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Employee Benefits

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IRS Releases Final HSA Comparability Regulations for Catch-Up and Accelerated Contributions

By Russell D. Chapman

The Internal Revenue Service has released final regulations providing guidance on employer "comparable" contributions to Health Savings Accounts (HSA) where: (1) an eligible employee has not established an HSA by December 31; (2) the employer has no notice of the establishment of such HSA by December 31; or (3) an employer accelerates comparable contributions for the calendar year for eligible employees who have incurred qualified medical expenses that exceed the cumulative employer contributions at the time.

An HSA is an account funded with contributions by eligible employees for the purpose of paying for the qualified medical expenses of the eligible employee and his or her tax dependents. While there is no legal requirement that an employer contribute to an eligible employee's HSA, those employers who *do* choose to contribute must do so in a comparable manner for all comparable participating employees. If an employer fails to make contributions in a comparable fashion, the employer is subject to excise taxes on the HSA contributions that are made. Generally, "comparable contributions" are either equal in amount or are the same percentage of the plan deductible for all similarly situated individuals during the calendar year. Comparable employees are eligible employees who are in the same category of employee and who have the same category of High Deductible Health Care (HDHC) plan coverage. For the purposes of an HSA, an eligible employee is any employee who is eligible for coverage under an employer's HDHC plan who does not also have coverage under another health care plan that would prohibit the employee from participation in the HSA.

Previously, IRS rules stated that an employer would not violate the HSA comparability rules if the employer failed to make comparable contributions to an eligible employee who had not established an HSA or who had not notified the employer of establishment of the HSA prior to December 31 of the plan year. However, that rule changed significantly in 2006 when the IRS removed this provision from the regulations without comment. Subsequent proposed regulations require an employer to comply with the HSA comparability rules even where an eligible employee either had not established an HSA by December 31 or had established an HSA but has not notified the employer of the HSA. However, the proposed rules offered an avenue of compliance with the HSA comparability rules by: (1) permitting employers to notify eligible employees of the deadline for establishment of an HSA and the specific policies for notifying the employer and (2) making a comparable contribution by April 15 of the following calendar year (for calendar year taxpayers). The final regulations adopt those proposed regulations without substantive revision.

The HSA comparability rules are based on a calendar year testing period; therefore, in order to comply with the comparability rules, an employer must make comparable contributions to an eligible employee's HSA so long as the HSA was established during the calendar year in which employer contributions were made. This means that an eligible employee may establish an HSA anytime during the calendar year (January 1 to December 31), and the employer will be required to make the full amount of comparable contributions to his or her HSA for that same calendar year. In order to establish an HSA, an eligible employee must complete and submit a trust or custodial agreement application to a qualified entity.

The HSA comparability rules do not apply to employers who offer employees the opportunity to contribute to their HSA on a pre-tax basis through an Internal Revenue Code Section 125 cafeteria plan.

The final regulations are effective as of April 17, 2008 and are applicable to employer contributions made for calendar years beginning on or after January 1, 2009.

HSA Comparability: Two Requirements for Employers who Contribute

To comply with the HSA comparability requirements where an HSA has either not been established by an employee or where an employee has established an HSA but has not notified the employer of the existence of that HSA, an employer must satisfy two requirements: (1) the notice requirement; and (2) the contribution requirement.

The Notice Requirement

The final regulations require the employer to provide notice to each eligible employee who has either not established an HSA or has not notified the employer that an HSA has been established by December 31. Written notice must be given no later than January 15 of following year (but no earlier than 90 days before the first employer HSA contribution for that calendar year) to eligible employees. Sample notice language is provided in the final regulations. The notice may be distributed electronically in compliance with applicable IRS rules. The eligible employee is obligated to follow the procedures for proper notice before the last day of February, following the plan year in question. That said, an employer may not require further notice of the existence of an HSA where the employer has knowledge of an established HSA or has previously made contributions to an HSA.

Contribution Requirement

Each eligible employee who gives proper notice to the plan must receive a comparable contribution from the employer to the HSA account (taking into account each month that the employee was a comparable participant in the HSA) plus reasonable interest by April 15 of the following calendar year.

Acceleration of Employer Contributions

For any calendar year, an employer may accelerate part or all of its HSA contributions for the entire year to the HSAs of comparable employees who have incurred qualified medical expenses that exceed the employer's cumulative HSA contributions at that time, provided that all comparable employees receive the same amount or percentage for that calendar year. Medical expenses must be incurred during the calendar year and considered qualified under Code Section 223(d)(2). If an employer chooses to accelerate its HSA contributions, it must establish reasonable uniform methods and requirements for both the availability of accelerated HSA contributions to all eligible employees and the determination of medical expenses throughout the calendar year.

An employer is not required to provide for interest with respect to accelerated or non-accelerated HSA contributions, except where specifically required under the regulations.

Employer Action

The current proposed rules may be relied upon, but need not be incorporated into arrangements until the final rules become effective for the plan year beginning on or after January 1, 2009. Employers may rely on the guidance offered under these final regulations now. To that end, employers should review current policies to determine whether and to what extent current HSA policies comply with the final regulations. Employers who evaluate their needs now will have ample time to draft the necessary notices and administrative policies required by the final regulations, ensuring avoidance of the 35% excise tax (on all HSA contributions the employer makes for the year) for failure to comply with comparability requirements.

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