Summary of current law rules pertaining to Health Savings Accounts (HSAs)

With comparison to Health Reimbursement Arrangements (HRAs) and Flexible Spending Arrangements (FSAs)

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	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
In General			
Definitions and Overview Box 1	A Health Savings Account (HSA) is a tax-advantaged trust or custodial account created for the benefit of an individual (<u>not</u> limited to employees) who is covered under a high-deductible health plan (HDHP). The trustee may be a bank, an insurance company (<u>not</u> just a life insurance company), other persons pre-approved to be trustees or custodians of IRAs or MSAs, or another person (*e.g.*, administrator) approved by the Secretary of Treasury. Contributions may be made by an employer, the individual, or a family member (subject to gift tax). Contributions to an HSA are deductible if made by an individual and are excludable from income and wages if made by an employer. Earnings grow tax-free and distributions for qualified medical expenses are tax-free. Nonqualified withdrawals are subject to income and penalty taxes. Excess contributions are subject to a 6-percent excise tax. Like an IRA, the HSA is owned by the individual and is portable. Debit or credit cards may be used for reimbursements. HSAs may be established in the same way that individuals establish IRAs or MSAs. Internal Revenue Service (IRS) permission or employer involvement is not required. The HSA provider need not require proof of HDHP coverage but may desire to do so for purposes of recordkeeping/reporting. If an employer sets up an HSA for an employee, however, the employer must verify that the employee is enrolled in an employer-offered HDHP. Legislation enacted in 2006 gives employers a five-year window to make a one-time consolidation of FSA or HRA balances to an HSA for employees on a nondiscriminatory basis. Consolidated amounts generally cannot exceed the balance in the FSA or HRA as of September 21, 2006.	A health reimbursement arrangement (HRA) is an arrangement funded solely by the employer. HRAs may be offered to employees or former employees. Amounts must be used for qualified medical expenses and balances may be carried forward. Depending upon the terms of the HRA, coverage may (or may not) continue if the employee terminates service. HRAs are not portable.	A health flexible spending arrangement (FSA) is an arrangement that may be funded by the employer and/or the employee via salary reduction. Health FSAs may be offered only to employees (self-employed persons are not eligible). Amounts must be used for qualified medical expenses, and balances may not carry forward beyond the coverage period. FSAs are not portable. Legislation enacted in 2006 provides important relief from prior law rules regarding the ability of an individual to be HSA-eligible as a result of FSA grace period coverage.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Contributions			
Employer Contributions – Generally Box 2	Employer contributions are excludable for income and employment tax purposes. Once an employer makes the contributions to an HSA, such employer cannot require that the HSA distributions be made exclusively for medical expenses or place any other restrictions or limitations on the HSA, including any limitation on rollovers or transfers. A requirement that HSA distributions satisfy reasonable administrative rules imposing minimum dollar amounts or limits on the frequency of distributions is allowed. *Excess and Erroneous Employer Contributions.* Whether an employer can recoup excess contributions made to an HSA depends on the facts. If an employer makes contributions to an HSA on behalf of an individual who was never HSA-eligible, then, yes, the employer can correct the error and recoup any amounts contributed. Notably, if amounts are not recouped by the employer, they must be reported as additional income on the employee's W-2. Additionally, if an employer makes contributions on behalf of an HSA-eligible individual but in excess of the respective contribution limits, the employer may recoup any excess contributions. If the employer fails to do so, such excess amounts must also be reported as additional W-2 income. Notably, if an employer contributes amounts to an HSA after an individual ceases to be an HSA-eligible individual, IRS guidance states that the employer may <u>not</u> recoup such contributions.	Employer contributions are permissible. Such contributions along with the coverage provided under the HRA are excluded from the employee's income.	Contributed amounts attributable to pre-tax salary deferrals by employees are permissible (these are treated under federal tax law as "employer contributions"). Like the HRA, contributed amounts and the coverage provided thereunder are excluded from the employee's income.
Employer Contributions – Comparability Box 3	Employer contributions must satisfy the "comparability" rules, unless HSA contributions are made through a cafeteria plan, in which case the nondiscrimination rules in Code §125 must be satisfied. The cafeteria plan nondiscrimination rules are discussed in Box 15. Employer contributions that are not provided through a cafeteria plan must be provided on a "comparable" basis to most eligible employees who have the same category of HDHP in order to avoid a 35-percent excise tax. For these purposes, "comparable" means that an employer must make <u>the same</u> HSA contribution, either as a dollar amount or as a percentage of the deductible, for <u>all</u> comparable participating employees, i.e., eligible individuals who are in the same category of employees and who have the same category of HDHP coverage. There are three categories of employees: current full-time employees, current part-time employees, and former employees (except former employees with coverage under an employer's HDHP because of an election under a COBRA continuation provision). Thus, contributions may reflect the differences in deductibles for family versus individual coverage or other differences in deductibles that apply to different employee groups covered by the HDHP. *Comparability Rules Apply to Employer's HDHP Coverage Only Unless Outside Plans Are Taken Into Account.* Where an employer makes contributions to the HSA of one group of employees with HDHP coverage, Treasury Department regulations require that comparable contributions only be made to the HSAs of all employees with HDHP coverage sponsored by the same employer (taking into account the various differences outlined above, such as the nature of HDHP coverage, the status of an employee as a full- or part-time employee, etc.). Thus, an employer need not make contributions to the HSAs of employees with HDHP coverage not otherwise sponsored by the employer. The regulations make clear, however, that where an employer makes contributions to the HSAs of a group of employees regardless of whether the employees have employer-sponsored HDHP coverage, the employer is required to make comparable contributions to the HSAs of <u>all</u> employees. *No Differential Vesting Rules Allowed.* The comparability rules are violated if an employer imposes a vesting requirement on contributions or imposes a condition precedent on an HSA contribution, such as requiring that the employee complete a health assessment or participate in a disease management program.	HRAs are subject to the nondiscrimination tests under Code §105(h).	Same as HRAs.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Contributions (continued)			
Employer Contributions – Comparability Box 3 (continued)	*Extra Contributions for Non-HCEs.* Legislation enacted in 2006 provides that employers may make additional contributions to non-highly compensated employees (non-HCEs) without violating the comparability rules. *Comment*: Because employer contributions made through a cafeteria plan are subject to more flexible rules than the general comparability rules governing HSAs, the ability to contribute higher amounts to non-HCEs is likely to be useful primarily for small businesses without cafeteria plans. *Special Rule for Mid-Year Enrollees.* An employer may contribute up to the maximum contribution amount allowed for mid-year enrollees (see Box 10) without violating the comparability rules. Existing guidance makes clear that such employer does not violate the comparability rules solely by reason of the fact that some employees, *i.e.*, mid-year enrollees, will receive more contributions on a monthly basis than employees who worked the entire calendar year. Notably, an employer is not required to contribute the full-year contribution limit for mid-year enrollees, and can instead satisfy the comparability rules by prorating employer contributions using the default monthly contribution rule (see Box 6 for further discussion). An employer, however, must treat all comparable mid-year enrollees the same. *Special Rules for Qualified HSA Distributions.* If an employer offers Qualified HSA Distributions (see Box 22 for a description) to any employee who is an eligible individual under any HDHP, such employer must offer the same to all employees who are eligible individuals under the same HDHP. Notably, however, an employer that offers qualified HSA distributions only to employees who are covered under the employer's HDHP are <u>not</u> required to offer the same to persons covered under third-party HDHPs. *Special Rule for Employees Who Have NOT Established An HSA By December 31st.* Employers must provide a notice to all employees who are otherwise owed a comparable HSA contribution. Such notice must be provided by January 15th of the year following the year for which the comparable contribution is payable. The notice must state that, for all individuals who both establish an HSA by the last day of February and notify the employer of such HSA, such individuals will receive a comparable HSA contribution. An employer has until April 15th to make the comparable contribution. *Special Rule Allowing For Accelerated HSA Contributions.* An employer can accelerate part or all of its HSA contributions for the entire year for one or more employees who have incurred qualified medical expenses in excess of the contributions made to date by the employer for that year. If an employer chooses to accelerate contributions, the employer must make this option available to all similarly situated employees and must establish reasonable procedures for determining need. Please note that applicable Treasury regulations provide special rules regarding contributions to employee spouses, former employees, and with respect to collectively and non-collectively bargained groups of employees.		
Individual Contributions Box 4	Contributions are deductible on an individual's income tax return or excludable from income if made through an employer salary reduction contribution.	Employee contributions are not permitted, although an HRA can be offered in conjunction with an FSA, subject to ordering rules discussed below.	Same as HSAs.
Restriction for Individuals Covered by Medicare Box 5	No contributions to an HSA can be made once an individual becomes eligible for Medicare, which is interpreted to require actual <u>enrollment</u> and not merely attaining the age of eligibility.	No restriction.	No restriction.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Contributions (continued)			
Maximum Deduction and Exclusion Box 6	*Prior to 2007.* For taxable years prior to 2007, the deduction and exclusion for contributions to an HSA could not exceed the lesser of the applicable deductible under the HDHP (see discussion at Box 12) or the statutory maximum. *2007 and Beyond.* Beginning in 2007, the "lesser of" rule was eliminated so that the deduction and exclusion cannot exceed the statutory dollar maximum, which for 2009 is: $3,000 (self-only coverage), or $5,950 (family coverage). *Indexing and Catch-Up.* The statutory maximums are indexed for cost of living, which is calculated and published by the Treasury Department by June 1st each year. Individuals who are age 55 or older may deduct an additional $900 in 2008. This catch-up amount will increase to $1,000 in 2009, at which point future indexing will cease. *Default Monthly Contribution Rule.* The statutory maximum limit is prorated for each month that an individual is HSA-eligible. Therefore, if an individual is only HSA-eligible for six months in 2009, his or her maximum deduction/exclusion limit would be $1,500 if covered by self-only HDHP coverage and $2,975 if covered by family HDHP coverage. The one exception to this rule, however, is if he or she is eligible to take advantage of the mid-year enrollee rule discussed above (see discussion at Box 10). *Coordinated Coverages.* If an individual has other coverage that does not provide benefits until the HDHP deductible has been satisfied (*e.g.*, a post-deductible HRA as described in Box 17), the maximum allowable deduction/exclusion is the lesser of the deductible under the HDHP or the deductible under the other coverage. *Rule Regarding MSAs.* The maximum deduction/exclusion is decreased by the aggregate amount paid into an MSA, but not by amounts consolidated pursuant to a Qualified HSA Distribution (see Box 22). *Administrative Fees.* Administrative fees for an HSA that are paid from HSA assets are not taxable distributions but do not increase the deduction/exclusion amount allowed. Administrative fees paid outside of the HSA do not decrease the contributions otherwise allowable.	No statutory limit but benefits for highly compensated employees (HCEs) may be limited by the application of nondiscrimination rules under the Code.	No statutory limit but benefits and salary reduction for highly compensated employees may be limited by the application of nondiscrimination rules under the Code.
Taxation of Distributions and Earnings			
Qualified Medical Expenses Box 7	There is no tax on distributions for qualified medical expenses. Qualified medical expenses are expenses for medical care defined under §213(d) of the Code (including nonprescription drugs) for the individual, spouse and dependents. Reimbursable medical expenses must be incurred after the HSA has been established. There is no requirement that an HSA distribution be made within any particular time period after the medical expense has been incurred. EXCEPTIONS: Reimbursable medical expenses from an HSA do not include expenses for health insurance *except*: (i) long-term care insurance; (ii) COBRA coverage; (iii) premiums for health care coverage while an individual, spouse or dependent is receiving unemployment compensation under federal or state law; (iv) for Medicare eligibles, premiums for any health insurance other than a Medicare supplemental policy; and (v) Medicare Part D, if the individual is 65 or older. Neither trustees, nor custodians, nor employers have any obligation to determine whether HSA distributions are used for qualified medical expenses.	There is no tax on distributions for qualified medical expenses. Qualified medical expenses are expenses for medical care as defined under Code §213(d) for the employee, spouse and dependents, and depending on the HRA's terms may include premiums for any accident or health coverage, including long-term care, for current employees, retirees and COBRA-qualified beneficiaries. Under current law rules, an employer (or plan administrator) is required to determine whether reimbursements are used for qualified medical expenses.	There is no tax on distributions for qualified medical expenses. Qualified medical expenses are expenses for medical care as defined under Code §213(d) for the employee, spouse and dependents. FSAs may *not* be used to reimburse insurance premiums, including long-term care. Like HRAs, under current law rules, an employer (or plan administrator) is required to determine whether reimbursements are used for qualified medical expenses.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Taxation of Distributions and Earnings (continued)			
Other Nonqualified Withdrawals Box 8	Distributions that are not reimbursements for qualified medical expenses are subject to income tax plus a 10-percent penalty, with exceptions to the penalty for Medicare eligibles, disability or death.	Amounts cannot be used for any purpose other than to cover qualified medical expenses.	Amounts generally cannot be used for any purpose other than to cover qualified medical expenses. *Comment*: One exception applies to Qualified Reservist Distributions (QRDs), as allowed for by the Heroes Earnings Assistance and Relief Tax Act of 2008 (the Heart Act). Under the terms of the Heart Act, a plan may allow qualified reservists who are ordered or called to active military duty to elect a taxable distribution of unused amounts from their FSAs.
Tax Treatment of Earnings Box 9	Earnings on HSA assets are not subject to tax while they are held in the HSA and are never taxed if they are distributed to reimburse for qualified medical expenses.	N/A	N/A
Eligibility			
Eligible Individual Generally Box 10	HSAs are available to any individual covered under an HDHP who is not simultaneously covered under a *non*-HDHP (*i.e.*, another health plan). Eligible individuals do not include individuals who may be claimed as dependents on another person's tax return or who are Medicare enrollees. *Mid-Year Enrollee Rule.* Beginning in 2007, individuals who enroll in HDHP coverage after the start of the year, either as part of employer-sponsored group coverage or on the individual market, are permitted to make contributions up to the full annual HSA contribution limit. Under prior law, to be eligible for the full year's HSA contribution, a person was required to be enrolled in the HDHP in each month of the calendar year. Individuals who take advantage of this rule, however, must remain an HSA-eligible individual for the next full calendar year. Failure to do so results in income inclusion plus a 10-percent penalty on any HSA contributions in excess of those that would be permitted under the default monthly contribution rule (see Box 6). Amounts contributed by individuals who fail to remain HSA-eligible for this testing period may not be withdrawn as an excess contribution. Neither employees nor HSA trustees are responsible for reporting whether an individual remains an HSA-eligible individual for the duration of the testing period; responsibility rests with the individual himself or herself. *Comment*: Individuals who enroll in HDHP coverage after the start of the year, either as part of employer-sponsored group coverage or on the individual market, remain subject to the full annual deductible under the HDHP. For such individuals, prior law limited HSA contributions to only those months in which they have qualifying HDHP coverage even though they are subject to the full year plan deductible. The mid-year enrollee rule provides an important "fix" by allowing individuals that enroll in an HDHP after the start of the taxable year to make contributions up to the full annual HSA contribution limit. *Comment*: There remains some question as to whether eligibility for the mid-year enrollee rule requires that an individual commence HDHP coverage after the start of the taxable year, or only that the individual become HSA-eligible after the start of the year. To the extent eligibility turns only on becoming HSA-eligible after the start of the year, this would permit individuals to make full contributions to an HSA where they have other disqualifying coverage for some portion of the year (*e.g.*, because of disqualifying coverage attributable to coverage under their spouse's FSA or HRA).	HRAs may be offered to current and former employees and individuals electing COBRA.	FSAs may be offered to current and former employees and individuals electing COBRA.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Eligibility (continued)			
Other Coverage Allowed for Eligible Individuals Box 11	For purposes of determining eligibility, other non-HDHP coverage does not disqualify the individual from contributing to an HSA if the coverage is provided under one of the enumerated exceptions. The exceptions are: long-term care; dental or vision; accident; disability; or "permitted insurance" (*e.g.*, insurance covering certain types of liabilities, specific illnesses or diseases, or hospitalization). *Pre-2006 Rx Coverage.* Under transition relief in effect through 2005, prescription drug coverage under a rider or separate plan was disregarded coverage that did not disqualify an eligible individual from HSA contributions. Beginning on January 1, 2006, prescription drug coverage is disqualifying other coverage. *EAPs, Disease Management, Wellness Programs and Clinics.* Eligibility under an employee assistance program (EAP), disease management, wellness program, or access to an employer's free clinic is not other coverage that disqualifies an otherwise eligible individual from HSA contributions as long as these arrangements do not provide "significant" medical benefits. Under this rule, therefore, the typical EAP that provides short-term counseling and referrals should not affect HSA eligibility. *Veterans Affairs Coverage.* An individual who is covered under comprehensive coverage offered by the Department of Veterans Affairs will not be deemed HSA-ineligible so long as he only receives medical benefits consisting of otherwise preventive or disregarded care. Legislation enacted in 2006 also provides important relief from prior law rules regarding the ability of an individual to be HSA-eligible as a result of FSA grace period coverage (see Box 18).	N/A	N/A
High-Deductible Health Plan – In General Box 12	For 2009, a health plan is considered to be an HDHP if it has an annual deductible of at least $1,150 for self-only coverage (or $2,300 for family coverage) and the total out-of-pocket expenses is not more than $5,800 for self-only coverage (or $11,600 for family coverage). The deductibles and out-of¬pocket limitations are determined on a 12-month period. If an HDHP is based on a 12-month period other than the calendar year (*i.e.*, a fiscal year plan), the deductible and out-of-pocket limitations that apply in the first month of the HDHP coverage may be applied for the next 11 months and need not be adjusted mid-coverage period. Deductible and out-of-pocket limits are subject to cost of living increases. A health plan must provide "significant benefits" to qualify as an HDHP. Therefore a plan that restricts benefits to expenses for hospitalization or inpatient care does not qualify. Family coverage is any coverage for more than one person and is not limited to spouses and dependents. Thus, if coverage includes a domestic partner, the domestic partner may become eligible to fund his or her own HSA. Out-of-pocket expenses include the deductible and copay amounts but not premiums. A family coverage plan will not fail to qualify as an HDHP if it provides an out-of-pocket limit of at least $2,200 for individual family members. If the HDHP has "embedded" deductibles for each individual under family coverage, the embedded deductible may not cause the family to exceed the overall $11,600 out-of-pocket limit in the aggregate. For example, to comply with the $11,600 maximum out-of-pocket rule for 2009 where family coverage is for six or more persons, the HDHP must pay for the sixth family member after all others have met their deductible even if the sixth family member has not met his or her embedded deductible.	N/A	N/A
High-Deductible Health Plan – Embedded Deductibles Box 13	A plan does not qualify as an HDHP if it has individual deductibles that with respect to any covered individual (under self-only or family coverage) are less than the statutory minimum deductible. Additionally, as discussed above, in Box 12, if an HDHP has "embedded" deductibles for each individual under family coverage, the embedded deductible may not cause the family to exceed the overall out-of-pocket limit (for example, $11,600 for 2009) in the aggregate.	N/A	N/A

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Eligibility (continued)			
High-Deductible Health Plan – Preventive Care Exceptions Box 14	HDHPs may have a zero deductible or a deductible below the minimum annual deductible for preventive care. In general, preventive care is treatment for a condition for which symptoms are not yet manifest, although the individual may have developed risk factors. Preventive care may include prescription drug treatment for an asymptomatic person (*e.g.*, statins to prevent heart disease or ACE inhibitors to prevent reoccurrence in stroke or heart attack victims). Preventive care also may include treatment that is incidental or ancillary to a procedure that constitutes preventive care (*e.g.*, removal of polyps during a diagnostic colonoscopy). State law characterizations of preventive care are not determinative.	N/A	N/A
Cafeteria Plans and Discrimination Testing			
Cafeteria Plans and Discrimination Testing Box 15	Contributions to HSAs may be made through an employer-sponsored cafeteria plan, which includes salary reduction contributions to the HSA or employer contributions to the HSA. If made through a cafeteria plan, the contributions to the HSA generally are not subject to the special rules for health FSAs that are designed to make the health FSA function as "insurance." For example, the rules for health FSAs that require the maximum employer contribution be available for the full 12 months is not applicable to an HSA that is funded through a cafeteria plan and employees may change their salary reduction contributions to an HSA at any time. Employer contributions to HSAs must either satisfy the comparability rule discussed above at Box 3 or be offered through a cafeteria plan arrangement that satisfies the nondiscrimination tests under Code §125. As a general matter, to be a cafeteria plan, an employee must have a choice between cash or nontaxable benefits. There are a number of alternative plan designs for incorporating an HSA into a cafeteria plan. First, an employee could be given a choice between cash and the HSA contribution itself, which would occur where the employee funds all or part of the HSA through salary reduction contributions. Second, an employee could be given a choice between cash and an employer contribution to the HSA, which may be less desirable from an employer perspective, or the employee may be given the choice between cash and a menu of benefits, including the HDHP/HSA coverage. For example, an HSA presumably would be part of a cafeteria plan if the only choice between cash and benefits given to the employee is a choice between paying any employee portion of the HDHP premiums on a pre- or post-tax basis (a so-called premium conversion arrangement). The nondiscrimination test under Code §125 requires generally that the eligibility for and utilization of the benefits under a cafeteria plan (i) not discriminate in favor of highly compensated employees, and (ii) not provide more than 25 percent of benefits to "key employees" (which includes all 5¬percent or more owners of the business as well as lesser owners and officers whose compensation exceeds certain statutory thresholds). *Comment*: The nondiscrimination testing rules for cafeteria plans have never been finalized in regulations. Currently, testing is based upon the Code §125 statutory rules, the legislative history thereto, and proposed regulations. Notably, on August 6, 2007, Treasury issued new proposed regulations for cafeteria plans that include modified and expanded nondiscrimination testing rules. The new proposed nondiscrimination testing requirements are modeled in large part on the rules that apply with respect to tax-qualified retirement plans. The regulations are generally effective for plan years beginning on or after January 1, 2009, but may be relied upon now. There remain many unanswered questions about the valuation of benefits and the various testing methods that may be used to show that a cafeteria plan satisfies the nondiscrimination rules (both under the current and new proposed regulations).	The health coverage elected through a cafeteria plan may include coverage in an HRA as long as it does not result in deferred compensation. This means that salary reduction dollars cannot be used to populate the HRA. HRAs are subject to the nondiscrimination rules under Code §105(h), which prohibit benefit or coverage discrimination in favor of highly compensated employees.	Health FSAs may be offered under a cafeteria plan. Health FSAs are subject to the nondiscrimination rules under Code §105(h), which prohibit benefit or coverage discrimination in favor of highly compensated employees. Health FSAs also are subject to rules that are designed to make the health FSA function like insurance. For example, employees in the health FSA must have the maximum contribution under the FSA available at all times during the coverage period; employees cannot change their health FSA elections absent certain changes in events; the coverage period must be 12 months; and health FSA amounts that are unused at the close of the coverage period must be forfeited. Notice 2005-42 permits employers to adopt a grace period up to 2 1/2 months immediately following the end of each plan year during which unused benefits or contributions remaining at the end of the plan year may be paid or reimbursed to plan participants for qualified benefit expenses incurred during the grace period. be problematic for employees who seek to be HSA-eligible as of the start of the taxable year. This is because the FSA grace period coverage is deemed to be other disqualifying coverage under the eligibility rules applicable to HSAs. As discussed in Box 18, the IRS has provided guidance describing how an employer may amend the cafeteria plan document to enable a health FSA participant to become HSA eligible during the grace period. Additionally, pursuant to legislation enacted by Congress at the end of 2006, employees with a "zero balance" in their FSA as of the end of the plan year are now eligible to make HSA contributions during the 2 1/2-month grace period.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Layering of Coverage			
With Other Health Insurance (Other Than Medical Reimbursement Arrangements) Box 16	As discussed above (see Box 10 above), an HSA-eligible individual may only be covered by a qualifying HDHP unless and until the minimum deductible under the HDHP has been satisfied. Under current law rules, certain permitted coverage (*i.e.*, coverage for long-term care, dental or vision, accident or disability, or insurance covering specific diseases, illness, or hospitalization) may be combined with an HSA regardless of whether the minimum annual deductible under the HDHP has been satisfied.	There are no restrictions on layering HRA coverage with other group or individual health insurance.	There are no restrictions on layering FSA coverage with other group or individual health insurance.
With Another Medical Reimbursement Arrangement (*i.e.*, HSA, FSA or HRA) Box 17	In general, an individual will not be eligible for HSA contributions at the same time he or she is covered by a general-purpose health FSA or HRA of the individual or the individual's spouse. However, an individual will be eligible to contribute to an HSA if such general-purpose health FSA or HRA permits payments or reimbursements only after the statutory minimum annual deductible for an HDHP has been satisfied. These arrangements are referred to as post-deductible HRAs or FSAs. *Comment*: Note that a post-deductible HRA or FSA may pay prior to the HDHP if the HDHP has a higher deductible than the statutory minimum. An individual will continue to be HSA-eligible if he or she is covered only by a limited-purpose FSA or HRA. A limited-purpose FSA is an arrangement that pays benefits for permitted coverage (but not through insurance or for long-term care services). A limited-purpose HRA pays benefits for permitted coverage provided directly by the HRA or through insurance.	See discussion on HSAs. An individual also may contribute to an HSA if his or her general-purpose HRA is suspended during a coverage period, or if the HRA covers medical expenses incurred after the individual retires. Specifically, an individual with an HRA may elect on a prospective basis to forgo the payment of medical expenses from the HRA. Medical expenses incurred during the suspension period cannot be reimbursed; however, reimbursements for permitted coverage or preventive services are allowed. An employer is not precluded from contributing to the HRA during the suspension period. In addition, an individual remains an eligible individual if an HRA is established to reimburse medical expenses incurred after an individual retires. Once the individual retires, but before he becomes eligible for Medicare, he will no longer be eligible for contributions to an HSA unless he suspends the HRA coverage as discussed above. An individual with coverage under a combination of an FSA, HRA, and HSA may receive reimbursements through the FSA or HRA prior to taking distributions from the HSA, as long as the individual does not seek multiple tax-favored reimbursements for the same expense. If an HRA is provided in addition to an FSA, special rules apply to the ordering of payments. Absent a specific ordering rule in the HRA document, the HRA funds must be used first if the FSA covers a medical expense that also is covered by the HRA.	See discussion for HSAs and HRAs. Note that long-term care coverage, which can be offered in an HSA and an HRA, cannot be offered in an FSA pursuant to Code §106(c). Employers may grant a 2 1/2-month grace period during which FSA contributions remaining at the end of the plan year may be reimbursed to plan participants for qualified benefit expenses incurred during the grace period. FSA grace period coverage can be problematic for employees who seek to be HSA-eligible as of the start of the taxable year. This is discussed in greater detail in Box 18, "With FSA Grace Period Coverage."

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Layering of Coverage (continued)			
With FSA Grace Period Coverage Box 18	Previously, an individual participating in an FSA who was covered by the grace period was generally not eligible to contribute to an HSA until the first day of the first month following the end of the grace period, regardless of whether he had any money left in his account. Moreover, IRS guidance made clear that an employer may not provide a limited-purpose or post-deductible FSA during the grace period for only those participants seeking to become HSA-eligible but must provide the same level of HSA coverage (*i.e.*, post-deductible or limited-purpose or general-purpose) to all participants. Pursuant to legislation enacted by Congress at the end of 2006, employees with a "zero balance" in their FSA as of the end of the plan year are eligible to make HSA contributions during the 2 1/2-month grace period. Recent IRS guidance makes clear that for purposes of the "zero balance" rule, an individual's account balance is determined using a "cash basis," *i.e.*, without regard to incurred but otherwise unreimbursed expenses. *Comment*: The new "zero balance" rule will undoubtedly help employers that seek to move a group of employees to HDHP coverage as of the start of the succeeding plan year, while still being able to provide FSA grace period coverage to remaining employees (*e.g.*, for those employees that opt out of HDHPs for the succeeding year). Imposition of a "cash basis" definition of "account balance" will, however, likely add some administrative complexity to use of this rule. Notably, there is also no apparent de minimis rule with respect to low-dollar amounts that may unintentionally remain in an FSA at the end of the year.	N/A	See discussion on HSAs.
Prescription Drug Coverage Box 19	The IRS provided a special transition rule through January 1, 2006 allowing for certain prescription drug coverage. Because the special transition rule expired on January 1, 2006, separate plans or riders for prescription drugs may not be provided in conjunction with an HDHP, because such coverage would be considered additional disqualifying insurance.	There are no restrictions on combining an HRA with specific prescription drug coverage.	There are no restrictions on combining an FSA with specific prescription drug coverage.
Rollovers			
To and From Other Medical Reimbursement Arrangements Box 20	Rollovers are permitted from MSAs and other HSAs. There is no limit on the number of trustee-to-trustee transfers that may be made during a 12-month period, but only one rollover may be made by the owner of the HSA during a 12-month period (*i.e.*, a distribution of the HSA that is re-contributed to an HSA within 60 days).	Subject to the one-time consolidation rule (see Box 22), rollovers to HSAs are not permitted. Any contribution to an HSA from an HRA account would be a contribution that would reduce the HSA deduction limit.	Subject to the one-time consolidation rule (see Box 22), rollovers to HSAs are not permitted.
To and From an Individual Retirement Account (IRA) Box 21	Prior to January 1, 2007, rollovers were not permitted into an HSA from a qualified retirement plan, including an individual retirement account (IRA). Pursuant to legislation enacted in 2006, beginning January 1, 2007, a one-time tax-free irrevocable rollover from an IRA into an HSA is permitted to be made. The amount of the rollover cannot exceed the applicable annual HSA contribution limit (which would vary depending on whether the person has individual or family HDHP coverage). Failure to maintain eligibility for HSA contributions for a period of 12 months following the IRA transfer would result in an assessment of income tax and a 10-percent penalty on the transfer. This provision also applies to Roth IRAs, but not "ongoing" SIMPLE or SEP IRAs. For this purpose, an IRA is treated as ongoing if an employer contribution is made for the plan year ending with or within the IRA owner's taxable year in which the qualified funding distribution would be made.	Rollovers to or from an IRA are not permitted.	Rollovers to or from an IRA are not permitted.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Consolidations of Existing HRA and FSA Funds Into HSAs			
General Rule Box 22	Legislation enacted in 2006 gives employers a 5-year window (*i.e.*, through 2011) to make a one-time trustee-to-trustee transfer of FSA or HRA balances to an HSA for employees on a nondiscriminatory basis, therefore consolidating funds (Qualified HSA Distribution). The amount consolidated cannot exceed the balance in the FSA or HRA as of September 21, 2006. If the employee fails to continue to be covered by the HDHP for a 12-month period after the transfer (or otherwise fails to be eligible for HSA contributions during that period), then the employee would incur income tax plus a 10-percent penalty on the transferred amount. IRS Notice 2007-22, which was released on February 15, 2007, provides that an employee with a balance in a general-purpose health FSA with a grace period or general-purpose HRA at the end of a health FSA or HRA plan year is treated as an eligible individual for HSA purposes as of the first day of the first month in the immediately following plan year if the following requirements are satisfied. Consolidated amounts that fail to meet these requirements would be included in the accountholder's income and subject to an additional 10-percent penalty: ■ An employer must amend the FSA or HRA written plan effective by the last day of the plan year to allow a Qualified HSA Distribution; ■ A Qualified HSA Distribution from the FSA or HRA must not previously have been made on behalf of an employee with respect to that particular FSA or HRA; ■ The employee must have qualifying high-deductible health plan (HDHP) coverage as of the first day of the month during which the Qualified HSA Distribution occurs, and must otherwise be an HSA-eligible individual; ■ The employee must elect by the last day of the plan year to have his or her employer make a Qualified HSA Distribution from the FSA or HRA to his or her HSA; ■ The FSA or HRA must make no reimbursements to the employee after the last day of the plan year; ■ The employer must make the Qualified HSA Distribution directly to the HSA trustee by the 15th day of the 3rd calendar month following the end of the immediately preceding plan year, but after the employee becomes HSA-eligible; ■ A Qualified HSA Distribution must not exceed the lesser of the balance in the FSA or HRA on (i) September 21, 2006, or (ii) the date of the distribution; and ■ Immediately following the Qualified HSA Distribution, the FSA or HRA must have a zero balance, and the employee must no longer be a participant in any non-HSA compatible health plan. Alternatively, effective on or before the date of the first Qualified HSA Distribution, the FSA or HRA must be converted to an HSA-compatible FSA or HRA. *Comment*: The one-time transfer of existing HRA or FSA funds will assist employers that seek to transition employees to HDHP coverage. The one-time transfer will help ensure that employees who are transitioning to the HDHP have HSA funds available from the start of HDHP coverage to meet initial out-of-pocket costs under the HDHP. Employees will benefit from the consolidation of the accounts because the HSA is owned by the employee and is fully portable. *Comment*: Under the guidance, mid-year consolidations of general-purpose FSAs (including those with grace period coverage) and HRAs generally will result in taxation and penalty for accountholders. This is because the coverage under the general-purpose FSA or HRA is deemed to continue for the duration of the FSA or HRA plan year, even if amounts are "zeroed down" pursuant to a consolidation. Such coverage would be disqualifying other coverage for purposes of the eligibility rules applicable to HSAs. See Box 11 for further discussion.	See discussion on HSAs.a	See discussion on HSAs.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Consolidations of Existing HRA and FSA Funds Into HSAs (continued)			
General Rule Box 22 (continued)	*Comment*: The Notice also reflects the IRS's view that all consolidations with respect to general-purpose FSAs without grace period coverage generally will result in taxation and penalty for accountholders, even where the consolidation is timed for the end of the plan year. *Comment*: The IRS guidance appears to give employees certain discretion with respect to the consolidation of existing FSA or HRA amounts into an HSA. Specifically, the guidance states that the employee "must elect" by the last day of the plan year to have his or her employer make a Qualified HSA Distribution from the FSA or HRA to his or her HSA. Query whether a negative election would comport with the guidance (*i.e.*, the employer will consolidate unless the individual employee opts out of the consolidation). *Comment*: In the case of a Qualified HSA Distribution that is made as of the close of a plan year, the requirement that the FSA or HRA be "frozen" as of the close of the plan year will preclude the use of administrative run-out periods with respect to HRAs and FSAs for the year in which a consolidation would occur. This is because the guidance expressly states that "the FSA or HRA must make no reimbursements to the employee after the last day of the plan year." Such a result seems inconsistent with existing HRA and FSA guidance that permits the use of such run-out periods and it is not clear why this requirement is necessary to effect a Qualified HSA Distribution. Employers and administrators will need to educate employees of the importance to seek reimbursements from their FSA or HRA well in advance of the close of the plan year to ensure that all covered expenses are reimbursed before funds are transferred in a Qualified HSA Distribution.		
Transition Rule Box 23	Notice 2007-22 also provides transition relief for Qualified HSA Distributions pertaining to amounts existing as of December 31, 2006. These arrangements need not have been "frozen" as of December 31, 2006 under the general rules for Qualified HSA Distributions discussed above. Under the transition rule for 2006, distributions that occurred under an FSA grace period during 2007 or that occurred from an HRA during 2007 did not cause the individual to be ineligible for HSA contributions from January through March 2007, provided that the Qualified HSA Distribution from the FSA with grace period or HRA occurred no later than March 15, 2007 and consisted of all amounts remaining in such FSA or HRA as of the date of the Qualified HSA Distribution (but not in excess of the September 21, 2006 balance). *Comment*: In contrast to the general rule (see Box 22), the transition relief did not require an employer to freeze an employee's FSA or HRA account balance as of the end of the 2006 plan year. Thus it appears that employers may have been able to resurrect HRA balances that may have been forfeited or otherwise terminated at the end of 2007 by employees who were seeking to be HSA-eligible as of January 1, 2007, and the employers may have been able to make Qualified HSA Distributions of such amounts into HSAs on behalf of their employees. Note that an employer could not resurrect an FSA balance that forfeited on December 31, 2006, since an FSA without a grace period had to forfeit any remaining funds under the "use-it-or-lose-it" rule. *Comment*: The transition rule required that consolidations occur no later than March 15, 2007, which did not give employers and administrators much time to effectuate consolidations. Although FSA amounts from 2006 had to be consolidated under the transition relief or were otherwise lost (under the "use-it-or-lose-it" rule), it appears that employers could have reestablished and frozen HRAs for 2007 and then could have chosen to consolidate reestablished HRA accounts under a Qualified HSA Distribution at a later date.	See discussion on HSAs.	See discussion on HSAs.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Consolidations of Existing HRA and FSA Funds Into HSAs (continued)			
Nondiscrimination Rule Box 24	Where an employer offers one employee the option to consolidate accounts, the employer must, in accordance with the comparability rules, offer to "any otherwise eligible individuals covered by the employer's HDHP" the option to consolidate existing medical reimbursement accounts into an HSA. Specifically, if an employer offers consolidation to an employee covered by any HDHP, including those sponsored by third-party providers or employers, the employer must offer the same consolidation option to all employees covered under any HDHP. If, however, an employer only offers the consolidation option to employees covered under an HDHP sponsored by the employer, then the employer must only extend the same consolidation option to all similarly situated persons covered under the employer's HDHP(s). *Comment*: It is not entirely clear whether an employee who declines a Qualified HSA Distribution may have a subsequent "bite at the apple." Notably, the statutory language of the Tax Relief and Health Care Act expressly permits an individual to make a one-time "distribution." Thus, an employee's decision not to consolidate presumably should not prevent him or her from consolidating at a later date.	See discussion on HSAs.	See discussion on HSAs.
Tax Treatment Generally Box 25	For consolidations that satisfy the general rule or the transition rule (see Boxes 22 and 23), the recipient accountholder is not taxed on transferred amounts. Additionally, such amounts do not affect or otherwise reduce the amount that an accountholder may contribute to an HSA in the year of the consolidation. This is because consolidated amounts are not treated as contributions for purposes of determining an individual's annual HSA contribution limit. Existing IRS guidance provides that an individual technically need not be HSA-eligible to receive a Qualified HSA Distribution. However, if an individual is not HSA-eligible immediately following a Qualified HSA Distribution, the full amount of the distribution is included in income and is subject to an additional 10-percent penalty. In addition to current law rules regarding when an individual is an "eligible individual," the IRS guidance indicates that an individual will be treated as HSA-ineligible and, therefore, subject to income inclusion and penalty where the following occurs: ■ Circumstance 1 – Where any amounts remain in a general-purpose FSA or general-purpose HRA immediately following consolidation. ■ Circumstance 2 – Where a Qualified HSA Distribution is made on behalf of an employee before he or she becomes covered by an HDHP. Under current law rules, an individual is not HSA-eligible for a given month unless enrolled in an HDHP as of the first day of the month. ■ Circumstance 3 – Where general-purpose HRA or general-purpose FSA coverage (including grace period coverage) continues after consolidation. Specifically, the IRS guidance provides that even if a Qualified HSA Distribution reduces the balance of an FSA or HRA to zero, the FSA or HRA coverage is deemed to continue for the duration of the plan year and, as such, is other disqualifying coverage. *Comment*: Regarding Circumstance 1, the guidance does not on its face permit individuals to disregard low-dollar or otherwise "de minimis" amounts remaining in an FSA or HRA immediately following consolidation. The lack of a de minimis rule could pose difficulties for the successful administration and execution of Qualified HSA Distributions.	See discussion on HSAs.	See discussion on HSAs.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Consolidations of Existing HRA and FSA Funds Into HSAs (continued)			
Tax Treatment Generally Box 25 (continued)	*Comment*: Regarding Circumstance 1, existing IRS guidance indicates that employers and administrators cannot avoid this result by immediately terminating or otherwise freezing the HRA or FSA of an employee (unless this action is taken for all employees uniformly) where amounts inadvertently remain in the HRA or FSA following a consolidation. Moreover, because each individual is granted by statute one consolidation per FSA or HRA arrangement, remaining amounts following consolidation cannot be subsequently transferred over to the employee's HRA or FSA. Thus, employers and administrators should be careful under this new rule to ensure that all amounts in an individual's FSA or HRA are consolidated. *Comment*: Regarding Circumstances 2 and 3, to avoid income taxation and penalty, Qualified HSA Distributions must occur no earlier than the first day of the month in which the HSA accountholder is enrolled in an HDHP for the entire month. In a typical case where continuing FSA or HRA coverage post-consolidation is treated as disqualifying coverage, employers or administrators will want to time all Qualified HSA Distributions for the close of the plan year and make transfers no later than 2 1/2 months after the close of the plan year.		
Other			
Establishing the Account Box 26	An individual may establish an HSA at any time on or after the date the individual becomes HSA-eligible. An individual may contribute up to the full annual limit once his or her HSA is established (subject to continued HSA eligibility). Whether an HSA is established is generally based on state trust laws. Most states take the view that an account is not established until it contains at least a de minimis amount of assets. Thus, in most instances, an HSA will not be deemed to be established until a monetary contribution has been made to an individual's HSA. *Comment*: When an HSA is established is important, in part, because medical expenses incurred prior to the date of establishment generally are not eligible for reimbursement from an HSA.	A participant's account balance (notional or otherwise) is generally established in accordance with an individual sponsor's plan terms.	A participant's account is generally established as of the first day of the plan year.
Trustee Obligations Box 27	Trustees are not obligated to substantiate that an individual is covered by an HDHP. Trustees are required to ensure that contributions do not exceed the statutory maximum contributions for HSAs, including catch-up contributions if the individual is age 55 or older. Trustees may rely upon an individual's representation as to age. Trustees may impose reasonable administrative rules, such as rules that impose a minimum dollar amount on distributions or limit the frequency of distributions. Trustees may not require substantiation as to qualified medical expenses because the owner must be allowed to take distributions from the HSA regardless of whether qualified medical expenses have been incurred. *Comment*: Presumably, a debit card system that allocates medical expenses to an HSA need not provide a cash distribution option to the owner of the HSA as long as the owner has another method to obtain a cash distribution from the HSA.	Amounts contributed to an "unfunded" HRA by an employer are not required to be held under separate trust. For various reasons certain employers may choose to pre-fund an HRA through the use of a voluntary employees' beneficiary association or "VEBA." VEBAs are subject to their own trust requirements. Regardless of whether an HRA is unfunded or funded, employers are generally required to substantiate that reimbursed expenses constitute qualified medical expenses (for definition of such, see Box 7).	Like unfunded HRAs, amounts contributed to an FSA are not required to be held under separate trust. Thus, contributed amounts are reflected as a bookkeeping account within the employer's general assets. Like HRAs, employers are generally required to substantiate that expenses reimbursed from an FSA constitute qualified medical expenses (for definition of such, see Box 7).
Number of Accounts Box 28	An HSA may be established for each spouse covered under an HDHP (*e.g.*, each spouse may have his or her own HSA) but they are subject to the combined deduction limit. Spouses may not jointly own a single HSA. Eligible individuals may maintain more than one HSA.	Presumably an employer could design an HRA with subaccounts for particular family members, but there appears to be no tax advantage for doing so.	Same as HRAs.
Transfers Incident to Divorce Box 29	Transfers of an individual interest to a spouse or former spouse under a divorce or separation agreement are not subject to tax. Upon such transfer the spouse is considered the new account beneficiary.	Subject to COBRA rules. See Box 32.	Same as HRAs.
Surviving Spouse Box 30	The surviving spouse who is the beneficiary of the HSA becomes the new account beneficiary and the decedent's estate receives a deduction.	May depend upon the terms of the particular HRA and application of COBRA.	Coverage may not continue upon death of the employee, unless continuation coverage is elected under COBRA.

	Health Savings Account (HSA)	Health Reimbursement Arrangement (HRA)	Flexible Spending Arrangement (FSA)
Other (continued)			
Estate or Other Beneficiary Box 31	On the date of death, the HSA loses its status as an HSA; in general, the estate or other non-spouse beneficiary will be subject to income tax in an amount equal to the fair market value of the assets, subject to special rules.	May depend upon the terms of the particular HRA and application of COBRA.	FSA coverage may not continue upon the death of the employee, unless continuation coverage is elected under COBRA.
COBRA Box 32	COBRA is inapplicable to HSAs, but it would apply to an HDHP that is an employer plan. *Comment*: Query whether other court orders could be obtained by a former spouse or children to access the HSA.	COBRA is applicable, but it is unclear how the account dollars are shared among all potential beneficiaries. Treasury/IRS have promised guidance on this issue.	COBRA is applicable.
Deferred Acquisition Cost (DAC) Tax Box 33	Excepted from the DAC tax.	N/A	N/A
Deduction Limits for Employer Welfare Funds Box 34	HSAs are not subject to the deduction limits for “welfare benefit funds” under Code §419(e)(1).	Not applicable unless the HRA is funded, in which case the HRA generally would be subject to the deduction limits for “welfare benefit funds” under Code §419(e)(1).	N/A
Prohibited Transactions Box 35	The prohibited transaction rules of Code §4975 generally apply to HSAs. Existing IRS guidance makes clear that the following transactions, among others, constitute prohibited transactions: ■ Where an account beneficiary borrows funds from his or her HSA. ■ Where a trustee of an HSA lends money to an HSA (such as a line of credit). ■ Where an account beneficiary pledges his or her HSA as security for a loan. In general, if an account beneficiary engages in a prohibited transaction with his or her HSA, the sanction is the disqualification of the HSA. Thus, the HSA stops being an HSA as of the first day of the taxable year of the prohibited transaction. Additionally, the assets of the HSA are deemed distributed and all appropriate taxes, including the 10-percent penalty tax for nonqualified distributions, apply.	N/A	N/A
Other Laws Box 36	The Department of Labor (DOL) has issued guidance which makes clear that an HSA generally is not an ERISA plan even if an employer contributes to an HSA through payroll or utilizes a single HSA provider for payroll contributions for its employees. Additionally, 2006 guidance from the DOL makes clear that an employer may even select an HSA provider, have some say over the investment options provided with respect to the HSA, and/or pay fees associated with the HSAs that it “offers” to employees, all without converting the arrangement into an ERISA plan. *Comment*: Whether an ERISA plan is established will depend on the specific facts of the employer’s involvement; employers and practitioners are encouraged to review closely the DOL guidance where avoidance of ERISA is an important planning goal or objective. Depending on their design, HSAs also may raise HIPAA compliance questions. State law tax conformity will also need to be reviewed.	An HRA is an ERISA welfare plan.	A health FSA is an ERISA welfare plan.

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