

HSA DISCLOSURE STATEMENT

OVERVIEW

Section 1201 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, 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. HSAs are established to receive tax-favored contributions by or on behalf of eligible individuals and amounts in an HSA may be accumulated over the years or distributed on a tax-free basis to pay or reimburse qualified medical expenses.

GENERAL REQUIREMENTS OF AN HSA

Your contributions must be made in cash, unless you are making a rollover contribution to another HSA account and the Custodian accepts non-cash rollover contributions. For calendar year **2008**, the maximum monthly contribution for eligible individuals with self-only coverage under an HDHP is 1/12 of the lesser of 100% of the annual **maximum** under the HDHP (**minimum of \$1,100**) but not more than **\$2,900**. For eligible individuals with family coverage under an HDHP, the maximum monthly contribution is 1/12 of the lesser of 100% of the annual **maximum** under the HDHP (**minimum of \$2,200**) but not more than **\$5,800**. In addition to the maximum contribution amount, catch-up contributions may be made by or on behalf of individuals age 55 or older and younger than 65. Your regular annual contributions for any taxable year may be deposited at any time during that taxable year and up to the due date for the filing of your federal income tax return for that taxable year, no extensions. This generally means April 15th of the following year. The Custodian of your HSA must be a bank, insurance company or a person who is approved to act in such a capacity by the Secretary of the Treasury. No portion of your HSA funds may be invested in life insurance contracts. Your interest in your HSA is nonforfeitable at all times. The assets in your HSA may not be commingled with other property except in a common trust fund or common investment fund. You may not invest the assets of your HSA in collectibles (as described in Section 408(m) of the Internal Revenue Code). A collectible is defined as any work of art, rug or antique, metal or gem, stamp or coin, alcoholic beverage, or any other tangible personal property specified by the IRS. However, if the Custodian permits, specially minted U.S. Gold and Silver bullion coins and certain state issued coins are permissible HSA investments. The assets of your HSA remain tax-exempt while the funds are in your account.

WHO IS ELIGIBLE TO ESTABLISH AN HSA

You are permitted to make a regular contribution to your HSA for any taxable year if you are an "Eligible Individual". An eligible individual means, with respect to any month, any individual who: (1) is covered under a high deductible health plan (HDHP) on the first day of such month; (2) is not also covered by any other health plan that is not an HDHP (with certain exceptions for plans providing certain limited types of coverage); (3) is not entitled to benefits under Medicare (generally, had not yet reached age 65); and (4) may not be claimed as a dependent on another person's tax return.

DEFINITIONS

High Deductible Health Plan (HDHP) is a health plan that satisfies certain requirements with respect to deductibles and out-of-pocket expenses. Specifically, for self-only coverage, an HDHP HSA an annual deductible of at least **\$1,100** and annual out-of-pocket expenses required to be paid (deductibles, co-payments and other amounts but not premiums) not exceeding **\$5,600**. For family coverage, an HDHP HSA an annual deductible of at least **\$2,200** and annual out-of-pocket expenses required to be paid not exceeding **\$11,200**. In the case of family coverage, a plan is an HDHP only if, under the terms of the plan and without regard to which family member or members incur expenses, no amounts are payable from the HDHP until the family HSA incurred annual covered medical expenses in excess of the minimum annual deductible. Amounts are indexed for inflation. A plan does not fail to qualify as an HDHP merely because it does not have a deductible (or HSA a small deductible) for preventive care (e.g., first dollar coverage for preventive care). However, except for preventive care, a plan may not provide benefits for any year until the deductible for that year is met.

Permitted Insurance shall include:

- (a) insurance if substantially all of the coverage provided under such insurance relates to:
 - liabilities incurred under worker's compensation laws;
 - tort liabilities;
 - liabilities relating to ownership or use of property; or
 - such other similar liabilities as the Secretary may specify.
- (b) insurance for a specified disease or illness;
- (c) insurance paying a fixed amount per day (or other period) of hospitalization.

Qualified Medical Expenses include amounts paid with respect to the individual, the individual's spouse, and the individual's dependents, for medical care defined under section 213(d) and such amounts are not compensated for any insurance or otherwise. Generally qualified medical expenses shall not include payment for insurance. Exceptions to this rule include coverage under:

- (a) a health plan during any period of continuation coverage required under Federal law;
- (b) a qualified long term care insurance contract (as defined in section 7702(b) IRC); or

- (c) a health plan during a period in which the individual is receiving unemployment compensation under any Federal or State law; or
- (d) in the case of an account beneficiary who HSA attained the age specified in section 1811 of the Social Security Act, any health insurance other than a Medicare supplemental policy (as defined in section 1882 of the Social Security Act).

Medical Care includes amount paid:

- (a) for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body;
- (b) for transportation primarily for and essential to medical care referred to above; or
- (c) for insurance covering medical care referred to in (a) and (b) above;
- (d) amounts paid for certain lodging while away from home primarily for and essential to medical care, if such medical care is provided by a physician in a licensed hospital and is no significant element of personal pleasure, recreation or vacation in the travel away from home. The amount is limited to \$50 per night per individual.

The term medical care does not include cosmetic surgery.

Dependent includes any of the following individuals who receive over half of their support for the calendar year from the taxpayer:

- (a) son or daughter, or a descendent of either;
- (b) stepson or stepdaughter;
- (c) brother, sister, stepbrother or stepsister;
- (d) father or mother or ancestor of either;
- (e) stepfather or stepmother;
- (f) son or daughter of a brother or sister;
- (g) brother or sister of the father or mother;
- (h) son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law; or
- (i) an individual (other than an individual who at any time during the year was the taxpayer's spouse) who, for the taxable year of the taxpayer, HSA as his/her principal place of residence, the home of the taxpayer and is a member of the taxpayer's household.

The terms brothers and sisters include half blood relatives. A child shall include a legally adopted child, a child who is placed in the taxpayer's home by an authorized placement agency for legal adoption, a foster child. A dependent does not include an individual who is not a citizen of the U.S. or of a country contiguous to the U.S. This does not include a child who is legally adopted by a U.S. taxpayer.

CONTRIBUTIONS

Contributions and Deductions

Contributions may be made by any combination of employer and individual. Employer contributions are excludable from income and individual contributions are deductible "above the line." That is, a taxpayer does not have to itemize deductions in order to take the contributions as a deduction. Employers may offer HSAs as part of a section 125(d) cafeteria plan.

Deduction Permitted if Contribution Made by Eligible Individual

If an "eligible individual" makes an HSA contribution, a deduction is permitted for the taxable year equal to an amount which is the aggregate amount paid in cash during such taxable year to an HSA. An individual's deduction may not exceed such individual's wages, salary, tips and other compensation derived from the employer. For a self-employed, such deduction may not exceed his/her earned income.

Limitation on Contributions

For calendar year 2008, the maximum monthly contribution for eligible individuals with self-only coverage under an HDHP is 1/12 of the lesser of 100% of the annual **maximum** under the HDHP (minimum of **\$1,100**) but not more than **\$2,900**. For eligible individuals with family coverage under an HDHP, the maximum monthly contribution is 1/12 of the lesser of 100% of the annual **maximum** under the HDHP (minimum of **\$2,200**) but not more than **\$5,800**.

Additional Contributions for Individuals 55 or Older

In addition to the maximum contribution amount, catch-up contributions may be made by or on behalf of individuals age 55 or older and younger than 65. Beginning in **2008**, the additional contribution amount is **\$900** and will increase by \$100 each year until it reaches \$1,000 for year 2009 and thereafter.

Separate Deduction Limits for Married Individuals

Each spouse is eligible for his/her own HSA account, in which case each spouse could contribute up to the maximum deductible amount into his/her own HSA account.

If a married couple is covered under the same high deductible health plan and each spouse makes contributions to a separate HSA account, then the maximum deduction may be divided equally between them or they can agree to divide it in another fashion.

Timing of HSA Contributions

HSA contributions must be made for a calendar year no later than the taxpayer's tax filing due date, not including extensions.

Employer Contributions to HSA

Employer contributions are not included in compensation paid to the employee. Employers deduct the HSA contributions on their tax return and report the amount on the employee's W-2 form. If the employee can choose between contributions by the employer to an HSA or employer contributions into another health plan of the employer, such employee will not be in constructive receipt of the contributions. If the employer chooses to make HSA contributions, then the employer is required to make comparable HSA contributions for all participating employees. A comparable HSA employer contribution is (1) the same dollar amount or (2) the same percentage of the annual limit under the high deductible health plan covering the employees divided into groups of "comparable coverage." Comparable coverage can vary between self-only individuals, family coverage and part time employees. A part time employee means an employee who customarily works less than 30 hours per week.

For example, suppose an employer maintains two high deductible plans, Plan A, with a deductible of \$1,500 for individual coverage and \$3,000 for family coverage, and Plan B, with a deductible of \$2,000 for individual coverage and \$4,000 for family coverage. The employer offers an HSA contribution to full time employees in Plan A of \$500 for individual coverage and \$750 for family coverage. In order to satisfy the comparability rule, the employer would have to offer full time employees covered under Plan B one of the following HSA contributions (1) \$500 for employees with individual coverage and \$750 for employees with family coverage or (2) \$667 for employees with individual coverage and \$1,000 for employees with family coverage. Different contributions (or no contributions) could be made for part time employees covered under either high deductible plan.

Previously, employer contributions under the comparability rules had to be the same amount or percentage of the deductible for all employees with the same category of coverage. Consequently, employers could not contribute higher amounts to lower-paid employees. The new rules provide an exception to the comparability rules allowing employers to contribute more to the HSAs of non-highly compensated individuals. For this purpose, the definition of "highly compensated employee" is based on same definition used for qualified retirement plans.

If employer contributions do not comply with the comparability rule during a period, then the employer is subject to an excise tax equal to 35% of the aggregate amount contributed by the employer to HSAs of the employer for that period.

EXCESS CONTRIBUTIONS

Generally, an excess HSA contribution is any contribution which exceeds the contribution limits, and such excess contribution is subject to a 6% excise tax on the principal amount of the excess each year until the excess is corrected.

Withdrawing Excess by Tax Filing Due Date

This 6% excise tax may be avoided if the excess amount plus the earnings attributable to the excess is distributed by your tax filing deadline including extensions for the year during which the excess contribution was made, and you do not take a deduction for such excess amount. If you decide to correct your excess in this manner, the principal amount of the excess returned is not taxable; however, the earnings attributable to the excess are taxable to you in the year that the distribution occurred.

Withdrawing Excess After Tax Filing Due Date

If you do not correct your excess contribution in the manner prescribed above by the due date for filing your tax return, then you may withdraw the principal amount of the excess (no earnings need be distributed). The 6% excise tax will, however, apply first to the year in which the excess contribution was made and each subsequent year until it is withdrawn.

Under Contribution Method

Another method of correcting an excess contribution is to treat a prior year excess as a regular contribution in a subsequent year.

Basically, all you do is under contribute in the first subsequent year where you have an unused contribution limit until your excess amount is used up. However, once again you will be subject to the 6% excise tax in the first year and each subsequent year that an excess remains.

ROLLOVER HSAS

Rollover Contributions From Another HSA or MSA

A rollover from another HSA/MSA is any amount you receive from one HSA/MSA and roll some or all of it over into another HSA. You are not required to roll over the entire amount received from the first HSA/MSA. However, any amount you do not roll over will be taxed at ordinary income tax rates for Federal Income Tax purposes and may be subject to an additional 15% for MSA and 10% for HSA excise tax if the distribution does not meet one of the exceptions. The following special rules also apply to rollovers between HSAs/MSAs:

- (a) The rollover must be completed no later than the 60th day after the day the distribution was received by you.
- (b) You may have only one HSA/MSA to HSA rollover during a 12 consecutive month period measured from the date you received a distribution of an HSA/MSA which was rolled over to another HSA.
- (c) You are not required to receive a complete distribution from your HSA/MSA in order to make a rollover contribution into another HSA, nor are you required to roll over the entire amount you received from the first HSA/MSA.
- (d) If you inherit an HSA/MSA due to the death of the account holder, you may not roll this HSA/MSA into your own HSA unless you are the spouse of the decedent.

***The new rules allow for a one-time contribution to an HSA of amounts distributed from an Individual Retirement Arrangement (IRA). The contribution must be made in a direct trustee-to-trustee transfer. The IRA transfer will not be included in income or subject to the early withdrawal additional tax. The transfer is limited to the maximum HSA contribution for the year, and the amount contributed is not allowed as a deduction. Generally, only one transfer may be made during the lifetime of an individual. If an individual electing the one-time transfer does not remain an eligible individual for the 12 months following the month of the contribution, the transferred amount is included in income and subject to a 10 percent additional tax.**

DISTRIBUTIONS

Taxation of Distributions

Any amounts distributed from your HSA account for qualified medical expenses are not included in your gross income for the year and are not subject to the 10% excise tax.

Any amounts distributed from an HSA account which are not used to exclusively pay for qualified medical expenses are included in the gross income of the taxpayer.

Also such distribution will be subject to a 10% excise tax.

Exceptions to the 10% excise tax include:

- (a) distributions due to the taxpayer becoming disabled (defined under section 72(m)(7) IRC)
- (b) distributions made to the beneficiary(ies) upon the death of the taxpayer.
- (c) distributions made to a taxpayer after such individual becomes eligible for Medicare. (The age specified in section 1811 of the Social Security Act is currently age 65.)
- (d) distributions from an HSA which are subsequently rolled over to another HSA within 60 days from the day of receipt of the distributions.

Distributions are not required to begin at 70½ like they are with an IRA.

Death Distributions

If the taxpayer designated his/her spouse as the designated beneficiary, the surviving spouse shall be treated as the account holder of the HSA after the taxpayer's death. This means that when the taxpayer dies, if the surviving spouse is the designated beneficiary, then such account is assumed automatically by the surviving spouse.

If a non-spouse beneficiary (other than the estate) is the designated beneficiary, then the HSA ceases to be an HSA on the date of death, and the fair market value of the HSA account on the date of death is treated as taxable to such non-spouse beneficiary for such taxable year.

If the taxpayer's estate is the designated beneficiary, then the fair market value of the assets in the account are includible in the decedent's gross income on the last tax return of the decedent.

Distributions made to a beneficiary shall not be taxable to the extent that the decedent incurred qualified medical expenses prior to death and such amounts are paid by the beneficiary within one year of the date of death. If the designated beneficiary is the estate and the decedent's gross income for the last taxable year is increased by the amount of the distribution, then the estate taxes are reduced by such amount.

Non-Medical Distributions

If you are withdrawing from your HSA account and you are not using it to pay qualified medical expenses, such distribution shall be included in your gross income for the year unless the distribution is received due to death, disability, a qualifying rollover distribution or the timely withdrawal of the principal amount of an excess contribution. Otherwise, non-medial distributions are subject to a 10% excise tax in addition to normal income taxes.

If you or your beneficiary engages in a prohibited transaction (as defined under Section 4975 of the Internal Revenue Code) with your HSA, it will lose its tax exemption and you must include the value of your account in your gross income for that taxable year. If you pledge any portion of your HSA as collateral for a loan, the amount so pledged will be treated as a distribution and will be included in your gross income for that year.

PENALTIES

If you receive a distribution for Non Medical reasons from your HSA, an additional 10% income tax will apply on the taxable amount of the distribution.

If you make an excess contribution to your HSA and it is not corrected on a timely basis, an excise tax of 6% is imposed on the excess amount. This tax will apply each year to any part or all of the excess which remains in your account.

You must file IRS Form 5329 with the Internal Revenue Service for any year an additional tax is due.

TRANSFERS

A direct transfer of all or a portion of your funds is permitted from this HSA to another HSA or vice versa. Transfers to not constitute a distribution since you are never in receipt of the funds. The monies are transferred directly to the new trustee or custodian.

If you should transfer all or a portion of your HSA to your former spouse's HSA under a divorce decree (or under a written instrument incident to divorce) or separation instrument, you will not be deemed to have made a taxable distribution but merely a transfer. The portion so transferred will be treated at the time of the transfer as the HSA of your spouse or former spouse.

PROHIBITED TRANSACTIONS