HSAs: How Health Savings Accounts Work

Created by federal law in 2004, health savings accounts ("HSAs") are portable, triple-tax-advantaged accounts that allow individuals to plan, save, and pay for current and future out-of-pocket medical expenses for themselves, their spouse, and dependents. HSA contributions, earnings and distributions for medical expenses are all tax advantaged—allowing individuals to realize significant savings by utilizing an HSA to pay and save for medical expenses.

To be eligible to contribute to an HSA, an individual must be covered by a high deductible health plan ("HDHP"). While HSAs are often established during an employment relationship, they may also be established by individuals in the marketplace and both employers and individuals are increasingly choosing HDHPs in an effort to lower premiums. Consequently, HSAs have become an integral part of an individual's ability to pay for escalating out-of-pocket healthcare costs.

Unlike other health accounts such as flexible spending accounts and health reimbursement arrangements, an HSA is an individually owned financial account. In order to open an HSA, an individual must take additional steps, outside of obtaining the HDHP, to open the HSA with a qualified HSA custodian or trustee. Many individuals do not understand the process and delay opening the account.

HSA Establishment Date Under State Law

The HSA's establishment date (when the account is deemed to be open by the HSA custodian/trustee) determines when an account holder may begin to use her HSA to pay for eligible medical expenses. Federal regulations state that medical expenses incurred before an individual establishes their HSA are not eligible medical expenses; therefore, HSA funds cannot pay for those expenses. ***If such expenses are paid for using the HSA before the HSA is established, then the expense is taxable and is likely subject to a 20 percent penalty*.**

While Section 223 of the Internal Revenue Code governs HSAs, state trust law governs aspects of the HSA and determines, among other aspects, the HSA's establishment date.

HSAs are triple-tax advantaged accounts that allow individuals to achieve significant savings by using their HSA to save for and pay for their qualifying medical expenses.

HSAs are individually owned financial accounts and must be opened, or established, with a qualified trustee or custodian.

HSAs are primarily regulated by Section 223 of the IRC, but state trust law of the state where the HSA is administered determines when the HSA is deemed to be established.

State trust law where most HSA custodians administer these accounts have been amended to recognize that an HSA may be deemed established in accordance with the qualifying health plan coverage—allowing HSA account holders and custodians to take full advantage of these important accounts.

Applying Trust Law: Maryland vs. Other States

Maryland trust law dictates that a trust is established when, among other requirements, the trustee accepts and takes legal ownership of the property to be placed in the trust.

- This means that an individual with an HSA governed by Maryland law may not use their HSA for expenses incurred prior to the date their HSA custodian accepts funding into the account—likely after the qualifying health coverage is in effect.

Missouri and Utah, where many HSA custodians are based, amended their respective state trust laws allowing HSAs to be deemed established on the effective date of the individual's underlying HDHP coverage.

- This allows individuals with HSAs governed by the laws of these states to use their HSA to pay for medical expenses incurred prior to the date they opened the account with the HSA custodian—a considerable competitive advantage that should be extended to account holders and custodians operating under Maryland law.

For example, consider a forty-year old mother covered by a HDHP with maximum out of pocket costs of $13,500 for her family with an effective date of January 1, 2020:

- The mother delayed opening her HSA with a Maryland-based HSA custodian until August 2020, after she needed it to pay for medical expenses, instead of opening it concurrent to the HDHP effective date of January 1, 2020.

- In July 2020, she is diagnosed with cancer, incurring medical bills of at least $13,500.

- **Unfortunately, the mother may not use her HSA to pay for the services received in July because she did not establish an HSA prior to incurring those costs**.
    - Had the HSA been governed by Missouri or Utah law, then the mother could have used the HSA opened in August but deemed established in January to pay for the medical expenses incurred in July.

ConnectYourCare is headquartered in Hunt Valley, MD, with nearly 180 employees living and working in MD.

ConnectYourCare has a national footprint, with nearly 520 employees nationwide. Florida and Idaho are home to our own internally-staffed call center.

ConnectYourCare administers consumer directed spending accounts for nearly 2,500 employers and distributors across the country and 2.5 million individual accountholders.

Maryland residents understand the value of HSAs. ConnectYourCare provides HSA services to nearly 145,000 Maryland HSA owners.

In 2017, ConnectYourCare was approved by the IRS as a passive Nonbank Custodian of HSAs.

ALLOWING ACCOUNT HOLDERS TO FULLY UTILIZE THEIR HSAs

If Maryland amends its law to allow an HSA to be established back to the date of the underlying HDHP coverage, then account holders would able to utilize their HSA for all of their medical expenses during the plan year. This change would allow account holders with HSAs governed by Maryland law parity with those whose HSAs are governed by Utah and Missouri trust laws.

MEET CONNECTYOURCARE

Based in Hunt Valley, Maryland, ConnectYourCare is a leading consumer-directed healthcare company providing services to employers and employees in the areas of tax- advantaged account administration, including health savings accounts ("HSAs"), health reimbursement arrangements ("HRAs"), health flexible spending accounts ("FSAs"), dependent care assistance programs ("DCAPs"), retiree health accounts, Consolidated Omnibus Budget Reconciliation Act ("COBRA"), transit and commuter programs, and student loan repayment programs.

ConnectYourCare's approach to consumer-directed healthcare is rooted in creating more efficient connections among the people who provide benefits (employers, health plans, financial institutions), the people accessing healthcare services (employees/members), and the people who deliver healthcare services (doctors, nurses, technicians, etc). ConnectYourCare's technology-enabled services platform empowers our consumers to take control of their healthcare saving and spending decisions.

In 2017, ConnectYourCare was approved by the IRS as a passive Nonbank Custodian of HSAs and has continued to grow its business as a custodian of HSA accounts.

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