AMERICAN BENEFITS COUNCIL

November 23, 2005

CC:PA:LPD:PR (REG-138647-04)
Room 5203
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Comments on Proposed Regulations Governing Employer Comparable Contributions to Health Savings Accounts under Section 4980G

Dear Sirs:

I am writing on behalf of the American Benefits Council ("the Council") regarding the proposed regulations interpreting the comparable contribution requirements under Code section 4980G of the Internal Revenue Code ("Code"). 70 Fed. Reg. 50233 (August 26, 2005). The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly, or provide services with respect to, to retirement and health plans that cover more than 100 million Americans.

The Council commends the Internal Revenue Service's ("Service") prompt publication of the proposed regulations as well as all of the other helpful and timely guidance that the Service has published on Health Savings Accounts ("HSAs"). Many of the Council's employer members either currently offer or are planning to offer an HSA and/ or high-deductible health plan ("HDHP") option as part of their array of health benefits, and view the HSA/ HDHP program as a cost effective way for employees to both pay for current health care expenses and also save for future health care expenses. However, under many such programs, employer contributions to the HSA are

a critical component of the benefit option. In order for the HSA option to be successful, employers need flexibility to structure the employer contribution in a manner that encourages a particular workforce to not only select the HSA, but also make meaningful contributions to it.

The comparability rules, which were designed for Archer Medical Savings Accounts ("MSAs"), originally only were intended to apply to self-employed individuals and small employers with 50 or fewer employees. These groups often have limited employer-provided health coverage options or may have none at all. In addition, employees within these groups are likely to be located in the same geographic location and wide variations in job types are less likely than in a large employer setting. Under these circumstances, restrictions on the ability to vary contributions to HSAs between employees are not likely to be problematic. However, the MSA comparable contribution rules are not flexible enough for larger employers, which, in contrast to small employers, have complex corporate structures, diverse employee groups, more options, richer benefits, and incentive programs to encourage healthy behavior.

Larger employers would like the flexibility to vary contributions to correspond with HDHP coverage options and to provide higher contributions for certain groups such as employees in different divisions, employees who bargain for their own benefits, employees who participate in wellness programs, lower-paid employees, chronically ill employees, and employees with a greater number of years of service. Strict rules that prevent an employer from varying HSA contributions in this manner are overly restrictive and will limit the success of the HSA option in the large employer market. Conversely, flexible rules will not cause discrimination. It is possible to change the current comparable contribution rule in the manner suggested without resulting in discrimination against lower paid employees. We therefore urge the Service to make these rules more flexible.

Our comments describe the issues that are a priority for our members. For each issue, we recommend that the proposed rules should be changed, as follows:

- Give employers the ability to vary contributions within objective employer groups such as for collectively bargained versus non-collectively-bargained employees or for employees of different subsidiaries;

- Give employers greater flexibility to vary contributions to correspond with different plans and levels of coverage (i.e., two HDHPs with different deductibles, and employee-plus-one coverage level);

- Adopt a flexible interpretation of what it means to make a contribution through a cafeteria plan;

- Eliminate the need for retroactive employer contributions to satisfy the comparability rules if an employee waits to establish the HSA until later in the year;

- Allow testing on a plan year rather than a calendar year basis; and

- Extend the effective date of the final rules to give employers at least a year from the date regulations are published in final form to implement changes.

Of course, in issuing guidance, the Service is subject to the constraints of the statute. However, the statutory language in many areas is ambiguous or silent. As such, the Service has discretion to broadly and favorably interpret particular provisions in a manner that provides flexibility to employers and ultimately encourages employees to select an HSA and make meaningful contributions to the account.

I. The Ability To Vary Contributions Within Objective Employer Groups

Issue

Under the proposed regulations, the benefits provided to collectively bargained versus non-collectively bargained employees, as well as the benefits provided to employees of different subsidiaries of the employer, must all receive the same HSA contribution if they have the same category of HDHP coverage. Employers often offer completely different benefit options to these groups, so requiring the same level of HSA contributions to all members of these groups is overly restrictive and unworkable.

Recommendation

Allow employers to vary contributions if such variance is based upon objective criteria such as collectively bargained versus non-collectively bargained, or different subsidiary groups.

Analysis

There is no compelling reason to require employers to contribute the same amounts to the HSAs of collectively bargained employees and non-collectively bargained employees. The collective bargaining process itself is designed to ensure that the combination of benefits provided to a certain group of employees is appropriate. Imposing another set of requirements after that process takes place does not accomplish any meaningful objective. For example, if one group bargained for a very generous employer HSA contribution, that would then apply to all other collectively bargained groups and the non-bargaining population as well without regard to the other types of benefits that these other groups may already receive. In other areas of employee benefits, collectively bargained employees are treated separately. For example, the nondiscrimination rules for cafeteria plans, self-insured heath plans and qualified retirement plans treat collectively bargained employees separately for purposes of the applicable tests. See, e.g., Code sections 410(b)(3), 125(g)(1) and 105(h)(3)(B)(iv). In addition, the strict funding limitations that apply to welfare benefit funds under Code section 419A do not apply to welfare benefit funds established under a collective bargaining agreement. Code section 419A(f)(5). Thus, there are many examples in the Code where collectively bargained employees are treated differently from non-collectively bargained employees.

Similarly, requiring employers to treat all subsidiaries in the same manner does not accomplish any meaningful objective. Employers often provide different benefit packages to various subsidiaries, which often vary in location and type of workforce, or offer more valuable benefits based upon region or type of work. Requiring an employer to adhere to a rule that measures all subsidiaries as though in one group, even though the members of that group may have different HDHP options, does not allow employers to structure offerings that include contributions to an HSA in a manner that suits each subsidiary.

There is room in the statute to support an interpretation by the Service that would allow benefits to vary based upon collective bargaining or subsidiary status. In this regard, Code section 4980G provides merely that

rules and requirements "similar" to the rules and requirements of section 4980E shall apply for purposes of this section. Thus, the Service could read a collective bargaining exception into the statute and create an exception to the rule under Code section 4980E which indicates that comparability testing must be done on a controlled group basis. Just as the Service recognized that it was necessary to create special rules for former employees, and appropriately drew a distinction in the proposed regulations between former employees who elect COBRA and former employees who are covered under the employer's HDHP without electing COBRA, similar exceptions could be drawn here. Under the proposed regulations, all employer contributions to the HSAs of former employees who are covered by the employer's HDHP must generally be comparable. However, the employer is not required to make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP because of a COBRA election. Thus, the proposed regulations already recognize that it makes sense to treat certain classes of individuals such as COBRA beneficiaries separately from other former employees. We ask that the Service recognize that there are other objective classes of employees who should be able to be treated separately as well.

II. The Ability To Vary Contributions To Correspond With Additional Levels Of Coverage and Different Plans

Issue

Employers offer a greater number of coverage levels than are recognized under the Code section 4980E, such as employee plus one and employee plus children. Similarly, employers may offer two different HDHPs, with separate deductibles or with the same deductible but different benefits.

Recommendation

State in the regulations that employers have the ability to vary HSA contributions for employees who have categories of HDHP coverage in addition to self-only and family coverage that are offered by the employer, such as employee plus one and employee plus children. Also, state that where an employer offers more than one HDHP, employees with coverage under one HDHP could be tested separately for comparable contribution purposes from employees with coverage under other employer-sponsored HDHPs

Analysis

We believe that the Service has discretion to recognize additional levels of coverage that are used in the marketplace such as employee plus one, or employee plus children. Indeed, the Service recognizes in its own HSA guidance that such levels exist. (Notice 2004-50, Q&A-12; Notice 2005-25). As noted above, Code section 4980G(b) merely requires the Service to develop rules that are "similar" to the rules under Code section 4980E. Thus, the fact that Code section 4980E(d)(3)(B) recognizes only self-only and family coverage does not preclude the Service from recognizing additional levels of coverage for purposes of the comparable contribution rules, particularly where the Service has acknowledged in other guidance that such coverage exists.

Similarly, where an employer offers more than one HDHP, employees with coverage under each HDHP should be tested separately for comparable contribution purposes. In a self-employed or small employer context, it would be rare to offer more than one HDHP. However, many large employers are offering more than one HDHP option, and should have the flexibility to vary HSA contributions for employees with different coverage. For example, if a large employer offers two HDHP options with the same deductible, but one pays 100% of expenses after the deductible is satisfied and one pays 80% of expenses after the deductible is satisfied, the employer may want to make higher contributions to the HSAs of individuals who elect the lesser coverage. This type of objective variation would not result in discrimination and would make the HSA rules more suitable for large employers. The fact that this ability is not expressly permitted under Code section 4980E should not preclude a determination that this is possible.

The current rules, which do not recognize all the levels of coverage generally offered by employers or recognize that employers may offer more than one HDHP, are not practical. Although the current rules do permit an employer to base its contributions on the percentage of an HDHP deductible instead of an actual dollar amount, this rule is not helpful where employers offer HDHPs with the same deductible but different benefits, as described in the example above. Further, even if different HDHP options have different deductibles, basing an employer's contribution on a percentage of the deductible does not allow an employer to budget how much will be spent on HSA contributions the following year, since that employer will not know in advance which employees will elect one option versus another. Because of these factors, the current proposed rules, if adopted in final form, will provide

a strong incentive for employers to either reduce the level of HSA employer contributions, or offer fewer levels of HDHP coverage and fewer plan options.

III. Clarify that an Employer is Permitted to Make A Non-Elective Contribution Through a Cafeteria Plan

Issue

The proposed regulations make clear that if an employer makes contributions through a section 125 cafeteria plan to the HSAs of employees, such contributions will be subject to the nondiscrimination rules under Code section 125 rather than the comparable contribution rules. However, existing guidance does not clearly identify all of the ways in which an employer may make a contribution through a cafeteria plan.

Recommendation

Clarify that in order to make an employer contribution through a cafeteria plan, an employer may either: (i) offer to give employees cash rather than making a contribution to an HSA, or (ii) permit employees to make pre-tax salary reduction contributions to the HSA, in which case all contributions made to the HSA, including non-elective employer contributions, are considered to be "made through the cafeteria plan."

Analysis

The conference report for the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 states that the comparability rules do not apply to contributions made through a cafeteria plan. In Notice 2004-50, Q&A-47, the Service cites this report and concludes that employers are permitted to make matching contributions (i.e., a contribution in an amount equal to the amount of the employee's HSA contribution or a percentage of the amount of the employee's HSA contribution) through a cafeteria plan without violating the comparable contribution requirements, but subject to the nondiscrimination requirements under Code section 125. Similarly, Notice 2004-50, Q&A-49 provides that contributions that are made by an employer as an incentive for participation in health assessments, disease management programs or wellness programs are not subject to the comparable contribution rules if the employee has the ability to elect cash rather than have an HSA contribution. These Q&A's do not clarify what requirements are necessary to "make contributions through a cafeteria plan" however, and do not identify all of an employer's options.

Prop. Treas. Reg. sec. 54.4980G-5 is consistent with earlier guidance in that it provides that if an employer makes contributions through a section 125 cafeteria plan to the HSAs of employees who are eligible individuals, the comparability rules do not apply, but the section 125 nondiscrimination rules do apply. Like earlier guidance, these proposed regulations do not identify what requirements must be satisfied in order to make contributions through a cafeteria plan. Q&A-3(b) of the proposed regulations contains an example under which an employer provides HDHP coverage through its cafeteria plan. Under the facts of the example, the employer automatically contributes to the HSA of each employee who is an eligible individual with HDHP coverage through the cafeteria plan and employees make no election with respect to the employer's HSA contributions and have no right to receive cash or other taxable benefits in lieu of the HSA contributions. The example concludes that the comparability rules apply to the employer's HSA contributions because the HSA contributions are not made through the cafeteria plan.

Notice 2004-50, Q&A-49, and the proposed regulations cited above suggest that offering a cash option with respect to an employer contribution is one method of making a contribution through a cafeteria plan. However, that should not be considered the only method. Indeed, the proposed cafeteria plan regulations specifically provide that an employer may make non-elective contributions through a cafeteria plan. Prop. Treas. Reg. § 1.125-1, Q&A-3 (which specifies that a written cafeteria plan must specify the manner in which employer contributions may be made under the plan, including by nonelective employer contributions to the plan)[1]. Accordingly, we urge the Service to provide further guidance in these proposed regulations clarifying that an employer make a non-elective contribution through a cafeteria plan, as long as such plan also allows employees to make pre-tax salary reduction contributions to the HSA.

The examples below are intended to illustrate that if the employer has a cafeteria plan and allows employees to make pre-tax contributions through that cafeteria plan, any employer contributions made to the HSA will also be treated as contributions made through the cafeteria plan, whether or not employees can elect to receive those contributions in cash. Alternatively, an employer could offer a cash option for the contribution in order to offer it

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[1] Presumably if an employer did not want employer contributions to be considered as made "through a cafeteria plan" it would be possible to leave such benefit out of the written cafeteria plan document.

through the cafeteria plan. For any contributions made through the cafeteria plan, the cafeteria plan nondiscrimination rules rather than the comparable contribution rules should apply. This means that if contributions are offered through a cafeteria plan, and these are subject to the Code section 125 nondiscrimination requirements, an employer should be able to vary contributions based on the following without being subject to the comparable contribution rules:

- Matching contributions;
- Contributions for completing a wellness program or health risk assessment;
- Greater contributions for lower paid employees;
- Greater contributions for employees with chronic health conditions; and
- Greater contributions for employees with a higher number of years of service.

Specifically, we urge the Service to incorporate the following examples into the regulations:

Example 1:

(i) Employer A provides HDHP coverage through its cafeteria plan. Employer A automatically contributes to the HSA of each employee who is an eligible individual with HDHP coverage through the cafeteria plan, and describes such contribution in the written cafeteria plan document. Employees make no election with respect to Employer A's HSA contributions and have no right to receive cash or other taxable benefits in lieu of the employer's HSA contributions, but do have the ability to make their own pre-tax salary reductions to fund their HSAs. Employer A contributes only to the HSAs of employees who have elected HDHP coverage through the cafeteria plan.

(ii) Employer A's HSA contributions are made through the cafeteria plan because employees have the right to make pre-tax salary reduction contributions to fund their HSAs and because the employer contribution is described in the written cafeteria plan document. Thus, the comparability rules do not apply to Employer A's HSA contributions.

Example 2:

(i) Employer B gives employees a choice between an HSA "seed money" contribution and cash. The seed money is only available to employees who

have coverage through Employer B's HDHP and varies based upon HDHP coverage level: $100 for employee-only coverage, $200 for employee plus one coverage, $300 for family coverage. In addition, all employees who earn less than $50,000 per year are entitled to an additional $200 seed money contribution. Finally, employees who show that they have a chronic health condition receive an additional $500 seed money contribution. Employer B's written cafeteria plan document describes all of these contributions as benefits available under the cafeteria plan and specifies that employees have a choice to receive such contributions in cash in lieu of depositing such contributions into the HSA. Employees do not have the ability to make pre-tax salary reductions to fund their HSAs.

(ii) Employer B's seed money contribution is made through the cafeteria plan because the employees have a choice between the contribution and cash, and because this contribution is described in the written cafeteria plan document. Accordingly, the cafeteria plan nondiscrimination rules rather than the comparable contribution rules apply. The result is the same whether or not employees have the ability to pay their HDHP premiums on a pre-tax basis through Employer B's cafeteria plan.

Example 3:

(i) Employer C makes a contribution of $100 to the HSAs of all employees who have coverage through Employer C's HDHP and who complete a health risk assessment and participate in Employer C's wellness program. Employer C's written cafeteria plan document describes the ability of participants to make pre-tax salary reduction contributions to their HSAs, and describes the $100 employer contribution as a non-elective employer contribution that participants do not have a choice to receive in cash.

(ii) The $100 employer contribution is made through the cafeteria plan because the employees have the ability to elect to make pre-tax salary reduction contributions to their HSAs and because the employer's cafeteria plan describes the $100 contribution as a non-elective employer contribution made through the cafeteria plan. Accordingly, the cafeteria plan nondiscrimination rules rather than the comparable contribution rules apply. The result is the same whether or not employees have the ability to pay their HDHP premiums on a pre-tax basis through Employer C's cafeteria plan.

Example 4:

(i) Employer D makes contributions to the HSAs of employees who have coverage through Employer D's HDHP, up to certain limits. Specifically, Employer D contributes one dollar of employer funds for every dollar that employees contribute to their HSAs through pre-tax salary reduction up to the following limits: $500 for employee-only coverage, $600 for employee plus one coverage, $700 for family coverage. Employer D's written cafeteria plan document describes this matching contribution as a non-elective employer contribution that participants do not have a choice to receive in cash.

(ii) Employer D's matching contributions are made through the cafeteria plan because the employees have the ability to elect to make pre-tax salary reduction contributions to their HSAs and because the employer's cafeteria plan describes the matching contributions as non-elective employer contributions made through the cafeteria plan. Accordingly, the cafeteria plan nondiscrimination rules rather than the comparable contribution rules apply. The result is the same whether or not employees have the ability to pay their HDHP premiums on a pre-tax basis through Employer D's cafeteria plan.

Example 5:

(i) Employer E makes $500 contributions to the HSAs of employees who have coverage through Employer E's HDHP, and who have at least 10 years of Service with Employer E. Employees are not given a choice to receive this contribution in cash, but are able to make pre-tax salary reduction contributions to their HSAs. Employer E's written cafeteria plan document describes this $500 contribution as a non-elective employer contribution that participants do not have a choice to receive in cash.

(ii) Employer E's contributions are made through the cafeteria plan because the employees have the ability to elect to make pre-tax salary reduction contributions to their HSAs, and because Employer E's cafeteria plan describes the contribution as a non-elective employer contribution made through the cafeteria plan. Accordingly, the comparable contribution rules apply. The result is the same whether or not employees have the ability to pay their HDHP premiums on a pre-tax basis through Employer E's cafeteria plan. However, the result would be different if employees were not given a choice to receive the contribution in cash and were not permitted to make pre-tax salary reduction contributions to their HSAs. In that case, the comparable contribution rules rather than the cafeteria plan nondiscrimination rules would apply.

IV. Comparability Should Be Based Only on Employees Who Have Actually Opened an HSA; Retroactive Contributions Should Not Be Required

Issue

Under the proposed regulations, the fact that an employee may delay in establishing an HSA during the year does not relieve the employer from meeting the comparable contribution rules for that individual, as long as that individual establishes an HSA by December 31st of that year, leading to administrative complexity for employers.

Recommendation

Change the rule in the proposed regulations to provide that if an employee delays in establishing an HSA during the year, the employer may, but is not required, to "make up" contributions on a retroactive basis. Rather, comparability is measured as of the date that an HSA is established.

Analysis

Prop. Treas. Reg. § 54.4980G-4, Q&A-6 provides that if an employee has not established an HSA at the time the employer funds its employees' HSAs, the employer complies with the comparability rules by contributing comparable amounts to the employee's HSA when the employee established the HSA, taking into account each month that the employee was a comparable participating employee. However, an employer is not required to make comparable contributions to an employee's HSA for a calendar year if the employee has not established an HSA by December 31st of the calendar year.

The above rule eliminates the incentive of an employee to complete the application materials to establish an HSA early in the year. The Service should therefore change this rule to provide that comparability will be measured as of the date that an individual establishes his or her HSA. This interpretation is consistent with Code section 4980G, which could easily be interpreted by the Service as applying to employees who actually have HSAs on the date that a particular contribution is made. Such an interpretation would further the health policy goal of encouraging employees to promptly establish HSAs during the year, and to make regular contributions to those accounts so that the amounts are available when needed. Such rule would also eliminate the administrative complexities associated with calculating the amount of an

employee's contribution at the end of the year, when HDHP coverage may have varied throughout the year.

V. Testing Should Be on a Plan Year, Rather than Calendar Year, Basis

Issue

Many employers have adopted HDHPs and HSAs to operate on a non-calendar year basis. If these employers change contribution structures from one plan year to the next, comparability testing on a calendar year basis will unnecessarily restrict plan design changes that take effect on the first day of the plan year and result in different HSA contributions than the previous year.

Recommendation

Allow an employer to test for comparable contributions on a plan year basis rather than a calendar year basis.

Analysis

The objective of the comparable contribution rules is to limit the amount of variance among employer contributions to HSAs of employees with HDHP coverage. Whether this is done on a calendar year or plan year basis should not matter.

Although Code section 4980E does reference "calendar year", the fact that Code section 4980G allows the Service to develop "similar" rules to 4980E means that the Service could interpret the calendar year comparable contribution requirement to be satisfied on a plan year basis. If this is not the rule, an unnecessary restriction could result, as the following example illustrates:

> Employer A offers an HDHP option that operates on a plan year from April 1st to March 31st. In plan year 1, Employer A makes HSA contributions for all employees with HDHP coverage under Employer A's plan. Employer A wishes to change that contribution structure so that in plan year 2, contributions are made for employees with HDHP coverage through Employer A or through any other source. Employer A wishes to make that change effective April 1st. There are employees who had HDHP coverage through other sources in the months of January, February and March.

In the above example, the comparable contribution rule is presumably violated because there are employees who had other HDHP coverage for the first three months of the year who will not receive contributions for those months. Thus, if the comparable contribution rule operates on a calendar year basis, employers with non-calendar year plans will be required to make changes in contribution structure before the beginning of their new plan year to satisfy the rules. This issue could be resolved by allowing employers with non-calendar year plans to test for comparability on a plan year basis rather than a calendar year basis. There are many examples in the Code where Congress considered the issue and chose to use a plan year rather than a calendar year for nondiscrimination testing related to benefit plans. See, e.g., Code sections 125(b), 401(a)(26), 401(k)(3), and 105(h). Accordingly, it is clear that plan year testing is an effective way to conduct nondiscrimination testing. We therefore urge the Service to be flexible and allow employers with a non-calendar year to use plan year testing for purposes of the comparable contribution rules.

VI. Effective Date

Issue

The proposed regulations provide that the final rules will apply to employer contributions made on or after the date the final regulations are published in the Federal Register. Employers need more time than that to implement changes.

Recommendation

Provide an effective date no earlier than contributions made on or after the first day of the plan year that begins at least twelve months after the final regulations are published.

Analysis

The proposed effective date of the date the final regulations are published in the Federal Register would not provide an adequate amount of lead time for plans to become compliant. Large employers typically design their benefit programs nine to eighteen months in advance of a given plan year. Accordingly, the earliest that an employer could implement the rules in the final regulations is the first day of the plan year that begins at least twelve months after the regulations are published in final form.

Conclusion

We believe that the Service has the authority to implement all of the recommendations described in this letter to provide the flexibility that employers need with respect to HSA contributions. We urge the Service to make these changes, which are necessary in order for HSAs to be a successful benefit option with large employers.

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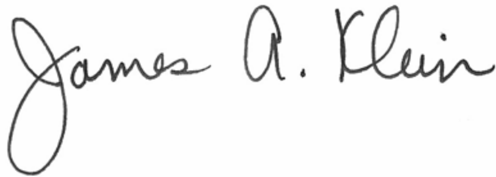
Thank you for consideration of our comments and recommendations. If we can be of additional assistance, you may contact me at (202) 289-6700.

Sincerely,



James A. Klein
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