



IRS Releases HSA Comparability Guidance

The IRS has proposed regulations on the health savings account (HSA) comparability requirements under the Tax Relief and Health Care Act of 2006. The regulations also explain the penalties for making contributions that are not comparable, which include a 35 percent excise tax.

Comparability Rules

If an employer contributes to its employees' HSAs outside of a cafeteria plan, the contributions must comply with the IRS comparability rules (see *Watson Wyatt Insider*, October 2005, September 2006). (Employers that provide HSA contributions through a cafeteria plan must comply with the cafeteria plan nondiscrimination rules instead.) Most employers allow employees to fund their HSAs through cafeteria plans on a pretax basis, but some HSAs are funded on an after-tax basis and thus are subject to the comparability rules.

Under the comparability rules, employers must contribute the same dollar amount or same percentage of the high-deductible health plan (HDHP) deductible for all eligible employees in the same coverage and employee categories. The HDHP coverage categories are self-only and family, with three subcategories within family coverage: self plus one, self plus two and self plus three or more. Employee categories are current full-time employees (those working 30+ hours/week), current part-time employees (those working fewer than 30 hours/week) and former employees (excluding those covered under COBRA).

An employer that fails to make comparable contributions to its employees' HSAs during a year must pay an excise tax of 35 percent of the aggregate amount of HSA contributions for the period.

These regulations do not affect employer contributions to the HSAs of collectively bargained employees.

Proposed Regulations

The IRS proposed rules provide the following guidance:

Larger contributions for NHCEs. The comparability rules allow employers to make larger contributions to the HSAs of nonhighly compensated employees (NHCEs). The proposed regulations interpret this to mean that an employer's contribution to the HSA of a highly compensated employee (HCE) may not exceed its contribution to the HSA of a comparable NHCE. Moreover, contributions to employees within each group must be comparable during a coverage period. So one HCE may not receive a higher contribution than another HCE in the same coverage and employee category.

Full contribution rule. The maximum annual HSA contribution may be made by or on behalf of employees who become HSA-eligible midyear and remain eligible on Dec. 1. If the employee does not remain HSA-eligible for 12 months after the last month of the taxable year, a portion of the contributions will be included in the employee's income and subject to an additional 10 percent penalty tax.

Employers can contribute up to the maximum on behalf of all HSA-eligible employees during the last month of the taxable year, including those who became HSA-eligible after Jan. 1 and eligible individuals hired after Jan. 1 (both referred to as midyear eligible individuals). An employer can make the maximum calendar-year HSA contribution or contribute more than a pro rata amount on behalf of midyear eligible individuals without violating the comparability rules merely because some employees receive more money on a monthly basis (over a shorter period) than employees who worked the entire year.

Although employers are not required to make these "greater than pro rata contributions," an employer that chooses to do so must contribute the same amount for all comparable midyear eligible individuals.

Qualified HSA distributions. Direct distributions from a health care reimbursement account (HCRA) or health reimbursement account (HRA) to an HSA may not exceed the lesser of the balance in the HCRA or HRA on Sept. 21, 2006, or the balance on the date of the distribution.

Under the proposed regulations, if an employer offers qualified HSA distributions to any HSA-eligible employee covered under any HDHP, the employer must offer qualified HSA distributions to all such individuals. However, an employer may offer qualified HSA distributions only to eligible employees covered under the employer's HDHP without violating the rules.

Excise tax return. Individuals liable for the excise tax under the comparable contribution rules must file Form 8928 ("Return of Certain Excise Taxes Under Chapter 43 of the Internal Revenue Code"). The excise tax is due when the return is due (without extensions) on the 15th day of the fourth month following the year in which the noncomparable contributions were made.

Effective dates. The regulations are proposed to apply to HSA contributions made on or after the first day of the year after the final regulation is published. However, taxpayers may use those provisions as guidelines for employer contributions made on or after Jan. 1, 2007.

The regulations related to the excise tax are proposed to be effective for calendar years or plan years beginning after the date the final regulation is published.