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The Winter *K&P Benefits Insider* highlights recent developments in Consumer Driven Healthcare with particular focus on Health Savings Accounts. Also in this issue is information on cafeteria plan grace periods, IRS end of year updates and carrier developments.

Consumerism: Employers' Answer to Rising Healthcare Costs

New findings show "a major change under way as employers embrace consumerism to help them control healthcare costs," according to a comprehensive review of consumer-directed healthcare trends just released by PricewaterhouseCoopers. The report includes results of a nationwide survey of nearly 150 CEOs from a broad geographic and industry spectrum and found that 90% of American workers "are as many as four steps removed from the cost and payment of care."

Most survey respondents agreed that requiring employees to pay a higher percentage of healthcare costs, as well as providing financial incentives for employee participation in healthy lifestyle programs, would help reduce their company's healthcare costs. Of the companies surveyed, 80% said costs could be reduced by providing employees with more information about healthcare quality and prices, yet only 38% currently regularly provide updated information. The report provides examples of how companies are using consumer-directed health plans, along with other components of consumerism, like preventive services and wellness and disease management programs, "to provide employees with more information regarding the quality and costs of the providers they visit and the services they use." (Source: PricewaterhouseCoopers' Health Research Institute, 10/03/2005)

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Health Savings Accounts

IRS Issues Health Savings Account Dollar Limits for 2006

On October 28, 2005, the IRS announced 2006 annual dollar limits for Health Savings Accounts (HSAs). The new limits are as follows:

- The maximum out-of-pocket limit under an HDHP cannot exceed $5,250 for single coverage and $10,500 for family coverage in 2006 (up from $5,000 and $10,000, respectively, in 2005).
- The 2006 monthly limitation on deductions for single coverage in an HDHP is 1/12 of the lesser of the annual deduction or $2,700. For family coverage, the limit is 1/12 of the lesser of the annual deduction or $5,450.

California Rejects Tax Benefit of Employer Contributions to an HSA

In October 2005, Governor Arnold Schwarzenegger signed legislation that amends California law to conform to several measures Congress passed in recent years, including the Medicare Expansion Act of 2003.

However, California law specifically excludes HSAs, which are authorized under the Medicare Expansion Act, from state conformity. The result is that employers' HSA contributions are taxed by the state as income to participating employees. HSA contributions made by the employer remain excludable from employee income for purposes of federal income tax.

California is one of a handful of states that has not aligned with federal law to provide favorable tax treatment for HSAs. Other states include:

Alabama	Arkansas
Kentucky	Maine
Massachusetts	Minnesota
Mississippi	New Jersey
Pennsylvania	Wisconsin

Observation from Assurant Health on HSAs

Results from a recent Assurant Health HSA survey reveal that these plans are becoming increasingly attractive to the uninsured. 44% of people applying for an HSA with Assurant did not report having prior insurance coverage, a 4% increase from the company's last survey.

In addition:

- 70% of HSA purchasers are families with children,
- 60% are over age 40, 29% of HSA purchasers have incomes of less than $50,000 a year.

Section 132 Transportation Limits Adjusted for 2006

For plan years beginning in 2006, the monthly limitation for Section 132 Parking plans has increased from $200 to $205.

The Transit/Vanpool monthly plan maximum will remain $105.

Additional information regarding this announcement can be accessed at www.irs.gov/pub/irs-drop/rp-05-70.pdf.

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Limited Purpose Flexible Spending Accounts

An employer looking to offer an HSA will want to consider offering a Limited-Purpose FSA under their current Section 125 flexible spending arrangement. Because a traditional FSA is considered non-high deductible coverage, it disqualifies participants from HSA eligibility. However, a Limited-Purpose Health FSA alleviates this problem by only allowing reimbursement of preventive, dental, and vision expenses. A Limited-Purpose Health FSA can offer post-deductible reimbursement for medical expenses, once the high deductible has been satisfied. FSA administrators generally require an Explanation of Benefits from the insurance carrier to substantiate satisfaction of the deductible.

In order to implement a Limited-Purpose FSA, the plan sponsor must amend the current plan document to incorporate this arrangement.

IRS Released Updated Form 2441

The IRS has released Form 2441 ("Child and Dependent Care Expenses") and Instructions for the 2005 tax year, revised to accommodate DCAPs with grace periods. Form 2441 is filed with the taxpayers' Form 1040, and is used to determine the amount of their dependent care tax credit, as well as to establish that the amount in Box 10 of Form W-2 is not taxable.

According to the instructions for line 13 of the Form, DCAP participants are directed to include any amount forfeited at the end of the tax year, or any amount not reimbursed but available to be carried forward and used during the plan grace period.

A copy of the Form and Instructions is available at www.irs.gov/pub/irs-pdf/f2441.pdf (Form) and www.irs.gov/pub/irs-pdf/i2441.pdf (Instructions).

Health Flexible Spending Account Grace Period and HSA Compatibility

On November 22, 2005, the IRS issued Notice 2005-86 clarifying how the implementation of a 2 ½ month grace period (as established by Notice 2005-42) on a health Flexible Spending Account (FSA) impacts a participant's eligibility for a Health Savings Account (HSA). The guidance clarifies that coverage by a traditional FSA grace period disqualifies a participant from making contributions to an HSA until the month following the expiration of the grace period. This is true even though an HSA participant may have reached his/her annual FSA limit during the plan year.

However, the notice provides direction on how to amend the FSA grace period in order to be HSA compatible. HSA compatible means a limited purpose, post deductible or combination limited-purpose post-deductible FSA grace period. If amended in this manner, all flexible spending account participants, regardless of whether or not they participate in the HSA, would be subject to the HSA compatible limited grace period. There is no option for a participant to choose between a traditional FSA and a HSA compatible FSA.

Eligibility to contribute to an HSA requires a participant be covered by a high deductible health plan (HDHP) and have no other non-HDHP coverage. A traditional FSA is non-HDHP coverage.

In addition to this general rule, the IRS notice provides for a special transition rule for coverage years ending prior to June 5, 2006. Under the guidance, an otherwise eligible participant may contribute to their HSA during coverage under their FSA grace period if: 1) the plan is amended to state the grace period is not available to individuals electing HDHP tied to an HSA, or 2) if the participant has no unused funds in their health FSA at the end of the plan year.

Contact the Kibble & Prentice Employee Benefits Tech Team

Would you like to obtain future copies of this newsletter by e-mail? If so, send us your name, phone number and e-mail address and we will add you to our e-mail list in time for the next mailing!

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Dependent Care FSA Grace Period Reporting Requirements Clarified

On September 7, 2005, the IRS issued Notice 2005-61 clarifying the Form W-2 reporting requirements that apply when an employer adopts a grace period for a Dependent Care Assistance Program (DCAP) immediately following the end of a cafeteria plan year. Employers can continue to rely on Notice 89-111 if actual total cash reimbursement amount is unknown when preparing Form W-2. Notice 89-111 provides that the amount of the employee's DCAP salary reductions for the year (plus any employer matching contributions) will be considered a reasonable estimate.

Employers that add a grace period to their DCAP may report the employee's DCAP salary reduction for the year (and any matching contributions) in Box 10 of Form W-2. See the following example:

- Employee elects DCAP salary reductions of $5,000 per year for both 2005 and 2006 under a cafeteria plan with a 2 ½ month grace period.
- At the end of 2005, the employee has a $500 remaining balance. Employee incurs $500 of DCAP expenses during the 2 ½ month grace period which is applied to the $500 2005 balance.
- For reporting purposes, the notice allows the employer to report $5,000 in Box 10 of Form W-2 for both the 2005 and 2006 calendar years. The $500 used during 2006 for reporting purposes remains under the 2005 Form W-2.

While this step improves the administrative burden of implementing a grace period, there remain potential compliance issues surrounding the adoption of a grace period on the DCAP account. In particular, the IRS has not commented on how to account for DCAP grace period balances when conducting nondiscrimination testing on the dependent care plan.

A copy of Notice 2005-61 is available at www.irs.gov/pub/irs-drop/n-05-61.pdf.

IRS Announces 2006 Cost of Living Adjustments

The IRS recently announced 2006 Cost of Living Adjustments applicable to the definition of a Highly Compensated Employee (HCE) and Key Employee (Key) for cafeteria plan non-discrimination testing purposes.

Current 2005	New for 2006
HCE: $95,000	HCE: $100,000
Key: $135,000	Key: $140,000

Definitions

Key Employee

- An employee who is a 1% owner and earns more than $150,000.
- A 5% owner.
- An officer of the employer who earns more than $140,000.

Highly Compensated Employee

- A 5% owner.
- An officer of the employer.
- Any employee who, in the preceding year, had compensation in excess of $100,000.

Our Mission

Kibble & Prentice is dedicated to assisting clients in making sound decisions that create value and manage risk.

Carrier Updates

Aetna Mental Health Parity

In response to the Federal Mental Health Parity Act, effective January 1, 2006, for new and renewing business (at the time of renewal) the outpatient mental health benefit will be subject to the specialist copay with the deductible waived.

Great-West Complies with Updated HIPAA Portability Rules

Pre-Existing Condition Exclusions (PCEs) must be included in an Initial Notice with enrollment materials. Upon enrolling any new employees on a Great-West plan, the Plan Administrator is responsible for securing from the new employee a certificate of creditable coverage from the new hire's prior insurance carrier, if any. The Plan Administrator is also responsible for determining whether or not the Plan's PCEs apply. If any PCEs do apply, then the Plan Administrator must provide the new employee a second notice advising him/her of the application of the PCE and how long before it expires.

If a new hire declines coverage when first available, the Plan Administrator must furnish a Special Enrollment Rights Notice advising the new hire of his/her right to enroll within 30 days of a qualifying life event such as marriage, birth or adoption.

LifeWise Health Plan of Oregon

LifeWise Health Plan of Oregon can now accept electronic funds transfer requests for premium payments through the Automated Clearing House (ACH) Network. Group administrators may expedite payments by sending them directly to LifeWise through their financial institution.

Regence Offers AdviCare to Employers with 100+ Employees

Regence BlueShield has partnered with American Healthways to offer AdviCare. AdviCare is a conditions management program currently available as a pilot for fully insured groups with 100 or more employees. Launched October 1, 2005 and extending through December 31, 2006, the pilot program – offered at no cost to employers and members – aims to help members improve their health and help employers reduce absenteeism and increase productivity. Members with Diabetes and Coronary Heart Disease (Coronary Artery Disease and Congestive Heart Failure) are candidates for the program. AdviCare will provide personalized support that addresses the whole person, not just the identified condition. It is designed to modify behaviors and empower members to achieve self-management of their chronic condition. Seasoned program nurses will reach out to help members understand and manage their condition according to their physician's care plan as soon as the condition is identified. Members may choose to decline participating in this program after being contacted. In addition, members can self-refer into the program if they have a qualifying condition. The AdviCare toll free telephone number is 1-866-782-7241. The program is completely confidential, and neither Regence nor AdviCare will release any information to any unauthorized entity.

Premera and Medicare Prescription Drug Coverage

Premera Blue Cross will not offer a Medicare prescription drug plan in 2006. All Premera Blue Cross group plans with prescription drug coverage (including pharmacy coverage under major medical) are considered creditable under Medicare guidelines. Creditable coverage notices were provided to all Medicare-eligible group plan members in October 2005.

Premera's Pharmacy Point of Sale Program Expansion

Premera Blue Cross is expanding their pharmacy Point of Sale program by adding new medications to the program's list of eligible drugs. The program is anticipated to be phased in during the first quarter of 2006 for most group plan members and all individual plan members (except for groups that have requested not to participate in the program).