HSA *Testing Period* Worksheet

Purpose: Use this Worksheet to learn more about the HSA testing period and to determine if (1) you are covered by the HSA testing period, (2) if you pass or fail the test, and (3) the consequences of failure. This Worksheet is designed to work in conjunction with the HSA Eligibility and Contribution Worksheet that determines HSA eligibility and HSA contribution limits as well as the IRA to HSA Worksheet that gives an overview of the IRA to HSA contribution rules. You are responsible for properly determining whether or not you are subject to and meet the test – not the HSA custodian or trustee. This Worksheet does not provide tax or legal advice – please consult with your own tax or legal advisor.

***Testing Period* Overview.** The testing period is a concept created by Congress to prevent you from receiving greater tax benefits than the government intended in two limited circumstances: (1) you become eligible for the HSA mid-year and remain eligible on December 1, and (2) you move money from an IRA, FSA or HRA into an HSA. In these cases, the rule requires that you maintain your HSA eligibility for a testing period. Individuals that fail to maintain their HSA eligibility during the testing period face taxes and a 10% penalty on the amount over contributed. The rules are different for regular contributions and IRA/FSA/HRA transfers. See page 2 for additional discussion.

1 Are You Subject to the Testing Period?

Answer the applicable question(s). Regular HSA contributions follow different testing period rules than IRA/FSA/HRA contributions. If you have both types of contributions, run the tests separately. See page 2 for help. ASSUMPTIONS: This worksheet assumes you were eligible for the HSA on the day of the contribution and that you are a calendar year taxpayer (most people).

For Regular HSA Contributions

Did you start your HSA mid-year and remained eligible on December 1?*

*If you ended eligibility mid-year see page 2.

Yes – Go to Step 2: You are subject to the testing period – Go to Step 2

For Contributions From IRA, FSA, or HRA

Did you move money into your HSA from an IRA, FSA or HRA?

No – Stop: Stop. You are not subject to the testing period.

2 Do You Pass the Testing Period?

See page 2 for detail. Note: run tests separately if multiple contribution types.

For Regular HSA Contributions

Were you eligible for the HSA on December 1 of the year of the HSA contribution and did you remain eligible through December 31 of the year following the year of the contribution?

For Contributions from an IRA, FSA, or HRA

Did you remain eligible for the HSA from the month of the distribution from the IRA/HRA/FSA until the last day of the 12th month following such month? For example, if you complete the funding on Dec 31, 2009, the test runs from Dec 1, 2009 – Dec 31, 2010.

Yes – Stop: **You Pass.** You do not owe taxes or penalties for testing period failure.

No – Go to Step 3: **You Fail.** Go to Step 3 .

3 Failed the Test?

If you failed the test, you may owe taxes plus a 10% penalty. See below. Note: this worksheet assumes you did not contribute more than the maximum applicable federal HSA limit. Different rules apply if you did (for example, you moved $20,000 from your IRA to your HSA). Special rules also apply if you do both types of contributions. See page 2 .

a. **Failure Due to Death or Disability.** You do not owe taxes or penalties if the failure to meet the testing period is because of the HSA owner's death or disability.

b. **Regular HSA Contribution Failed Test.** To determine the amount of your tax and penalty you first determine the proper contribution amount using the "sum of the months" calculation. Use the table in paragraph 8 on page 2 for this purpose. Important: do <u>not</u> remove the amount as an excess.

c. **IRA/FSA/HRA Contribution Failed Test.** You need to pay taxes plus a 10% penalty on the amount you moved from your IRA, FSA or HRA. Important: do <u>not</u> remove the amount as an excess.

HSA Testing Period Worksheet - Definitions and Instructions

1. **Additional Background for Regular Contributions.** Starting in 2007, the HSA rules allow you to contribute the full federal HSA contribution limit even if you are only eligible for an HSA starting as late as December 1. This is beneficial for individuals starting HSA eligibility mid-year. The pre-2007 "sum of the months" rule stated that individuals could only contribute 1/12 times the number of months eligible for the HSA times the applicable federal HSA limit (a pro-rata amount). The new law; however, has a catch. In order to get the benefit of the full federal HSA limit, you need to meet a testing period. If you fail to meet the testing period, the pre-2007 sum of the months rule becomes a factor. If you started your HSA eligibility mid-year and took advantage of the rule allowing you to contribute more than the pre-2007 sum of the months method, then you need to meet the testing period. If you fail the test, you will owe taxes plus a 10% penalty on the amount over contributed – see paragraph 8 below. For additional guidance and examples, please refer to IRS Notice 2008-52. See also our HSA Eligibility and Contribution Worksheet.
2. **Additional Background for IRA/FSA/HRA Contributions.** Starting in 2007, the law allows you to move money from an Individual Retirement Account (IRA), Flexible Spending Account (FSA), or Healthcare Reimbursement Account (HRA) into an HSA. These transactions are subject to complicated rules beyond the scope of this Worksheet – seek professional help. See also our IRA to HSA Worksheet for more information on IRA funding of HSAs. This worksheet covers only the testing period for IRA/FSA/HRA direct transfers. IRA/FSA/HRA transfers are subject to different testing period rules than regular contributions.
3. **Change in HDHP Coverage Type.** You are not required to maintain the same type of High Deductible Health Plan (HDHP) coverage to remain eligible. For example, if you change from family HDHP coverage to single HDHP coverage during the testing period that does not result in test failure. The HDHP coverage as of December 1 is used to determine contribution limits.
4. **Not Subject to Testing Period But Fail to Maintain HSA Eligibility Full Year.** If you have already met any initial year testing period, you may still be required to reduce your HSA contribution if you fail to maintain your eligibility for the full year, determined by whether or not you were eligible as of December 1. This same rule applies if you start your HSA mid-year but are no longer eligible on December 1. You are not subject to the testing period. Instead, you are simply not allowed to contribute more than the sum of the months method allows. For example, assume Ted starts his HSA in 2010 and remains eligible until he turns 65 in July, 2012. Ted meets his testing period. Ted, is not allowed to make a full contribution in 2012 because he will not be eligible on December 1, 2012. He must use the sum of the months method to calculate his eligible contribution amount. If he contributes too much, he must remove it as an excess contribution or face a penalty of 6% per year it remains in the HSA. This is very different treatment than the testing period. See our HSA Eligibility and Contribution Worksheet to determine your eligible amount.
5. **Example. Part A:** Jim, age 53, enrolls in a family HDHP on December 1, 2009. Jim is not an eligible individual for any months prior to December in 2009. Jim can contribute the greater of the 2009 HSA federal limit for families, $5,950, or the sum of the months limit, $495.83 (1/12 x $5,950 – one month's eligibility). Jim contributes $5,950 and is subject to the testing period.
   Part B: Now assume that Jim ceases to be an eligible individual in June 2010. The testing period for 2009 ends on December 31, 2010, so Jim failed the testing period by not remaining eligible for the entire testing period. In 2010, Jim must include in gross income $5,454.17, the amount contributed to the HSA for 2009 minus the sum of the monthly contribution limit ($5,950 - $495.83 = $5,454.17). In addition, Jim must pay a 10% penalty tax of $545 ($5,454.17 x .10). Jim leaves the $5,454.17 in the HSA.
6. **Calculating The Sum of the Months Amount to Determine Tax and Penalty Amounts** . CAUTION: This chart is for regular contributions only. If you funded your HSA from your IRA/FSA/HRA do not use this chart.

	Sum of the Months Contribution Worksheet	Individual	Family
A	Enter Total Amount Actually Contributed to HSA for Tax Year[1]		
B	Federal Limit (this limit changes every year for inflation).	$3,000 (2009) $3,050 (2010)	$5,950 (2009) $6,150 (2010)
C	Catch-Up Contribution (if between ages 55-65 add $1,000 for years after 2008)		
D	Add B + C = Total Federal Limit		
E	Divide D by 12 = Monthly Contribution Eligibility		
F	Insert # of Months Eligible in the Year[2]		
G	Multiply E x F = Total Eligible Amount Based on Sum of Months		
H	Subtract G from A = Base for Taxes & Penalty[3]		

[1]This includes all employer and individual contributions – not HSA to HSA rollover or transfer amounts.
[2]HSA contribution amounts are determined on a monthly basis and then aggregated. To determine how much you may contribute, you must determine the number of months you were covered by a HDHP and otherwise eligible as of the first day of that month.
[3]If zero or negative, no taxes or penalty owed. If a positive number, you owe taxes and a 10% penalty on this amount. File IRS Form 8889. You should leave this amount in the HSA and use it for eligible medical expenses. Do not take out as the return of an excess contribution or you may owe additional taxes and penalties on that distribution as well.

7. **Taxes and Penalties Detail.** For regular contributions, you owe federal income taxes plus a 10% penalty on the amount as calculated above. For IRA/FSA/HRA direct transfers, you owe federal income taxes plus a 10% penalty for the amount moved if you fail the testing period test. Any interest or earnings on the amount is not subject to tax or penalty. The 10% penalty applies even if you are over age 65. The amount should remain in the HSA or you will be subject to additional taxes and penalties for using your HSA for non-qualified distributions. Do not take the amount out as the return of an excess contribution. If you use these funds for non-eligible medical expenses you will be subject to taxes plus the 10% penalty applicable to HSA distributions.
8. **Both Regular and IRA to HSA Contributions.** If you start mid-year and make both a regular HSA contribution and an IRA to HSA contribution, then you run the tests separately. They do not interact and you can pass one and fail the other. If you fail the regular contribution test but not the IRA to HSA test (it's a shorter test), then the amount included in gross income depends upon how you split the contributions. See IRS Notice 2008-51, Q&A 6-8 for details.