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**Re: Transition Relief for HSA Rollovers Requires Action by March 15, 2007**

Dear Clients and Other Friends:

This week the IRS issued Notice 2007-22, offering guidance on a provision of the Health Opportunity Patient Empowerment Act of 2006 (the "HOPE Act"), which allows balances in health Flexible Spending Arrangements (health FSAs) and Health Reimbursement Arrangements (HSAs) to be rolled directly into Health Savings Accounts (HSAs). That guidance includes special rules for 2006 balances that can only be used if action is taken by March 15, 2007. This letter briefly summarizes the rollover opportunity.

**HSA Rollovers – Before the Transition Relief**

An employer can provide for HSA rollovers by amending its health FSA or HRA plan documents before the end of the plan year to allow HSA rollovers and to freeze the year-end balance. The amendment must offer HSA rollovers to any otherwise eligible individual covered by the employer's High Deductible Health Plan (HDHP). The HSA rollover has to be contributed directly to the HSA trustee by the employer no later than the 15<sup>th</sup> day of the third calendar month following the end of the plan year (for calendar year plans, March 15).

To be eligible for a HSA rollover, a participant in a health FSA or HRA must have been participating in the employer's health FSA or HRA plan on September 21, 2006. An individual is limited to one HSA rollover from a health FSA and one rollover from an HRA plan. The amount that can be rolled over is limited to the lesser of the participant's balance in that plan as of September 21, 2006 or the date of the rollover.

In order to receive favorable tax treatment, an individual must have HDHP coverage on the first day of the month in which the rollover takes place and cannot have any health coverage that would otherwise prevent that individual from making tax-deductible HSA contributions. If an individual is not HSA-eligible at the time of the rollover (and for 12 months after), the amount of the rollover will be included in gross income and will be subject to an additional 10 percent tax.

Rollovers can be made from either HSA-compatible or general purpose health FSAs or HRAs. Rollovers from general purpose health FSAs or HRAs should only be done at the end of the plan year because rollovers from these plans at other times of the year will result in taxable income and a 10 percent penalty tax. A rollover from a general purpose FSA must result in a \$0

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balance for the participant as of the last day of the plan year. No reimbursements can be made to the participant after the last day of the plan year. For general purpose HRAs, the participant's coverage must end after the last day of the plan year. Again, no claims can be paid to the participant after the last day of the plan year.

**Transition Relief for 2006 Health FSAs or HRAs**

The IRS has provided for two exceptions to the rules described above for employers who would like to allow their employees to roll over their health FSA or HRA balances from 2006.

1. Employers have until March 15, 2007, to amend their written health FSA or HRA plan to allow HSA rollovers.
2. If any claims have been paid to a participant after the last day of the 2006 plan year (i.e., on or after January 1, 2007), that will not disqualify the participant from rolling over the remaining balance in the FSA or HRA to an HSA.

All other provisions described above for HSA rollovers of health FSA or HRA balances for plan years 2007 and after must be met.

If you are interested in providing HSA rollovers to your employees or if you need additional information on this subject, please let us know.

Very truly yours,

Sonja Lemmer Martens

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