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, or HSAs. The concept of establishing an HSA is important, though, because you don't enjoy certain benefits of an HSA until you formally establish your account. In this paper, we travel to the intersection of HSAs and account establishment to see what impact formally establishing an HSA has on contributions to and tax treatment of 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, or IRC (the section 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, or IRS, has deferred to state tax law to determine when an HSA is established. Most states require that, for a trust to be established, the owner must:

- signal an intent to open a trust
- name a beneficiary
- 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 this date important?

Until you've established your HSA, you can't access contributions. Some trustees allow employers and individuals to make deposits into an HSA before it is established, but funds can't flow out of the account until the owner establishes his HSA.

Also, you can't reimburse any eligible expenses tax-free from your HSA if the date of service is before the date that you established your HSA – even if those eligible expenses are cost-sharing associated with your HSA-qualified medical plan.

4. When can I establish my HSA?

You can establish your HSA at any time on or after the first day of the first month that you're HSA-eligible. The original legislation and subsequent IRS notices make it clear that you must

be HSA-eligible on the first day of the month to be HSA-eligible for that month. Thus, if you become HSA-eligible when you enroll in your new employer's HSA-qualified medical plan Feb. 19, you become HSA-eligible March 1 and can establish your HSA any time on or after March 1.

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 of coverage, 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 and post employer or employee contributions to your HSA before July 1, though you won't have access to the funds before July 1.

- You can't reimburse eligible expenses tax-free from your HSA if the date of service is prior to July 1. Any distributions for any expenses incurred prior to July 1 are included in your taxable income and subject to a 10% 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 trustee 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 eligible expenses incurred before July 11.

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

The grace period is an additional period during which you can incur expenses eligible for reimbursement 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, you can't establish your HSA before April 1.

You can reimburse your eligible medical, prescription drug, dental, vision over-the-counter supplies (and over-the-counter drugs and medicine with a prescription) from your Health FSA during the grace period. You can't reimburse eligible 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 (which you can't establish before April 1)

8. I enrolled in an HSA-qualified medical plan Oct. 1 and met HSA eligibility criteria 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 on 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 criteria.

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

9. How different are various state laws?

One state – Utah – allows accountholders to establish their HSAs retroactively. HSA owners can establish their HSAs back to the date that they became HSA-eligible as long as they fund their accounts before the earlier of (1) date that their personal income tax returns are due or (2) the date that he actually files his return. For example, an individual who became HSA-eligible Feb. 1, 2015, can establish his HSA as of that date (and reimburse tax-free all eligible expenses with dates of service on or after that date) as long as he funds his HSA before filing his 2015 personal income tax return.

It's important to note that the Utah law doesn't overrule federal tax law. Thus, with respect to the exception to Utah trust law for HSAs, an individual can't become HSA-eligible before federal tax law says that he's HSA-eligible. Nobody can become HSA-eligible before the first day of the first full month that she's HSA-eligible, which means that an individual who:

- meets all HSA eligibility criteria when he enrolls on his employer's HSA-qualified medical plan on May 15 (whether that date is the employer's anniversary date or a new employee's first day of eligibility to enroll in the medical plan) become HSA-eligible June 1.

- enrolls in an HSA-qualified plan as of Jan. 1 but carries a traditional Health FSA balance into his grace period that ends March 15 can't become HSA-eligible and therefore establish his HSA before April 1.

In both these cases, most states' trust laws require that he fund his HSA on or after June 1 or April 1 before he can establish his HSA prospectively. If his HSA is governed by Utah law, he can establish his HSA retroactively as long as he makes an initial deposit before he files his personal income tax return for that year. In neither scenario can he reimburse any eligible expenses tax-free that he incurred before he met federal HSA eligibility criteria June 1 or April 1 in the scenarios above.

This information is accurate as of May 18, 2016. 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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