

**GOVERNANCE & RISK DEPARTMENT YEAREND PROCESSING GUIDE**

07

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## I. GENERAL FORM CHANGES

### 1098 Mortgage Interest Statement

Box 4 has been changed to "Mortgage Insurance Premiums" to allow the reporting of certain mortgage insurance premiums paid or accrued after December 31, 2006. A new box 5 has been added to replace the "Blank Box" section that was previously box 4 during 2006.

### 1099-B, DIV, INT, MISC, and OID

Beginning January 1, 2007, trustees and middlemen of certain grantor trusts known as widely held fixed investment trusts (WHFITs) are required to report to the IRS and to the trust interest holder (TIHs) all items of gross income on the applicable 1099. The written tax information statement must be furnished to the TIH by March 17, 2008.

### 1099-G, Certain Government Payments

A separate Form 1099-G is required to report distributions from a contributory program treated as unemployment compensation. Use box 1 to report total payments of \$10 or more in unemployment compensation and before any income tax was withheld.

## II. 5498 & IRA PROCESSING

### 1. What's New

**Special catch-up contributions.** Section 831 of the Pension Protection Act of 2006 allows for special catch-up contributions of up to \$3,000 by 401(k) plan participants whose employer that maintained the plan filed for bankruptcy. Report these contributions in the box to the left of box 10 with indicator "BK." Participants who are age 50 or older that make these special contributions can not also make catch-up IRA contributions.

**Qualified charitable distributions.** A qualified charitable distribution is counted for purposes of the required minimum distributions (RMDs) that participant who attain the age of 70 ½ must take.

**Non-spouse designated beneficiaries.** Guidance on reporting for IRAs of nonspouse designated beneficiaries have been added to the Inherited IRAs section of the instructions guide. More specifically, the IRA must be established in a manner that identifies it as an IRA with respect to a deceased individuals and also identifies the deceased individual and the beneficiary, for example, "Tom Smith as beneficiary of John Smith". Thus, the decedent's name must be shown on the beneficiary's Form 5498 and annual statements.

**Qualified reservist distributions.** Any individual who received a "qualified reservist distribution" may make one or more contribution to his/her IRA without regard to the IRA contribution limits, provided that:

- The aggregate amount repaid to the IRA does not exceed the original military distribution; and
- The contribution is made within the 2-year period beginning on the day after the end of the active duty period (or August 17, 2008, if later)

Report any repayment of a qualified distribution in the blank box to the left of box 10 with indicator code "QR".

**Blank box.** If the blank box is used to report more than one type of contribution, a separate Form 5498 will be required for each type of contribution.

### 2. 2007 Form 5498 Box-by-Box Instructions

**Box 1. IRA Contributions (other than amounts in Boxes 2-4 and 8-10):** Report any contributions made to a traditional IRA in 2007 and through April 15, 2008, designated for 2007. Include any excess contributions even if the excess contribution was later removed. Also, include employee contributions to an

IRA under a SEP plan. Do not report excess contributions made in previous years which are being treated as contributions for 2007 by the IRA owner (i.e., do not report carry-forwards).

**Box 2. Rollover Contributions:** Report any rollover contributions made to a traditional IRA, Roth, SEP, or SIMPLE IRA that were received during 2007. This includes direct rollovers from qualified workplace retirements plans. It does not include conversions of traditional IRAs, SEP, or SIMPLE IRAs to Roth IRAs. Reports the rollover of property using the fair market value (FMV) of the property on the date you receive it.

**Box 3. Roth IRA Conversion Amount:** Report amounts converted (or reconverted) from traditional IRAs, SEP or SIMPLE IRAs to ROTH IRAs during 2007. Do not include amounts rolled over from one Roth IRA to another Roth IRA. Report such rollover amounts in Box 2.

**Box 4. Recharacterized Contributions:** Enter any amounts recharacterized plus earnings from one type of IRA to another.

**Box 5. Fair Market Value of Account:** Enter the FMV of the account on December 31.

**Box 6. Life Insurance Cost Included in Box 1:** For endowment contracts only, report the amounts included in Box 1 allocable of the cost of the life insurance.

**Box 7. Checkboxes:** Check the appropriate box.

**IRA.** Check "IRA" if you are filing Form 5498 to report information about a traditional IRA account.

**SEP.** Check "SEP" if you are filing Form 5498 to report information about a SEP IRA. If you do not know whether the account is a SEP IRA, check the "IRA" box.

**SIMPLE.** Check "SIMPLE" if you are filing Form 5498 to report information about a SEP IRA account. Do not check this box for a SIMPLE 401(k) plan.

**Roth IRA.** Check "Roth IRA" if you are filing Form 5498 to report information about a ROTH IRA account.

**Box 8. SEP Contributions:** Enter employer contributions to a SEP IRA (including salary deferrals under a SARSEP) during 2007 including contributions made in 2007 for 2006, but not including contributions made in 2008 for 2007. Do not enter employee contributions to an IRA under a SEP plan. Report any employee contributions to an IRA under a SEP Plan in Box 1. Also include in Box 8, SEP contributions made by a self-employed person to his or her own account.

**Box 9. SIMPLE Contributions:** Report any contributions made to a SIMPLE IRA during 2007. This includes employee salary deferral contributions, employer matching contributions and employer non-elective contributions.

**Box 10. Roth IRA Contributions:** Enter any contributions made to a Roth IRA in 2007 and through April 15, 2008 designated for 2007. Include any excess contributions even if the excess contribution was later removed. Do not report any rollovers or conversions in this box.

**Box 11. Check if RMD for 2008:** Check this box if the IRA owner must take a required minimum distribution (RMD) for 2008. This box must be checked for the year in which the IRA owner reaches age 70 ½ even though the RMD for that year need not be taken until April 1 of the following year. Then check this box for each subsequent year an RMD is required to be made.

### 3. General Rules

#### Fair Market Value after Death

If the IRA owner died, a Form 5498 must be filed with respect to the decedent, reflecting the fair market value of the account, as well as any contributions made by the decedent for the year of death. The IRA Financial Institution can reflect the fair market value as of the date of the death, or as an alternative, the fair market value as of the end of the year (generally zero), because the year-end valuation will be reported on the beneficiary's Form 5498 and annual statement.

### **Paper or Magnetic Media**

Paper forms may be filed with the IRS for filers with less than 250 Forms 5498 for the year. However, when filing 250 or more, the information must be submitted to the IRS on magnetic media. ECC-MTB no longer accepts 3 1/2-inch diskettes for filing of information returns and Tax Year 2007 will be the last year tape cartridges will be accepted. Due to processing deadlines tape cartridges must be received by December 1, 2008.

### **Electronic Reporting**

For filers required to file on magnetic media, you may choose to file electronically instead. Electronic submissions are filed using the Filing Information Returns Electronically System (FIRE System) which operates 24 hours a day, 7 days a week (except from 2p.m. EST, December 20, 2007 thru January 2, 2008, for upgrading). You may access the system via the Internet at <http://fire.irs.gov>.

### **Filing Deadline**

The 2007 filing deadline to the IRS is June 2, 2008; Form 8809, Application for Extension of Time to File Information Returns, is used by the financial institution to request an automatic 30-day extension. The extension request must be filed by the due date of the return. Under certain hardship conditions, you may request an additional 30-day extension by filing another Form 8809. Form 8809 is available as a fill-in form on the FIRE System and is highly recommended in lieu of the paper form.

### **Combined Federal & State Filing**

Through the Combined Federal/State Filing Program, for states that participate, the IRS will automatically forward original and corrected Forms 1099-R and 5498 filed electronically or magnetically to the appropriate state agency for approved filers.

### **Filing Corrected Form 5498**

If a form 5498 is filed with incorrect information, a corrected Form 5498 should be filed with the IRS "as soon as possible." The three-tier penalty structure for correcting Form 1099-R does not apply to Form 5498 corrections. However, the penalty for failure to timely file or correct Form 5498 is \$50 per return with no maximum, unless the failure was due to reasonable cause and "promptly" corrected.

If a Form 5498 that should have been filed was omitted from the original submission, do not submit the form as a correction. File the omitted form as an original submission. A corrected return is only filed to correct information previously submitted to the IRS. Corrected forms must be provided to the IRS on magnetic media if 250 or more corrected Forms 5498 are being submitted.

### **Reporting to the IRA Holder**

The December 31, 2007 fair market value (FMV) must be reported to the IRA holder (i.e., IRA owner or beneficiary) by January 31, 2008, in any format, even if no contributions were made. IRA contributions that are made for 2007 must be reported to the IRA owner on Form 5498 or substitute form, by June 2, 2008. "Annual account statements" are sometimes used as substitute forms.

If the IRA Financial Institution furnished the FMV statement and no contributions, rollovers, recharacterizations, or Roth IRA conversions were made for 2007, no Form 5498 or substitute is required to be sent if the FMV statement contains the legend, "This information is being furnished to the Internal Revenue Service." In addition, the FMV statement must designate which information is being furnished to the IRS.

If contributions, rollovers, recharacterizations or Roth IRA conversions were made in 2007, for 2007 and no contributions are made in 2008, for 2007, the FMV statement may be used as a substitute Form 5498 if:

1. The statement contains the tax year, form number and form name prominently displayed together in one area of the statement. For example, they could be shown in the upper right part of the statement;
2. All applicable money amounts and information (including box numbers) required to be reported are tilted on the substitute in substantially the same manner as the official IRS form;
3. The statement contains a legend designating what information is being furnished to the IRS; and

4. Appropriate instructions to the recipient, similar to those on the back of the recipients' copy of the Form 5498 are provided.

Failure to file Form 5498 (or substitute) to the IRA holder will result in a \$50 penalty for each failure, unless it is shown that the failure was due to reasonable cause.

#### **Reporting for Required Minimum Distribution Information**

Traditional, SEP and SIMPLE IRA Financial Institutions need to identify to the IRS (on Form 5498) for the immediately preceding year (i.e., on 2007 Form 5498 (Box 11) for a 2008 RMD) each IRA owner who is required to take a RMD. Also, the IRA Financial Institution must provide the IRA owner a statement by January 31 of the calendar year of the RMD that either informs the IRA owner that a RMD is required for the year or specifies the RMD amount.

#### **Electronic Delivery of IRA Forms to Recipients**

IRA Financial Institutions are allowed to deliver Forms 1099-R and 5498 to the recipient electronically. Recipients must specifically consent to receiving statements electronically and not have withdrawn the consent before the statement is furnished. The financial organization must also satisfy the format, posting and notification rules described in part M of the 2007 General Instructions for Forms 1099, 1098, 5498 and W-2G.

### **III. 1099-R Processing**

#### **1. What's New**

**Certain qualified distributions.** A TIP has been added on page R-1 of the instructions to indicate that there is no special reporting for qualified charitable distributions, qualified HSA distributions, or payments of qualified health and long-term care insurance premiums for retired public safety officers.

**Non-spouse designated beneficiaries.** The Pension Protection Act of 2006 (PPA) added Code Section 402 (c) (11), which permits non-spouse beneficiaries to directly roll over distributions that are otherwise rollover-eligible from an eligible retirement plan to an individual retirement plan (IRA). This law change, which effects both defined benefit and defined contributions plans, is effective for distributions made after December 31, 2006.

**Section 402(f) notice requirements.** The PPA modified the notice requirements related to distributions from defined contribution and defined benefit plans. Specifically, the PPA permits the Special Tax Notice, the Participant Consent notice, and the Qualified Joint and Survivor Annuity notice to be provided to participants as early as 180 days before the annuity starting date. In addition, the Participant Consent notice, which must describe a participant's right to defer a distribution, now must also include a description of the consequence of failing to defer receipt of a distribution. The PPA changes apply to notices distributed in plan years that begin after December 31, 2006, without regards to the annuity starting date for distributions.

#### **2. 2007 Form 1099-R Box-by-Box Instructions**

**Box 1. Gross Distribution:** Report the total amount of the distribution. The total amount of the distribution includes income taxes, but it does not include a CD penalty. If property other than cash is distributed (e.g., an in-kind distribution of stock) report the fair market value of the property on the date of distribution.

**Box 2a. Taxable Amount:** For traditional IRAs (including SEPs) or SIMPLE IRAs, generally, report the same amount as in Box 1, because the IRA trustee or custodian is not required to compute the taxable amount. However, if this is a corrective distribution plus net income attributable, report only the earnings in this box. If this is a distribution rolled over to an accepting workplace retirement plan using Code G, report "0" in this box. If this is a recharacterization using Code R or Code N, report zero in this box. For distributions from a Roth IRA, generally leave this box blank.

**Box 2b. Taxable Amount not Determined:** Generally, enter "X" in this box for distributions from Traditional, SEP, or SIMPLE IRAs. For Roth IRAs, this box should be marked unless reporting a corrective distribution of a contribution, plus net income attributable, by the applicable deadline.

**Box 2b. Total Distribution:** Enter an "X" in this box for a total distribution (i.e., one or more distributions within one year in which the entire IRA balance is distributed).

**Box 3. Capital Gain (Included in Box 2a):** If any amount is taxable as a capital gain, including any amount from a charitable gift annuity, report it in box 3.

**Box 4. Federal Income Tax Withheld:** Report any federal income tax withheld.

**Box 5. Employee Contributions/Designated Roth Contributions or Insurance Premiums:** Enter the employee's contributions to a profit-sharing or retirement plan, designated Roth account contributions, or insurance premiums that the employee may recover tax free (only after tax contributions).

**Box 6. Net Unrealized Appreciation (NUA) in Employer's Securities:** Use this box if distributions from a qualified plan (except qualified Roth account) include securities of the employer corporation or a subsidiary or parent corporation.

**Box 7. Distribution Code(s):** Enter the appropriate code to show the type of distribution being made, as shown on the back of the form. Check the IRA/SEP/SIMPLE box if the distribution is from a Traditional, SEP or SIMPLE IRA. Reporting distributions from revoked IRAs depends on how the IRA was first established.

**Box 8. Other:** Enter the current actuarial value of an annuity that is part of a lump-sum distribution. Do not include this item in boxes 1 and 2a.

**Box 9.a. Your Percentage of Total Distribution:** If this is a total distribution and it is being made to more than one person, enter the percentage received by the person whose name appears on the Form 1099-R. This box is not applicable for any IRA distributions or a direct rollover.

**Box 9b. Total Employee Contributions:** You are not required to enter the total employee contributions in box 9a., but may be helpful to the recipient.

**Box 10-15. State and Local Information:** Not required to be completed for the IRS.

### 3. General Rules

#### Paper or Magnetic Media

Form 1099-R is prepared by the IRA Financial Institution (e.g., trustee/custodian). If you are filing less than 250 Forms 1099-R for the year, paper forms may be used, although the IRS encourages the use of magnetic media or filing electronically. When filing 250 or more, the IRS does require the information to be filed on magnetic media.

#### Filing Deadline

The information must be reported to the recipient by January 31, 2008 for distributions received in 2007. The filing deadlines to the IRS, for either paper or magnetic media, is February 28, 2008 (March 31, 2008, if filing electronically).

For paper or electronic/magnetic media filing, you may request an automatic extension of 30 days to file by sending Form 8809. No signature or explanation is required for the extension. However, you must file Form 8809 by the due date of the returns in order to get the 30-day extension.

#### Transmittal Form

When filing paper Forms 1099-R to the IRS, the forms must be submitted with a transmittal Form 1096 and Form 4804 if filing on magnetic media. No transmittal form is required if you file information returns electronically.

### **Filing Corrected Forms 1099-R**

If a Form 1099-R is filed with incorrect information, a corrected Form 1099-R should be filed as soon as possible, along with furnishing statements to recipients showing the correction. If there are less than 250 corrections, the corrections may be filed on paper, even though the original may have been filed on magnetic media. However, if submitting 250 or more corrections, magnetic media is required.

### **Combined Information Reporting after Merger & Acquisition**

The IRS allows a successor financial organization, after a merger or acquisition, to combine information reporting. These information returns include Form 5498 used to report IRA contributions, and IRS Form 1099-R, used to report IRA distributions. Under the standard procedures, each financial organization is responsible for reporting the transactions that occurred. Thus, unless the alternative procedure is used, both the predecessor and the successor financial organization must file Forms 1099-R and 5498 for transactions that occurred in the acquisition year.

### **Responsibility for Withholding**

For IRA distributions, the payer (the financial organization acting as trustee, custodian or issuer) must withhold, and is liable, for the taxes required to be withheld under the IRA distribution withholding rules. Withholding is not required if the total annual distribution amount is \$200 or less.

## **4. Penalties**

### **Penalties for Late or Incorrect 1099-R Filing to the IRS**

Form 1099-R is subject to a three-tier penalty structure for corrective reporting. The three-tier penalty structure is intended to encourage timely corrections.

#### **Three-Tier Penalty**

The three-tier structure for a late or incorrect Form 1099-R to the IRS is as follows:

Tier 1. Corrected or late forms filed no later than 30 days after the filing deadline will be subject to a \$15 IRS penalty, per form with a maximum penalty of \$75,000 per year.

Tier 2. Corrected or late forms filed more than 30 days after the filing deadline, but by August 1, will be subject to a \$30 IRS penalty, per form with a maximum of \$150,000 per year.

Tier 3. Corrected or late forms filed after August 1 will be subject to a \$50 IRS penalty, per form with a maximum of \$250,000 per year.

#### **Waiver for Prompt Cause**

No penalty is imposed if the failure is shown to be due to reasonable cause and not willful neglect.

#### **Waiver for Prompt Corrections**

If filers of late or incorrect Forms 1099-R (and Form 5498) promptly correct the return, the penalties will be waived (assuming the error was due to reasonable cause and not willful neglect).

#### **Waiver for Inconsequential Errors**

Also inconsequential error or omission is not considered a failure to file correct information and is thus exempt from penalties. An inconsequential error or omission is any failure that does not hinder the IRS from processing the 1099-R or from correlating the 1099-R information with information on recipient's federal income tax return. Errors and omissions that are never inconsequential are those relating to:

- The appropriate form for the information provided;
- a dollar amount;
- a significant item in a payee's address; and
- whether the statement was furnished in person or by "statement mailing", when required.

#### **Penalties for Failure to Furnish Payee Statements**

Besides penalties for failing to timely or correctly file Form 1099-R to the IRS, penalties also apply when failing to furnish a timely or correct 1099-R to payees. The penalty is \$50 per failure with a maximum penalty of \$100,000 per year. Exceptions exist for inconsequential errors or omissions. An inconsequential

error or omission is any failure that cannot reasonably be expected to hinder or prevent the payee from timely receiving correct information and reporting such information on their federal income tax return. No penalty is imposed if the failure is shown to be due to a reasonable cause and not willful neglect.

**IRA Reporting Penalties Table**

<b>Violation</b>	<b>Penalty</b>
Failure to furnish copy of IRA plan agreement or disclosure statement	\$50 per failure
Failure to furnish amended IRA plan or disclosure statement when required	\$50 per failure
Failure to furnish a correct disclosure statement	\$50 per failure
Failure to timely furnish Form 5498 (or substitute)	\$50 per failure
Failure to furnish a fair market value statement to the recipient	\$50 per failure
Failure to furnish Form 1099-R to recipient	\$50 per day (\$100,000 max per year)
Filing a corrected Form 1099-R to IRS	Corrections filed no later than 30 days after the filing deadline will be subject to a \$15 penalty, per form; after 30 days but by August 1, \$30; and \$50 after August 1.
Failure to timely furnish withholding notice to recipient	\$10 per failure (\$5,000 max per year)

**IV. SIMPLE IRA PROCESSING**

**1. General Rules**

**Eligible Employers**

Employers can set up a SIMPLE IRA plan if they do not maintain another qualified plan and only if it has 100 or fewer employees who receive \$5,000 or more in compensation from the preceding year. Once the SIMPLE plan is established, the employer must continue to meet the 100 employee limit each year.

**Eligible Employees**

After the employer determines that it is an eligible employer, and establishes a SIMPLE IRA Plan, it must then determine which employees are eligible to participate. Employees who receive at least \$5,000 in compensation from their employer during any two previous years (whether or not consecutive years), and are reasonably expected to receive at least \$5,000 in compensation during the current year, are considered "eligible employees" and must be permitted to make pretax deferrals to the SIMPLE and receive employer contributions (i.e., matching or non-elective)

**Contribution Limits**

Contributions are made up of salary reduction contributions and employer contributions.

**Employee contributions-** The amount the employee chooses to have contributed from their salary to the plan cannot be more than \$10,500 for 2007. The employer cannot place a restriction on the contribution amount, except to comply with the \$10,500 limit.

**Catch-up contributions-** The plan can permit participants who are age 50 or over at the end of the calendar year to also make a \$2,500 catch-up contribution.

**Employer Contributions**

In addition to allowing eligible employees to make voluntary salary elective deferrals to the SIMPLE IRA Plan, the employer must make contributions. Employer contributions must be fully vested. The employer must choose either a i) matching or ii) a non-elective contribution formula for each year:

**i) Employer matching contributions-** Match, dollar for dollar, up to 3% of the employee's compensation, for only those employees who elected to defer. Compensation for this purpose includes the employee deferral. No cap on compensation applies to matching contributions under a SIMPLE IRA Plan.

In no more than two of any five-year period, the employer could choose to match, dollar for dollar a percentage lower than 3% of compensation (but not lower than 1%) for employees. The employer must notify the employee within a reasonable time before the 60-day period before the beginning of the year of the lesser contribution amount.

**ii) Non-elective contributions-** Instead of matching contributions, employers can choose to make nonelective contributions of 2% of compensation on behalf of each eligible employee who has at least \$5,000 of compensation for the year. If this option is selected, the employer must make nonelective contributions whether or not the employee chooses to make salary reduction contributions. Only \$220,000 of the employee's compensation can be taken into account to figure the contribution limit.

### **Distributions**

Distributions are subject to IRA rules and includible in income for the year received. Tax-free rollovers can be made from one SIMPLE IRA to another. Early withdrawals are subject to a 10% additional tax. However, the tax is increased to 25% if funds are withdrawn within 2 years of beginning participation.

## **V. RECHARACTERIZATION REPORTING**

For recharacterizations that occur in 2007, financial organizations are instructed to report the contribution that was recharacterized (the contribution to the first IRA) on Form 5498 for the year for which it was designated.

However, the financial organization will report the recharacterization transfer out of the first IRA on a 2007 Form 1099-R, showing the contribution amount, and the attributable earnings, in Box 1, Gross distribution, 0 (zero) in Box 2a, Taxable amount, and in Box 7, Distribution code, either Code R or Code N will be used.

Code R is used only to report the recharacterization of a contribution that was made in or designated for the prior year ("Recharacterized IRA contribution made for 2006"). Code N is used to report the recharacterization of a contribution that was made in, and designated for, the current year ("Recharacterized IRA contribution made for 2007").

Example: If a Traditional IRA contribution that was made in 2006, or 2007 and designated for 2006, is recharacterized to a Roth IRA in 2007, Code R will be used on the 2007 Form 1099-R. However, if a Traditional IRA contribution that was made in 2007 and designated for 2007 is recharacterized to a Roth IRA in 2007, Code N will be used on the 2007 Form 1099-R.

The IRA that receives the recharacterized contribution will still report the recharacterization on Form 5498. However, the 2007 Form 5498 includes a box titled "Recharacterized contributions" (Box 4). All recharacterized contributions received by an IRA in the same year must be totaled and reported on one Form 5498 in Box 4. A single Form 5498 covering all recharacterizations, contributions, and rollovers is permitted.

### **Recharacterization is Irrevocable**

An individual may make an election to recharacterize an IRA contribution by notifying, on or before the Financial Institution of the IRA to which the contribution will be treated as being made.

### **Other Recharacterization Rules**

When recharacterizing contributions, any rollovers and tax-free transfers between the same types of IRA are disregarded. The trustee-to-trustee transfer would be done from the last IRA to which the assets were transferred. Recharacterizing is never treated as a rollover for purposes of the one-rollover-per-year rule.

For IRA owners who have died, executors or anyone charged with the responsibility for filing the decedent's final Federal income tax return may elect to recharacterize an IRA contribution.

If a Roth IRA has multiple primary beneficiaries as of December 31 of the year following the year of death, and separate accounting is being used for each beneficiary's share of the Roth IRA, the designated beneficiary will be determined separately for each beneficiary's share of the Roth IRA.

If separate accounting is not used, the oldest primary is the designated beneficiary whose single life expectancy is used to calculate the death distribution period.

## VI. ROTH IRA PROCESSING

### 1. Contributions

A contribution to a Roth IRA may be made by making regular or spousal contributions of up to \$4,000 (\$5,000 if age 50 or older), by converting a Traditional IRA to a Roth IRA, or by rolling over a Roth IRA to another Roth IRA. For Roth IRA Financial Institutions, Roth IRA contributions will be reported separately from Traditional IRA contributions (i.e., in a separate box on Form 5498 and on a separate Form 5498).

Example: Kim has a Traditional IRA and a Roth IRA with ABC Financial Institution. ABC Financial Institution will report each IRA separately (i.e., two separate Forms 5498) to Kim and to the IRS.

Roth IRA contributions and the fair market value (FMV) of the account are reported to the IRS on Form 5498. Rollover contributions made in 2007 from other Roth IRAs, are reported in Box 2. Amounts converted from a Traditional IRA should be reported in Box 3 (Roth IRA conversion amount).

Recharacterized contributions are reported in Box 4 "Recharacterized contributions."

The fair market value of the account, generally as of December 31, is reported in Box 5. A deceased Roth IRA owner's FMV may be reported as either Zero (0) or the date-of-death value.

Box 7 (check for IRA, SEP, SIMPLE, Roth IRA) if an amount was not entered in Box 1 (IRA Contributions), 3 (Roth conversions), 8 (SEP contributions), 9 (SIMPLE) or 10 (Roth contributions) you must mark the appropriate Box 7. If you entered an amount in Box 1, 3, 8, 9, or 10 you may, but are not required to mark the appropriate box in Box 7.

Regular and spousal Roth contributions (including catch-up contributions) made 2007 including those made in 2008 through April 15, 2008, designated for 2007 are reported in Box 10.

The 2007 Form 5498 is sent to the IRS by June 2, 2008. The financial organization must file on magnetic media if filing 250 or more reports. The December 31, 2007 FMV, must be reported to the IRA holder by January 31, 2008 in any format, even if no contributions were made.

### 2. Distributions

Form 1099-R is used to report distributions from Roth IRAs. The boxes to be completed for a 2007 Roth IRA distribution are as follows:

Box 1- Report the total amount of the Roth IRA distributions. The total amount of the distributions includes income taxes that were withheld, but it does not include a CD penalty.

Box 2a- Generally, leave this box blank. However, if this is a corrective distribution of a contribution plus a net income attributable, report the net income attributable in this box.

Box 2b- "Taxable amount not determined" – This box should be marked unless reporting a corrective distribution of a contributions, plus net income attributions, by the applicable deadline.

Box 7- Enter the appropriate code to show the type of distributions being made, as shown on the back of the form. (See Chart below) Do not check the IRA/SEP/SIMPLE box.

### 3. Distribution Codes

The 2007 Explanations for Codes J, Q, and T shown in the Guide to Distribution Codes for Roth IRA distributions:

Distribution Codes	Explanations	Used with code, if applicable
J- Early Distribution from Roth IRA	Use Code J for a distribution from a Roth IRA when Code Q or code T does not apply. But use Code 2 for an IRS levy and code 5 for a prohibited transaction.	8 or P
Q-Qualified Distributions from a Roth IRA	Use Code Q for a distribution from a Roth IRA if you know that the participant meets the 5-year holding period and:  * The participant has reached age 59 ½, or * The participant died or * The participant is disabled.  Note: if any other code, such as 8 or P applies, use Code J.	None
T-Roth IRA Distributions, exception applies	Use Code T for a distribution from a Roth IRA if you do not know if the 5-year holding period has been met but :  * The participant has reached age 59 ½, or * The participant died or * The participant is disabled.  Note: if any other code, such as 8 or P applies, use Code J.	None

The instructions for code 2 (Early distribution, exception applies) state to use code 2 for a Roth IRA conversion if the participant is under age 59½, for an early distribution from an IRA (Roth IRA) because of an IRS levy, and a distribution that is part of a series of substantially equal periodic payments.

**4. Reporting Revoked Roth IRAs**

Roth IRA revocations should be reported in the same manner as traditional IRA revocations.

**5. Reporting Roth Conversions**

A conversion (or reconversion) of a Traditional, SEP or SIMPLE IRA to a Roth IRA is reported as a Traditional IRA distribution and a Roth IRA conversion contribution even if the conversion is accomplished by means of a trustee-to-trustee transfer.

The entire amount converted from a Traditional, SEP, or SIMPLE IRA is reported on Form 1099-R as a distribution from the Traditional, SEP, or SIMPLE IRA. For the 2007 Form 1099-R:

- In Box 1 and Box 2a, report the total amount distributed.
- In Box 7, use the appropriate distribution code. Use Code 2 if the individual was under age 59 1/2 and you know the funds were converted to a Roth IRA, otherwise use Code 1. Code 7, Normal distribution, will be used if the individual is age 59 1/2 or older on the date of the conversion.

The instructions to the 2007 Form 5498 indicate that an amount that is converted (or reconverted) to a Roth IRA should be reported in Box 3, Roth IRA conversions. It is not reported in Box 2.

## VII. EDUCATIONAL SAVINGS ACCOUNTS (ESA) PROCESSING

### 1. Contributions

An ESA contribution, including an excess ESA contribution, may be removed before the first day of the sixth month of the tax year following the year for which the contribution was made (i.e., May 31) without the additional 10% penalty. Contributions, plus attributable earnings can be withdrawn up to the May 31 deadline. The earnings will be taxable for the year in which the contribution was made. No 6% excess contribution penalty applies if the excess (and any attributable earnings) is removed by the deadline.

The May 31 correction deadline allows some time after the April 15 contribution deadline for the responsible individual to fix an excess contribution and avoid the IRS 6% excess contribution penalty. Excess contributions not timely removed are subject to a 6% excess contribution penalty.

The financial organization is required to send statements (which would alert the responsible individual to the problem) by April 30 of the following year.

#### Excess Contributions

An excess contribution occurs when the total contribution for the year exceeds \$2,000 (\$500 for 2001 and earlier), when a contributor whose MAGI exceeds the applicable limit makes a contribution, or when any amount was contributed for a year prior to 2002 in which a contribution was also made to a qualified tuition program for such beneficiary.

Example: Mike and Kim are married, file jointly, and have MAGI of \$51,000. Kim makes a \$2,000 ESA contribution for her seven-year-old daughter Taylor for this year. However, her husband also makes a \$1,000 contribution for Taylor for this year. An excess contribution of \$1,000 has occurred for the year. The \$1,000 may be timely removed plus attributable earnings. The earnings on the \$1,000 will be taxable for the year in which the contribution was made. Generally, a contribution that is made when the designated beneficiary attains age 18 or afterwards is an excess contribution, unless the beneficiary is a special needs person.

#### Reporting ESA Contributions

Form 5498-ESA, Coverdell ESA Contribution Information, is used for reporting ESA contribution information. The boxes to be completed for 2007 ESA contributions are as follows:

Box 1. Coverdell ESA Contributions - Enter contributions to a Coverdell ESA made in 2007 and through April 15, 2008, designated for 2007. Rollovers should not be included in Box 1 (report rollovers in Box 2).

Box 2. Rollover Contributions - Report any rollover (or transfer) contributions between ESAs, and rollovers from certain U.S. Savings Bonds.

The deadline for filing the 2007 Form 5498-ESA with the IRS is June 2, 2008. If Form 5498-ESA must be filed with the IRS, the instructions state that the ESA Financial Institution must provide a statement to the beneficiary (participant) by April 30, 2008. For more information about the requirement to furnish statements to participants, ESA Financial Institutions should follow the rules in Part M of the General Instructions for Forms 1099, 5498 and W-2G.

### 2. Distribution

Distributions from ESAs that do not exceed "qualified education expenses" are tax-free (i.e., excluded from gross income).

#### Qualified Education Expenses

Qualified education expenses include expenses of an individual regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or part-time basis. Such expenses include post-secondary tuition, fees, books, supplies, and equipment reduced (adjusted) by certain scholarships and educational assistance.

### Changing the Designated Beneficiary

In Article VI of Form 5305-E or 5305-EA (March 2002), the contributor may check a box to either allow or not allow the responsible individual to change the designated beneficiary to another family member. Changing the designated beneficiary (i.e., the person for whom the account was established) is not treated as a distribution, and thus is not taxable, if the new designated beneficiary is a member of the family of the old designated beneficiary.

### Reporting ESA Distributions

For 2007, ESA distributions are reported on Form 1099-Q, Payments from Qualified Education Programs (Under Sections 529 and 530).

An ESA Financial Institution does not have to report the earnings and basis portion of a distribution in box 1 and 2, unless the distribution includes a distribution of earnings on excess contributions. However, the payer/trustee must provide the ESA's fair market value as of December 31, 2007 in the box below 5 and 6.

The boxes to be completed for a 2007 ESA distribution are as follows:

Box 1. Gross Distribution - Enter the gross distribution amount, whether in cash or in-kind, including a refund, a payment upon death or disability, or a withdrawal of excess contributions plus earnings in this box.

Boxes 2. Earnings and 3. Basis - If you are not reporting earnings and basis, leave Boxes 2 and 3 blank (i.e., do not enter zero) unless the gross distribution includes a distribution of earnings on excess contributions. If so, you should file two Forms 1099-Q; one to report the returned contribution plus earnings, and the other to report the distribution of the other part of the account. When calculating the earnings on a returned contribution, use the same formula for calculating net income attributable for returned IRA contributions.

Box 4. Trustee-to-Trustee Transfer - Check this box if the distribution was made directly to another ESA or a qualified tuition program. If you do not have records of whether a gross distribution from an ESA made in 2007 was a trustee-to-trustee transfer, leave Box 4 blank.

Box 5. Checkbox- Check the Coverdell ESA box.

Box 6. Designated Beneficiary Checkbox - Check this box if the recipient is not the designated beneficiary.

Box below Boxes 5 and 6 - If earnings and basis are not reported in Boxes 2 and 3, enter the Fair Market Value of the ESA as of the end of the year (labeled "FMV") in the box below Boxes 5 and 6. In addition, use this space to indicate that the amount in Box 2 includes earnings on excess contributions by entering distribution code 2 or 3 (as applicable). Otherwise, you may, but are not required to, include a distribution code in this space.

For 2007, the distribution codes are: code 1 - Distributions (including transfers); code 2 - Excess contribution plus earnings taxable in 2007; code 3 - Excess contribution plus earnings taxable in 2006; code 4 Disability; code 5 - Death; and code 6 - prohibited transaction. You may abbreviate as needed. For example, for distribution code 1, you may enter "distr. code 1."

The 2007 Form 1099-Q or a substitute form must be provided to the designated beneficiary by January 31, 2008 and to the IRS by February 28, 2008 (unless filing electronically in which case the deadline is March 31, 2008).

### 3. Electronic Delivery of Form 1099-Q and 5498-ESA to Recipients

IRS Forms 1099-Q and 5498-ESA can be delivered to the recipient electronically (e.g., on a website or via e-mail). Recipients must specifically consent to receiving statements electronically. Presumably, for an ESA, the responsible individual would need to consent on behalf of the designated beneficiary. The financial organization must also satisfy the format, posting, and notification rules described in Part M of the General Instructions for forms 1099, 1098, 5498, and W-2G

## VIII. HEALTH SAVINGS ACCOUNTS PROCESSING FOR 2007

Health Savings Accounts (HSAs) under IRS Code section 223 were created by the Medicare Prescription Drug and Modernization Act of 2003 signed into law by President Bush on December 8, 2003, effective January 1, 2004.

The HSA program has two parts:

1. A high deductible health plan (HDHP) to cover large medical expenses; and
2. A tax-sheltered savings account (like an IRA), from which amounts can be withdrawn to pay for or reimburse medical expenses until the deductible (out-of-pocket amount) is met and the insurance plan begins to pay.

### 1. What's New:

In 2007, new HSA legislation was enacted to continue making the HSA more compelling to employers and employees. Highlights of the changes include:

#### Annual Contribution Maximums Increased

The 2007 annual HSA contribution maximum for individual High Deductible Health Plan (HDHP) coverage is \$2,850. The 2007 annual HSA contribution maximum for family HDHP coverage is \$5,650. The HDHP deductible no longer has any bearing on the annual HSA contribution maximum.

#### FSA and HRA Transfers into an HSA

For the next five (5) years an employer can make a one-time transfer of Flexible Spending Account (FSA) and Health Reimbursement Arrangement (HRA) balances into an HSA. The amount of the transfer cannot exceed the balance of the FSA/HRA as of September 21, 2006, and the employer must make this transfer option available to all employees. The employee who elects this transfer must maintain an HSA-eligible HDHP for a period of 12 months after the transfer.

#### HSA Contributions for Mid-Year Enrollees

Anyone enrolling in an HSA-eligible HDHP at any point during the calendar year can now contribute the annual contribution maximum (\$2,650 for individual plans and \$5,650 for family plans) to their HSA. Participants must maintain their HSA-eligible HDHP for a period of 12 months after their initial contribution is made.

#### IRA Transfer into an HSA

An individual can now make a one-time, irrevocable transfer from an Individual Retirement Account (IRA) to an HSA. The transfer does not count against the annual contribution maximum and requires the individual to be in an HSA-eligible HDHP for a period of 12 months after this transfer is complete.

#### Greater Contribution Limits for Lower Paid Employees

Employers can now make greater HSA contributions to those employees that earn less than \$100,000 annually. However, if the employer elects to exercise this right, they must make the same contribution amount to all employees who earn less than \$100,000 annually.

#### FSA Grace Period No Longer Impacts HSA Eligibility

If an individual begins a year with a zero balance in their FSA, or transfers the balance of their FSA to an HSA, the grace period coverage will not have any impact on the individual's ability to make an HSA contribution.

#### High Deductible Health Plan (HDHP)

An individual is eligible to establish and contribute to an HSA if, with respect to any month, the individual is covered under a high deductible health plan (HDHP) on the 1st day of such month. Generally, a plan qualifies as an HDHP if it has:

- a. A minimum deductible for self-only coverage of \$1,050 for 2006 and \$1,100 for 2007 (indexed annually for inflation);

- b. A minimum deductible for family coverage of \$2,100 for 2006 and \$2,200 for 2007 (indexed annually for inflation);
- c. A maximum out-of-pocket limit (including deductibles and co-pays) of \$5,250 for 2006 and \$5,500 for 2007 for self-only coverage and \$10,500 for 2006 and \$11,000 for 2007 for family coverage (indexed annually for inflation);

Except for preventive care, an HDHP may not provide benefits for the year until the deductible is met. Generally, if an individual's insurance pays for part of incurred expenses before he reaches his deductible amount, the plan is not an HDHP.

### **Prescription Drug Plans**

After January 1, 2006, if an HDHP provides prescription drug benefits, prescription drug expenses must be subject to the annual deductible or the individual may not contribute to the HSA.

## **2. General Rules**

### **Preventative Care**

An HDHP can provide preventative care benefits without a deductible or with a deductible below the minimum annual deductible (e.g., preventative care can have first dollar coverage). Preventative care includes:

- Periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations (e.g., annual physicals);
- Routine prenatal and well-child care and child and adult immunizations;
- Smoking cessation and obesity weight-loss programs; and
- Screening for services such as for cancer (e.g., mammograms), heart and cardio vascular diseases, infectious diseases, mental health conditions, and obstetric and gynecological conditions.

### **State Law Requirements**

The underlying required type of high deductible health insurance may not be available in all states because of state law requirements. If a state requires a health plan to provide certain benefits without a deductible or at a deductible that is less than the minimum annual deductible, the plan may not be an HDHP. However, for non-calendar year health plans, a plan that would otherwise qualify except that on its most recent renewal date before January 1, 2006, it complied with state law on effect on January 1, 2004, will be treated as an HDHP. This relief only applies to coverage period of 12 months or less that began before January 1, 2006.

### **Other Limits on Eligibility**

- The individual may not be covered by another health insurance plan (excluding "permitted insurance" or coverage by certain other plans).
- The individual must not be enrolled in Medicare.
- The individual must not have actually received any medical benefits through the Department of Veterans Affairs at any time during the previous three months.
- The individual must not be covered under TRICARE (the health care program for active duty and retired members of the uniformed services, their families, and survivors) because currently TRICARE does not offer an HDHP. If TRICARE later offers an HDHP and someone selects it, they will be eligible for an HSA.
- The individual may not be claimed as a dependent on someone else's tax return.

### **Establishing the HSA**

The HDHP must be in place before the HSA can be established. Generally, any financial organization that offers IRAs is permitted to offer HSAs. The HSA Financial Institution is not required to determine or verify an individual's eligibility to contribute to an HSA.

### **IRS Model HSA Documents**

The IRS issued model agreement s Forms 5305-B, Health Savings Trust Account, and 5305-C, Health Savings Custodial Account, (dated August 2004) which an individual may use to establish an HSA at any financial organization. The appropriate form to use depends on whether the financial organization will be acting as a

trustee or custodian of the HSA. They are written and pre-approved by the IRS. A copy must be given to the HSA owner.

#### **Disclosure Statement**

The HSA rules do not require the use of a disclosure statement.

#### **HSA Investment Options**

The HSA Financial Institution may decide (restrict) what type of investments to offer for the account. HSA funds may be invested in investments approved for IRAs, such as mutual funds, certificates of deposit, annuities, and stocks and bonds. HSA assets may not be invested in life insurance or collectibles such as antiques, precious gems and metals, rugs, stamps or coins, works of art, and alcoholic beverages or other tangible personal property specified in IRS guidance under IRS code §408(m)).

#### **Prohibited Transactions**

Rules similar to the prohibited transaction rules for IRAs apply to HSAs. The prohibited transaction rules are designed to ensure that the assets of a HSA are invested to benefit only the HSA plan itself (i.e., not the HSA holder personally), and to discourage an HSA holder from using the assets of the HSA plan in a self-serving or self-dealing manner. The entire HSA balance is treated as if it were distributed and may be subject to the IRS 10% early distribution penalty if the HSA owner is under age 65. The HSA holder will receive an IRS Form 1099-SA showing distribution reason code 5 (Prohibited transaction) in Box 3, Distribution code.

#### **Pledging the HSA as Security for a Loan is Prohibited**

Pledging the HSA as security for a loan for the HSA holder is prohibited. The consequence of pledging the HSA as security (i.e., collateral) for a loan is that only the fair market value of the assets that were pledged is treated as distributed.

#### **Fees**

The HSA Financial Institution may assess fees. Administration and account maintenance fees that are deducted from the HSA balance are not taxable distributions. Also administration and account maintenance fees deducted from the HSA balance do not increase the maximum annual HSA contribution limit.

Some financial organizations will allow the HSA holder to pay administration and maintenance fees out-of-pocket rather than have them deducted from the HSA balance. Administration and account maintenance fees paid directly by the HSA owner or employer (outside the HSA) are not considered contributions.

#### **HSA Holder Reporting and Recordkeeping**

The account holder is responsible for keeping adequate records to prove that the deductible was met or that the distribution was a qualified expense. IRS Form 8889, Health Savings Accounts (HSAs) is filed by the individual with his federal income tax return to report contributions and distributions and compute the HSA deduction.

### **3. Contribution Rules**

Contributions to the HSA can be made by the HSA owner, the employer, or both or a family member or any other person on behalf of an eligible individual. Contributions of stock or property are not allowed.

#### **Contribution Limits**

The maximum amount for self-only coverage per year is \$2,700 for 2006 and \$2,850 for 2007 (indexed annually for inflation). While the maximum amount for family coverage is \$5,450 for 2006 and \$5,650 for 2007 (indexed annually for inflation).

Beginning in 2007, the deductible contribution is not limited to the annual deductible under the high deductible health plan.

#### **Excess Contributions**

Similar to an IRA, there is a 6% penalty for amounts contributed to an HSA in excess of the allowable contribution limit. The penalty applies each year until the excess is corrected. The penalty does not apply if the excess amount and net income attributable (NIA) are timely withdrawn. Although the statutory deadline

for withdrawal is the HSA owner's tax-filing deadline, including extensions, the IRS has indicated that the applicable deadline for taxpayers who file a timely return is October 15 of the year following the year for which the contribution is made.

### **Catch-up Contributions**

Individuals age 55 and older can make additional "catch-up" contributions of \$700 for 2006 and \$800 for 2007, to their HSA, in addition to the maximum annual contribution. Contributions must stop once the individual is enrolled in any type of Medicare.

### **Married Individuals**

For a married couple, if each spouse has self-only HDHP coverage (i.e., neither spouse has family coverage) then each spouse can contribute to an HSA in their own name, up to the individual coverage amount which is \$2,850 for 2007.

If either spouse has family coverage, then both spouses are treated as having family coverage. If each spouse has family coverage under a separate family HDHP, both are treated as having family coverage under the plan. The contribution limit, after reduction for any Archer MSA contributions, is split equally between both spouses unless they agree on a different division.

If either spouse is age 55 or older and not enrolled in Medicare, each spouse's contribution limit is increased by the catch-up contribution amount.

### **Contribution Deadlines**

Contributions for the previous tax year can be made to a new or existing HSA up to the deadline (not including extensions) for filing the eligible individual's federal income tax return. The deadline for calendar year taxpayers is April 15.

### **Other Contribution Rules**

Although the maximum contribution is determined on a monthly basis, the payment(s) may be made in one or more payments.

An individual may establish and maintain HSAs at more than one financial organization; however, the annual contribution limit applies to all plans in the aggregate.

A married couple can both potentially contribute to an HSA; however, no joint HSA is permitted (each eligible spouse would need to open a separate HSA).

### **Reporting HSA Contributions for 2007**

Form 5498-SA is used to report contributions to HSAs. The boxes to be completed for HSAs are as follows:

**Box 2.** Shows the total employer and employee/self-employed contributions made in 2007 to an HSA. Also include any qualified HSA funding distributions (i.e., trustee-to-trustee transfers from an IRA to an HSA) received during 2007.

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

**Box 4.** Shows any rollover contributions made to the HSA from another HSA or Archer MSA received during 2007. Include qualified HAS distributions (direct transfers of employer contributions from flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs) to an HAS.

**Box 5.** Shows the fair market value of the HSA at the end of 2007.

**Box 6.** The HSA box should be checked.

The 2007 Form 5498-SA, Copy B must be provided to the HSA holder by June 2, 2008. The 2007 Form 1099-SA must be provided to the IRS by June 2, 2008.

#### 4. Rollover rules

A rollover between HSAs (or between an Archer MSA and an HSA) is a tax-free movement of money or other assets. The rollover process begins when the HSA owner requests a distribution from the Financial Institution of his HSA plan. All or any portion of the HSA may be withdrawn, subject to any fees or investment penalties of the financial organization. The distribution is issued in the name of the HSA owner. All distributions from HSAs, including those that are rolled over, must be reported on Form 1099-SA.

The second step in a rollover occurs when the HSA owner redeposits or reinvests some or all of the distribution that was received earlier. The HSA owner generally has 60 days after the day he received the distribution to complete the rollover. Rollovers are reported on IRS Form 5498-SA.

Rollovers may be made from Archer MSAs and other HSAs (once per year and within 60 days after the date of receipt). An exception to the 60-day rollover rule applies for HSA distributions not used to pay for qualified medical expenses, but were the result of a mistake of fact due to reasonable cause.

##### **FSA/HRA Rollovers**

Beginning in 2007, the Tax Relief and Health Act of 2006 added new options for funding HSAs. Section 302 of the Act allows for a one-time direct transfer from flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs) to HSAs as rollover contributions by 2012. The amounts rolled over to HSAs from FSAs or HRAs are over and above the amounts allowed as annual contributions to an HSA. The provision is limited to one distribution with respect to each health FSA or HRA of the individual. If an individual 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% additional tax.

##### **IRA Rollovers**

Also beginning in 2007, eligible individuals can elect to make a one-time direct trustee-to-trustee transfer from their IRA (other than a SIMPLE or SEP IRA) to their HSA. The maximum amount that can be transferred is the maximum HSA contribution limitation for the year. The IRA transfer will not be included in income or subject to early withdrawal tax penalty. However, if an individual electing the one-time transfer does not remain an eligible individual for the 12 months following the month of contribution, the transferred amount is included in income and subject to a 10% additional tax.

##### **Rollovers Reported to the IRS**

The financial organization that distributed the funds will report the HSA distribution on IRS Form 1099-SA. The financial organization that received the rollover contribution will report the rollover on IRS Form 5498-SA, including and transfers from IRAs, FSAs, and HRAs. The HSA owner will report the rollover transaction (including the amount taxable, if any) on the appropriate lines of IRS Form 8889 and line 21 of the IRS Form 1040.

##### **Who Can Rollover an HSA Distribution**

The HSA owner and the surviving spouse beneficiary of a deceased HSA owner can roll over an HSA distribution to another HSA.

##### **Transfers**

HSA-to-HSA transfers occur when HSA funds or assets are moved from one financial organization to another without the HSA owner having control or custody of the funds. Also, Archer MSA funds may be transferred to an HSA. The transfer process usually begins when the HSA owner requests that the current Financial Institution of his HSA transfer the funds (or property) directly to a new Financial Institution. Usually, a transfer request form that is provided by the new HSA Financial Institution is completed and mailed to the current HSA Financial Institution.

Generally, all or any portion of the HSA assets may be transferred, subject to any fees or investment penalties that may apply.

##### **Rollover Rules Do Not Apply to Transfers**

Transfers between HSAs do not have to follow the rollover rules and are, accordingly, less problematic than rollovers. The frequency of transfers is not restricted; that is, the one-rollover-per-year rule does not apply. The ability to complete an unlimited amount of transfers from the same HSA plan within a year is an

advantage transfers have over rollovers. Transfers do not have to be completed within 60 days because a transfer is not a distribution.

#### **Transfers Not Reported to the IRS**

A transfer between HSAs or from an Archer MSA to an HSA is a non-reportable transaction. Unlike rollovers between HSAs, the IRS does not require reporting for incoming or outgoing transfers. A Form 1099-SA should not be prepared by the transferring financial organization and the receiving organization should not report the transfer on IRS Form 5498-SA.

#### **Who Can Transfer HSAs**

HSA-to-HSA transfers can be initiated either by the HSA owner or the surviving spouse beneficiary of a deceased HSA owner. HSA assets can be transferred from the deceased spouse's HSA to the surviving spouse beneficiary's own HSA.

#### **Transfers due to Divorce or Legal Separation**

As part of a divorce or legal separation, all or a portion of an individual's HSA may be awarded to a spouse or former spouse (receiving spouse). Such a transfer to the receiving spouse's HSA is not taxable to either party.

### **5. Distributions Rules**

The accountholder is permitted to receive distributions from an HSA at any time for any purpose. The financial organization or employer cannot restrict HSA distributions to qualified medical expenses. The financial institution is not responsible to verify whether the distribution is for a qualified medical expense.

#### **Method of Distribution**

The method of distribution could be by check, debit card, or check card. The financial organization may place reasonable restrictions on both the frequency and the minimum amount of distributions. For example, the organization could have a policy that prohibits distributions of less than \$50 or only allows 10 distributions per month.

#### **Reimbursing the HSA Owner**

Instead of paying for qualified medical expenses directly from the HSA, the individual could first pay for the expenses with his own (non-HSA) money and then reimburse himself from the HSA.

#### **Timing of the Distribution or Reimbursement**

The HSA owner would likely take an HSA distribution or reimburse himself in the same year that the medical expense was incurred; however, that is not necessary. The HSA owner can defer to a later year distributions from HSAs to pay or reimburse expenses incurred in the current year as long as the expenses were incurred after the HSA was established. Also, an HSA distribution in the current year can be used to pay or reimburse expenses incurred in any prior year as long as the expenses were incurred after the HSA was established.

#### **Treatment of the HSA after Death**

The HSA owner can name a beneficiary to inherit HSA assets after the owner's death. Upon the death of the individual, the funds in the account are payable to the named beneficiary.

#### **Spouse Beneficiary**

If an individual is married, and the spouse is the named beneficiary, the spouse is treated as the owner of the account after the death of the individual. The spouse can continue to access the HSA tax-free. The spouse would pay income tax on any non-medical expense for which a withdrawal is made.

#### **Nonspouse Beneficiary**

If the beneficiary is not the spouse, the account will no longer be treated as an HSA after the individual's death. The fair market value of the account will become taxable to the recipient (including the estate of the decedent) in the year the HSA owner died, but no penalty will apply. The taxable amount to a beneficiary other than the estate will be reduced by any qualified medical expenses incurred by the deceased individual before death and paid by the recipient of the HAS within one year after the date of the death.

Because the HSA ceases to be treated as an HSA when the owner dies with a nonspouse beneficiary, several issues need to be addressed by the financial organization's legal counsel. Presumably, Form 1099-INT or 1099-DIV would need to be filed for any interest or dividend income after the date of the owner's death because the account is no longer tax-deferred. Also, it is unclear what type of account the HSA becomes after death.

#### **Reporting HSA Distributions for 2007**

The HSA Financial Institution is responsible for tracking the owner's age and for reporting the distribution from the HSA to both the HSA holder and the IRS. The financial institution is not responsible for verifying whether the distribution is for a qualified medical expense. Form 1099-SA is used to report distributions from HSAs. The boxes to be completed for an HSA distribution are as follows:

**Box 1. Gross Distribution** - Enter the gross distribution amount received. The amount may have been a direct payment to the medical service provider or distributed to the HSA holder.

**Box 2. Earnings on Excess Contributions** - Shows the earnings on any excess contributions withdrawn by the due date of the individual's tax return.

**Box 3. Distribution Code** - Identifies the distribution type: 1 - Normal distribution; 2 - Excess contributions; 3 - Disability; 4 - Death distribution other than code 6; 5 - Prohibited transaction; 6 - Death distribution after year of death to a nonspouse beneficiary.

**Box 4. FMV on Date of Death** - If account holder died, show FMV of the account on the date of death.

The 2007 Form 1099-SA or a substitute form must be provided to the HSA holder by January 31, 2008. The 2007 Form 1099-SA must be provided to the IRS by February 28, 2008, unless filing electronically in which case the deadline is March 31, 2008.

### **IX. 1220 MEDIA PROGRAMMING CHANGES**

#### **1. General Changes**

- a. ECC-MTB no longer accepts 3 1/2 inch diskettes for filing information returns.
- b. Tax Year 2007 will be the last year ECC-MTB accepts tape cartridges. Due to processing deadlines, tape cartridges must be received by December 1, 2008, in order to be processed for the current year. After December 1, 2008, the only acceptable method of filing information returns with ECC-MTB will be electronically through the FIRE System.
- c. Test procedures have been eliminated from Part A, since tape cartridges will not be acceptable after December 1, 2008. Electronic filing specification, Part B, Sec. 4 details testing procedures for electronic files.
- d. Form 8809, Application for an Extension of Time to File Information Returns, is available as a fill-in form on the FIRE System and is highly encouraged in lieu of paper Form 8809. (See Part E, Sec. 1.)

#### **2. Programming Changes**

##### **A. Programming Changes – Transmitter “T” Record**

- i) For all forms, Payment Year, Field Positions 2-5, must be incremented to update the four-digit report year (2006 to 2007), unless reporting prior year data.

##### **B. Programming Changes- Payer “A” Record**

- i) For all Forms, Payment Year, Field Positions 2-5, must be incremented to update the four-digit reporting year (2006 to 2007), unless reporting prior year data.
- ii) For Form 1098, Amount Code 4 was changed to Mortgage Insurance Premiums. Amount Code 5 was added for Filer's Use.

- iii) Three fields were deleted from Payer 'A' Record and are no longer required. The deleted fields are Original File Indicator, position 48, Replacement File Indicator, position 49, and Correction File Indicator, position 50. Positions 48-50 are now blank.

#### C. Programming Changes- Payee "B" Record

- i) For all Forms, Payment Year, Field Positions 2-5, must be incremented to update the four-digit reporting year (2006 to 2007), unless reporting prior year data.
- ii) Form 1098-T, Method of Reporting Indicator, position 550, was simplified. A single indicator of '1' is used to indicate if the method of reporting changed from the previous year. A blank indicates no change occurred.
- iii) Form 1099-R, Date of Designated Roth Contributions, position 552-559, changed to First Year of Designated Roth Contribution, positions 552-555. Only the year of the first Roth contribution is required not the complete date.
- iv) For Form 1099-R, Distribution Code 'B' may now be used with codes 'P' and '4'.
- v) The state of Utah, state code 49, was added to the Combined Federal/State Filing Program. See Part A, Sec. 12 for the Participating States and Their Codes table.

#### X. FUTURE CONSIDERATIONS

##### IRS Yearend Changes for 2007:

**Charitable IRA Rollover.** The PPA permits taxpayers to make direct distributions from an IRA to qualified charities. Specifically, for 2006 and 2007 only, an individual age 70 1/2 or over may direct such a contribution, up to a limit of \$100,000 per year. While the taxpayer will not be entitled to a charitable income tax deduction for the amount paid directly from the IRA, the charitable distribution will not be considered taxable income to the taxpayer. This is a clear benefit to taxpayers who would otherwise be adversely affected due to limitations on charitable deductions, or lose a portion of their itemized deductions due to the AGI phase-out rules. Moreover, the charitable gift made from the IRA will count as part or all of the annual required minimum distribution amount. Although lobbyists are actively striving to have this provision extended, the current law sunsets after 2007.

**Mortgage Insurance Premiums.** Lenders are required to report total premiums of \$600 or more paid or accrued for 2007 for qualified mortgage insurance premiums. Unless, the provision is extended, the deduction allowed by certain borrowers will end after 2007.

##### IRS Yearend Changes for 2008:

**Reduction in Capital Gains Tax Rate.** The 5% tax rate on net capital gains and qualified dividend income for tax year 2007 drops to 0% for 2008. This means the gains and dividends that otherwise would be taxed in the two lowest ordinary tax brackets (10% and 15%) will not be subject to federal income tax. The 0% rate is scheduled to continue through the tax years 2009 and 2010.

**Increased Retirement Contribution Limits.** The contribution limit for individual retirement accounts (both traditional and Roth) increases to \$5,000 for 2008. A catch-up provision permits an additional contribution of up to \$1,000 by individuals who are at least age 50 in 2008.

**Modified AGI Limit for Roth IRA Contributions Increased.** The estimated 2008 AGI phaseout ranges for Roth contributions are \$101,000-\$116,000, unmarried; \$159,000-\$169,000, married filing jointly; and \$0-\$10,000, married filing separately.

**XI. PROCESSING DATES**

<b>Form</b>	<b>Description</b>	<b>Bower/Recipient/ Participant</b>	<b>Due to IRS</b>	<b>Or, if filing electronically</b>
<b>1098</b>	Mortgage Interest Statement	January 31	February 28	March 31
<b>1098-E</b>	Student Loan Interest Statement	January 31	February 28	March 31
<b>1098-T</b>	Tuition Payments Statement	January 31	February 28	March 31
<b>1099-A</b>	Acquisition or Abandonment of Secured Property	January 31	February 28	March 31
<b>1099-B</b>	Proceeds from Broker & Barter Exchange Transactions	January 31	February 28	March 31
<b>1099-C</b>	Cancellation of Debt	January 31	February 28	March 31
<b>1099-DIV</b>	Dividends & Distributions	January 31	February 28	March 31
<b>1099-G</b>	Certain Government Payments	January 31	February 28	March 31
<b>1099-INT</b>	Dividends & Interest	January 31	February 28	March 31
<b>1099-LTC</b>	Long Term Care and Accelerated Death Benefits	January 31	February 28	March 31
<b>1099-MISC</b>	Miscellaneous Income	January 31	February 28	March 31
<b>1099-OID</b>	Original Issue Discount	January 31	February 28	March 31
<b>1099-Q</b>	Coverdell IRA Withdrawals	January 31	February 28	March 31
<b>1099-R</b>	IRA Withdrawals	January 31	February 28	March 31
<b>1099-S</b>	Proceeds from Real Estate Transactions	January 31	February 28	March 31
<b>1099-SA</b>	HSA Withdrawals	January 31	February 28	March 31
<b>5498</b>	IRA Contributions	January 31	June 2	June 2
<b>5498-ESA</b>	Coverdell IRA Contributions	April 30	June 2	June 2
<b>5498-SA</b>	HSA Contributions	June 2	June 2	June 2