The Pension Digest

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What to Do – A Person Wants to Make a Charitable IRA Distribution in 2012

Right now a distribution cannot qualify as a charitable IRA distribution. IRA accountholders should be informed of this fact. Up until the laws authorizing a charitable IRA distribution expired on 12/31/11, a person age 70½ or older was able to direct his or her IRA custodian to withdraw an amount of up to $100,000 from his or her IRA and have such proceeds sent directly to a qualifying charitable organization. The distribution was tax free if certain rules were met.

What made this so attractive?

The majority of tax filers over age 70½ use the standard deduction when filing their taxes, making them unable to claim a deduction for their charitable contributions. Individuals were allowed to withdraw funds from their IRA and contribute them to the eligible charity of their choice. <u>These contributions were then excluded from their income.</u> This exclusion, in effect, was the equivalent of claiming a tax deduction. Needless to say, this provision was also a great benefit for many charities. Since the maximum contribution/ deduction amount was $100,000, this benefit was substantial. <u>These contributions were also considered part of the taxpayer's required minimum distribution for the year — another benefit.</u>

What's the outlook for 2012?

It is very uncertain that there will be new legislation authorizing charitable IRA distributions for 2012. Tax revenues are needed and this provision reduces revenues. The most conservative approach is for a person to wait until a new tax law is enacted authorizing such distributions again. For those individuals over age 70½ and who are willing to assume the risk of a new law being enacted, they could instruct their IRA custodian to send their distribution amount directly to a qualifying charitable organization. The payee of the check must be the charitable organization. If the law would be enacted on a retroactive basis (i.e. for tax year 2012), then it would qualify as a qualified charitable IRA distribution. These individuals must act on the advice of their tax advisors. ◆

SIMPLE-IRA Summary Description — IRA Custodian Must Furnish by October 2012 for 2013

What are a financial institution's duties if it is the custodian or trustee of SIMPLE IRA funds? After a SIMPLE IRA has been established at an institution, it is the institution's duty to provide a Summary Description each year within a reasonable period of time before the employees' 60-day election period. CWF believes that providing the Summary Description 30 days prior to the election period would be considered "reasonable." The actual IRS wording is that the

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Summary Description must be provided "early enough so that the employer can meet its notice obligation." You will want to furnish the Summary Description to the employer in September or the first week of October. The employer is required to furnish the summary description before the employees' 60-day election period.

IRS Notice 98-4 provides the rules and procedures for SIMPLEs. This notice is reproduced in CWF's 2011 IRA Procedures Manual. If you do not have this resource manual, an order form is enclosed for your convenience.

The Summary Description to be furnished by the SIMPLE IRA custodian/ trustee to the sponsoring employer depends upon what form the employer used to establish the SIMPLE IRA plan.

As you are probably aware, the employer may complete either Form 5305-SIMPLE (where all employees' SIMPLE IRAs are established at the same employer-designated financial institution) or Form 5304-SIMPLE (where the employer allows the employees to establish the SIMPLE IRA at the financial institution of his or her choice).

There will be one Summary Description if the employer has used the 5305-SIMPLE form. There will be another Summary Description if the employer has used the 5304-SIMPLE form. If you are a user of CWF forms, these forms will be Form 918-A and 918-B.

The general rule is that the SIMPLE IRA custodian/trustee is required to furnish the summary description to the employer. This Summary Description will only be partially completed. The employer will be required to complete it and then furnish it to his employees. The employer needs to indicate for the upcoming 2013 year the rate of its matching contribution or that it will be making the non-elective contribution equal to 2% of compensation.

However, in the situation where the employer has completed the Form 5304-SIMPLE, the IRS understands that many times the SIMPLE IRA custodian/trustee will have a minimal relationship with the employer. It may well be that only one employee of the employer establishes a SIMPLE IRA with a financial institution. In this situation, the IRS allows the financial institution to comply with the Summary Description rules by using an alternative method.

To comply with the alternative method, the SIMPLE IRA custodian/trustee is to furnish the individual SIMPLE IRA accountholder the following:

- ✓ A current 5304-SIMPLE — this could be filled out by the employer, or it could be the blank form
- ✓ Instructions for the 5304-SIMPLE
- ✓ Information for completing Article VI (Procedures for withdrawal) (You will need to provide a memo explaining these procedures.)
- ✓ The financial institution's name and address.

Obviously, if an institution provides the employee with a blank form, he/she will need to have the employer complete it, and, the employee may well need to remind the employer that it needs to provide the form to all eligible employees.

CWF has created a form which covers the "alternative" approach of the Summary Description being provided directly to an employee.

The penalty for not furnishing the Summary Description is $50 per day.

Special Rule for a "transfer" SIMPLE IRA

There is also what is termed a "transfer" SIMPLE IRA. If your institution has accepted a transfer SIMPLE IRA, and there have been no current employer contributions, then there is no duty to furnish the Summary Description.

However, if there is the expectation that future contributions will be made to this transfer SIMPLE IRA, then the institution will have the duty to furnish the Summary Description.

Reminder of Additional Reporting Requirements

The custodian/trustee must provide each SIMPLE IRA account holder with a statement by January 31, 2013, showing the account balance as of December 31, 2012, (this is the same as for the traditional IRA), and include the activity in the account during the calendar year (this is not required for a traditional IRA). There is a $50 per day fine for failure to furnish this statement (with a traditional IRA, it would be a flat $50 fee). ◆

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Proper IRS Reporting for IRA Distributions Timely Rolled Over

It still happens, a financial institution as the IRA custodian timely prepared a 2011 Form 1099-R for an IRA accountholder who had taken a distribution from her IRA in 2011 and then she had rolled it over into the same or another IRA. The IRA accountholder and/or her tax preparer believe the 2011 Form 1099-R was prepared in error.

Some taxpayers and some tax preparers mistakenly believe an IRA custodian has made the mistake and not them.

Mistaken rationale #1. Since the IRA accountholder rolled the distribution over at the same institution, that institution should know it does not prepare the Form 1099-R. The rollover means there is no taxation so no Form 1099-R needs to be prepared.

The IRS instructions for the Form 1099-R are clear: all distributions are to be reported on the Form 1099-R except true transfer distributions. In the mid-1980's the IRS had a distribution code informing the IRS that the individual had stated at the time of the distribution that he or she intended to rollover the distribution. The IRS discontinued the use of the rollover code because too many people never followed through with making their rollovers.

Mistaken rationale #2. Since the IRA accountholder rolled the distribution over at the same institution, that institution is not to use reason code "1" in box 7 of the Form 1099-R. The individual or the tax preparer will argue - "your preparation of the Form 1099-R is going to cause me or the individual tax problems; if you would be reasonable such problems do not need to be."

It is not the IRA custodian which caused the problem. The problem is - the individual or the tax preparer don't follow or don't want to follow the procedures the IRS wants used for this situation. An IRA custodian must follow the IRS procedures.

There doesn't need to be any tax problems if the individual's tax return is prepared properly to demonstrate that the distributed IRA funds were properly rolled over. Line 15b on the 1040 tax return needs to be completed to show there is no taxable amount because the individual rolled over the distribution. The IRA custodian which received the rollover contribution will report such contribution in box 2 of Form 5498. It is always a good idea for a tax payer or the tax preparer to attach confirming documentation since 5498 forms are not filed until May 31st of the following tax year.

There will be times when an IRA custodian's personnel will be able to explain that the financial did not make an error without having to furnish a written letter or email. For some claimed error situations, it is best to furnish a letter. On page , there is set forth a written response CWF furnished the IRA custodian to furnish to the tax preparer.

In responding to an individual or the tax preparer, you might suggest the IRS instructions for completing lines 15 a and b of Form 1040 be reviewed along with the 1099-R instructions.

In summary, IRS instructions must be followed by an IRA custodian regardless if an IRA accountholder or tax preparer would prefer not to.

CWF Letter to IRA Custodian on Form 1099-R Corrections.

June 10, 2012

Mr. John Waters
Peoples Savings Bank
Oak Park, AA,

Subject: Request For Change in a Form 1099-R

Dear John:

You have had an accountant or a tax preparer tell an individual that the bank made an error in how it prepared a 2011 Form 1099-R and that the bank must prepare a "corrected" Form 1099-R. If the bank does not does so, it will cause tax difficulties for the individual.

For the reasons discussed below, the bank prepared the 2011 Form 1099-R correctly. The bank as the IRA custodian must prepare IRS reporting forms according to IRS instructions. The bank has done so. In this situation, the bank cannot accommodate the request of the tax preparer that a corrected Form 1099-R needs to be prepared. You may furnish a copy of this letter to the tax preparer and the IRA accountholder.

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As you know, I asked you if the tax preparer had set forth a written explanation of why the bank had made an error. He or she has not done so.

Factual situation. An individual withdrew funds from his or her IRA in 2011. Since the individual was younger than age 59½ at the time of the distribution, the bank as the IRA custodian prepared the 1099-R with a reason code "1" in box 7. This individual did return the money to the IRA within the 60 days; this distribution will NOT be taxable and the 10% penalty tax will not apply as long as the tax return is or was prepared to explain that he or she rolled over the distribution. The instructions for completing lines 15a and b on the Form 1040 should be reviewed by the tax preparer and the individual. I have also attached a copy of the two pages explaining the IRS distribution codes from the instructions for Forms 1099-R and 5498. A long time ago (mid-1980s) the IRS had a code informing the IRS that the individual had stated at the time of the distribution that he or she intended to rollover the distribution. The IRS discontinued the use of the rollover code because too many people never followed through with making their rollovers.

In summary, if line 15b of Form 1040 is completed or has been completed to show that the IRA distribution is not taxable because it was rolled over, the individual should experience no tax difficulties. An amended tax return should be filed to reflect the rollover if the original return did not explain the rollover.

Sincerely,

James Carlson

President/Attorney

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Dec. 31, 2012 is RMD Deadline for 5-Year Rule if Death Occurred in 2006

This article is a reminder to an IRA custodian to make sure that any nonspouse beneficiary using the 5-year RMD rule must close out an inherited IRA by December 31, 2012, if the IRA accountholder died in 2006. If not closed, the beneficiary will owe the 50% tax on the balance as of December 31, 2012.

The IRS acknowledged in 2009 that the 5-year rule needed to be changed on account of the 2009 law waiving when the IRA owner had died during 2004-2008. Since there were no RMDs for 2009, the IRS ruled that 2009 would not be used to determine (i.e. it would be skipped) the end of the 5-year period for determining when the IRA had to be closed. A beneficiary was, in effect, given one more year before the inherited IRA had to be closed. Illustration. Jane Doe died in May of 2006 at the age of 67. Her son, Mark, age 43 in 2006, had elected the 5-year rule as the beneficiary. The balance of Jane's IRA as of 12-31-05 had been $28,600. The balance as of 12-31-11 was $34,900. He has not yet withdrawn any funds. What rules apply to his situation and what options does he have? Had there been no RMD waiver for 2009, his 5-year RMD schedule would have been:

2006	Any withdrawal amount permissible
2007	Any withdrawal amount permissible
2008	Any withdrawal amount permissible
2009	Any withdrawal amount permissible
2010	Any withdrawal amount permissible
2011	Account must be closed by 12-31-11

With the RMD waiver for 2009, his 5-year RMD schedule changes as follows. In essence, he gets an additional year to close out the inherited IRA.

2006	Any withdrawal amount permissible
2007	Any withdrawal amount permissible
2008	Any withdrawal amount permissible
2009	Any withdrawal amount permissible, but the year is not considered for purposes of the 5-year rule;
2010	Any withdrawal amount permissible
2011	Any withdrawal amount permissible
2012	Account must be closed by 12-31-12 ◆

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RMD Comparison Chart (IRS)
(IRAs vs. Defined Contribution Plans)

This chart highlights some of the basic RMD rules as applied to IRAs and defined contribution plans (e.g. 401(k), profit sharing and 403(b) plans.

Required Minimum Distributions for Account Owners		
	IRAs including SEP, SIMPLE and SARSEP IRAs	**Defined Contribution Plans**
When do I take my first RMD (the required beginning date)?	You must take your first RMD by April 1 of the year following the year in which you turn 70½, regardless of whether you are still employed.	April 1 of the year following the later of the year you turn 70 ½ or the year you retire (if allowed by your plan). If you are a 5% owner, you must start RMDs by April 1 of the year following the year you turn 70½.
When do I reach age 70½?	You reach age 70½ on the date that is 6 calendar months after the date of your 70th birthday. **Example**: Your 70th birthday was June 30, 2010. You reached age 70½ on December 30, 2010. You must take your first RMD (for 2010) by April 1, 2011. **Example**: Your 70th birthday was July 1, 2010. You reached age 70½ on January 1, 2011. You do not have an RMD for 2010. You must take your first RMD (for 2011) by April 1, 2012.	Same as IRA rule
What is the deadline for taking subsequent RMDs after the first RMD?	After the first RMD, you must take subsequent RMDs by December 31 of each year beginning with the calendar year containing your required beginning date. **Example**: You turn 70½ on July 15, 2010. You must take your first RMD, for 2010, by April 1, 2011. You must take your second RMD, for 2011, by December 31, 2011, and your third RMD, for 2012, by December 31, 2012.	Same as IRA rule
How do I calculate my RMD?	Your RMD is generally determined by dividing the adjusted market value of your IRAs as of December 31 of the preceding year by the distribution period that corresponds with your age in the Uniform Lifetime Table (Table III in IRS Publication 590, *Individual Retirement Arrangements (IRAs)*). If your spouse is your sole beneficiary and is more than 10 years younger than you, you will use the Joint Life and Last Survivor Expectancy Table (Table II in IRS Publication 590). Required Minimum Distribution Worksheets	Same as IRA rule Your plan sponsor/administrator should calculate the RMD for you.
How should I take my RMDs if I have multiple accounts?	If you have more than one IRA, you must calculate the RMD for each IRA separately each year. However, you may aggregate your RMD amounts for all of your IRAs and withdraw the total from one IRA or a portion from each of your IRAs. You do not have to take a separate RMD from each IRA.	If you have more than one defined contribution plan, you must calculate and satisfy your RMDs separately for each plan and withdraw that amount from that plan. Exception: If you have more than one 403(b) tax-sheltered annuity account, you can total the RMDs and then take them from any one (or more) of the tax-sheltered annuities.
May I withdraw more than the RMD?	Yes, an IRA owner can always withdraw more than the RMD. You cannot apply excess withdrawals toward future years' RMDs.	Same as IRA rule
May I take more than one withdrawal in a year to meet my RMD?	You may withdraw your annual RMD in any number of distributions throughout the year, as long as you withdraw the total annual minimum amount by December 31 (or April 1 if it is for your first RMD).	Same as IRA rule
What happens if I do not take the RMD?	If the distributions to you in any year are less than the RMD for that year, you are subject to an additional tax equal to 50% of the undistributed RMD.	Same as IRA rule

Note: There are no RMD requirements for a Roth IRA while the owner is alive. However, designated Roth accounts are subject to the RMD rules.

Is an RMD Due for 2012?

Alice was born on July 3, 1942. Does she have a required minimum distribution (RMD) for 2012?

No. An IRA accountholder must take an RMD for the year she attains age 70½. Alice attains age 70½ on January 3, 2013. She does not attain age 70½ in 2012. She will be required to take an RMD for 2013. Her deadline will be April 1, 2014, since that is her required beginning date (i.e. the April 1 for the year after one attains age 70½).

If Alice had been born on June 30, 1942 she would have attained age 70½ on December 30, 2012, and there would be an RMD due for 2012. ◆

Is it Still Possible to Establish a SIMPLE-IRA Plan for 2012?

Yes, if the sponsoring business has never sponsored a SIMPLE-IRA Plan before and if the business has not made any contributions for 2012 to another type of retirement plan (e.g. profit sharing plan or SEP).

A person or business can set up a SIMPLE-IRA plan effective on any date between January 1 and October 1 of a year, provided it did not previously maintain a SIMPLE-IRA plan. This requirement does not apply if there is a new employer that comes into existence after October 1 of the year the SIMPLE-IRA plan is set up and you set up a SIMPLE-IRA plan as soon as administratively feasible after you come into existence. If it previously maintained a SIMPLE-IRA Plan, it can set up a SIMPLE-IRA plan effective only on January 1 of a year. A SIMPLE-IRA plan cannot have an effective date that is before the date you actually adopt the plan. ◆

Exceptions for the 10% Tax

CWF has prepared the following chart to make it easier for you to understand the numerous exceptions to the 10% additional tax rule. The general rule is that a recipient of a distribution before age 59½ will owe an additional 10% tax. The law is written to penalize individuals who withdraw funds from an IRA or pension plan and use it for reasons other than retirement. The individual will also include this distribution in his or her gross income and pay tax at the marginal tax rate which applies to him or her. What makes the 10% subject confusing is that in some instances there are rules applying to IRA distributions, but not QP distributions, and vice versa. Some observations.

1. The first-time home buyer exception applies to IRA distributions It does not apply to distributions from 401(k) plans. The 10% tax will be owed if a 401(k) participant takes a distribution from a 401(k) plan to purchase a house.

2. In some situations, a person does NOT want to directly roll over his or her entire 401(k) account. Rather, a person will want to instruct the plan administrator to distribute a certain amount of cash and to directly roll over the remainder. For example, one of your customers, Thomas Juergens, is going through a divorce. His wife has a 401(k) plan and the court order rules he is entitled to $30,000 of her 401(k). He is entitled to a direct rollover to an IRA, if he so chooses. Thomas would like to receive $5,000 in cash to pay off some debts. He would like to roll over the remainder. Thomas has two options. Option #1 is to directly roll over the $30,000 to an IRA and then withdraw the $5,000 from the IRA. Since the withdrawal has come from the IRA, he will owe the 10% additional tax, or $500 ($5,000 x 10%). Option #2 is to instruct the 401(k) plan to pay him $5,000 (less 20% withholding) and to directly roll over the remaining $25,000. Since the distribution is from the 401(k) plan, he will NOT owe the additional 10% tax. Obviously, in this situation, Thomas would want to use Option #2 if he understood the rules. A similar type situation exists when a person is a participant in a pension plan and separates from service after attaining age 55. Any funds withdrawn from the pension plan will escape the 10% tax whereas if the participant directly rolls over all of his or her funds to an IRA and then takes a distribution he or she will owe the 10% additional tax.

3. Every distribution to a beneficiary escapes the 10% additional tax. A spouse who has elected to treat a deceased spouse's IRA as his or her own IRA or has rolled over the deceased spouse's QP balance to an IRA is no longer a "beneficiary." Any distribution from his or her IRA will be assessed the 10% additional tax unless "another" exception would apply.

4. There is no exception to the 10% tax just because the distribution is on account of a "hardship." The hardship rules may allow a 401(k) participant to receive a distribution, but the person will owe the additional 10% tax.

5. There is no exception to the 10% tax just because the employer terminates the 401(k) or other pension plan. ◆

Description of Distribution Reason	Does Exception Apply for an IRA Distribution	Does Exception Apply for a Distribution from a QRP
1. Made to IRA accountholder or QRP participant who is age 59½ or older	Yes	Yes
2. Made to a beneficiary or estate on account of the IRA accountholder's or QRP participant's death.	Yes	Yes
3. Made to IRA accountholder or QRP participant on account of disability.	Yes	Yes
4. Due to an IRS levy	Yes	Yes
5. Made for the IRA accountholder or QRP participant's (and dependent's) — not in excess of unreimbursed medical expenses that are more than 7.5% of the person's AGI.	Yes	Yes
6. Made as part of a series of substantially equal period payments over your life or life expectancy. ** If from a QRP, the participant must separate from service before the payouts begin*	Yes	Yes*
7. Roth Conversion	Yes	Yes
8. Certain military reservist distributions. **Applies only to elective deferrals.*	Yes	Yes*
9. Certain disaster area distributions	Yes	Yes
10. Distributions made to the participant after separated from service, if the separation occurred in or after the year he or she reached age 55. **However age 50 applies to qualified public safety employees in governmental plans.*	No	Yes*
11. Distributions made to an alternate payee under a qualified domestic relations order.	No	Yes
12. Distributions of dividends from employee stock ownership plans.	No	Yes
13. Qualified higher education expenses.	Yes	No
14. Distributions made to pay for a first-time home purchase.	Yes	No
15. Distributions made to pay health insurance premiums if you are unemployed.	Yes	No
16. Qualified HSA Funding Distribution	Yes	No

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Common HSA Misunderstandings

HSAs are certainly growing in popularity, slowly but surely. This article discusses a number of common HSA misperceptions by some HSA owners and some HSA custodians.

Misunderstanding #1. The person who has his or her name on the family HDHP insurance policy has more HSA rights than his or her spouse.

As explained below, with respect to establishing and contributing to an HSA, the rights of both spouses are identical.

Jane and John Doe have just walked into your financial institution and told you the following. In December of 2011 Jane Doe purchased a HDHP with family coverage from First Health Insurance Company. This plan covered her and her husband, John Doe. Both are in their late 30's. An HSA was established with Jane Doe as the HSA owner. John did not establish an HSA for himself.

The couple terminated their HDHP with First Health Insurance Company as of June 30th. John purchased from Second Health Insurance Company on June 20, 2012 a family HDHP effective as of July 1, 2012. The couple now wants to set up an HSA for John and transfer Jane's HSA funds in John's new HSA. Jane would no longer have an HSA. The transfer cannot be done. Under current law, there is no authority to transfer or rollover funds from one spouse's HSA to the other spouse's HSA.

Such a transfer would result in a reportable distribution subject to being included in their joint income and subject to the 20% additional tax.

John and Jane may believe that since the HDHP has been written in his name as the primary insured that he must maintain an HSA. He does not. In order to be HSA eligible, a person must be covered by a HDHP and must meet the other three standard requirements (not covered by a low deductible, not be enrolled in Medicare and not be a dependent).

In both insurance situations both spouses were and are eligible to make HSA contributions into their respective HSAs, subject to the contribution rules applying to married individuals.

There may come a time when the HSA laws will be changed to allow a married couple to maintain a "joint" HSA, but presently the law does not. Presumably, the law would be written to allows spouses to combine their individual HSAs into a joint or family HSA. Again, present law requires one owner HSAs and not joint owner HSAs.

Misunderstanding #2. A person's need to recontribute a reimbursement payment from the HDHP.

As discussed in a number of prior newsletters, an individual will be better-off the sooner he or she understands that an HSA is primarily meant to be a reimbursement account and not a direct payment account.

Example. Jane Doe has an HSA with a balance of $3,000 as of January 1, 1012. She is covered by a HDHP; the plan an annual deductible of $1,500. Jane Doe incurs a number of medical expenses in July of 2012. She has total hip replacement surgery in early July with a total expense of $25,000. Later in the month she also pays $300 for a new walker and $900 for physical therapy. The sellers want to be paid immediately; they don't want to wait to have the HDHP pay these expenses.

In order to pay the $1500 of medical expense not covered by the HDHP because of the deductible she withdraws $1,500 from her HSA. She also withdraws $1,200 to pay for the walker and the physical therapy.

The HDHP has now sent her two reimbursement checks, one for $300 and one for $900. We will assume there are no co-payments.

Jane truly believes as many people do that she has the duty under the law to re-contribute the $300 and the $900 into her HSA.

Often the HSA custodian will need to provide a discussion to Jane of the tax laws applying to her situation. Tax laws are not always logical. Tax laws many times are more complicated that they should be.

The current HSA laws applying to Jane's situation.

HSA law #1. All distributions will be included in her federal income unless she can demonstrate that they were used to pay qualified medical expenses. No problem, she withdrew $2700 from her HSA and paid $2700 of qualifying medical expenses.

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HSA Misunderstandings,
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HSA law #2. The tax laws define a maximum amount a person is eligible to contribute to an HSA. This limit depends on whether she has single ($3100/$4100) or family ($6250/$7250) HDHP coverage and whether she is older or younger than age 55. All of her contributions must count against the applicable limit except for qualifying rollover contributions, mistaken distributions and true HSA transfers.

Therefore, when she recontributes the $1200 it will count against her contribution limit. If she contributes too much, she will have an excess contribution situation. It would need to be corrected by withdrawing the excess amount.

A person is allowed to make one rollover contribution every 12 months. If she had not made a previous rollover, she could roll over either the $900 or the $300, but not both. A person may redeposit a mistaken distribution. At this point the IRS has a limited definition of what is a mistaken distribution. Under current IRS guidance a mistaken distribution is one which the HSA owner had a reasonable belief that the HDHP would not reimburse the incurred expense. Some insurance companies seem to believe that individuals are allowed to treat any reimbursement situation as a mistaken distribution situation. We disagree and most HSA custodians disagree. In summary, a person should only take a distribution from her HSA if she knows the HDHP will not pay for the expense. Other cash sources need to be used or the seller of the walker or the physical therapy provider needs to submit the expenses to the HDHP as soon as possible.

Misunderstanding #3. The HSA custodian cannot limit HSA investments to saving or time deposits, but must offer a checking account or debit card. The HSA custodian may impose reasonable restrictions on distributions (e.g. once per month) and may limit the investments to saving or time deposits or trust investments.

Misunderstanding #4. The HSA custodian must answer all of the HSA owner and the accountant's HSA questions. A financial institution acting as an HSA custodian has certain limited duties to perform. The HSA owner and accountant are primarily responsible to comply with the HSA tax rules. There will be times when they will need perform research or ask the IRS for guidance.

Misunderstanding #5. Qualified HSA funding distributions are not being made by IRA owners because they won't be benefitted.

Not so. Many IRA owners don't have the foggiest idea of what a qualified HSA funding distribution is and whether or not they would benefit by doing this special type of nontaxable transfer/rollover.

HSAs are authorized by federal income tax laws. The laws are complex. The IRS provided substantial HSA guidance from 2004-2008. Only limited guidance has been furnished from 2008-2012. Additional guidance by the IRS would certainly be welcomed. ◆

HSA Distributions and Federal Income Tax Withholding

There is no federal income law requiring an HSA custodian to withhold federal income tax with respect to an individual's HSA withdrawals.

There is no box or section on the Form 1099-SA where the HSA custodian indicates how much federal income tax was withheld.

An HSA custodian never wants to withhold federal income tax on a voluntary basis from an HSA distribution. It will only unnecessarily complicate things.

Form 945 (Annual Return of Withheld Federal Income Tax) is the reconciliation form for distributions from IRAs, pensions, annuities and gambling winnings, etc. It is used to report withholding reported on Forms 1099 and W-2G. It is not to be used to report withholding from HSAs.

As a customer service, the HSA custodian may wish to advise the HSA owner that he or she may be required under the federal income tax laws mandating estimated payments to make estimated tax payments if HSA withdrawals have been used for nonmedical reasons. In general, an individual who takes a distribution which is not used to pay a qualified medical expense must include the distribution in his or her income (at his or her marginal income tax rate) and also pay a 20% penalty tax. And if he or she does not make the required estimated payments, the individual may be assessed additional penalty taxes plus interest. CWF will be adding this discussion to its HSA distribution forms. ◆