



AMERICAN BENEFITS COUNCIL

THE FINANCIAL SERVICES ROUNDTABLE



December 22, 2006

VIA ELECTRONIC AND OVERNIGHT MAIL

W. Thomas Reeder
Benefits Tax Counsel
Office of Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Guidance Requested Regarding New Health Savings Account Rules

Dear Tom:

We are writing on behalf of the American Benefits Council, the U.S. Chamber of Commerce and the Financial Services Roundtable to request that the Department of the Treasury (“Treasury”) provide guidance as soon as practicable regarding certain new Health Savings Account (“HSA”) rules, which were enacted as part of the Tax Relief and Health Care Act of 2006 (the “Act”). This letter addresses only those provisions of the Act that significantly impact employer-sponsored health coverage and HSA administration in connection with the start of the January 1, 2007 calendar year. Please note that we anticipate submitting a second comment letter regarding the various other provisions of the Act not addressed herein. To assist employers and administrators with respect to administering high deductible health plans (“HDHPs”) and HSAs for 2007, we request guidance clarifying the following:

- The different meanings of the term “balance” for purposes of the medical account consolidation rule and grace period exception, as contained in section 302 of the Act;
- For purposes of the employer’s statutory option to consolidate medical accounts, an employer may reestablish health reimbursement arrangements (“HRAs”) in effect on September 21, 2006, which were subsequently terminated or forfeited;
- The employer’s statutory option to consolidate medical accounts applies to all Flexible Savings Arrangements (“FSAs”) and HRAs, including limited-purpose and post-deductible FSAs and HRAs;

- Amounts remaining in an employee's FSA as of the start of an FSA grace period in 2007 year will not render the employee HSA-ineligible for any portion of the grace period so long as a qualified HSA distribution is made to an HSA by no later than December 31, 2007;
- Employers may choose to make multiple qualified HSA distributions, provided that no employee receives more than one qualified HSA distribution per arrangement;
- "Bundled" HDHP/HSA coverage elections for 2007 made pursuant to an employer's cafeteria plan for 2007 may be "unbundled" with respect to the HSA contribution component only, so that employees may increase contributions during 2007 to take advantage of the higher contribution limits provided by the Act.

Guidance Should Clarify the Meaning of the Term "Balance" for Purposes of Administering the Consolidation and Grace Period Provisions of Section 302 of the Act.

The term "balance" is utilized in two contexts in section 302 of the Act. First, the term "balance" is utilized in connection with the medical account consolidation rule of section 302, which provides, in part, for the consolidation of existing FSA and HRA funds into an HSA via a one-time "qualified HSA distribution" from an FSA and HRA. A "qualified HSA distribution" is limited to the lesser of "the balance in such arrangement on September 21, 2006, or as of the date of such distribution." Second, the term "balance" is utilized in connection with the administrative grace period exception of section 302 of the Act, which provides, in part, that an employee with a zero "balance" in his or her FSA prior to the start of an administrative grace period is not disqualified from making HSA contributions during such grace period.

Each of these "balance" rules serves a distinct statutory purpose. We recommend that administrative guidance interpret the language in a manner that is consistent with the legislative intent. Specifically, we request Treasury issue guidance clarifying that (i) for purposes of the medical account consolidation provision under section 302 of the Act, "balance" means the amount available for reimbursement to an employee from his or her HRA or FSA as of September 21, 2006, without regard to incurred but unreimbursed claims, and; (ii) for purposes of the administrative grace period exception, the term "balance" includes amounts incurred as of the end of the plan year (but prior to the start of the grace period) so long as such amounts are reimbursed either by the end of the plan year or by the end of any claims "run-out" period provided under the plan.

With respect to the consolidation provision of section 302 of the Act, Congress did not want employers to be incented to increase existing HRA balances, thereby allowing employees to later take advantage of the consolidation option to fund their HSAs. Therefore, Congress imposed a rule limiting amounts available for consolidation to the lesser of the balance on September 21, 2006, or the amount at the time of consolidation. We believe that construing the term "balance" to disregard claims incurred but reimbursed as of September 21, 2006, comports with the intent that the September 21, 2006 date serve as a an appropriate measure to ensure that HRAs and FSAs were not increased solely to take advantage of the consolidation. Moreover, administrators and recordkeepers may readily capture the account balance data as of a specified date.

We recommend a different administrative interpretation of the term “balance” with respect to the administrative grace period exception. Specifically, we request Treasury issue guidance clarifying that the term “balance” includes claims incurred by a participant by the end of the FSA plan year but prior to the start of the grace period, so long as such claims are in fact reimbursed by the plan by the end of either the FSA plan year or a claims “run-out” period, if provided by the FSA plan. Such an interpretation is consistent with the purpose of this relief provision, which is to allow individuals who effectively have no other coverage during a grace period to fully contribute to an HSA. An employee who incurs sufficient claims by the end of the plan year to “zero down” his or her FSA has no remaining coverage under the FSA at the start of the administrative grace period, regardless of whether such funds have actually been disbursed. Any other interpretation would penalize employees who are transitioning to an HDHP in 2007 and who, otherwise, would have only a matter of days to apply for and receive their remaining reimbursement under the FSA.

Guidance Should Permit Employers to Reestablish Certain Forfeited or Terminated HRA Balances Previously Existing on September 21, 2006.

An FSA or HRA that provides for reimbursement of medical expenses before the employee satisfies the deductible under an HDHP disqualifies the employee from making HSA contributions even if the employee participates in an HDHP. Under prior law, there was no mechanism for an employer to consolidate an HRA or FSA into an HSA. As a result, some employers that sought to move employees to HAS-eligible HDHP coverage for 2007 have terminated or will terminate the HRAs of their employees so that the HRA coverage will not render employees ineligible to contribute to an HSA. Alternatively, certain employees seeking to move to HDHP coverage for 2007 may have voluntarily forfeited their HRA monies in order to become HSA eligible for the start of the new plan year (typically January 1, 2007). In light of the new medical savings account consolidation option provided to employers under section 302 of the Act, guidance is necessary to clarify that employers may choose to reestablish HRAs in effect on September 21, 2006, which were subsequently terminated by the employer or forfeited by the employee.

Guidance Should Clarify that an Employer’s Statutory Option to Consolidate Medical Accounts Applies to Limited Purpose and Post-Deductible FSAs and HRAs.

As noted above, the medical account consolidation rule of section 302 permits a one-time “qualified HSA distribution” from an FSA or HRA into an HSA. The statute does not distinguish between a general purpose FSA or HRA and a limited purpose or post-deductible FSA or HRA, nor does the definition otherwise exclude the latter category of FSAs and HRAs. We see no policy rationale for distinguishing between general and limited scope FSAs and HRAs for purposes of the medical account consolidation rules. Accordingly, we request guidance clarifying that the consolidation option provided by section 302 applies to all FSAs and HRAs, including limited purpose and post-deductible FSAs and HRAs. Additionally, we request guidance clarifying that an employee who transitions between a general purpose FSA or HRA and a limited purpose or post-deductible FSA or HRA after September 21, 2006, will be treated as participating in the same “arrangement” sponsored by the employer for purposes of the medical account consolidation rule.

Guidance Should Clarify the Timing of a Consolidation of FSA Funds Under the Grace Period Provisions of Section 302 of the Act.

Section 302 provides that an employee will not be treated as having disqualifying coverage during an FSA grace period if the remaining funds in the FSA as of the end of the coverage period are rolled over in a “qualified HSA distribution.” Administrative guidance should clarify that amounts remaining in an employee’s FSA as of the start of an FSA grace period in any given taxable year will not render the employee HSA-ineligible for any portion of the grace period, so long as a qualified HSA distribution is made to an HSA by no later than the end of the taxable year to which the grace period relates. For example, an employee should not be treated as disqualified from making HSA contributions for any month in 2007 on account of the FSA grace period coverage during 2007, provided that the qualified HSA distribution with respect to any remaining balance in the FSA as December 31, 2006, is actually made no later than December 31, 2007.

Guidance Should Clarify that an Employer May Exercise its Option to Consolidate Medical Accounts on Multiple Dates, Provided No Employee Receives More Than One Qualified HSA Distribution Per Arrangement.

Section 302 provides for one qualified HSA distribution from an FSA and one qualified HSA distribution from an HRA in which an employee participated as of September 21, 2006. Guidance should clarify that an employer may choose to exercise its option to consolidate medical accounts on more than one date, provided that no employee receives more than one qualified HSA distribution per arrangement. For example, an employer might choose to provide for qualified HSA distributions in 2007 for those employees who are enrolled in the HDHP. In 2008, however, an employer might choose (but should not be required) to provide for qualified HSA distributions to those employees who were enrolled in HRAs or FSAs as of September 21, 2006, but were not enrolled in an HDHP until 2008 and, therefore, could not have participated in the rollovers to HSAs in 2007. We believe that such an interpretation would allow employers to consolidate medical accounts over the course of the 5-year window provided in the statute without expanding the rollover opportunity for any individual employee beyond the statutory intent. If guidance permits such a design, the comparability rules applicable under section 302 would need to be interpreted accordingly, so that an employer would be deemed to have made a comparable qualified HSA distribution if such distributions are made to all those employees who had HDHP coverage and were eligible for a qualified HSA distribution at the time that each qualified HSA distribution occurs.

Guidance Should Clarify that “Bundled” HDHP/HSA Coverage Elections Made Through A Cafeteria Plan May Be Unbundled with Respect to the HSA Contribution Component.

Existing administrative guidance makes clear that HSA accountholders may increase or decrease contributions to an HSA on a monthly basis, including where such contributions are made through a cafeteria plan. See Q&A 58 of IRS Notice 2004-50. Therefore, most HSA eligible individuals generally will be able to increase their monthly HSA contributions to take advantage of the higher contribution limits for 2007 provided by section 303 of the Act.

Some employers, however, have utilized a “bundled” election under their cafeteria plans. Such an election bundles the group health coverage with a fixed monthly contribution to a corresponding medical reimbursement account. For example, an employer might provide employees with the option under the cafeteria plan to choose between (i) bundled low-deductible health coverage with a fixed \$200 per month contribution to an FSA, and (ii) bundled HDHP coverage with a fixed \$400 contribution to an HSA.

We ask Treasury to make clear that employers may permit employees to “unbundle” their elections with respect to HSA contributions after the start of 2007, in order for these employees to increase cafeteria plan elections and take advantage of the increased statutory maximum contribution limits for 2007. Such elections should not be limited to a change in family status event under the cafeteria plan rules; otherwise these employees would be unable to utilize payroll deduction to take advantage of the increased HSA contribution limits. We believe that such guidance would be consistent with Notice 2004-50, which generally does not require a family status change in order to increase HSA contributions.

Very truly yours,



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