IRS NOTICES 2008-51 & 2008-52

EXPLANATION

By

Larry Grudzien
Attorney at Law

Introduction

The Internal Revenue Service (IRS) released IRS Notices 2008-51 and 2008-52 on June 4, 2008. These notices clarify the changes made by the Tax Relief and Health Care Act of 2006 for rolling over IRA funds to an HSA and for the new annual HSA contribution limit. The following will first review the rules and then explain what items have been clarified.

IRS Notice 2008-51: IRA Rollover to HSAs

Background: For tax years beginning after 2006, an individual is allowed to make a one-time contribution to his or her HSA of an amount distributed from his or her IRA. The contribution must be made in a direct trustee-to trustee transfer. Amounts distributed from the IRA are not includible in the individual's income to the extent that the distribution would otherwise be includible in income. Such distributions are not subject to the 10-percent additional tax on early distributions.

In determining the extent to which amounts distributed from the IRA would otherwise be includible in an individual's income, the aggregate amount distributed from the IRA is treated as includible in an individual's income to the extent that the aggregate amount which would have been includible in the individual's income if all amounts were distributed from all of the individual's IRAs of the same type (i.e., in the case of a traditional IRA, there is no pro-rata distribution of basis).

The amount that can be distributed from the IRA and contributed to an HSA is limited to the otherwise maximum deductible contribution to the HSA computed on the basis of the type of coverage under the HDHP at the time of the contribution. The amount that can otherwise be contributed to the HSA from the IRA in a given year is reduced by the amount contributed from the IRA. No deduction is allowed from the amount contributed from an IRA to an HSA.

An individual is allowed only one distribution and contribution during his or her lifetime, except when a distribution and contribution are made during a month in which an individual has individual coverage as of the first day of the month. In such a case, an additional distribution and contribution may be made during a subsequent month within the taxable year in which the individual has family coverage. The limit applies to the combination of both contributions.

If the individual does not remain an eligible individual during the testing period, the amount of the distribution and contribution is includible in the individual's gross income. The testing period is the period beginning with the month of the contribution and ending on the last day of the 12th month following such month. The amount is includible for the taxable year of the first day during the testing period that the individual is not an eligible individual. A 10-percent additional tax also applies to the amount includible. An exception applies if the individual ceases to be an eligible individual by reason of death or disability.

These changes do not apply to amounts in simplified employee pensions ("SEPs") or Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) retirement plans.

Clarifications:

1. A participant in certain SIMPLE IRAs and SEPs will be allowed to rollover funds to an HSA. These plans include any plan in which no employer contribution have been made for the plan year ending with or within the IRA owner's taxable year in which the qualified HSA funding distribution is made.

2. A death beneficiary of an IRA or Roth IRA can roll over his or her funds to an HSA after the death of the IRA account owner.

3. To be eligible to rollover funds from an IRA to an HSA, an individual must own the IRA from which the distribution is made. An individual may not use his or her IRA rollover funds for another individual.

4. If an individual owns more than one IRA and wants to rollover funds from more than one IRA, he or she must first rollover funds to one IRA and then take those combined funds to rollover to an HSA. An individual may not use more than one IRA to rollover funds to an HSA.

5. To be able to rollover funds for a particular year, the rollover must be accomplished by the due date of the individual's tax return for the year.

6. A direct transfer of IRA funds to an HSA is made if the IRA check for the distribution is made payable to the HSA trustee or custodian. The IRA or Roth IRA account owner can be given the check to deliver to the HSA trustee or custodian.

7. If an individual decides to make more than one distribution from his or her IRA during the year, a separate testing period applies to each distribution.

8. An individual remains an eligible individual during the testing period even if his or her coverage changes from family coverage to individual coverage.

9. If an individual does not continue to be covered by a HDHP during the testing period, his or her distribution from an IRA to a HSA will be included in his or her income for the year in which he or she first fails to be an eligible individual (covered by a HDHP). Earnings on the amount contributed that is taxed will not be included in the individual's income.

IRS Notice 2008-52: Annual HSA Contribution Limit

Background: The maximum annual contribution to an HSA is the sum of the limits determined separately for each month, based on status, eligibility and health plan coverage as of the first day of the month. Any individual who begins HDHP coverage in mid-month would not be eligible to make an HSA contribution until the beginning of the following month.

For tax years beginning after 2006, an individual, who becomes covered under an HDHP in a month other than January and who is covered by a HDHP in December of that year, may make a full deductible HSA contribution for the year if he or she has HDHP coverage for the entire "testing period". The testing period is the period beginning with the last month of the taxable year and ending on the last day of the 12th month following such month. If an individual does not remain an eligible individual during the testing period, the amount of the contributions attributable to months preceding the month in which the individual was not an eligible individual (which could have not have been made but for the provision) will be includible in the individual's gross income.. The amount is includible for the taxable year of the first day during the testing period that the individual was not an eligible individual. A 10-percent additional tax also applies to the amount includible. An exception applies if the individual ceases to be an eligible individual by reason of death or disability.

Clarifications:

1. If an individual fails to remain an eligible individual (covered by an HDHP) for the entire testing period, the amount that he or she can deduct as an HSA contribution is now determined by how many months he or she was covered by an HDHP during the year. The amount of the contribution included in an individual's income will be computed by subtracting the sum of the monthly contribution limits that the individual would have otherwise have been entitled to contribution from the amount actually contributed.

2. When an individual fails to remain an eligible individual during the testing period, the amount that is taxable does not need to be distributed from his or her HSA. Withdrawing this amount from the HSA will not prevent the inclusion of the amount in income or additional 10 percent tax. Earnings on the amount contributed are not included in gross income or subject to the 10 percent additional tax.

3. When an individual fails to remain an eligible individual during the testing period, the 10 percent tax applies regardless of the age of the HSA accountholder. When an individual withdraws an amount from his or her HSA for nonmedical reasons, the 10 percent tax does not apply after the individual attains the age of Medicare eligibility (i.e., age 65).

4. To remain an eligible individual during the testing period, an individual does not need to keep the same level of HDHP coverage. If an individual switches coverage during the testing period from family to single coverage, no amount will included in the his or her income.

5. The amount included in an individual's gross income because he or she failed to remain an eligible individual during the testing period is not considered an excess contribution and subject to the 6 percent tax.