.com. Our website is www.lcbenefits.com.

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