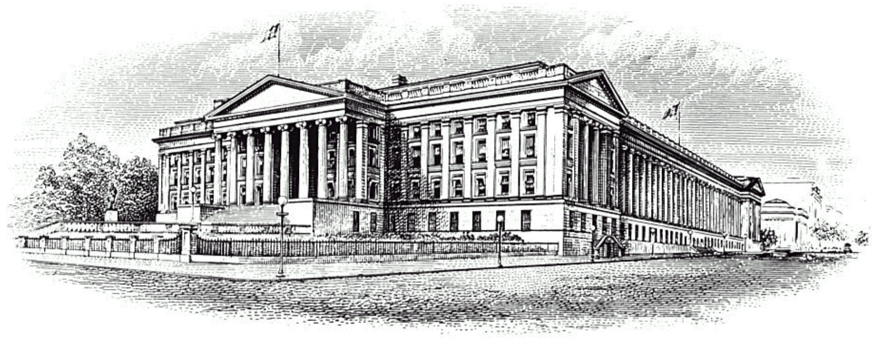

DEPARTMENT OF THE TREASURY

OFFICE OF PUBLIC AFFAIRS

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TREASURY AND IRS ISSUE GUIDANCE ON HEALTH REIMBURSEMENT ARRANGEMENTS

Today the Treasury Department and the Internal Revenue Service issued guidance that clarifies the tax treatment of health reimbursement arrangements (HRAs) in which the employee's health benefit arrangement provides for employee-controlled reimbursement of medical costs.

"With this new guidance, we clear the way for employers to adopt health plans with patient-directed features so that employees have more choice and greater control over their health care coverage," stated Treasury Secretary Paul O'Neill.

The guidance, consisting of a notice and a revenue ruling, provides that medical benefits paid by Health Reimbursement Arrangements (HRAs) that meet certain requirements are not taxable. The guidance also clarifies that HRAs generally are not subject to the complex design requirements for health Flexible Spending Arrangements funded through salary reduction under a cafeteria plan.

The primary requirements for an HRA are that (1) the plan must be funded solely by the employer and cannot be funded by salary reduction, and (2) the plan may only provide benefits for substantiated medical expenses. If the plan provides for payments or other benefits irrespective of medical expenses, all amounts paid by the plan become taxable, including prior medical reimbursements.

Under this guidance HRAs can:

- Allow the carryover of unused amounts to later years (i.e., the "use-it-or-lose-it rule" does not apply) and
- Reimburse employees for the purchase of health insurance.

In addition, the guidance provides that:

- HRAs may allow former employees, including retirees, continued access to unused reimbursements;

- HRAs may provide that an FSA funded by salary reduction reimburses expenses before the HRA; and
- HRAs are group health plans subject to the COBRA continuation requirements.

The text of the notice and revenue ruling are attached.

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