



# SPECIAL Alert

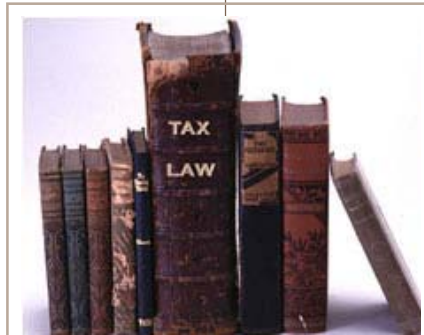
## In This Issue

*In this fourth McGrawWentworth Special Alert for 2005, we will examine recent guidance issued by the IRS addressing the comparability requirements for Health Saving Accounts (HSAs). The comparability rules set forth that if an employer makes a contribution to any employee's HSA, the employer must make comparable contributions to all eligible employees' HSAs. The new guidance offers more clarifications on the practical issues surrounding the comparability requirements.*

*We welcome your comments and suggestions regarding this issue of our Special Alert. For more information on this article, please contact your Account Manager or visit the McGrawWentworth web site at [www.mcgrawwentworth.com](http://www.mcgrawwentworth.com).*

## “Comparability Requirements for HSAs”

The IRS recently issued new guidance addressing the comparability requirements that apply to employer contributions to employee Health Savings Accounts (HSAs). This guidance is currently proposed and has not yet been finalized. The Federal Government is seeking comments regarding the practicality of these proposed regulations. Comments are requested by November 25, 2005.



These regulations are proposed and do not offer an effective date. Once comments are reviewed, the IRS will publish final regulations in the Federal Register. The IRS has indicated taxpayers may rely on this guidance pending the issuance of final regulations.

### Background

The Medicare Modernization and Improvement Act added a new section to the tax code to address HSAs, Section 4980 G. This section includes a requirement that an employer make comparable contributions to all employees HSAs if they make a contribution to any employee's HSA during the year. An employer that fails to make comparable contributions to employees' HSAs within the calendar

year will be assessed a 35% excise tax on the aggregate amount of any contributions that have been made to employees' HSAs during the calendar year.

The Medicare Modernization Act included very few details on determining “comparable” contributions. Guidance issued last summer provided more detail, however many

issues surrounding comparable contributions remained unclear.

### Overview

The new proposed regulations expand the guidance addressing employer comparable contributions to employees' HSAs. It is important to understand, this legislation does **not** require employers to make contributions to an HSA on behalf of an employee. However, if an employer chooses to make a contribution, the employer is obligated to make “comparable” contributions to the HSAs of all “comparable participating” employees.

The guidance can be divided into two types:

- Plan design issues
- Administrative issues

### Plan Design Issues

The regulations require employers to make comparable contributions to participating employees HSAs. This is not to say the employer does not have any flexibility. There are permitted variations allowed.

- If an employer has several high deductible health plan options available, the employer can contribute a percentage of the deductible. For example, if an employer offered 3 high deductible plan options of \$2,000, \$4,000 and \$6,000; the employer could contribute 50% of the deductible and have contributions of \$1,000, \$2,000 and \$3,000. The variation in dollar amount is permitted because the contribution is determined as a percent of the deductible. The same percent of the deductible must be contributed for every employee electing each plan option.
- The employer can also vary contributions based on "categories of coverage" meaning self-only or family coverage. Self-only coverage is employee only coverage; family coverage means that an employee and at least one



other family member is covered by the plan. The employer can contribute a separate amount for those employees electing self-only coverage and those employees electing family coverage. However, the employer can not vary the contribution within the "category of coverage".

For example, if an employer funds \$500 of an HSA for self-only

coverage and \$1,000 for family coverage, the funding must be consistent for all employees electing self-only coverage (\$500) and family coverage (\$1,000). The new guidance makes a point of clarifying the employer can contribute to the HSAs only of those electing self-only coverage or only those electing family coverage. The actual review of comparable contributions will be done separately for self-only electors and family coverage electors.

- The proposed regulations clarify that the contributions of certain individuals are not taken into account in determining whether or not an employer satisfies the compa-

rability requirement. **Specifically, the contributions for independent contractors, sole proprietors, and partners in a partnership are not taken into account under the comparability rules.**

This clarification is important for partnerships. Partners can fund their HSAs at a higher level than the partnership funds for other employees participating in a high deductible plan with an HSA. This disparate funding will not violate the comparability requirements.

- Comparability requirements do not apply to rollover deposits from an HSA or Archer MSA (Medical Savings Account). An individual can rollover a balance from one HSA to another and not impact the comparability requirement.
- Contributions can also be varied by category of employees. A permitted "category" is the distinction between full- and part-time employees. Employers can contribute different amounts to full-time employees' HSAs than part-time employees' HSAs. Employers can contribute to HSAs for all full-time employees and not make a contribution for part-time employees and still meet the comparability requirement. However, the employer cannot vary contributions within a class of either full-time or part-time employees.
- The guidance specifically states, collectively bargained employees cannot be considered a separate category of employee for the purposes of satisfying the comparability

## NOTABLE THOUGHTS

**CONTINUOUS EFFORT - NOT STRENGTH OR INTELLIGENCE - IS THE KEY TO UNLOCKING OUR POTENTIAL.**

**SIR WINSTON CHURCHILL**

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requirements. If an employer negotiates a separate contribution amount for collectively bargained individuals, the plan will not meet the comparability requirement. It is important all employer contributions to an HSA remain consistent, except where the government allows deviation. For HSA contributions, deviation is not permitted as a result of a collective bargaining agreement.

- If an employer offers an HDHP and makes a contribution toward an employee's HSA, they must make comparable contributions for any employees enrolling in the HDHP. If an individual secures HDHP coverage from a source other than the employer (an individual policy or a spouse's plan), the employer is not required to make a comparable contribution to that individual's HSA. However, if the employer makes the contribution for one employee that secures coverage elsewhere, the employer must make comparable contributions for any employees that secure HDHP coverage outside the employment arrangement.
- The new regulations reiterate, matching contributions will not satisfy the comparability requirements. However, the comparability rules are waived if the contributions are made via a Section 125 plan. The Section 125 non-discrimination rules do apply to contributions made via a Section 125 plan. Therefore, an organization could structure the plan to allow for an employer to match an employee contribution up to

a certain maximum amount. For example, the employer could match each dollar an employee sets aside in the HSA. Providing the employee contribution was collected pursuant to salary reduction permitted by Section 125, this arrangement would not be subject to the comparability requirement. However, the arrangement must pass the non-discrimination requirements of Section 125.

- The regulations also state an employer will fail the comparability requirements if the employer conditions contributions to an HSA based upon participation in a health assessment, disease management and/or wellness program. If the employer structures their contributions to increase at an employee's attained age or after a specific number of years in service, this will also violate the comparability requirements.



This guidance has clarified many issues relating to plan design. If your organization has launched an HSA arrangement or is planning to do so, it is important to review these clarifications to determine if your arrangement will meet the comparability requirements.

### ***Administrative Issues***

The guidance also addresses certain procedural issues regarding comparable contributions.

- Employers must take into account an employee's eligibility on a month to month basis. Contributions may be made annually or at more frequent intervals during the plan year. The employer must follow the same frequency of contributions for all eligible employees. If the frequency is quarterly, the contributions must be made on a quarterly basis for all qualifying employees.

- Employers may still satisfy the comparability requirements even if the same amount is not contributed to all employees HSAs during the plan year, if the differences are attributable to different covered timeframes. If an employee becomes eligible mid-year, the employer does not have to provide the entire annual election to meet the comparability requirement; they need only contribute the monthly allotment for months the individual is covered by the plan.

- The guidance also states employers will not fail the comparability requirement if the employer pre-funds the account at the beginning of the plan year and some participants quit mid plan year. For example, if an employer chooses to fund an HSA at \$500 for the plan year and makes that contribution to every eligible participant's HSA at the beginning of the plan year, the employer will not fail the comparability

requirement if a participating employee does not remain enrolled in the plan for the full plan year. The guidance reminds us the employer is not entitled to a refund of any amounts contributed to an HSA.

- The employer can require an employee to establish the HSA in order for the employer to make comparable contributions. If the HSA is established at some point during the plan year, the employer must make the contributions that the employee qualifies for during the plan year. For example, if an individual is covered by an HDHP for the entire plan year, but officially establishes the HSA in June, the employer must make up the contributions for January through June. However, if the employee fails to establish an HSA by December 31; then the employer is not required to make contribu-



tions on the employee's behalf for that plan year. The employer will still meet the comparability requirement even though no contribution was made on behalf of employees who failed to set up the HSA by year-end.

- An employer is permitted to make additional contributions at year-end to correct any potential comparability requirement violation. The employer has until April 15<sup>th</sup> of the following year to make these corrections.

These procedural clarifications will be helpful to employers that have launched Consumer Driven Health Plans with an HSA.

### **Conclusion**

This recent guidance is just the latest in a series of clarifications addressing Health Savings Accounts (HSAs). HSAs were created by the Medicare Modernization Act. However, very few details were included

in this Act. The government has spent the better part of the last two years issuing HSA guidance.

Employers launching HSAs need to be careful if they intend to provide any funding to these accounts on behalf of covered employees. The failure to offer comparable contributions can result in significant financial penalties to an organization. However, the regulations state if a failure to comply with the comparability requirement is the result of reasonable cause and not "willful neglect", the excise tax penalty may be waived relative to the failure involved.

If you have any questions regarding this new HSA guidance, please contact your McGraw Wentworth Account Director. **MW**

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