The Pension Digest

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ALSO IN THIS ISSUE –

Collin W. Fritz and Associates, Inc., *"The Pension Specialists"*

IRS Clarifies HSA Reporting Procedures for Death Situations

The IRS issued Form 5305-C (Health Savings Custodial Account in August of 2004). Article VII reads as follows:

Article VII

If the account owner dies before the entire interest in the account is distributed, the entire account will be disposed of as follows:

1. If the beneficiary is the account owner's spouse, the HSA will become the spouse's HSA as of the date of death.
2. If the beneficiary is not the account owner's spouse, the HSA will cease to be an HSA as of the date of death. If the beneficiary is the account owner's estate, the fair market value of the account as of the date of death is taxable on the account owner's final return. For other beneficiaries, the fair market value of the account is taxable to that person in the tax year that includes such date.

The above language is unclear. It could be read to provide for two possible results.

The first alternative was that an HSA is only created for the surviving spouse if he or she was the "sole beneficiary." If the surviving spouse was not the sole beneficiary, then he or she would be treated as a nonspouse beneficiary. This would mean the surviving spouse would have to include his or her share in income.

Example: John, an HSA account owner, names his wife and two children as primary beneficiaries of his HSA. The spouse is to receive 50% of the HSA, with each child receiving 25%. The balance in the account on the date of John's death is $5,000. Under this alternative, upon the death of the HSA

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Will Some IRA Vendors Ever Get It Right?

We understand that it is still fairly common for IRA software to treat, as two transactions, the withdrawal of funds from a traditional IRA, where the IRA accountholder has instructed to withhold federal and/or state income taxes. First, a Form 1099-R is prepared to report the net amount paid to the individual. Then a second Form 1099-R is prepared to report the amounts withheld for state and federal income taxes. Apparently some IRA software vendors are unaware that it is never correct to prepare two Forms 1099-R with respect to an IRA distribution involving withholding. To do so places the financial institution at risk for being fined by the IRS for preparing the Form 1099-R incorrectly. The financial institution can also expect that many of its IRA accountholders will be unhappy with the incorrect preparation of their Forms 1099-R.

Here is a real-life example. ABC, Inc. is the mythical software vendor. For illustration purposes, we have used a fictitious name and changed the amounts; however, the manner in which the 1099-Rs were prepared is exactly how the one vendor's software prepared them.

Jessica King withdrew $40,000 from her traditional IRA during 2006. She was 48 years old at the time of the distribution. She is ineligible for any of the exceptions to the 10% tax imposed on a premature withdrawal from an IRA. She had instructed that she wanted $8,000

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withheld for federal income tax purposes, and $2,000 for state income tax purposes. She was paid the net amount of $30,000. The IRA custodian had sent her two 2006 Forms 1099-R in January of 2007. They had been prepared as follows:

1099-R #1—

Box 1— $30,000 (gross distribution)
Box 2a — $30,000 (taxable amount)
Box 7 — Reason Code 1 (Premature IRA distribution — individual not yet age 59½)

1099-R #2—

Box 1— $10,000 (gross distribution)
Box 2a — $10,000 (taxable amount)
Box 4 — $8,000 (federal withholding)
Box 10 — $2,000 (state withholding)
Box 7 — Reason Code 7 ("normal" IRA distribution)

This individual's accountant had called the IRA custodian to complain that the two 1099-R forms were incorrect, and she wanted them corrected as soon as possible. The second Form 1099-R is wrong, because it has a "7" as the reason code in box 7. This is informing Jessica and the IRS that the 10% tax is not owed with respect to the $10,000. The accountant believes there should only be one Form 1099-R issued, rather than two.

CWF agrees with the accountant that the two (2) Forms 1099-R were prepared incorrectly, and that corrections were necessary.

Why the errors?

The withholding requirement has been difficult for some computer programmers. They choose to write their programs to reflect two separate transactions: (1) the net amount paid to the recipient, and (2) the net amount withheld. There does need to be a method of identifying the withheld amounts so that the proper amounts will be remitted to the IRS and the state department of revenue, if applicable. The better approach was adopted by those programmers who concluded that there was just one "integrated" transaction, with only one 1099-R being prepared.

In the above transaction, Jessica has withdrawn $40,000. She will include the $40,000 in her income, and calculate her tax at whatever marginal tax rate applies to her. She will owe the additional 10% tax on the $40,000. However, in order to comply with the withholding/estimated tax laws, she has elected to have withholding to cover some or all of her tax liability with respect to this withdrawal

What does the IRS require?

The IRS instructions as to how many 1099-Rs must or may be prepared is found on page R-2 of the "Instructions for Forms 1099-R and 5498." As with many things written by the IRS, the instructions are not written as clearly as they could or should be written. The instructions state: "An IRA includes all investments under one IRA plan or account. File only one Form 1099-R for distributions from all investments under one plan that are paid in 1 year to one recipient, unless you must enter different codes in box 7. You do not have to file a separate Form 1099-R for each distribution under the plan."

Until one reads the last sentence, it is very clear that only one Form 1099-R should be prepared for multiple distributions with the same distribution code. That is, the IRS reporting rules do not permit the preparation of two 1099-R forms, if they will both show the same reason code in box 7.

The last sentence is somewhat confusing. One could argue that the last sentence infers that you may file separate 1099-R forms. However, the IRS most likely will take the position that the last sentence is just reinforcing the statement that multiple distributions with the same reason code are reported on just one Form 1099-R, and not on multiple forms.

The only time multiple 1099-R forms are to be prepared is when there have been multiple distributions and different reason codes apply. There must be a Form 1099-R prepared for each applicable reason code.

What corrections need to be made?

There needs to be one "correct" 2006 Form 1099-R. It needs to be prepared in the following manner:

Check the "corrected" box at the top of the form.
Box 1— $40,000 (the correct gross distribution)
Box 2a — $40,000 (the correct taxable amount)
Box 4 — $8,000 (federal withholding)
Box 10 — $2,000 (state withholding)
Box 7 — Reason Code 1 (the entire $40,000 was a premature IRA distribution)

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A "corrected" Form 1099-R also needs to be prepared to zero-out the second Form 1099-R as follows:

Check the "corrected" box at the top of the form.
Box 1— $0.00
Box 2a — $0.00
Box 4 — $0.00
Box 10 — $0.00
Box 7 — Reason code 7 (leave this as it was filed on the original return)

For their own reasons, many IRA software vendors have chosen the two-transaction approach. Presumably, they know that using a code "7" to report the withholding distribution is wrong when the recipient is younger than age 59½. However, they have used this approach for many years. 2006 is certainly not the first year they have adopted the approach of reporting the withholding on a separate Form 1099-R.

As with everything, IRA reporting has become more complex. Even so, we would suggest that those of you who use IRA software resulting in the preparation of two (2) Form 1099-Rs should contact the software vendor and ask that they correct their reporting when there is withholding. The IRS could certainly impose the graduated $50 per incorrect forms fine on the financial institution. ◆

IRS Re-Releases the 2007 Form 5498-SA

Due to the signing of the Tax Relief and Health Care Act of 2006 in December of 2006, the already-released 2007 HSA reporting forms and instructions had to be revised. Form 5498-SA, HSA, Archer MSA, or Medicare Advantage MSA Information, has been re-released. The related instructions have not yet been released

From the "Instructions for Participant" found on the back of the recipient's copy, we do get some new information. Box 2, Total contributions made in 2007, will include the trustee-to-trustee transfers from IRAs. As we suspected, the eligible distributions from an IRA that are transferred to an HSA will be reported in Box 2, the same as any other HSA contribution. (We still have no word on how it is to be reported by the IRA custodian/trustee on the Form 1099-R.)

In addition, eligible trustee-to-trustee transfers from a medical Flexible Spending Account (FSA) or a Health Reimbursement Account (HRA) to an HSA are reported in Box 4 of the 5498-SA, Rollover contributions. So even though it is administered as a trustee-to-trustee transfer, it is reported like a direct rollover into the HSA.

Revised instructions for both IRAs and HSAs are being made available on a piece-meal basis. CWF will continue keep you informed of all changes. ◆

☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city, state, and ZIP code		1 Employee or self-employed person's Archer MSA contributions made in 2007 and 2008 for 2007 $ 2 Total contributions made in 2007 $	OMB No. 1545-1518 **2007** Form **5498-SA**	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S federal identification number	PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2008 for 2007 $		**Copy C For Trustee** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		4 Rollover contributions $	5 Fair market value of HSA, Archer MSA, or MA MSA $	
Street address (including apt. no.) City, state, and ZIP code		6 HSA ☐ Archer MSA ☐ MA MSA ☐		
Account number (see instructions)				

Form **5498-SA** Department of the Treasury - Internal Revenue Service

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Instructions for Participant

What's new. See boxes 2 and 4 for qualified HSA funding distributions added by the Tax Relief and Health Care Act of 2006. Box 2 includes trustee-to-trustee transfers from an IRA to an HSA. Box 4 includes direct transfers from an HRA or an FSA to an HSA.

This information is submitted to the Internal Revenue Service by the trustee of your health savings account (HSA), Archer MSA, or Medicare Advantage MSA (MA MSA).

Generally, contributions you make to your HSA or Archer MSA are deductible. However, employer contributions to your HSA are not deductible. If your employer makes a contribution to one of your Archer MSAs, you cannot contribute to any Archer MSA for that year. If you made a contribution to your Archer MSA when your employer has contributed, you cannot deduct your contribution, and you will have an excess contribution. If your spouse's employer makes a contribution to your spouse's Archer MSA, you cannot make a contribution to your Archer MSA if your spouse is covered under a high deductible health plan that also covers you.

Contributions that the Social Security Administration makes to your MA MSA are not includible in your gross income nor are they deductible. Neither you nor your employer can make contributions to your MA MSA.

See Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, and its instructions or Form 8889, Health Savings Accounts (HSAs) and its instructions. Any employer contributions made to an Archer MSA are shown on your Form W-2 in box 12 (code R); employer contributions made to HSAs are shown in box 12 (code W).

For more information, see Pub. 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Account number. May show an account or other unique number the trustee assigned to distinguish your account.

Box 1. Shows employee or self-employed person's Archer MSA contributions made to your Archer MSA in 2007 and through April 15, 2008, for 2007. You may be able to deduct this amount on your 2007 Form 1040. See the Form 1040 instructions.

Note. The information in boxes 2 and 3 is provided by the trustee for IRS use only.

Box 2. Shows the total employer and employee/self-employed contributions made in 2007 to your HSA or Archer MSA. This includes qualified distributions (trustee-to-trustee transfers) from an IRA to fund an HSA. The trustee of your MA MSA is not required to, but may, show contributions to your MA MSA.

Box 3. Shows the total HSA or Archer MSA contributions made in 2008 for 2007.

Box 4. Shows any rollover contribution you made to this Archer MSA in 2007 after a distribution from another Archer MSA or shows any rollover to this HSA from another HSA or Archer MSA. Also included are qualified HSA funding distributions (direct transfers of employer contributions) from a health flexible spending arrangement (FSA) or health reimbursement arrangement (HRA) to fund an HSA. See Form 8853 or Form 8889 and their instructions for information about how to report distributions and rollovers. This amount is not included in box 1, 2, or 3.

Box 5. Shows the fair market value of your HSA, Archer MSA, or MA MSA at the end of 2007.

Box 6. Shows the type of account that is reported on this Form 5498-SA.

Other information. The trustee of your HSA, Archer MSA, or MA MSA may provide other information about your account on this form.

Note. Do not attach Form 5498-SA to your income tax return. Instead, keep it for your records.

Documenting Procedures for the Type of IRA an Individual Opens

The period of January through April of each year is the time of year when IRA accountholders (and accountants) come to an IRA custodian/trustee with a story about how their IRA "type" needs to be changed from a traditional IRA to a Roth IRA, or vice versa. In many cases, the IRA custodian/trustee should not make this change. In some cases, it will be possible for the individual and the financial institution to change the type of his or her IRA.

Example. Andrew opened a Roth IRA in January of 2005, for 2004. In March of 2007, he comes into the financial institution and states that the IRA should have been a traditional IRA; he has been taking deductions on his tax return for his contributions. He wants the IRA custodian/trustee to do whatever is necessary so that he has a traditional IRA instead of a Roth IRA. The financial institution serving as the Roth IRA custodian/trustee would need a reason or some legal authority to make the requested change. The allowed period for recharacterizing the contribution is long past. The deadline for recharacterizing a 2004 contribution was October 15, 2005.

The financial institution, in this case, was easily able to prove that Andrew had, indeed, opened a Roth IRA. He had completed and signed a Roth IRA plan agreement, and in the note portion of his check he had written, "Roth IRA, 2004." He had done so because the IRA officer had requested that he do so.

It is likely that some individuals will try to blame the IRA custodian/trustee for this type of mistake. Therefore, the best plan of attack is to be certain this situation never arises, or be certain the financial institution has adequate proof of the type of IRA opened. A financial institution must have excellent procedures in place to document exactly which type of IRA an individual is opening. CWF's primary recommendation is to thoroughly discuss the differences between Roth and traditional IRAs to make certain the individual understands the various rules and tax advantages. Next, be certain to have the individual sign the appropriate plan application, and provide them with the plan agreement booklet. As additional documentation, have the individual write the year for which the contribution was made and the type of IRA in the "note" portion of their check. You could also recommend that after opening the account, the individual discuss the IRA with their tax advisor to make certain they are eligible to open the IRA and to discuss the tax issues. You will want to remind them that there are time limits which must be met if they decide they need to recharacterize the contribution. ◆

IRA Funds Cannot Be Transferred "At Will" to a Spouse

When two persons who are married each have an IRA, it is not possible for one spouse to simply transfer funds from their IRA to the IRA of the other spouse, or for one spouse to withdraw funds from the other's IRA and then roll over the funds into their own IRA. The only situations under which IRA funds may be transferred from one spouse to another are through divorce, or because of the death of one spouse.

CWF had a consulting call where an accountant advised an IRA accountholder to withdraw funds from his wife's IRA and place them in his own IRA, and then withdraw them, as needed, to pay for the wife's long-term care expenses. The tax laws do not authorize this transfer. The first consequence is that the individual now has an excess contribution in his IRA. To correct the problem, the excess contribution, along with the applicable earnings, must be removed from the husband's account. The earnings become taxable income in the year during which the contribution was made.

We are assuming the reason for the transfer was to shelter the funds from taxation. However, because such a transfer between spouses is impermissible, a second consequence of this transaction is that the amount of the distribution will be taxable income to the wife, as it will be deemed a normal IRA distribution by the IRS.

The husband, in this case, did have a Power of Attorney (POA) which would allow him to withdraw funds from the wife's IRA on her behalf. Using a POA to withdraw funds from a spouse's IRA is perfectly permissible. It was the <u>transfer</u> of the funds from the wife's IRA to the husband's IRA that was impermissible. A rollover into his own IRA is also unauthorized.

Summary. A financial institution needs to have procedures in place to identify and flag the above situation. You will want your IRA personnel to be aware that IRA funds cannot be transferred or rolled over from one spouse's IRA to the other spouse's IRA unless there is a death or divorce. ◆

Another Impermissible (Invalid) Spousal Rollover Situation

CWF received another consulting call concerning the following rollover situation. In early 2006, an individual had received a check, made payable to himself, from his employer's 401(k) plan. This individual endorsed the check and gave it to his wife, who endorsed the check and placed the funds in her own IRA account as a rollover.

We understand that most married couples consider their assets to be "joint." However, under the law, only the person from whose account the funds were issued can roll over the funds. Rollovers are "personal." <u>The wife is not permitted to place these funds in her own IRA as a rollover.</u> Only in cases of death or divorce can a spouse's interest in an IRA account be transferred to the other spouse.

Can the funds now be placed in the husband's IRA? No, because the 60-day rollover period is long past. The result of placing the funds in the wife's IRA is that these funds will now be taxable to the husband in the year received (2006).

An additional problem is that the wife now has an excess contribution of the rollover amount in her IRA. This amount, plus the related income, must be withdrawn by 4/17/07 plus extension (10/15/07). If not withdrawn, a 6% excise tax is owed on the excess for every year this excess remains in the account.

Does the financial institution have any responsibility in this situation? The individual could argue that the bank should have known that this was an invalid rollover, and informed them of such. Although this is not required, it would definitely be good customer service to do so.

Summary. A financial institution will always want to be aware of the source of any funds which are being rolled over. Funds distributed to one spouse cannot be rolled over into the IRA of the other spouse. ◆

Marketing Roth IRAs to Individual's Over Age 70½

Financial institutions may be overlooking individuals aged 70½ and older as a group to target for Roth IRA marketing. Such individuals may well be attempting, at this time in their lives, to accumulate wealth to be left to their heirs. Many individuals this age are both still working and collecting Social Security, and have dollars to invest.

As you are aware, after attaining age 70½, an individual is no longer eligible to contribute to a traditional IRA. An excellent way for these individuals to invest is to establish and fund a Roth IRA, where the earnings are allowed to grow tax free. Neither the earnings nor basis in a Roth IRA will be taxed upon distribution, if the distribution is qualified.

For 2006 and 2007, individuals aged 70½ and older are allowed to contribute the lesser of their compensation or $5,000 to a Roth IRA. Financial institutions who are not targeting this age group may be missing a considerable number of long-term Roth IRA deposits.

Example #1: Ed, age 74, and Susan, 67, are married. Susan is still working, and made $28,000 in 2006; Ed is retired, with no reportable compensation. How much can Ed and Susan contribute to their Roth IRAs for 2006? Because they are older than age 50, and had income in excess of $10,000, each can contribute the full amount of $5,000 for 2006 (a total of $10,000). Ed can make a spousal contribution based upon Susan's income. (Susan is eligible for a traditional IRA contribution.)

Example #2: Same scenario as Example #1, except Susan makes $8,000 in 2006. In this case, how much can they contribute to their Roth IRAs? Again, because they are older than age 50, they can contribute the lesser of their compensation or $5,000. Because their compensation is only $8,000, that is the total amount they may contribute to their Roth IRAs. If Susan would contribute the maximum of $5,000 to her Roth IRA, Ed would only be able to contribute the remainder ($3,000) to his Roth IRA. They could split the allowed $8,000 contribution any way they choose, as long as the $5,000 maximum is not exceeded.

However, their Roth contributions cannot exceed their income for the year. If, by mistake, they each contributed $5,000 to their Roth IRA, there would be an excess contribution problem. CWF believes the excess would be deemed to arise in the Roth IRA of the spouse who had the least compensation, which would be Ed's Roth IRA.

Summary. Roth IRAs are a great wealth-planning tool, with the bonus of tax-free distributions when qualified distributions are made. People are living longer, and are always seeking ways to accumulate wealth and yet avoid taxation. Individuals who are no longer eligible to make a traditional IRA contribution are a great group for a financial institution to target for marketing Roth IRAs.

For your information, CWF has brochures and statement stuffers available to explain Roth IRAs to your customers. ◆

Joint Ownership of HSA Is Not Allowed

There seems to be some confusion among financial institutions and their HSA customers concerning whether an HSA must be an individual account or whether it can be a joint account. An HSA must be an individual account. An HSA is owned by the HSA custodian on behalf of the HSA account owner. The HSA plan agreement states: "The account owner named on the application is establishing this health savings account exclusively for the purpose of paying or reimbursing qualified medical expenses of the account owner, his or her spouse, and dependents." Although the IRS may not have written this statement as clearly as they could, it does imply only one individual is the account owner. The account owner may then use HSA funds to pay the expenses of his or her spouse and dependents.

Your customers are certainly familiar with joint ownership of a checking or savings account, where both a husband and wife have the ability to sign checks and/or withdraw funds from the account.

The confusion may arise because HSAs can be set up as a checking or savings account (as well as other

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types of investment accounts). Even though the HSA is the owner's personal account, it is possible to allow a spouse, dependent, or other authorized individual to sign checks and withdraw funds from the HSA. However, a power of attorney will need to be executed in order for someone other than the account owner to have access to the HSA funds. The account cannot be set up with joint ownership. Even though additional individuals have access to the funds under a power of attorney, the governmental reporting of contributions and distributions will solely be in the name of the account owner.

Financial institutions may need to explain this "one HSA owner" concept to their customers. CWF has available a special HSA Power of Attorney form for your customers to authorize someone in addition to themselves to withdraw funds from their HSA. ◆

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account owner, the spouse and the children would be taxed in the year of death on their portion of the HSA, $2,500 to the spouse and $1,250 to each of the children.

The second alternative was that an HSA is created for the surviving spouse to the extent of his or her designated share. The IRS has recently informed us that the second alternative applies to a surviving spouse beneficiary. He or she does not need to be the sole beneficiary. Whatever amount or percent he or she is designated to receive as an HSA beneficiary, that amount or percent becomes the HSA of the surviving spouse.

Under the new interpretation, the spouse's portion of the HSA will be transferred tax free to the spouse's HSA. The spouse could have the assets transferred to an existing HSA or could establish a new one, even if the spouse was never eligible to have an HSA in the first place. There is no change for the children.

CWF Comments: The good news, this really should not change anything in the HSA custodian's/trustee's procedures. It just allows more spouses to have the HSA treated as their own. It now makes it easier for the HSA account owners. Anyone wanting multiple beneficiaries, including his or her spouse, can now name them without the concern that the spouse will be fully taxed in the year of the HSA account owner's death. Multiple HSAs will no longer be needed to achieve this desired result for a spouse beneficiary.

Year of Death Reporting to HSA Non-Spouse Beneficiaries: Previous IRS reporting instructions were vague, at best, for certain reporting situations after the death of the HSA account owner. The IRS is still saying that upon the death of the HSA owner, the HSA ceases to be an HSA for all non-spouse beneficiaries. This is not new. What's new is how to report it. The IRS has informed us of the following:

* Upon death of the HSA account owner, the ownership of the account balance is immediately transferred to the non-spouse beneficiary <u>and the account ceases to be an HSA for all non-spouse beneficiaries. It can no longer be reported as an HSA.</u>

* The FMV on the date of death is to be reported on Form 1099-SA as a distribution to the beneficiary whether or not the beneficiary actually came in and took it. Even if they do not take the balance, it is reported as a deemed distribution in the year of death.

* Any amount remaining in the account is not an HSA, cannot be reported as an HSA, AND all subsequent earnings are to be reported annually on Form 1099-INT/DIV/MISC/etc., like any other non-HSA, non-IRA account!

An example is definitely warranted here.

Example: Jerry, an HSA account owner, has named his spouse and two children as the primary beneficiaries of his HSA that is invested in an interest-bearing account. Again, the spouse is to receive 50%, and each of the children 25%. The balance in the account on the date of Jerry's death, November 1, 2006, is $7,000. None of the beneficiaries come into the HSA custodian until January 15, 2007. The spouse's $3,500 is transferred to the spouse's own HSA as of the date of death. The December 31, 2006, Fair Market Value of $3,600 is reported to the spouse as owner of the HSA. Standard HSA reporting continues for the spouse who is now the owner of the HSA.

Two 2006 Form 1099-SAs are issued, one each for the children, in the children's names and social security numbers, for $1,750 each. These are HSA death dis-

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tributions, IRS code 6. This will be the last HSA reports executed for the non-spouse beneficiaries. Remember, the accounts are no longer HSAs.

By December 31, 2006, the actual remaining balance in the account or accounts for the beneficiaries is $3,600, $1,800 each. The additional $100 since the date of death, $50 for each child, must be reported on the 2006 Form 1099-INT in each child's name and Social Security Number.

On January 15, 2007, each child takes his or her own share of the balance, which is now $1,850 each. This is NOT an HSA distribution. However, the additional earnings since December 31, $50 each, is reported on the 2007 Form 1099-INT at the end of the year. It is as if the children are each taking a withdrawal from his or her personal savings account.

CWF Comments: Believe it or not, this is consistent with the IRC. Upon death of the HSA owner, the HSA clearly is no longer an HSA for non-spouse beneficiaries. The IRS has made it clear to CWF that regardless of any action or non-action on the part of the non-spouse beneficiaries, this is the required procedure. If the non-spouse beneficiaries come to the HSA custodian/trustee in a timely fashion, there isn't much of a problem. The problem occurs in a situation like our example above. The HSA custodian/trustee learns of the death, but the beneficiaries do not come forward until later. The HSA ceases to be an HSA, but what is it? That is an excellent question. It appears the IRS expects it to be an account similar to the investment of the HSA, just not an HSA. If it was an HSA Savings Account, it becomes a Personal Savings Account. It appears to us that this needs to be at least a disclosure statement item, if not part of the HSA plan agreement, so it is clear what type of account it becomes upon the death of the HSA account owner. For instance, would you want the interest-bearing HSA Checking Account becoming a Personal Checking Account? What about those HSA debit and stored-value cards becoming personal accounts? The lines of ownership are clear, yet the paperwork and actual administration could be unclear. Paperwork could be non-existent at the time of death and until the beneficiaries come to the custodian/trustee.

What about an estate beneficiary? The procedure is similar. The HSA ceases to be an HSA on the date of death. The HSA's value as of the date of death is to be included on the decedent's final income tax return. Even so, the IRS representative indicated that the HSA custodian is to prepare the Form 1099-SA for the estate, and not the decedent, for the year the death occurred, using the estate's Taxpayer Identification Number (TIN), NOT the Social Security Number of the deceased. The FMV on the date of death is reported in Box 4 of Form 1099-SA, again in the name and TIN of the estate. The FMV on the date of death is NOT reported to the decedent. If the FMV of the account at the time the estate takes a distribution is higher than it was on the date of death, it appears the amount (difference) could be reported on the year-of-death 1099-SA or on an appropriate 1099 (INT/DIV/MISC/etc.) If the assets are not taken until after the year of death, it appears only a 1099-INT/DIV/MISC/etc. can be used.

CWF Conclusion: It will be curious to see if any of these situations or questions are clarified in writing in the revised reporting instructions for 2007, once they are available. While we recommend following the above new/revised procedures, CWF only has this on written, but unofficial, authority via e-mail. Some issues remain unsettled and probably will be unsettled for a while. We still have unanswered questions for IRAs, and they are over thirty years old. HSAs are only in their fourth year.

Since there are really two sources for HSA reporting information within the IRS/US Treasury, the HSA Division and the Reporting Division, we will be following up with the Reporting Division for further clarification. Be assured, CWF will keep our readers informed as further questions are clarified. ◆