FORD & HARRISON LLP
THE RIGHT RESPONSE AT THE RIGHT TIME
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Problem

In today's tough economic environment many employers are looking for ways to contain and reduce their health care costs while also allowing employees more control in managing their healthcare expenses. Many employers are implementing high deductible health plans along with health savings accounts (HSA) as a vehicle to help reduce the company's healthcare costs and assist employees with saving for and managing healthcare expenses.

How can employers assist their employees to fund an HSA without increasing costs to the company or health plan?

Solution

Many employers are assisting their employees efforts to fund an HSA by allowing employee contributions to an HSA via salary reduction on a pre-tax basis through the company's cafeteria plan. Additionally, employers are allowing a one-time rollover from the employee's healthcare flexible spending account (FSA) or health reimbursement arrangement (HRA) to the employee's HSA.

In order to allow pre-tax contributions to an HSA, the company's cafeteria plan must be amended to permit such contributions. Many of the cafeteria plan rules will apply to such contributions including cafeteria plan rules regarding non-discrimination requirements. However, under proposed cafeteria plan regulations, employees making HSA contributions under the cafeteria plan must be allowed to start or stop an election or increase or decrease the election at any time as long as the change is effective prospectively.

For companies who wish to allow a rollover of certain unused FSA or HRA balances from an FSA in a cafeteria plan or HRA to an HSA ("qualified HSA distribution"), the following requirements must be satisfied:

1. amend the FSA or HRA written plan with respect to all employees, effective by the last day of the plan year, to allow a qualified HSA distribution;

2. no qualified HSA distribution has previously been made on behalf of the employee from the FSA or HRA:

3. by the last day of the plan year, the employee elects to have the employer make a qualified HSA distribution from the FSA or HRA to the employee's HSA;

4. the qualified HSA distribution doesn't exceed the lesser of the balance of the FSA on Sept. 21, 2006, or the date of the qualified HSA distribution;

5. balances are determined on a cash basis, without taking into account expenses incurred but not reimbursed as of any date;

6. the distribution is made no later than Dec. 31, 2011; and

7. the employer makes the distribution directly to the trustee or custodian of the employee's HSA.

Generally, to receive favorable tax treatment of the qualified HSA distributions, the employee must also be an eligible individual under HSA rules, such distributions must be made to the HSA within two and a half months after the end of the FSA or HRA plan year, and the distribution must result in a zero balance in that year's FSA or HRA.

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