



SPECIAL Alert

Volume Three, Issue Five

June 2007

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In this fifth McGraw Wentworth Special Alert for 2007, we will address recent guidance on Health Savings Accounts (HSAs). Health Savings Accounts are custodial or trust accounts individuals can use to save tax-favored dollars to be used for IRS eligible medical expenses.

The new guidance provided annual indexed amounts for HSAs in 2008. Additional guidance also addresses the comparability requirements for employers if they provide funding for an HSA and the employee fails to establish account. The new guidance also addresses comparability requirements if an employer chooses to accelerate their contributions to the account if the employee experiences medical claims that exceed the funds available in their HSA.

We welcome your comments and suggestions regarding this issue of our Special Alert. For more information on this article, please contact your Account Manager or visit the McGraw Wentworth web site at www.mcgrawwentworth.com.

“New Health Saving Accounts Guidance”

The IRS recently released several new guidelines for health saving accounts (HSAs). This Special Alert describes:

- 2008 cost of living adjustments for Health Savings Accounts.
- Comparability requirements when an employee fails to establish an HSA.
- Comparability requirements if an employer accelerates contributions to an HSA.



HSAs are individually-owned tax-favored trust or custodial accounts. Distributions and interest are tax-favored when the funds are used to pay for an IRS qualified medical expense.

Not everyone can contribute to an HSA. In fact, only employees covered by a qualifying high deductible health plan with no other comprehensive health plan coverage can contribute to these accounts. HSAs are fairly complicated. If you are interested in learning more about them, please read our *Benefit Advisor* at http://www.mcwent.com/Benefit_Advisor/2007/BA_Issue_3.pdf.

Cost of living adjustments for HSAs are an annual event. What’s more, the Department of Treasury and the Internal Revenue Service recently proposed new guidelines for comparable contributions. These new guidelines amend the

detailed information provided several years ago and are a tremendous help for employers establishing consumer driven health plans with HSAs.

The IRS has requested comments on the proposed guidelines and will hold a public hearing in the fall to discuss any suggested changes. This guidance does not include an effective date because the IRS wants to review employer comments and collect feedback in the public hearing. However, taxpayers can follow the proposed guidelines until final regulations are published in the Federal Register.

2008 Cost of Living Adjustments

The IRS regulates high deductible health plans and HSAs. Following are the 2008 updated indexed limits for high deductible health plans and health savings accounts:

- The minimum annual deductible for a high deductible health plan did not change in 2008. The deductible must be at least \$1,100 for single coverage and at least \$2,200 for family coverage.

- The maximum out-of-pocket expense limit increased slightly for singles and families. The 2008 limit for singles is \$5,600 up from \$5,500 in 2007. The 2008 limit for families is \$11,200 up from \$11,000 in 2007.
- The contribution limits increased as well. The 2008 limit for single coverage is \$2,900, up from \$2,850 in 2007. The 2008 limit for families is \$5,800, up from \$5,650 in 2007.

In the past, the IRS typically released these indexed amounts very late in the year. However, the Tax Relief and Health Care Act of 2006 requires the IRS to release them before June 1 beginning in 2008. Organizations considering high deductible health plans or currently offering a high deductible health plan with an HSA will welcome the early release of the 2008 amounts.

Employer Comparable Contributions

Employers are not required to contribute to an employee's HSA. However, if they do contribute to one employee's HSA, they must contribute a comparable amount to all employees' HSAs. The comparability requirements are complicated; you can learn more about the details at http://www.mcwent.com/Special_Alert/2006/Special_Alert_Issue_6.pdf.

There is a step employees must take to establish an HSA. Many vendors require employees to complete an HSA application, including a signature card. If the employee fails to establish an HSA, how can an employer provide comparable contributions?

To meet the comparability requirements, the employer must take the following steps for employees without HSAs (or when the employer is unsure whether an employee has an HSA):

1. Before December 31 of each year the employer must send a written notice to employees without HSAs. If the employer is unsure whether or not an employee has an HSA, that employee must also receive a notice.
2. The notice must state the employer will make comparable contributions if the employee can verify he or she has established an HSA by the end of February in the following calendar year.
3. If the employee notifies the employer by the end of February of the HSA details, the employer must deposit all required comparable contributions as if the employee had the HSA in place from the beginning of the year or the point in the year where he or she is first eligible to contribute. The employer has until April 15 of the following year to make comparable contributions to that account. The employer must contribute all the funds necessary to meet the comparability requirement.



Sample wording for the notice follows:

- You may be eligible to receive HSA contributions from (employer's name) if you are covered by the high deductible

health plan. We contribute to the Health Savings Account for each eligible employee (employers should define the eligibility requirements as well as the IRS requirements for contributing to an HSA).

- In order to receive the employer contributions, you must:
 - Establish the HSA on or before the last day in February of (insert the year after the year for which the contribution is being made).
 - Notify (insert name and contact information for the employer representative) of your HSA information on or before the last day in February of (include the year following the year in which the contributions are made). You should include all the specific information requested such as the account number and the address of the HSA trustee. (The employer should also state the specific method the employee must use to convey the information.)
- If you establish the HSA by the last day of February and provide the information this notice requests, you will receive the employer contributions, plus reasonable interest, by April 15 (of the year following the year in which the contribution should be made). If you do not establish the HSA or do not notify us that you have established an

HSA following the guidelines explained in this notice, we are not required to make any contributions to your HSA for (indicate the year in which the contributions apply).

- Please contact (insert contact name and information for the employer representative) if you have any questions.

The new guidance explains the steps employers need to take to make sure they meet the comparability requirements for employees that do not establish an HSA or fail to provide enough information about the HSA for the employer to make the comparable contributions.

Employees must receive this notice no earlier than 90 days before the first employer contribution for that calendar year and no later than January 15 of the following year.

Accelerated Contributions

Another challenge employers with consumer driven health plans have faced is helping employees with significant health claims when the employees do not yet have enough money in their HSAs to cover their expenses. This situation creates a unique conundrum for employers who contribute to HSAs. The employee expects the employer to fund part of the HSA soon, but the employee needs the funds now. This creates a certain tension.

Although employers are not required to accelerate the contributions in these cases, the proposed regulations allow employers to

contribute sooner if the employee's claims exceed the funds in the HSA. Such contributions will not violate the comparability requirements (which do include comparability in timing the contributions as well).

The following are the requirements an employer must meet to accelerate the contributions:

1. The employee's qualified medical expenses must have been incurred during the calendar year.
2. The employer must offer to accelerate the contributions equally for all eligible employees.
3. The employer must establish consistent methods and requirements for accelerating contributions and determining qualifying medical expenses year-to-date.
4. The employer needs to have a uniform process for all employees requesting accelerated contributions.

If the employer accelerates contributions and the employee quits mid-year, the employer cannot ask the employee to return the money. Once funds are deposited in an employee's HSA, the employee owns the funds. This situation, however, will not affect the employer's comparability requirements.

Concluding Thoughts

Employers currently offering a high deductible plan with HSAs will welcome the early release of the in-

dexed amounts for 2008. It will allow employers to inform their employees of benefits and limits for the 2008 plan year in a timely manner.

The new guidance on the comparability requirements is simply in its proposed stages. The government has requested comments on these regulations and will hold a public hearing in the fall. It is likely the IRS and the Department of Treasury will tweak some of the details of this proposed guidance. However, until the final comparability requirements are issued, employers can rely on these rules in two common situations: notifying employees that fail to establish an HSA and accelerating contributions to an employee's HSA.

If you have any questions regarding Health Savings Accounts, please contact your McGraw Wentworth Account Director. **MW**



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