



## IRS Releases Guidance on Health Savings Accounts

### *Notice 2008-51 – Guidance on One-Time Distribution From an IRA to HSA*

The Internal Revenue Service (IRS) recently issued Notice 2008-51, which provides guidance on qualified Health Savings Account (HSA) funding distributions under Internal Revenue Code (“Code”) Section 408(d)(9). In short, a “qualified HSA funding distribution” is a direct transfer from a traditional individual retirement account (IRA) or Roth IRA to an individual’s HSA which is excluded from gross income and is not subject to the 10% additional tax which would otherwise be imposed under Code Section 72(t), provided that the individual remains HSA-eligible during the applicable testing period. The testing period begins with the month in which the distribution is contributed to the HSA and ends on the last day of the 12th month following that month.

Although only one qualified funding distribution generally is permitted during an individual’s lifetime, a second transfer is allowed during the same year if the individual changes from self-only high deductible health plan (HDHP) coverage to family HDHP coverage. In addition, if an individual wishes to transfer amounts from multiple IRAs, funds must first be consolidated into one IRA before making the transfer. The amount transferred to the HSA is not allowed as a deduction and counts against the individual’s maximum annual HSA contribution.

Notice 2008-51 describes the effect of a qualified HSA funding distribution on the taxation of IRA distributions, including the pro-rata basis recovery rules and the recapture tax under Code Section 72, and provides examples illustrating the applicable rules. Although employers generally will not be involved in qualified HSA funding distributions, Notice 2008-51 confirms that they are not responsible for reporting whether an employee remains HSA-eligible during the testing period.

Code Sections 408(d)(9) and 223(b)(4)(C), allowing qualified HSA funding distributions from IRAs to HSAs, were effective for taxable years beginning after December 31, 2006.

### *Notice 2008-52 – Guidance on HSA Contribution Limits*

The IRS also recently issued Notice 2008-52 which provides guidance on HSA contribution limits. Effective for 2007 and later years, the Health Opportunity Patient Empowerment Act of 2006 (the “Act”) changed how an individual’s maximum HSA contribution is calculated.

For 2004 through 2006, the maximum annual HSA contribution was the lesser of the annual deductible under a HDHP, or the statutory maximum under Code Section 223(b)(2)(B). For 2007 and later years, the maximum annual HSA contribution no longer

depends on an individual's HDHP deductible; rather, the indexed maximum HSA contribution limit is determined under Code Section 223(b)(2)(A) for self-only HDHP coverage (\$2,900 for 2008) and Code Section 223(b)(2)(B) for family HDHP coverage (\$5,800 for 2008).

Under the IRS' so-called "full contribution" rule added to Code Section 223(b)(8) by the Act, if an individual is eligible for an HSA on the first day of the last month of the individual's taxable year (*i.e.*, December 1 for calendar-year taxpayers), the individual's maximum HSA contribution for the year is the greater of the following:

1. the sum of the limits determined separately for each month under Code Section 223(b)(2), based on eligibility and HDHP coverage on the first day of each month, plus applicable catch-up contributions for each month, if applicable; or
2. the maximum annual HSA contribution under Code Sections 223(b)(2)(A) or 223(b)(2)(B) based on the individual's HDHP coverage (self-only or family) on the first day of the last month of the individual's taxable year, plus catch-up contributions, if applicable.

This full contribution rule allows individuals who are HSA-eligible on December 1 to make a full year's contribution. However, the full contribution rule is applicable only if the individual remains HSA-eligible during the "testing period" which begins on the first day of the last month of the individual's taxable year and ends on the last day of the 12th month following that month (*i.e.*, for calendar-year taxpayers, December 1 of the current year to December 31 of the following year).

If an individual does not remain eligible during the testing period, the portion of the individual's HSA contributions for the year that exceeds the sum of the monthly contributions limits for the year

is includible in gross income and is subject to an additional 10% tax regardless of the individual's age (*i.e.*, even after age 65). However, Notice 2008-52 indicates that this amount does not constitute an excess contribution and, therefore, is not subject to the 6% excise tax imposed under Code Section 4973 on contributions in excess of the maximum HSA contribution limit for the year. In addition, earnings on the excess amount are not included in gross income or subject to the additional 10% tax provided that the earnings remain in the HSA or are used for qualified medical expenses. Note that an individual is not required to keep the same level of HDHP coverage during the testing period to remain eligible. Notice 2008-52 includes a variety of examples to further explain the contribution limit rules described above.

It is interesting to note that the Code does not contain the "greater of" language cited above with respect to the full contribution rule. Absent Notice 2008-52, a strict reading of the Code would result in including 1/12 of the applicable annual limit for the individual's December HDHP in the monthly sum calculation only for months in which the individual was not otherwise HSA-eligible.

Code Sections 223(b)(2)(A) and 223(b)(8), allowing full contributions for months preceding the month that an individual is an eligible individual, were effective for taxable years beginning after December 31, 2006.

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