

Avoiding Operational and Compliance Pitfalls and Traps with your Consumer Driven Plan

Presented by

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Overview

- Key HSA Compliance Issues
- New HSA Rules for 2007
- New Health Benefit Card Rules

Key HSA Compliance Issues

- ERISA Applicability
- Prohibited Transaction Issues
- Offering HSAs to own employees
- HSA Implementation
- Reporting Issues
- HIPAA Privacy

#1 ERISA (How to Avoid It)

- ERISA Headaches
- HSA product availability issues
 - Will custodian/trustee service an ERISA plan?
- DOL Guidance
 - FAB 2004-1
 - FAB 2006-2
- Steps to avoid ERISA applicability

ERISA Headaches

- Headaches if ERISA applies . . .
 - Form 5500
 - SPD and Plan Document
 - COBRA ??
 - Code's COBRA provisions do not apply but ERISA may
 - HIPAA Privacy issues apply if HSA part of health plan
 - Claims procedures
 - Generally, claims are self-adjudicated
 - Fiduciary Requirements
 - Code's Prohibited Transaction Rules apply whether ERISA's prohibited transaction rules apply or not

ERISA Applicability

- Prior to April 7, 2004, no guidance issued by DOL on either MSAs or HSAs
- Original view was that HSAs would be treated like IRA's
- IRAs that satisfy the following four "Safe Harbor" conditions are not subject to ERISA:
 - No contributions are made by the employer
 - Pre-tax contributions are employee contributions for DOL purposes
 - Participation is completely voluntary
 - The employer does not endorse the program (but can publicize the program and collect contributions via payroll deduction)
 - The employer receives no consideration other than reasonable compensation for services actually rendered (Labor Reg. 2510.3-2(d))
 - Same requirements apply to voluntary group insurance

ERISA Applicability

- DOL issued Field Assistance Bulletin (“FAB”) 2004-1:
 - Establishes “safe harbor”
- DOL found that employer contributions were less significant in determining whether ERISA applies to HSAs so they tweaked the safe harbor to allow for employer contributions without triggering ERISA

ERISA and FAB 2004-1

- FAB 2004-1 Revised Safe Harbor for HSAs
 - Employers may contribute to an HSA without triggering ERISA so long as the employer satisfies all of the following conditions:
 - Participation is completely voluntary
 - No restrictions on account holder's ability to move funds to another HSA trustee
 - Allows employer to limit its contributions to 1 HSA trustee or a specified group of HSA trustees
 - No restrictions on use of funds other than *those permitted by code*
 - Does not make or influence investment decisions
 - No representation that HSA is part of employee benefit plan sponsored by employer
 - Does not receive *any* payment or compensation

FAB 2006-2

- FAB 2006-02 clarifies aspects of FAB 2004-1 as well as other ERISA related issues
 - Employer may establish HSA on behalf of employee and make “employer” contribution w/o violating “completely voluntary” requirement (Q-1)
 - Salary reductions from employees must be voluntary in order to satisfy the safe harbor
 - Under banking rules can HSA be established without accountholder involvement?
 - ERISA is not triggered solely because employer chooses a particular vendor to whom it makes contributions (Q-2)

FAB 2006-2

- FAB 2006-02 (cont')
 - The employer does not “make or influence” investment decisions solely by choosing a vendor that offers same funds as employer’s 401(k) (Q-3)
 - FICA savings generated through cafeteria plan are not “compensation” to the employer (Q-4)
 - Employers can pay trustee/custodian fees directly without triggering ERISA (Q-5)
 - Employer/trustees can offer HSAs to its own employees without triggering ERISA so long as same product offered in normal course of business (Q-6)

Steps to Avoid ERISA

- Include clear disclaimer regarding HSA status as an individual financial account – NOT an employer sponsored benefit plan
 - Review vendor materials
 - Review enrollment materials
 - Carefully draft HSA summaries
- Employer must not make or influence investment decisions
- Be wary of implementing distribution restrictions
- Ensure no outside compensation to employer related to HSA

#2: Prohibited Transaction Issues

- Code prohibits certain transactions involving HSA between “fiduciary” and “disqualified person” (aka “DP”)
 - Code Section 4975
 - ERISA Section 406 (if ERISA applies)
 - Administered by DOL (even if ERISA does not apply)
 - Consequences for DP other than accountholder
 - (Code) Excise Tax for non-compliance
 - (ERISA) Equitable remedies
 - Consequences for Accountholder
 - HSA ceases to be an HSA under Code Section 223.

Prohibited Transaction Issues

- Who is a fiduciary?
 - HSA Accountholder
 - Trustee or any other person with discretionary authority over management and/or control over plan assets
 - Person who renders investment advice for a fee
- Who is DP?
 - Fiduciary
 - Service Provider
 - Employer of employees covered by HSA
 - Family member of the above

Prohibited Transaction Issues

- What are the prohibited transactions?
 - Any direct or indirect
 - Sale or exchange of property between HSA and DP
 - Lending of money or other extension of credit between HSA and DP
 - Furnishing of goods or services between the HSA and DP
 - Transfer or use of HSA income or plan assets by DP
 - Fiduciary deals with income or assets for his/her own interest
 - Receipt of consideration by fiduciary for personal account from a party dealing with the HSA income or assets

Prohibited Transaction Issues

- Identifying PTs
 - Must have right players
 - Fiduciary
 - DP
 - Generally transaction must involve HSA assets (but not always)
 - E.g. compensation to service providers
 - Rule of Thumb: if DP receives compensation with respect to a transaction involving the HSA, analysis is required.

Prohibited Transaction Issues

- Exceptions to Prohibited Transaction Rules
 - Necessary services for reasonable compensation (the service provider exception)
 - No exceptions for “fiduciary transactions”
 - Independent fiduciary must approve transaction
 - Ancillary services by a bank to the extent certain conditions are met
 - Nominal overdraft protection may fit here (see AO 2003-02). But be wary of specifically designed credit lines
 - Investment of HSA assets in all or part of the assets in deposits that bear reasonable rate of interest in a bank

Prohibited Transaction Issues

- One DOL Opinion on HSAs on point:
 - DOL Adv. Op. 2004-09A
 - Trustee deposits \$100 in account for setting up HSA with trustee
 - What if \$100 given directly to accountholder?
- IRA Guidance
 - PTE 93-1 and 93-33 (toasters and relationship banking)
- PBM Case
- Nationwide (12b-1 Fee) Case

Prohibited Transaction Issues

- FAB 2006-02 (cont')
 - Employer receives “compensation” if it receives discount on services offered by vendor in conjunction with HSA. This may violate prohibited transaction requirements (Q-7)
 - Failing to promptly forward contributions to trust is a prohibited transaction (even if ERISA does not apply) (Q-8)
 - IRA Class PT exemptions on free or reduced cost services not applicable to HSAs (Q-9)
 - Cash incentives TO HSA not prohibited (Q-10)
 - Incentives to accountholder are problematic
 - Credit in conjunction with HSA may be problematic depending on facts and circumstances (Q-11)
 - HSA cannot be used as security
 - Accountholder cannot benefit in individual capacity from HSA
 - But personal line of credit to accountholder may be permissible

Prohibited Transaction Issues

- Situations in which PT might occur
 - Retention of card interchange fees by trustee who also issues card
 - Receipt of fees (e.g., 12b-1 or Inv Adv fees) from investment funds
 - Receipt of commissions or “finder fees” by service provider from another service provider
 - Choosing investment management company owned by fiduciary or family member of fiduciary
 - Inducements offered to accountholder
 - Free services
 - Incentives/rebates
 - Credit extension

#3. Offering HSAs to Employees of Custodian/Trustees

- ERISA issues
 - Endorsement (how do you avoid?)
 - Receipt of Compensation (see FAB 2004-1)
- Prohibited Transaction Issues
- FAB 2006-02
 - Employer/trustees can offer HSAs to its own employees without triggering ERISA so long as same product offered in normal course of business (Q-6)
 - May be possible to subsidize fees as well (Q-5)

#4. HSA Implementation Issues

- Application issues/considerations
 - Patriot Act and other KYC rules
 - E-Sign
- Spousal consent issues
- What is the effective date of the HSA?
 - Why does it matter?
 - 2006 HSA Act allows for Full Annual Contribution
 - QME Determination
 - IRS/Treasury View
 - As reflected in Notice 2007-22, based on state trust law, but generally the later of the HSA establishment date, or date first contribution is made

#5: Reporting Issues

- Trustee
 - 1099-SA (distributions)
 - Reporting issues related to excess contribution withdrawals
 - 5498-SA (contributions)
- Employer
 - W-2 for employer contributions
 - Include cafeteria plan contributions
- Account holder
 - 1040 and Form 8889

#6: HIPAA Privacy

- HSA is generally not a health plan subject to HIPAA
- Disclosure from health plan/HDHP to custodian/trustee generally prohibited without HIPAA authorization
 - Business Associate agreement generally does not solve the problem
 - Covered entity may only disclose to business associate for payment or health care operations of the plan (including organized health care arrangement)
 - HSA not part of the health plan
 - Easy solutions!!!!

A NEW ERA OF HSAs BEGINS

*Overview of the HSA Provisions of the
Tax Relief and Health Care Act of 2006*

Overview of HR 6111

- Effective January 1, 2007 in most instances
- Modifies annual contribution limit for everyone to statutory maximum (eliminates “lesser of deductible” rule)
- Allows full annual contribution (determined under new rules) for certain individuals who are eligible only part of the year; i.e. no pro-ration provided certain conditions are satisfied
- Allows one time trustee to trustee transfer of IRA amount subject to certain limits

Overview of HR 6111

- Allows one time tax rollover from health FSA and/or HRA to HSA for certain individuals with balance as of 9/21/06
- Facilitates HSA establishment for participants in Health FSA with grace period provided that on or before the last day of the plan year the balance is zero
- Requires Treasury to issue HSA COLAs on or before June 1 each year
- Modifies comparability rule to allow greater HSA contributions for non-HCEs than HCEs

Modified Annual Contribution Amount

- Prior rule
 - Annual contribution amount is sum of “monthly limits” for each month individual is an eligible individual
 - Monthly limit equals $1/12$ of “*lesser of deductible*” or statutory maximum for applicable level of coverage”

Modified Annual Contribution Amount

- Example of prior rule:
- Bob (who is under age 55) is enrolled from January 1, 2007 through December 31, 2007 in an HDHP, single coverage, with a \$1200 deductible.
- Under old rule, Bob may only contribute \$1200 in 2007 instead of \$2850 (the statutory maximum for single coverage).

Modified Annual Contribution Amount

- New rule:
 - Annual contribution amount is sum of “monthly limits” for each month individual is an eligible individual (same as old)
 - Monthly limit equals $1/12$ of statutory maximum for applicable level of coverage (i.e., single or family)

Modified Annual Contribution Amount

- Example of new rule:
- Bob (who is under age 55) is enrolled from January 1, 2007 through December 31, 2007 in an HDHP, single coverage, with a \$1200 deductible.
- Under new rule, Bob may contribute \$2850 in 2007 instead of \$1200 (the maximum contribution amount under the prior rule).
- Contribution increase=\$1650

Modified Annual Contribution Amount

- Good news
 - Increases contribution amount to the extent the deductible is less than statutory maximum contribution amount
 - Additional amounts can be “saved” for future use (accruing earnings) and/or used to cover expenses incurred after deductible is satisfied (e.g., co-insurance)

Modified Annual Contribution Amount

- Good news (cont)
 - Eliminates complicated contribution calculation rules for
 - Plan's with carry over deductible
 - deductible must still meet adjusted minimum deductible rule
 - Plan's with embedded deductible
 - Embedded deductible must still meet family deductible minimum
 - Married couples who are eligible individuals
 - Married couples simply split family statutory maximum w/o regard to family deductible levels

Exception to Pro-rata Rule

- Prior Rule:
 - Maximum contribution was “sum of monthly limits” based on # of months individual was eligible individual
 - Deductible under plan typically not pro-rated, which caused gap between HSA contribution amount and participant responsibility

Exception to Pro-rata Rule

- Example of prior rule:
- Bob (who is under age 55) is enrolled from July 1, 2007 through December 31, 2007 in an HDHP, single coverage with a deductible of \$3000.
- Bob's monthly limit is \$237.50 (1/12 of \$2850). Bob is an eligible individual in 2007 for 6 months.
- Bob's annual contribution amount for 2007 is \$1425; however, Bob's deductible is \$3000 even though he is in the plan for only 6 months.

Exception to Pro-rata Rule

- New rule
 - Pro-rata rule still applies EXCEPT:
 - Individual is treated as being an eligible individual for the *entire year* If
 - individual is an eligible individual *in December* of such year and
 - the individual remains an eligible individual through December of the next year (“Testing Period”)

Exception to Pro-rata Rule

- New rule (cont)
 - For months that individual was not an eligible individual, individual treated as having the coverage in effect in December of the year he/she became an eligible individual
 - Applies to additional contribution for age 55+ accountholders
 - If individual ceases to be an eligible individual during Testing Period:
 - Amounts attributable to months treated as an eligible individual under this rule subject to income and 10% excise tax

Exception to Pro-rata Rule

- Example of new rule:
 - Bob (who is under age 55) is enrolled from July 1, 2007 through December 31, 2007 in an HDHP, single coverage with a deductible of \$3000.
 - Bob's remains eligible through December 31, 2008
 - Bob's annual contribution amount for 2007 is \$2850 (as opposed to \$1425 under prior rule)
 - If Bob ceases to be eligible during testing period, then \$1425 (6/12 of \$2850 for January through June) is included in income and subject to 10% excise tax

Exception to Pro-rata Rule

- Good News
 - Reconciles traditional application of deductible with maximum contribution rules
- Bad news
 - Significant tax consequences if cease to be an eligible individual during Testing Period
 - Does not apply unless eligible individual in December (i.e., covered by December 1st) of year

One time transfer of IRA funds

- Prior rule:
 - IRA funds could not be transferred to HSA on a tax free basis
- New Rule:
 - One time tax free trustee to trustee transfer of IRA funds to HSA permitted
 - Limited to maximum annual contribution amount
 - May make an additional contribution if you change from single to family during the year
 - COUNTS AGAINST ANNUAL CONTRIBUTION AMOUNT
 - Not treated like a rollover

One time rollover of FSA/HRA

- Prior rule:
 - HRA and/or Health FSA amounts could not be transferred to an HSA on a tax free basis
- New rule:
 - Employer may make one-time tax free transfer of “Applicable Balance” to HSA anytime before January 1, 2012
 - Applies to Health FSA and HRA individually
 - Applicable Balance=lesser of balance as of September 21, 2006 or balance as of the date the transfer is made
 - Transfer is only available to those who had a balance on September 21, 2006

One time rollover of FSA/HRA

- New rule (cont)
 - Treated as a rollover contribution (thus, not counted against maximum annual contribution amount)
 - Rollover amount included in income and subject to 10% excise tax if cease to be an eligible individual anytime prior to end of month ending 12 months after month rollover made (“Testing Period”)
 - Balance determined under cash basis rule (balance without regard to expenses incurred prior to that date but not yet reimbursed)-see Notice 2007-22

One time rollover of FSA/HRA

- Notice 2007-22--Guidance regarding rollovers

- Permanent guidance:

An employee with a balance in a general purpose FSA *with a grace period* or general purpose HRA *at the end of a plan year* is treated as an eligible individual for HSA purposes as of the first day of the first month of the immediately following plan year provided that:

- (i) the employer amends the health FSA or HRA written plan effective by the last day of the plan year to allow a qualified HSA distribution;
- (ii) a qualified HSA distribution from the health FSA or HRA has not been previously made on behalf of the employee with respect to that particular health FSA or HRA;
- (iii) the employee has HDHP coverage as of the first day of the month during which the qualified HSA distribution occurs, and is otherwise an eligible individual;

One time rollover of FSA/HRA

- Permanent Guidance (cont')
 - iv) the employee elects by the last day of the plan year to have the employer make a qualified HSA distribution from the health FSA or HRA to the HSA of the employee;
 - (v) the health FSA or HRA makes no reimbursements to the employee after the last day of the plan year;
 - (vi) the employer makes the qualified HSA distribution directly to the HSA trustee by the fifteenth day of the third calendar month following the end of the immediately preceding plan year, but after the employee becomes HSA-eligible;
 - (vii) the qualified HSA distribution from the health FSA or HRA does not exceed the lesser of the balance of the health FSA or HRA on (a) September 21, 2006, or (b) the date of the distribution; and
 - (viii)(a) after the qualified HSA distribution there is a zero balance in the health FSA or HRA, and the employee is no longer a participant in any non-HSA compatible health plan or (b) effective on or before the date of the first qualified HSA distribution the general purpose health FSA or general purpose HRA written plan is converted to an HSA-compatible health FSA or HRA, as described in Rev. Rul. 2004-45, for all participants.

One time rollover of FSA/HRA

- Example of new rule:
 - Bob has \$500 balance on September 21, 2006.
 - On December 31, 2008, Bob has a \$300 balance in his Health FSA (with a grace period). Bob wants to enroll in HDHP and establish an HSA on January 1, 2009 but Health FSA is general purpose.
 - Bob's employer may transfer \$300 to Bob's HSA on December 31.

Relief from FSA Grace Period

- Prior Rule:
 - Notice 2005-86—if participant in general purpose Health FSA (w/ grace period) on last day of plan year (either active or COBRA qualified beneficiary), participant disqualified from HSA establishment until first day of first month following end of grace period **EVEN IF ZERO BALANCE** on last day of plan year or any time prior to end of grace period

Relief from FSA Grace Period

- Prior rule (cont)
 - Example of prior rule:
 - Bob participates in calendar year Health FSA with 2 ½ month grace period ending March 15 of following year. Bob receives reimbursement for full election amount on December 15, 2007 so that he has \$0 balance on December 31, 2007.
 - Although Bob has \$0 balance, Bob is not eligible for an HSA until April 1, 2008.
 - Only solution provided under Notice 2005-86 was to convert FSA during grace period to limited purpose FSA for ALL HEALTH FSA PARTICIPANTS

Relief from FSA Grace Period

- New rule:
 - Grace period does not disqualify an individual if individual has zero balance on last day of plan year
 - This can be accomplished in one of two ways:
 - Spend funds down prior to end of the plan year
 - Make the one time tax free rollover under applicable rules

Earlier Issuance of COLAs

- New rule:
 - The 12 month period on which COLAs for a year are based ends March 31 of the prior year.
 - Treasury must issue new COLAs no later than June 1 of the prior year
 - For 2008 COLAs are as follows (Rev Proc 2007-36):
 - Minimum deductible 1100/2200 (same as 2007)
 - OOP Maximum 5600/11,200 (up from 5500/11,000)
 - Contribution maximum 2900/5800 (up from 2850/5650)

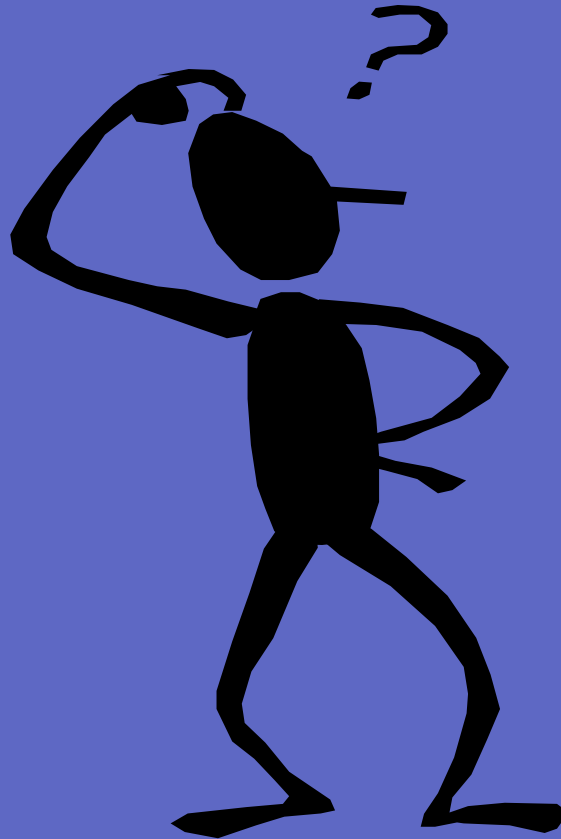
Exception to Comparability Rule for Non-HCEs

- Prior Rule:
 - Employers who contribute to employees' HSAs must make “comparable contributions” (same amount or same percentage of deductible) to all “comparable participating employees”
 - The only distinctions in comparable participating employees were:
 - Full-time
 - Part-time
 - Former employees
 - No distinctions permitted for HCEs and non-HCEs

Exception to Comparability Rule for Non-HCEs

- New Rule:
 - With regard to contributions made to the HSAs of non-HCEs, HCEs are not comparable participating employees.
 - Example of new rule:
 - Employer contributes \$300 to the HSAs of all full-time employees with single HDHP coverage who are highly compensated. Employer contributes \$500 to the HSAs of all full-time employees with single HDHP coverage who are non-highly compensated.
 - Employer does not violate the comparability rule.

What's In the 2007 "HSA Grab Bag"?



Electronic Payment Card Guidance

Electronic Payment Card Guidance

- Revenue Ruling 2003-43
 - First piece of guidance on use of electronic payment card with medical reimbursement arrangements
 - Guidance needed to reconcile general rule that substantiation must be provided prior to making reimbursement
 - Established restrictive parameters for card use to limit situations in which card was used for non-medical
- Notice 2006-69
 - Clarifies rules established by Rev. Rul. 2003-43
- Notice 2007-02
 - Extends until 12/31/2007 health care merchant category code treatment for grocery stores, supermarkets and discount stores (and mail order/web based retailers that have pharmacies)

Electronic Payment Card Guidance

- Revenue Ruling 2003-43 parameters
 - Swipe privilege limited to providers with a health-related Merchant Category Code (MCC)
 - Other specifications
 - Type of Card
 - Available balance linked to FSA/HRA balance
 - Substantiation Requirements
 - Auto adjudication (3 categories)
 - Fall-out claims/Pay and chase

Electronic Payment Card Guidance

- Rev. Rul. 2003-43 requirements (cont')
 - Certification Prior to Enrollment and Annually
 - Participant enrollment form language required
 - Re-affirmation Upon Swipe
 - Language on back of card
 - Sufficiency of cardholder agreement
 - Suspension of Swipe Privilege if Abuse
 - Participant Required to Retain Substantiation
 - All swipes
 - Duration ?

Electronic Payment Card Guidance

- Revenue Ruling 2003-43 requirements (cont')
 - Three Auto-adjudication Categories for Merchants with health care related MCC
 - Copay Match (generally network claims)
 - Match of copay
 - Plan participant specific
 - Recurring Claim (after initial paper claim)
 - Recurrence as to amount, provider, time period
 - Real Time Match
 - Real time verification via (electronic, fax, etc)

Electronic Payment Card Guidance

- Clarifications made by 2006-69-Auto adjudication
 - Co-pay match:
 - Multiple of co-pay or combination of co-pays for single benefit with variable co-pays
 - Amount cannot exceed 5 times co-pay (or if variable co-pay-5 times greatest co-pay amount for single benefit)
 - Must be co-pay of specific employee/cardholder
 - TPA/Employer must certify co-pay
 - Spouse/dependent co-pays not allowed
 - Transaction must originate with health care provider (i.e. merchant with a health care related merchant category code)
 - If amount exceeds maximum amount, must substantiate entire expense

Electronic Payment Card Guidance

- Clarifications made by 2006-69-Auto-Adjudication (cont')
 - Inventory Information Approval System
 - Merchant approves expense at point of sale from pre-approved list
 - Card use is restricted to eligible expense amount
 - Appropriate data is collected and maintained
 - Identity of individual
 - Nature of expense
 - Amount incurred
 - Date incurred
 - Data can be sent to employer/administrator at POS or at later date OR just made accessible at later date [e.g., in event of IRS audit]
 - Contrast with real time under 2003-43
 - » The Good – health care MCC not required
 - » The Bad – Claims level data must be accessible
 - » The Ugly – Coordination between retailers and TPAs

Other Guidance in 2006-69

- Confirms that EOB roll-over does not require additional participant certification
- Clarifies that original auto-adjudication categories limited to health care MCC
- Confirms that pay and chase limited to auto-adjudication categories
- Confirms that self-substantiation and sampling not permitted
- Confirms that penalty for non-compliance is all reimbursements (even those properly substantiated) may be taxed

Transition Relief (Notice 2007-02)

- Notice 2007-02 Transition Relief
 - Allow supermarkets and discount stores to use 2003-43 until 2008
 - Pharmacies required to use IAS (unless 90% rule satisfied) beginning in 2009
- IAS Implementation Issues
 - Who has responsibility for ---
 - IRS 213(d) determination
 - Claims data retention
 - List maintenance

Question & Answer

