

IRS Notice 2005-86 HSA Eligibility During a Cafeteria Plan Grace Period

On November 22, 2005, the IRS released guidance on the impact to a Health Savings Account (HSA) of the now permissible grace period for health flexible spending accounts (see IRS Notice 2005-42).

GENERAL RULE

In general an individual that is covered by a health flexible spending account (health FSA), including coverage under a spouse's health FSA, is not eligible to contribute to an HSA until the first day of the month following the end of the grace period coverage under the health FSA. This exclusion applies regardless of whether the individual actually has unused funds in the health FSA during the grace period or not.

PLAN OPTIONS

Transitional Rule for FSA Plan Years Ending Prior to June 5, 2006

Additional options were provided to allow plans to comply in the short run. For FSA plan years that end prior to June 5, 2006 only, an individual will remain eligible to contribute to an HSA while covered by a health FSA that provides a grace period if:

1. The individual has no unused funds in the health FSA at the beginning of the grace period; or
2. The employer amends the health FSA to not provide a grace period for an individual that elects coverage under an HSA.

Permanent Rule

In the long term, a plan has three options relating to the interaction of a health FSA and an HSA:

1. Do not provide a grace period under the health FSA;
2. Provide a grace period under the health FSA and not allow contributions to the HSA account during those months, as noted in General Rule above; or
3. Provide a grace period under the health FSA, but limit coverage during the grace period to that of a Limited Purpose or Post-Deductible FSA (i.e. only dental/vision/wellness expenses are covered or only expenses that exceed the deductible of the high deductible health plan are covered).

Whichever option is selected, it must apply to all participants in the health FSA and must apply for the entire grace period. A plan cannot offer the ability to choose between options of an HSA compatible health FSA and a health FSA that is not HSA compatible.