



Nationwide produces this publication to provide public defined contribution plan sponsors with information about federal legislative and regulatory activity that may be relevant to plan administration and/or design.

Federal Legislative and Regulatory Report

January 2004

I. IRS issues General Guidance for Health Savings Accounts

Health Savings Accounts (HSAs), created as part of last year's Medicare reform bill, became available January 1, 2004.¹ The IRS has issued initial HSA guidance in Notice 2004-2, and additional guidance is scheduled for later this year.

HSAs are IRA-like accounts designed to help individuals pay for certain types medical expenses. Eligible individuals can establish an HSA with an HSA trustee/custodian and fund them with their own contributions, employer contributions or with pre-tax salary deferrals through an employer sponsored cafeteria plan. Eligible individuals are those individuals who on the first day of each month are covered under a high deductible health plan (HDHP) and who are:

- Not covered under any health plan that is not an HDHP (certain exceptions apply)
- Not entitled to benefits under Medicare and
- Not claimed as a dependent on another person's tax return

The table beginning on page 2 summarizes IRS Notice 2004-2

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¹ Our December 2003 Report provided an extensive discussion of HSAs.



The following Q&As are summarized and referenced from IRS Notice 2004-2

<p>What is the most significant HSA guidance?</p>	<p>Unlike Flexible Spending Accounts (FSAs) and other kinds of Health Reimbursement Arrangements (HRAs), expenditures do not have to be approved by a third party to be reimbursed. HSA trustees/custodians are not responsible for determining if the expenditures are eligible for reimbursement. HSA account holders are responsible for making this determination and keeping records. [Q&A 29]</p> <p>Employers making contribution to an employee’s HSA do not have to determine if HSA distributions are to be used for qualified medical expenses. [Q&A 30]</p>
<p>What is a “High Deductible Health Plan”?</p>	<p>Generally, an HDHP is plan that satisfies certain requirements with respect to deductibles and out-of-pocket expenses.</p> <p>For self-only coverage, the HDHP must have an annual deductible of at least \$1,000 and out-of-pocket expenses (deductibles, co-payments and other expenses but not premiums) limited to \$5,000. These amounts are doubled for family coverage and indexed for inflation.</p> <p>Preventive care plans with small or no deductibles still qualify as an HDHP. Except for preventative care, plans may not provide benefits in any year until the deductible is met. [Q&A 3]</p> <p>Example: A Plan provides coverage for A and his family, and provides payment of covered medical expenses of any member of A’s family if the member has incurred covered medical expenses during the year in excess of \$1,000 even if the family has not incurred covered medical expenses in excess of \$2,000. If A incurred medical expenses of \$1,500 in a year the Plan would pay \$500. Thus benefits are potentially available under the health plan even if the family’s covered expenses do not exceed \$2,000.</p> <p>Conclusion: Because the plan provides family coverage with an annual deductible of less than \$2,000 the plan is not an HDHP.</p>
<p>Does the HSA have to be opened at the same institution that provides the HDHP?</p>	<p>No. An HSA can be established through a qualified trustee/custodian who is not the HDHP provider. If the HSA trustee/custodian does not sponsor the HDHP, the trustee/custodian may require proof or certification that the potential HSA accountholder is an eligible to establish an HSA. [Q&A 10]</p>
<p>How is the 2004 contribution limit for an HSA calculated?</p>	<p>The maximum HSA contribution limit is determined monthly based on eligibility and health plan coverage.</p> <p>Examples of calculations: For single coverage, the annual contribution for the HDHP is the smaller of 1/12 of the annual deductible under the HDHP or \$2,600. If the annual deductible is \$2,600, the monthly contribution limit is \$216.67 (\$2,600/12). However, if self-only coverage under an HDHP begins on June 1, 2004 and continues for the rest of the year, the maximum contribution to the HSA would be \$1,516.69 (\$216.67 x 7). [Q&A 12 and 13]</p>
<p>How is the catch-up contribution calculated HSA account holders between ages 55 and 65?</p>	<p>For these individuals (and their spouses) between the ages of 55 and 65 covered under the HDHP, HSA contribution limit is increased by \$500 for 2004 and is calculated on a monthly basis. After an individual reaches age 65 (Medicare eligibility age) contributions including catch-up must cease.</p>



	<p>Example of catch-up calculation: An individual who has self-coverage with an annual deductible of \$1,000 under an HDHP has been making contributions to an HSA, reaches age 65 and becomes eligible for Medicare benefits in July 2004.</p> <p>This individual is no longer eligible to make HSA contributions including catch-up contributions after June 2004. The monthly contribution limit is \$125 (\$1000/12 + \$500/12 for catch-up contributions). The individual may make contributions for January through June totaling \$750 (6 X \$125), but may not make any contribution for July through December 2004. [Q&A 14]</p>
What is the deadline for making HSA contributions?	Contributions to HSAs may be made in cash installments or a lump sum no later than the taxpayers income tax filing deadline (usually April 15 of the year following the tax year) without extensions. [Q&A 21]
May HSAs reimburse over the counter drugs used for medical care?	Yes. [Q&A 26]
Are HSAs subject to COBRA continuation coverage?	No. [Q&A 35]
May eligible individuals use debit, credit or stored value cards to receive distributions from the HSA for qualified medical expenses?	Yes. [Q&A 37]

The IRS is seeking HSA comments on issues that need to be addressed in future IRS guidance including the relationship between HSA and the rules governing cafeteria plan FSAs, the relationship between HSAs, health FSAs or HRAs, and corrective procedures for excess employer contributions to an employee's HSA that exceed the statutory limitation.

Find it online

You can download the complete text of this Notice from www.irs.gov/pub/irs-drop/n-04-02.pdf.

II. Servicemembers Civil Relief Act (SCRA) Becomes Law

Congress determined that civil protections for active duty members of the military and their families needed to be updated and strengthened to prevent them from being adversely affected because of military service. Late last year, Congress passed and President Bush signed the Servicemembers Civil Relief Act (H. R. 100) which updates and expands the Soldiers' and Sailors' Civil Relief Act of 1940. The law covers all active duty military including the National Guard.

One of the most important features of SCRA is the clarification of the maximum amount of interest that may be charged on credit obligations including retirement plan loans during active military service.

This chart outlines Servicemembers' interest-rate rights that apply to retirement-plan loans.

How does SCRA affect interest rates charged on retirement plan loans?	<p>SCRA limits the amount of interest that can be charged on retirement plan loans incurred prior to military service to a maximum of 6% annually during period of military service.</p> <p>The 6% annual interest rate includes service charges, renewal charges, fees or any other charges (except for bona fide insurance) with respect to the loan.</p>
What steps does a servicemember need to take to have the plan loan interest rate reduced to 6% for the period of active duty?	<p>To take advantage of the maximum 6% interest rate, active duty personnel must:</p> <ul style="list-style-type: none"> ➤ Take out plan loan with an interest rate in excess of 6% prior to active military service. Loans taken out during active military service will be subject to the plan's regular interest rate. ➤ Notify plan/plan sponsor of military service and request interest rate reduction. Interest rate cannot be reduced prior to notification. ➤ Plan/plan sponsor should be notified in writing either during military service or within 180 days after terminating military service that service member wants plan loan interest in excess of 6% reduced to 6% for the period of active military service. Service members should be prepared to provide copies of military orders showing when active duty began and ended. <p>Note: Members of the military usually earn less than they did in their civilian jobs, which may make it difficult to repay loans at the higher interest rates. Creditors may seek court ordered relief from interest rate reduction if they believe military service does not materially affect service member's ability to pay the higher interest rate.</p>
When does SCRA interest rate reduction period begin and end?	<p>SCRA maximum interest rate protection begins on the first day of active military duty and terminates on the date service member is released from military service or dies while on active duty. Active duty also includes time spent recovering from wounds and/or illness.</p>
What if the interest that is charged on plan loan during military service exceeds 6%?	<p>Excess interest must be permanently forgiven. Loan repayments made after military service cannot include forgiven excess interest.</p>
If the original plan interest rate exceeds 6%, can a plan participant on active military duty keep the plan's original rate?	<p>Yes. Servicemembers may keep plan's original higher rate by waiving rights to a reduced interest rate of 6%. The waiver must be in writing, between the participant and the plan and executed during or after military service.</p> <p>Comment: Participants in defined contributions plans may want to keep the plan's higher original interest rate to increase their account balances.</p>
When does SCRA become effective?	<p>SCRA is effective immediately.</p>

SCRA expands other protections and rights including:

- **Housing Eviction Protection.** Active duty members of the Armed Forces and their dependents cannot be evicted from housing when the amount of rent or lease-payments are \$2,400 per month or less. These monthly amounts will be adjusted annually for inflation.
- **Lease Termination Rights.** Active duty service members who are permanently reassigned or deployed to a new location have the right to terminate housing and car leases.
- **Double Taxation Protection.** If a service member's spouse works in a state that is not the same state where the couple maintains their permanent legal residence, the service member's income cannot be used to determine the spouse's tax rate in the state where the spouse is working.
- **Protection in Civil Proceedings.** It is often difficult for service member to attend civil court proceedings while on active duty. SCRA provides automatic 90 day stays in civil proceedings with possible further extensions.

III. Final Disclosure Regulations for QJSA Benefits

Retirement plans may offer a number of distribution payment options including lump sums, installment payments and annuities. Private sector defined benefit plans and some defined contribution plans require that married participants take benefit payments as a **Qualified Joint and Survivor Annuity (QJSA)** unless the participant waives this form of payment and the participant's spouse consents to the waiver.

The Treasury Department has finalized regulations affecting the contents of QJSA disclosure explanations that are provided to married participants prior to selecting a form of retirement benefit. These guidelines may be of interest to public sector employers whose plans require a QJSA and who are want to increase participant understanding of various payout options that are offered under their retirement plans.

This table outlines the major requirements found in the Final QJSA Disclosure Regulations.

What is a Qualified Joint and Survivor annuity?	A QJSA is an annuity payable on the life of a retired participant and the life of the participant's spouse following the participant's death. A QJSA must be at least 50% but not more than 100% of the annuity amounts that were payable during the participant's lifetime. Example: Joe retired from the XYZ defined benefit plan and receives his retirement benefit as a 50% QJSA. While Joe is alive his monthly annuity payment is \$2,000/month. After his death his spousal beneficiary will receive lifetime monthly annuity payments of \$1,000 per month.
What kinds of plans must provide for QJSA?	QJSA are required for private sector defined benefit plans and money purchase plans, although some other kinds of defined contribution plans may also offer this distribution option.
What is described in the QJSA Explanation?	The QJSA Explanation is a written description of the terms and conditions of the QJSA, participant's and spousal rights, including the participant's right to waive QJSA with spousal consent. Once the spouse consents to



	the participant's waiver of the QJSA, the participant is able to choose another form of payment offered under the plan such as a lump sum, other types of annuities or installment payments.
What are the QJSA disclosure requirements under the final regulations?	<p>The QJSA disclosure explanation must now contain information to help participants compare and understand the relative values of the plan's different payment options. The QJSA must describe the:</p> <ul style="list-style-type: none"> ➤ Optional forms of benefit payments and their features ➤ Eligibility requirements for the optional form of benefit payment ➤ Financial effect of the choosing another type of benefit payment instead of the QJSA <p>Defined benefit plans will need to provide meaningful numerical comparisons between the mandatory QJSA and relative values of other benefit payment options offered under the plan.</p> <p>Examples of these comparisons using different ages and types of benefit payments may be found in the final regulations.</p>
Are there special disclosure requirements rules for defined contributions plans that require payments to be made to married participants in the form of a QJSA?	Yes. The explanation must state that the QJSA benefit will be provided through a commercial annuity from an insurance company purchased with the participant's account balance. If estimates are used instead of an insurance company quote that information must be disclosed.
What is the effective date for the final disclosure regulations?	Final regulations for QJSA disclosures are effective for annuity payments starting on or after October 1, 2004.

Find it online

You can download the complete text of the regs from www.irs.gov/pub/irs-REGS/TD9099.pdf.

IV. Keeping watch

Nationwide Retirement Solutions continues to monitor SEC and various attorneys general investigations into mutual-fund trading practices and related issues. The most recent information on these issues is on the Employer page of your plan Web site. In addition, we report guidance on legislative and regulatory activity that is relevant to government sector defined contribution plans through these communications:

- *Plan Sponsor Voice* newsletter – distributed quarterly – next edition due in February, 2004
- *Federal Legislative and Regulatory Report* – distributed monthly
- *Legislative and Regulatory Alerts* – distributed on an ad hoc basis to announce breaking news