benefit strategies LLC

HSA GPS Fact Sheet Series

Establishing an HSA

Trust law can be tricky, especially for individuals whose only exposure to trusts is through their Health Savings Accounts (HSAs). The concept of *establishing* an HSA is important, though, because you don't enjoy certain benefits of an HSA until you become HSA-eligible and formally establish your account. In this paper, we travel to the intersection of HSAs and account establishment to see what effect establishing an HSA has on the tax treatment of contributions to and distributions from your HSA.

1. What does it mean to establish an HSA?

An HSA is a trust. Section 223 of the Internal Revenue Code (IRC), the part of tax law that authorizes HSAs, refers to *establishing* an HSA as a key activity with respect to contributions and distributions. The law doesn't specify how an accountholder establishes her account. The Internal Revenue Service (IRS) defers to state tax law to determine when an HSA is established. Most states require that, to establish a trust, an individual must:

- signal an intent to open a trust,
- name a beneficiary, and
- place corpus – or something of value – into the trust.

2. Don't I just establish a trust when I become HSA-eligible?

No. Merely being *eligible* to own, open, and fund an HSA isn't sufficient to *establish* your HSA. You must take certain action – based on the law of the state that governs your account – to formally establish your HSA.

3. Why is the establishment date important?

Until you become HSA-eligible and establish your HSA, you can't access balances. Some administrators allow employers and individuals to make deposits into an HSA before the account is established, but funds can't flow out of the account until an HSA-eligible owner formally establishes an HSA.

Also, you can’t reimburse tax-free from your HSA any qualified expenses with a date of service is before the date that you establish your HSA – even if those qualified expenses are cost-sharing associated with your HSA-qualified medical plan and you incur them after you are eligible to open an HSA.

4. When can I establish my HSA?

You can establish your HSA in accordance with the trust laws of the state that governs your account. Under the estate laws of 49 states, you can establish your HSA at any point after you become HSA-eligible.

Owners of HSAs governed by Utah can establish their HSAs retroactively to the date that they first enroll in an HSA-qualified medical plan, even if they’re not yet HSA-eligible. In that case, they can establish an HSA but can’t reimburse qualified expenses tax-free before they

- become HSA-eligible under federal law **and**
- establish the HSA under the applicable state law.

5. My employer’s medical plan anniversary date is June 15. Aren’t I HSA-eligible on that date?

No. You’re not HSA-eligible until the first day of your first month they you meet all HSA eligibility requirements, which in your case is July 1. Here’s what this means for you:

- You can complete the paperwork for your HSA at any time, including on or before June 15. Your HSA administrator may be able to set up your account before July 1. Your administrator may be able to process contributions to your HSA before July 1, though the deposit won’t post to your HSA before July 1 and you won’t have access to the funds before that date.

- You can’t reimburse qualified expenses tax-free from your HSA if the date of service or purchase is prior to July 1, even if the applicable state law allows your administrator to establish your HSA prior to that date. Any distributions for any expenses incurred prior to July 1 are included in your taxable income and subject to a 20% additional tax. The additional tax doesn’t apply if you’ve reached age 65 or are disabled under Section 72 of the IRC.

6. I’m HSA-eligible as of July 1. My first payroll deposit doesn’t go to my HSA administrator until July 11. When is my HSA established?

Under the trust law of most states, your HSA isn’t established until July 11. Thus, you can’t reimburse tax-free any qualified expenses incurred before July 11. Utah trust law allows your administrator to establish your HSA as of July 1 in this situation, as long as you met all HSA eligibility requirements by that date.

7. My Health FSA had a 2½-month grace period, and I carried a balance into the grace period. What effect does that have on my ability to establish my HSA?

The grace period is an additional period of time during which you can incur and reimburse qualified expenses through the Health FSA. If you have a general Health FSA (as opposed to a Limited-Purpose Health FSA, which reimburses dental, vision, and select preventive care services only), you can't open or establish your HSA before the end of the grace period. If your Health FSA runs on a calendar year, your Health FSA grace period ends March 15. Since you don't become HSA-eligible until the first day of the first month that you meet eligibility criteria, under the laws of all states but Utah you can't establish your HSA before April 1.

You can reimburse your qualified medical, prescription drug, dental, and vision expenses, as well as over-the-counter supplies and equipment (and over-the-counter drugs and medicine with a prescription) from your Health FSA during the grace period. You can't reimburse tax-free qualified expenses that you incur between March 16 and March 31 from either your Health FSA (which reimbursed expenses incurred through March 15) or your HSA (even if your HSA is governed by Utah law and you can establish your HSA by March 15).

8. I enrolled in an HSA-qualified medical plan Oct. 1 and met HSA eligibility requirements immediately. I didn't get around to completing my HSA paperwork until Oct 17. Do I have to wait until Nov. 1 to establish my HSA?

No. Once you're HSA-eligible as of the first day of a month (in this case, October), you can establish your HSA as of any day of the month. The key points are these:

- You're not HSA-eligible until the first day of the first full month that you meet eligibility requirements.

- Once you're HSA-eligible, you can establish your HSA as of any day of the month. You then can reimburse qualified expenses tax-free from your HSA as long as the dates of service are on or after the date that you establish your account.

In this scenario, you can establish your HSA and begin to reimburse qualified expenses tax-free either effective Oct. 17 (the law in most states) or as far back as Oct. 1 (Utah).

In fact, it's common for an HSA owner to establish his HSA mid-month. If the account is funded via pre-tax payroll contributions, the first payroll deduction typically isn't deposited into the HSA until sometime during the first two weeks of the first month that the account is opened. The date of that first payroll deposit becomes the date that the HSA is established.

9. How different are various state laws?

A state may allow an accountholder to establish her HSA retroactively to sometime before the initial contribution into their accounts. To date, only Utah has amended its trust laws to permit retroactive establishment. Utah trust law allows HSA owners to establish their accounts back to the day that they enroll on an HSA-qualified medical plan, as long as they open the account by the date that their personal income tax returns are due for that tax year. This provision allows HSA owners who experienced a delay between their enrollment in HSA-qualified coverage and the funding of their account – delays in processing their applications, timing of the initial payroll deposits, etc. – to reimburse all qualified expenses incurred before the initial deposit.

It's important to note that state trust law, including Utah's, doesn't allow an HSA owner to reimburse qualified expenses tax-free before the date that she gains HSA-eligibility. Here are several examples:

- HSA-qualified coverage is effective June 15. Individual can establish her HSA as of June 15 per Utah trust law, but she can't reimburse tax-free any expenses incurred before July 1 – the date that she's first HSA-eligible under federal law. *Under most states' trust laws, she can't establish her HSA before July 1, nor can she reimburse any qualified expenses tax-free with dates of service before July 1.* The Utah law provides no reimbursement advantage.

- HSA-qualified coverage begins Jan. 1 and HSA owner is covered by a general Health FSA grace period through March 15. She can establish her HSA back to Jan. 1 under Utah trust law, but she can't reimburse any qualified expenses tax-free before April 1 – the date that she's first HSA-eligible under federal law. *Under most states' trust laws, she can't establish her HSA before April 1, nor can she reimburse any qualified expenses tax-free with dates of service before April 1.* The Utah law provides no reimbursement advantage.

- HSA-qualified coverage begins May 1. Individual meets all HSA eligibility requirements immediately, but her first payroll contribution doesn't reach the account until May. 6. She can establish her HSA as of May 1 under Utah law. Because she's HSA-eligible under federal law as of May 1, she can reimburse tax-free any qualified expense that she incurs on or after that date if her HSA is governed by Utah law. *Under most states' trust laws, she can't establish her HSA before May 6, nor can she reimburse any qualified expenses tax-free with dates of service before May 6.* The Utah law does provide a reimbursement advantage.

This information is accurate as of Nov. 5, 2018. Please note that this discussion is for informational purposes only and is based on current regulations. It doesn't represent, and shouldn't be construed as, a substitute for professional advice. Please consult your personal legal, financial, or tax counsel to discuss your personal situation and refer to IRS Publication 969.

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