HSAs – IRS GUIDANCE ON ROLLOVERS FROM HEALTH FSAs AND HRAs

The IRS has recently issued Health Savings Account (HSA) guidance, IRS Notice 2007-22, on an optional, one-time, tax-free rollover from a health Flexible Spending Account (health FSA) and Health Reimbursement Arrangement (HRA) into an HSA account. These rollovers, known as “qualified HSA distributions,” were created by the Tax Relief and Health Care Act of 2006. Rollovers into HSAs are only available for contributions and distributions before Jan. 1, 2012. Notice 2007-22 provides guidance applicable to rollovers and provides additional transitional relief applicable to qualified HSA distributions of 2006 year-end balances. We are awaiting additional guidance for mid-year terminations.

As noted above, this guidance is optional. If you do not want to provide for qualified HSA distributions from your health FSA or HRA, no action is necessary.

If you wish to provide for qualified HSA rollovers for a plan year, the health FSA or HRA must be nondiscriminatory, and the following requirements must be satisfied in order for the distributions to receive the favorable tax treatment:

- Before the end of the plan year:
  - The health FSA or HRA must be amended to permit qualified HSA distributions covered by a high deductible health plan.
  - The participant must elect the rollover to the HSA, and no reimbursements may be made from the health FSA or HRA after the last day of the plan year.
  - The year-end balance must be frozen.

- The qualified HSA distribution does not exceed the lesser of the health FSA or HRA balance on Sept. 21, 2006, or on the date of the distribution.

- The rollover is made directly to the HSA by the 15th day of the third calendar month following the end of the plan year.
After the qualified HSA distribution, the participant’s year-end balance in his or her health FSA or HRA account must be $0, and the participant must have no other non-HSA compatible coverage, or the health FSA or HRA must be converted into an HSA compatible design.

In addition, if you desire to provide this optional benefit to participants in your health FSA or HRA who have a year-end balance as of Dec. 31, 2006, the above-described amendment, election and transfer must be completed by March 15, 2007. The year-end balance in the health FSA or HRA did not need to be frozen as of Dec. 31, 2006.

If you have any questions about this guidance, about participation in HSAs, or how to make this option available to your eligible participants, please contact one of the members of Reed Smith’s Employee benefits team listed below, or the Reed Smith attorney with whom you regularly work.

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