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Q&A

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IMPORTANT NOTE

These Questions & Answers on the federal Tax Aspects of Health Savings Accounts (“the HSA Q&As”) are provided by UMB Bank, n.a. (“UMB” or “Bank”) as a service to persons who are considering opening a Health Savings Account (“HSA”). They have been updated to incorporate changes made by the Tax Relief Act and Health Care Act of 2006, effective for tax years beginning after December 31, 2006. The HSA Q&As are furnished with the understanding that (i) qualifications for opening and maintaining an HSA are complex, (ii) these HSA Q&As are believed to be accurate as of January 23, 2007, (iii) future changes in the law or interpretations of the law may occur that could make the information in these HSA Q&As incorrect or incomplete, and (iv) UMB is under no obligation to update the information in these HSA Q&As. Furthermore, these HSA Q&As are furnished with the understanding that an individual considering whether to open an HSA is doing so only after having first read these HSA Q&As and, to the extent the individual believes necessary, after having consulted with the person’s own accountant or tax advisor. Bank is not responsible for providing tax advice to any individual. These HSA Q&As only describe information relating to the tax treatment of HSAs under the federal Internal Revenue Code (the “Code”), and do not address any other information or laws that may apply to HSAs (including state laws or laws of any other taxing jurisdiction).

GENERAL HSA INFORMATION

What is a Health Savings Account (HSA)?

An HSA is a tax-favored savings account which allows funds to be accumulated tax-free to pay for current and future qualified health care expenses. The Medicare Prescription Drug Improvement and Modernization Act of 2003 made HSAs possible.

What are the federal tax advantages of an HSA?

Contributions to HSAs are tax deductible and withdrawals used for qualified medical expenses are not subject to tax or penalty. In addition, interest earned on HSA funds is tax-free if used to pay for qualified medical expenses. Please seek a tax consultant for state-specific information.

What is a Qualified High Deductible Health Plan?

Generally, a Qualified High Deductible Health Plan satisfies certain requirements with respect to deductibles and out-of-pocket expenses. For single coverage, a Qualified High Deductible Health Plan has an annual deductible of at least \$1,200 (\$2,400 for family) and annual out-of-pocket expenses (deductibles, coinsurance, copayments and other amounts, but not premiums or non-network costs) not exceeding \$5,950 (\$11,900 for family). Plans may provide first-dollar coverage for preventive care.

How do I access my account?

You can access your account online at www.assuranthealth.com through the *My HSA Account* login. Login near the bottom of the page under Current Customers.

CONTRIBUTIONS

Who may contribute to an HSA?

Any person (an eligible individual, an employer, a family member, or any other person) may make contributions to an HSA on behalf of an eligible individual.

How is money contributed to the HSA?

Contributions can be made electronically through the Web site or with a check using the contribution coupons included in the checkbook. If an employer offers an HSA through a cafeteria plan, the employer or administrator can make contributions via a check sent to UMB Bank,

n.a., the account custodian, using the HSA Tools Employer/Employee Contribution Form, form 29163. This form is sent with the Employer HSA Tools welcome letter and available at www.assuranthealth.com through the *My HSA Account* login.

How much may be contributed to an HSA?

The maximum amount that may be contributed to an HSA for any year is a certain amount established by the IRS for each year (depending on whether you have single coverage or family coverage). The amounts established by the IRS for 2010 and 2011 are \$3,050 for individual coverage and \$6,150 for family coverage. The same annual contribution limit applies regardless of the plan deductible and whether the contributions are made by an employee, an employer, or both. If you enroll in a High Deductible Health Plan January 1 through December 1 of the current tax year, you are allowed to make the full deductible HSA contribution for the year. Thus, you are allowed to make contributions for months prior to enrolling in an High Deductible Health Plan.

If you are age 55 or over, you can make additional catch-up contributions to your HSA. As of January 1, 2009, the amount of this additional catch-up contribution is \$1,000.

In what form may contributions be made to an HSA?

Contributions to an HSA must be made in cash. As custodian of your HSA, UMB Bank, n.a. ("UMB") will accept contributions by check or direct deposit. UMB will also accept rollovers or transfers of assets from an Archer MSA, an HSA, an FSA, or an IRA, in accordance with the requirements of the Internal Revenue Code. The custodian will require that those rollover contributions be in the form of cash. All contributions to your HSA will initially be made to an interest bearing HSA Deposit Account at UMB Bank, n.a. Other investments may be available within your custodial account as disclosed by us from time to time.

When can I make my first contribution to the HSA?

Contributions can only be made after your HSA has been established. You should not mail a contribution until you receive your HSA bank account number.

Is the "catch-up" contribution allowed for both the accountholder and spouse?

Yes. Both can make catch-up contributions if they are 55 or older and each has his/her own account even if established solely for the purpose of catch-up.

Is the HSA contribution pro-rated for the first year?

As of January 1, 2007, first-year accounts are not pro-rated. The full annual limit may be deposited the first year regardless of when the account was opened. The accountholder must remain HSA eligible for at least 12 months.

What are the rules regarding contributions made by your employer?

If an employer makes contributions to employees' HSAs, the employer must make available comparable contributions on behalf of all employees with comparable coverage during the same period. Contributions are considered comparable if they are either of the same amount or the same percentage of the deductible under the plan. If employer contributions do not satisfy the comparability rule during a period, then the employer is subject to an excise tax equal to 35 percent of the aggregate amount contributed by the employer to HSAs for that period.

The comparability rule does not apply to contributions made through a cafeteria plan. The provision provides an exception to the comparable contribution requirements which allows employers to make larger HSA contributions for non-highly compensated employees than for highly compensated employees. For example, an employer is permitted to make a \$1,000 contribution to the HSA of each non-highly compensated employee for a year without making contributions to the HSA of each highly compensated employee.

If contributions can be made by anyone on behalf of the account beneficiary, who can legally take the tax deduction?

In computing adjusted gross income, an eligible individual can deduct contributions made on his/her behalf by a family member. Employer contributions to an employee's HSA are excludable from the employee's gross income, but are not deductible by the employee on his/her federal income tax return.

ROLLOVERS AND TRANSFERS

What are the rules regarding rollovers and transfers of HSAs?

You may withdraw any portion or all of the funds from one HSA or Archer MSA and roll them to an HSA account with another custodian or trustee. However, you are required to roll the funds into a new HSA within 60 calendar days of your receipt of the funds. Another rule provides that you are only allowed to make one HSA rollover in a 12-month period. The 12-month period begins on the date you receive

the distribution, not on the date you roll it to another HSA. In addition, you may transfer your Archer MSA or HSA funds directly from one HSA custodian or trustee to another without ever having direct control or custody of the funds. Rollover and transfer contributions are not deductible and do not count against the annual contribution limits discussed earlier in these HSA Q&As.

What are the rules regarding the rollover of FSA or HRA funds into an HSA?

Your employer is permitted to make a one-time, tax-free rollover of unused Healthcare FSA or HRA balances to your HSA under certain conditions:

- Employers offering this option must give all employees covered under the employer's High Deductible Health Plan the opportunity to roll over funds to the HSA.
- The rollover must be the lesser of the amount in the FSA and/or HRA as of September 21, 2006, or the amount in the account at the time of distribution. This means only employees who had the Healthcare FSA or HRA on September 21, 2006, and through the time of distribution may make rollovers to their HSA. This does not apply to FSAs or HRAs established after this date.

Note: September 21, 2006 is the date the legislation was proposed.

- The rollover must occur before January 1, 2012.
- Your employer must send the rollover directly to your custodian (UMB Bank, n.a.).
- You must have coverage under a High Deductible Health Plan for 12 months after the transfer. If you do not, the funds transferred will be treated as taxable income and subject to a 10% excise tax.

Funds rolled over from an FSA or HRA into your HSA are not subject to the maximum annual contribution limits. This means rollovers from the FSA or HRA to the HSA will not reduce the maximum annual contribution to the HSA during the calendar year.

What are the rules regarding the rollover of IRA funds into an HSA?

You are allowed a one-time, tax-free trustee-to-trustee transfer of IRA funds into an HSA if certain conditions are satisfied:

- The transfer of funds from the IRA to HSA must be made in a direct trustee-to-trustee transfer.

- You must be covered by a High Deductible Health Plan and remain eligible for 12 months after your IRA rollover. If you are not eligible for 12 months after the rollover, the funds transferred will be treated as taxable income and subject to a 10% excise tax.
- Only Traditional or Roth IRAs can be rolled over to an HSA.
- The amount of the IRA rollover to the HSA is subject to the maximum annual contribution limits. This means amounts transferred from your IRA, plus your employer contributions, plus your contributions, will all apply against the maximum annual contribution limit. You must ensure that the total of all these does not exceed the maximum annual contribution limits (*see contribution limits on page 3*).

What happens to the HSA balance at the end of the year?

Unspent HSA funds belong to the account holder and roll over each year. There is no “use it or lose it” provision with HSAs. These funds, and any new contributions, can continue to be used for qualified medical expenses.

When will the custodian return excess contributions?

The custodian will return contributions that the custodian believes in good faith would exceed the sum of the maximum annual family coverage deductible plus the catch-up contribution amount as determined by the IRS. Since maximum annual contribution limits may vary depending on your age and whether you have individual or family coverage, you should not rely on Assurant Health to determine whether your contributions exceed the maximum annual contribution. The custodian will also return contributions when you notify Assurant Health that you have made an excess contribution. You may be charged a fee if we return the contribution.

ELIGIBILITY AND ELIGIBLE EXPENSES

Can medical expenses incurred before the HSA was established be paid from the HSA?

For HSAs established for calendar year 2005 and later years, medical expenses may not be paid from an HSA if the expenses were incurred before the HSA was established.

If each spouse has different coverage, which plan is used to determine eligibility?

For participants who are married, if either spouse has family coverage both are treated as having only that family coverage.

Can an otherwise eligible individual who is covered by both a Qualified High Deductible Health Plan and also by insurance or accident coverage for one or more specific diseases or illnesses, such as cancer, diabetes, asthma or congestive heart failure, contribute to an HSA if the insurance provides benefits before the deductible of the Qualified High Deductible Health Plan is satisfied?

Yes. The tax code provides that an eligible individual covered under a Qualified High Deductible Health Plan may also be covered for any benefit provided by permitted insurance. The phrase “permitted insurance” includes insurance for accidents and for a specified disease or illness. Therefore, an eligible individual may be covered by a Qualified High Deductible Health Plan and also by permitted insurance for one or more specific diseases, such as cancer, diabetes, asthma or congestive heart failure, as long as the principal health coverage is provided by a Qualified High Deductible Health Plan.

WITHDRAWALS AND DISBURSEMENTS

What can HSA funds be used for?

Funds should be used to pay for qualified medical expenses. However, if they’re not used for qualified medical expenses incurred by someone under age 65, the amount withdrawn is taxable and subject to a 10% penalty by the IRS. After age 65, there is no penalty for non-qualified withdrawals but amounts are taxable at ordinary income rates. Funds used to pay for the following are tax-free and penalty-free:

- Qualified medical expenses as defined under section 213 of the IRS Code
- COBRA insurance
- Health insurance premiums for those receiving unemployment compensation
- Qualified long-term care insurance and expenses
- Medicare and retiree health insurance premiums, but not Medicare supplement premiums

Are disbursements for all non-qualified expenses subject to penalty – and who determines that?

The accountholder is responsible for determining if withdrawals are for qualified medical expenses. If the IRS questions any withdrawals, it is the sole responsibility of the accountholder to prove those withdrawals were for qualified medical expenses. The only time disbursements for non-qualified expenses are not subject to penalty is at age 65 and older.

If the entire family is not covered under an accountholder's Qualified High Deductible Health Plan, can the accountholder still use his/her HSA funds to pay for qualified expenses incurred by family members not covered by the plan?

Yes. Per the Treasury Department, the accountholder may use HSA funds to pay the qualified expenses of dependents as defined under the federal tax code.

How do I order checks?

Checks can be ordered via the HSA Tools Web site at www.assuranthealth.com by selecting the *My HSA Account* login or by calling the HSA Tools toll-free number at 866.899.6200. The first checkbook is provided at no cost.

How do I get additional debit cards?

Although one debit card (two if a spouse is covered) is sent when the account is first established, additional cards can be ordered via the HSA Tools Web site at www.assuranthealth.com by selecting the *My HSA Account* login or by calling the HSA Tools toll-free number at 866.899.6200. Additional cards requested subsequent to the initial account set up are \$5 each. There is no charge for replacement of a lost or stolen card.

If my qualified health plan begins February 1 but I don't enroll online to establish the financial account until March, when can I begin to take disbursements from my account?

Qualified expenses incurred on or after March 1 are eligible for reimbursement once the financial account has been established.

TAX QUESTIONS

What is the tax treatment of an HSA?

An HSA is generally exempt from tax (like an IRA), unless it has ceased to be a qualified HSA. Earnings on amounts in an HSA are not included in gross income while held in the HSA.

Are HSA accumulations tax-free and tax-deferred?

Yes. HSA accumulations are tax-free if used to pay for qualified medical expenses. Accumulations are tax-deferred if they are held in the account until the age of 65 and then used for purposes other than qualified medical expenses.

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

Contributions made by an eligible individual to an HSA are deductible by the eligible individual in determining adjusted gross income (i.e. above-the-line). The contributions are deductible whether or not the eligible individual itemizes deductions. Qualified medical expenses paid by or reimbursed from HSA withdrawals may not be taken as itemized deductions on the account holder's federal tax return.

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

If your employer makes a contribution to an HSA for you, you are not allowed to deduct that contribution on your income tax return. Your employer, however, will be able to deduct the contribution up to your maximum contribution limit for that year. Although you cannot deduct your employer's HSA contribution, the contribution is not taxable to you or subject to income tax withholding or other employment taxes if it does not exceed your maximum contribution limit for that year.

Under certain circumstances, for tax years beginning after December 31, 2006, employers may make a one-time contribution to their employees' HSAs from an FSA or HRA that is being terminated. Special rules apply. Consult your tax advisor.

What are the income tax consequences after an HSA account holder's death?

Upon death, any remaining HSA balance becomes the property of the beneficiary. If the beneficiary is the surviving spouse, distributions not used for qualified medical expenses are subject to ordinary income tax. If the beneficiary is a person other than a surviving spouse, the HSA ceases to be an HSA as of the date of the account holder's death, and the beneficiary is required to include in gross income the fair market value of the HSA assets as of the date of death. This amount is reduced by any payments from the HSA made for the account holder's qualified medical expenses, if paid within one year after death.

How are disbursements taxed if the accountholder is no longer eligible for an HSA?

If the accountholder is no longer eligible for an HSA (for example, he/she is over age 65 and enrolled in Medicare, or no longer has a High Deductible Health Plan), distributions used to pay for qualified medical expenses are still tax-free. If distributions are used to pay for items other than qualified medical expenses, they are taxed as ordinary income (and subject to the 10% penalty if the accountholder is under the age of 65).

How are disbursements from an HSA taxed?

HSA disbursements used to pay for qualified medical expenses are not taxed. Any disbursements not used to pay for qualified medical expenses are subject to ordinary tax, plus an additional 10% penalty. This penalty does not apply in the case of distributions made after the accountholder's death, disability or attaining age 65.

What happens when HSA contributions exceed the amount that may be deducted or excluded from gross income?

A contribution made by you or your employer to an HSA that exceeds the amount allowed by law, or which is made during any year when you are not eligible to contribute, is called an "excess contribution."

Excess contributions are not deductible by you or your employer and are included in your gross income for each year they remain in your HSA. In addition, excess contributions are subject to a 6% excise tax. However, you may avoid the excise tax if you remove the excess contribution from your HSA, together with any net income attributable to the excess contribution, before the due date for filing your federal income tax return, including extensions, for the year for which the excess contribution was made. In that case, the net income attributable to the excess contribution would be taxable as income for the year in which the distribution is made, but, the removed excess contribution would not be taxable as income to you. Rollover contributions do not count in determining whether an excess contribution has been made.

Clients should be aware that neither Assurant Health nor its agents or affiliates are in the business of offering tax advice. Clients should consult a qualified tax professional for tax advice. Federal and state requirements are subject to change.

This policy has limitations, exclusions, reductions of benefits, and terms under which the policy may be continued in force or discontinued. For costs and complete details of coverage, call us or your insurance agent.



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About Assurant Health

Assurant Health has been in business since 1892 and is the brand name for products underwritten and issued by Time Insurance Company, John Alden Life Insurance Company and Union Security Insurance Company. Together, these three underwriting companies provide health insurance coverage to people nationwide. Each underwriting company is financially responsible for its own insurance products. Primary products include individual medical, small group and short-term health insurance products, as well as non-insurance products and consumer-choice products such as Health Savings Accounts and Health Reimbursement Arrangements. Assurant Health is headquartered in Milwaukee, Wisconsin, with operations offices in Minnesota, Idaho and Florida, as well as sales offices across the country. The Assurant Health Web site is www.assuranthealth.com.

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