LegalNews

Employee Benefits

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Here are the employee benefits developments for December 2006 that may be of interest to you. Please contact us if you want more information regarding a particular subject or if something you read raises a question or concern about your own programs or an idea for changing what you are currently doing.

QUALIFIED RETIREMENT PLANS: DECEMBER 2006 DEVELOPMENTS

Determination letter ruling requests are due to be filed with the IRS by January 31, 2007, for individually designed qualified retirement plans sponsored by employers having employer identification numbers (EINs) ending in "1" or "6," in accordance with the new IRS cyclical program for requesting determination letters. (Rev. Proc. 2005-66) If your individually designed plan should be making a determination letter request by January 31, 2007, and you have not been contacted about the filing, *please contact us immediately*. Separate rules and timing rules apply for pre-approved (prototype plans).

IRS lifts the moratorium on issuing determination letters, announced in 1999, for cash balance plans involving a conversion from a traditional defined benefit plan. (Notice 2007-6) IRS officials indicated that clarifications enacted under the Pension Protection Act of 2006 ("PPA") allowed IRS to begin processing these determination letter applications.

The Department of Labor issued early guidance for plans in providing the benefit statements required by the Pension Protection Act. (Field Assistance Bulletin 2006-3) DOL announced that it will be sufficient for plans to achieve "good faith compliance" with the requirements of PPA Section 508(a), regarding benefit statements, until regulations are issued. The announcement allows the use of, in certain situations, multiple documents to make up the statement; electronic forms of communication to distribute the information; and notices the plan was previously using to explain participants' diversification rights. A 45-day grace period following the end of each quarter was provided for issuance of that quarter's required statement, pending issuance of further regulations.

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EMPLOYEE WELFARE BENEFIT PLANS: DECEMBER 2006 DEVELOPMENTS

The Tax Relief and Health Care Act of 2006, signed by the President on December 20, 2006, includes several provisions to enhance health savings accounts (HSAs). Other acronyms used in this item include flexible spending accounts (FSAs); health reimbursement accounts (HRAs); and high deductible health plans (HDHPs).

- FSA and HRA terminations may fund HSAs. (Code Sections 106(e) and 223(c)(1)(B)(ii)). Effective for distributions on or after December 20, 2006, the Act allows the roll over of unused health FSA and HRA balances to an HSA and disregards certain health FSA coverage in determining HSA eligibility.
  - A health FSA or HRA can permit fund transfers without violating otherwise applicable requirements for health FSAs and HRAs (such as the comparability rules for HSA contributions).
  - The transferred amount is treated as an employer contribution to the HSA so it does not reduce the employee's ability to make HSA contributions for the year of transfer.
  - Only one such transfer per person is allowed.
  - The amount that may be transferred cannot be greater than the lesser of the balance in the employee's FSA and/or HRA on September 21, 2006, or on the date of transfer.
  - The one-time only transfer must be completed before January 1, 2012.
  - The intent of the legislation is to assist individuals in transferring from coverage under traditional health care arrangements to HDHPs. The transferring employee must remain covered by the HDHP for a required period (generally 12 months) after the transfer in order to avoid tax penalties.
  - For tax years beginning after December 31, 2006, for purposes of determining who is eligible to maintain an HSA, coverage by a health FSA is disregarded during any extended grace period following the end of the health FSA's plan year during which unused benefits or amounts remaining in the account at the end of that plan year may be paid or reimbursed to plan participants for medical expenses incurred during that period.
- Effective for tax years beginning after December 31, 2006, individuals may complete a one-time tax-free rollover of an IRA distribution into an HSA. (Code Sections 408(d)(9) and 223(b)(4)).
  - An eligible individual can withdraw IRA funds and transfer the funds tax-free to an HSA.
  - This is a once-only opportunity.
  - In general, the amount of the rollover cannot exceed the 223(b) HSA annual funding limit based on the individual's coverage status at the time of transfer.

    - The transferring individual must remain covered by an HDHP for a (generally 12 months) period of time in order to avoid tax penalties.
    - The transferred amount reduces the individual's HSA deductible contribution limit for the year of the transfer.
- Effective for tax years beginning after December 31, 2006, certain limits on the annual plan deductible limitation on HSA contributions are repealed. (Code Section 223(b)(2)).
    - Limits based on the individual's annual deductible under his or her HDHP are removed.
    - The new limit per month is one-twelfth of the maximum dollar contribution in the statute (for self-only coverage in 2007, $237.50 per month; for family coverage in 2007, $470.83 per month). These amounts are adjusted for inflation.
- The cost-of-living adjustments for HSA and HDHP dollar amounts are changed for tax years beginning after December 31, 2006. (Code Section 223(g)(1)). The cost-of-living adjustment will have to be determined by March 31 for the following year, instead of the current deadline of August 31, and IRS must publish the number by June 1 as an aid to administrators offering open enrollment in the fall.
- Effective for tax years beginning after December 31, 2006, the contribution limit for an individual electing mid-year HDHP and HSA coverage is increased. (Code Section 223(b)(8)).
    - An individual establishing a health FSA mid-year may contribute a full year's HSA contribution in the initial part year of participation.
    - An individual taking advantage of this increased contribution limit must remain an HDHP participant for a required period of time (generally 12 months) in order to avoid tax penalties.