

FREQUENTLY ASKED QUESTIONS

ELIGIBILITY REQUIREMENTS

What is a Health Savings Account?

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 added section 223 to the Internal Revenue Code to permit eligible individuals to establish health savings accounts (HSAs) for taxable years beginning after December 31, 2003. An HSA allows individuals to pay for qualified health expenses and save for future qualified medical and retiree health expenses on a tax-free basis. An HSA is similar to an Individual Retirement Account ("IRA"). Like an IRA, an HSA is established for the benefit of an individual, is owned by that individual, and is "portable." Thus, if the individual is an employee who changes employers or leaves employment, the HSA stays with the individual. However, an IRA cannot be used as an HSA nor can you combine an IRA and an HSA in a single account.

Who is eligible for an HSA?

To be eligible for an HSA, you must be covered by a high deductible health plan and you must not be covered by other health insurance. (This restriction does not apply to insurance for specified illness or disease or accident, disability, dental care, vision care, long-term care or hospitalization insurance) In addition, you cannot be enrolled in Medicare nor can you be claimed as a dependent on someone else's tax return. You are also ineligible for an HSA if, while covered under a high deductible health plan, you are also covered (whether as an individual, spouse, or dependent) under a health plan that is not a high deductible health plan.

May an individual establish more than one HSA?

An eligible individual may establish and contribute to more than one HSA. However, the rules governing HSAs, such as those setting maximum annual contribution limits, apply no matter how many HSAs are established by an eligible individual. Thus, for example, the account balances of all HSAs established by an individual are aggregated for purposes of applying the maximum annual contribution limit described below.

What is a "high deductible health plan"?

A high deductible health plan is a health insurance plan that has an annual deductible (determined yearly by the Treasury Department). In 2009, the deductible must be at least: (1) \$1,150 for individual (self-only) coverage or (2) \$2,300 for family coverage (coverage of more than one individual). In 2009 the annual out-of-pocket expenses required to be paid under the health plan cannot exceed \$5,800 for individual coverage or \$11,600 for family coverage. Out-of-pocket expenses include deductibles, co-payments, and other amounts the participant must pay for covered benefits, but do not include premiums. High deductible health plans can have first dollar coverage (no deductible) for preventive care and higher out-of-pocket expenses (copays & coinsurance) for non-network services. (The dollar amounts described above are subject to annual cost of living adjustments.)

Who can offer a high-deductible health plan?

A high-deductible health plan may be offered by a variety of entities, including insurance companies and health maintenance organizations (HMOs).

Are HSAs allowed under a cafeteria plan?

If a high deductible plan is offered as part of a cafeteria plan, it can be used to establish your eligibility for an HSA. (A cafeteria plan or flexible benefit plan is an employee benefit plan that permits employees to choose from a variety of benefits, including health and accident insurance cash, tax advantages and retirement plan contributions.)

May HSA contributions made under a cafeteria plan be changed?

If you elect to make HSA contributions under a cafeteria plan, you may start or stop the election or increase or decrease the amount of your HSA contribution at any time, as long as the change is effective prospectively.

May an individual who uses a discount card for health care services or products contribute to an HSA?

A discount cardholder may be eligible to establish an HSA if the individual is covered by a high-deductible health plan and is required to pay health care costs, taking into account the discount, until the HDHP deductible is satisfied.

May an individual covered by an Employee Assistance Program (EAP), disease management program, or wellness program establish an HSA?

An individual who is covered by such programs may still be eligible to establish an HSA if the programs do not provide significant medical care or medical treatment benefits. Certain screening and preventive care services are disregarded when determining whether a program provides significant medical care or treatment benefits.

ESTABLISHING AN HSA

How do you establish an HSA?

If you are an eligible individual, you can establish an HSA with a qualified HSA trustee or custodian, in much the same way that individuals establish IRAs with qualified IRA trustees or custodians. No permission or authorization from the Internal Revenue Service ("IRS") is necessary. Sterling HSA requires you to complete an application form available on our website (www.sterlinghsa.com).

Can you revoke your HSA custodial agreement?

You may revoke a Sterling Health Services, Inc. ("Sterling HSA") Custodial Agreement within a period of seven (7) days after the date upon which you enter into the Agreement. To revoke the Agreement, please write to Sterling HSA at 475 14th Street, Suite 120; Oakland CA 94612. If you mail your notice of revocation, the postmark date (or date of certification or registration, if sent by certified or registered mail) will be deemed the date of delivery and the date of revocation. If you revoke your account in accordance with these time limits, you are entitled to a return of the entire amount deposited to your account without adjustments for any fees, expenses, commissions, or investment gains or losses.

CONTRIBUTIONS TO HSAs

Who may contribute to an HSA?

Contributions to HSAs can be made by an eligible individual, the individual's employer, the individual's family members, and any other person. Contributions made by the individual are deductible from the individual's adjusted gross income. Contributions made by the individual's employer are excluded from the individual's income and are not taxable to the individual. Contributions from all sources are aggregated for purposes of applying the maximum annual contribution limit described below.

How do you make contributions to an HSA?

Contributions to an HSA must be made in cash or its equivalent. As custodian of your HSA, Sterling HSA will accept contributions by check or via the Automated Clearing House (ACH) Network. Sterling HSA will also accept rollovers or transfers of assets from a medical savings account ("MSA"), as permitted by the Internal Revenue Code.

How much can you contribute to an HSA?

The maximum contribution for 2009 is \$3,000 for an individual or \$5,950 for a family. (These dollar limits will be adjusted for inflation each year.) These annual contribution limits apply regardless of whether the contributions are made by an individual, the individual's employer, the individual's family members, or any other person. The maximum contribution limits apply regardless of the deductible amount you purchased or when you opened the HSA qualified insurance plan.

Do special rules apply to contributions by spouses?

HSA contributions by spouses are divided equally between them unless they have agreed to a different division.

What is the tax treatment of an eligible individuals' HSA contributions?

Contributions to your HSA, up to the applicable maximum contribution, are deductible from your adjusted gross income, whether or not you itemize deductions.

What is the tax treatment of employer contributions to an HSA?

Employer contributions to an employee's HSA are excludable from the employee's gross income, up to the maximum contribution limit for that employee. Although the employee cannot deduct the employer's HSA contributions, the contributions are not taxable to the employee nor are they subject to withholding from wages for income tax or other employment taxes. HSA contributions by employers are considered a type of benefit, and are therefore, tax-deductible for the employer.

Is there a catch-up contribution?

Individuals age 55 plus may make catch up contributions. In 2009, the catch up contribution is \$1,000. This amount remains the same for subsequent years.

What if my spouse who is also 55 wishes to make a catch up contribution?

Your spouse may make a catch up contribution as well. In accordance with IRS regulations, Sterling HSA will set up a separate account for this purpose.

Is there a deadline for contributions to an HSA for a taxable year?

Contributions for any taxable year can be made in one or more payments, at any time prior to the deadline, without extensions, for filing your federal income tax return for that year, but not before the beginning of that year. For calendar year taxpayers, this deadline for contributions is generally April 15 following the year for which the contributions are made.

What happens when HSA contributions exceed the maximum amount that may be deducted or excluded from gross income in a taxable year?

An "excess contribution" (a contribution made by you or your employer that exceeds the amount allowed by law) is not deductible by you or your employer and is included in your gross income if made on your behalf by your employer. An excise tax of 6% for each taxable year is imposed on excess individual and employer contributions.

If the excess contributions for a taxable year and the net income attributable to such excess contributions are paid or distributed to you before the deadline (without extensions) for filing your federal income tax return for the taxable year, then the net income from the excess contributions are included in your gross income for the taxable year in which the distribution is received. However, the excise tax would not be imposed on the excess contributions nor would the distribution of the excess contributions be taxed. Allowable rollover contributions do not count in determining whether an excess contribution has been made.

Are rollover contributions to HSAs permitted?

Rollover contributions from MSAs and other HSAs into an HSA are permitted. These rollover contributions to your HSA need not be in cash and are not subject to the annual contribution limits. Rollovers from an IRA are permitted once in a lifetime until 2011, and cannot exceed the maximum contribution limits for that calendar year. Rollovers from a health reimbursement account ("HRA") or a health flexible spending account ("FSA") to your HSA are permitted and are in addition to the maximum contribution limits. There are strict IRS requirements and limitations that apply to FSA rollovers.

Can you pledge any part of your HSA as security for a loan?

Any portion of your HSA that you pledge as security for a loan will be treated as a distribution for the year the pledge is made. The amount pledged is includable in your gross income and a 10% premature distribution penalty tax on the pledged amount may also be imposed.

Do HSA administration and account fees count toward the maximum annual contribution limit?

If such fees are paid directly to your HSA trustee or custodian by you or your employer, the fees are not considered contributions to your HSA and do not count toward the maximum annual contribution limit. If, instead, you authorize your HSA trustee or custodian to withdraw payment for such fees from your HSA, the amount withdrawn does not increase the maximum annual contribution limit. For example, if your maximum annual contribution limit is \$3,000 and a \$50 administration fee is withdrawn from your HSA, your annual contribution limit remains at \$3,000. It does not increase to \$3,050.

Will Sterling HSA provide tax advice in connection with your HSA?

Sterling HSA does not provide tax advice concerning your HSA. It is your sole responsibility to determine the tax consequences of establishing an HSA. Please discuss any questions you may have with your tax advisor.

How are HSA contributions treated for tax/payroll purposes?

HSA contributions can be made pretax unless you are dealing with an individual or an employer who does not have a Section 125 Plan or Premium only Plan document that allows these dollars to be deducted on a pretax basis. Even in the event that one of the situations above is the case an HSA account holder can still make an HSA contribution post tax and then deduct it from their W2 at the end of the year.

HSA contributions are entirely tax free on a Federal basis in all states (whether those contributions are made by an employer or employee). At this time a handful of states, including California do not follow Federal tax guidelines and State taxes still apply.

Technically HSA contributions through a 125 cafeteria plan by salary reduction are treated as employer contributions — that is why they are excluded from income and wages. While most people consider salary reduction amounts as "employee contributions", technically, this is not the case — they are reported as employer contributions.

Salary reductions for health insurance are typically reported in box 12 — employees may need this information if State or local taxes do not exclude such amounts. Some employers may also include employer contributions to health insurance in box 12, so that employees know what they are receiving. A good HSA administrator will automatically issue tax documents to all account holders so they may add all HSA contributions onto their State tax return. Ultimately it is the account holder responsibility to report all HSA contributions.

DISTRIBUTIONS FROM HSAS

When can you receive distributions from your HSA?

You are permitted to receive distributions from your HSA at any time. At Sterling HSA, you may withdraw funds from your account by asking us to pay a bill on your behalf, by paying an expense directly with your debit card, or by transferring funds from your Sterling HSA account into your checking account on the internet.

How are distributions from an HSA taxed?

Distributions from an HSA used exclusively to pay for the qualified medical expenses of you or your spouse or eligible dependents are generally excludable from gross income. The amount of any distribution not used exclusively for such qualified medical expenses is includable in your gross income and may be subject to an additional 10% premature distribution penalty tax on the amount includable. (This 10% penalty tax does not apply to distributions made after your death, disability, or attainment of age 65). In addition, distributions made for expenses that are reimbursed by another health plan are includable in your gross income, whether or not the other health plan is a high-deductible health plan.

Must Sterling HSA determine whether HSA distributions are for qualified medical expenses?

Sterling HSA is not required to determine whether distributions from your HSA are used for qualified medical expenses. It is your sole responsibility to make that determination. You are also solely responsible for maintaining adequate records for tax purposes and for paying any taxes and penalties which may result from any distribution. Please discuss any questions you may have with your tax or legal advisor. We keep copies of medical bills and payments made on your behalf. We can make these copies available to you as you need them.

May a mistaken distribution be repaid without adverse tax consequences or penalty?

The amount of a mistaken distribution is not included in your gross income nor is it subject to the 10% penalty or excise tax on excess contributions if: 1) you receive the distribution as a result of a mistake of fact due to reasonable cause and 2) you repay to your HSA the amount of the mistaken distribution no later than April 15 following the first year you knew or should have known of the mistake. (Please note that your HSA trustee or custodian is not obligated to allow you to repay mistaken distributions to your HSA.).

May distributions from an HSA be deferred to later taxable years?

Distributions from your HSA to pay or reimburse qualified medical expenses incurred in the current year may be deferred to later taxable years, as long as those expenses were incurred after your HSA was established. Distributions from your HSA in the current year can be used to pay or reimburse qualified medical expenses incurred in prior years, as long as those expenses were incurred after your HSA was established. You must keep proper records in order for these distributions to be excludable from your gross income.

What medical expenses are eligible for tax-free distributions from your HSA?

At present, qualified medical expenses include the following, but only to the extent these expenses are not covered by insurance or otherwise:

Abdominal supports	Long term care insurance premiums
Abortion	Medicare Parts A & B after age 65
Acupuncture	Metabolism tests
Air conditioner (when necessary for relief from difficulty in breathing)	Neurologist
Alcoholism treatment	Nursing (including board and meals)
	Obstetrician

sickness/disability)	Ambulance	Operating room costs
	Anesthetist	Ophthalmologist
only)	Arch supports	Optician
	Artificial limbs	Optometrist
doctor	Autoette (when used for relief of	Oral surgery
	Birth control pills (by prescription)	Organ transplant (including donor's expenses)
services	Blood tests	Orthopedic shoes
	Blood transfusions	Orthopedist
care)	Braces	Osteopath
	Cardiographs	Oxygen and oxygen equipment
	Chiropractor	Pediatrician
	Christian Science Practitioner	Physician
	Contact Lenses	Physiotherapist
	Contraceptive devices (by prescription)	Podiatrist
	Convalescent home (for medical treatment	Postnatal treatments
	Crutches	Practical nurse for medical services
	Dental treatment	Prenatal care
	Dental x-rays	Prescription medicines
	Dentures	Psychiatrist
	Dermatologist	Psychoanalyst
	Diagnostic fees	Psychologist
	Diathermy	Psychotherapy
	Drug addiction therapy	Radium therapy
	Drugs (by prescription)	Registered nurse
	Elastic hosiery (by prescription)	Special school costs for the handicapped
	Eyeglasses (by prescription)	Spinal fluid test
	Fees paid to health institute prescribed by a	Splints
	FICA and FUTA taxes paid for medical	Sterilization
	Fluoridation unit	Surgeon
	Guide dog	Telephone or TV equipment to assist the hard-of-hearing
	Gum treatment	Therapy equipment
	Gynecologist	Transportation expenses (relative to health care)
	Healing services	Ultra-violet ray treatment
	Hearing aids and batteries	Vaccines
	Hospital bills	Vasectomy
	Hydrotherapy	Vitamins (by prescription)
	Insulin treatment	Wheelchair
	Lab tests	X-rays
	Lead paint removal	Certain permissible premiums for dental insurance, accident, cancer and COBRA.
	Legal fees	
	Lodging (away from home for outpatient	

For more information, see IRS Publication 502: Medical and Dental Expenses (Section 213(d)).

DEATH OF AN HSA ACCOUNT HOLDER

What happens to your HSA upon your death?

When you open your Sterling HSA account, you will be asked to designate one or more beneficiaries to whom distribution of your HSA will be made upon your death. You may revoke

this beneficiary designation at any time and designate different individuals as beneficiaries. Any beneficiary designation you make must be delivered to Sterling HSA prior to your death on a form provided by or acceptable to Sterling HSA. If you do not make a valid beneficiary designation prior to your death, Sterling HSA will distribute the assets in your HSA to your estate. In some states, your spouse's consent may be necessary if you wish to name a person other than or in addition to your spouse as beneficiary or if you change an existing beneficiary designation. Please consult with your attorney before making your beneficiary designation.

What are the income tax consequences after your death?

If your spouse is the named beneficiary of your HSA, your HSA becomes the HSA of your spouse upon your death, subject to the completion of documents required by Sterling HSA. The surviving spouse is subject to income tax only the extent distributions from the HSA are not used for qualified medical expenses. If your HSA passes to a person other than your surviving spouse, the HSA ceases to be an HSA as of the date of your death, and the beneficiary is required to include the fair market value of the HSA assets as of the date of your death in his or her gross income. The includable amount is reduced by any payments from the HSA for your qualified medical expenses, if such payments are made within one year after your death.

If you have not made a valid beneficiary designation, your HSA ceases to be an HSA upon your death and the fair market value of the assets in your HSA, as of the date of death, is includable in your gross income for the year of death.

HEALTHCARE FSA LIMITED PURPOSE PROVISION

How does an HSA work if my client has a healthcare FSA?

A group can offer health savings accounts (HSAs) along side a healthcare flexible spending account (FSA) as long as the group has a "limited purpose provision" added to their healthcare FSA plan document. This can be done by most healthcare FSA administrators. The "limited purpose provision" allows employees with a healthcare FSA to use their FSA funds "first dollar" for dental and vision – anything non medical, but the employee must use their HSA funds up to the statutory minimum deductible amount for medical before they can use their healthcare FSA funds for medical expenses. This rule also applies to employees whose spouses have an FSA with their employer even if the HSA account holder's employer does not offer a healthcare FSA. The limited purpose provision does not apply to those employees who do not have an HSA. Without the limited purpose provision added to the healthcare FSA plan document, an employee with a healthcare FSA cannot have an HSA. A dependent care FSA is not affected by the addition of an HSA.

IRS Publication 969 covers the Healthcare FSA/HSA stacking rules and "limited purpose provisions" on a high level. Please see "Other Coverage" under the HSA subhead at <http://www.irs.gov/publications/p969/ar02.html#d0e172>

DOMESTIC PARTNERSHIPS

Can HSA funds be used for a domestic partner?

HSAs are a Federal program and as such covered by Family Protection Act which does not recognize domestic partnerships even if the state of residency does. In the state of California for example, an employee's domestic partner could be covered under the employee's health plan however, the employee can only make a single HSA contribution (assuming there were no children). In such a case, the employee cannot use his/her HSA funds for the domestic partner's expenses (even if qualified) without being taxed and penalized. The only way for a domestic partner to be a recognized for Federal tax purposes is if the partner qualifies to be a legal tax dependent.

S CORPORATIONS AND PARTNERSHIPS

I have a client who is an S Corporation. Can the company contribute for the owner(s)?

A company cannot contribute to the HSA account of individuals owning 2% or more of the company), pay administrative fees on their behalf and write it off as a business expense (as they could do for contributions to other employees). The 2% + owners or Partners themselves can have HSA compatible coverage and establish HSAs. They would need to contribute with

their own after-tax dollars. Because the 2%+ owners or Partners are not receiving an employer contribution, they can choose to fund their HSA in anyway they see fit and are not limited to the comparability requirements. At the end of the year, the owners/Partners would deduct their HSA contributions from their individual tax return.

OTHER MATTERS

What kind of statements will you receive in connection with your HSA?

Sterling HSA will send you a quarterly statement showing the activity in your HSA custodial account. You may also register online to view your account balance and activity at any time as well as transfer funds online.

What information must be reported to the IRS?

We report contributions and disbursements to the IRS. Those reports are also given to the accountholder in Form 5498SA (yearly contributions) and Form 1099SA. Sterling HSA's fourth quarter report will help accountholders complete this form. We will also mail Forms 5498SA and 1099SA by the time deadlines required by the IRS (May 31 and February 28, respectively.)

Here are the two links on DOL Guidance on HSAs:

www.hsafinder.com/11-06_04.shtml

www.hsafinder.com/pdf/fab_2006_02.pdf