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Health Savings Accounts and the Bankruptcy Estate

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Introduction

Section 541 of the Bankruptcy Code defines "property of the estate" to include "all legal or equitable interests of the debtor in property as of the commencement of the estate."[1] Consistent with a policy of expanding the bankruptcy estate, the property listed under section 541 is available to the trustee to satisfy the estate's creditors once a petition has been filed. This aggregation provides the debtor an opportunity for a fresh start and ensures effective distribution among creditors and thus "promotes the fundamental purpose of the Bankruptcy Code."[2] Although section 541(a) defines "property of the estate" broadly, section 541(b) list those items that are specifically excluded from the property of the estate.[3]

Further, section 522 allows a debtor to set aside certain property as exempt from the claims of creditors.[4] Section 522 provides federal exemptions but it also permits states to create their own exemptions. Section 522 also allows for a state to opt out of the federal exemptions. Under section 522(b)(1) provides a state can enact legislation specifically opts out of the federal

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[1] 11 U.S.C. § 541 (2012).
[2] *Id.*
[3] *Id.* § 541(b).
[4] COLLIER ON BANKRUPTCY, ¶ 522.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009), *available at* LEXIS, 5-522 Collier on Bankruptcy P 522.01.

exemption scheme, thereby "denying its citizens access to the federal exemptions."[5] Finally, under 522(b)(2), if the state has not opted out of the federal exemption scheme, "a debtor [may] choose between the exemptions set forth in state law and a federal exemption package."[6]

In the interest of public policy, these exceptions and exemptions prevent the debtor from emerging from the bankruptcy without any assets, thereby allowing the debtor to maintain an appropriate standard of living.[7] Since healthcare is an essential part of that standard of living, the Bankruptcy Code allows for specific exemptions relating to heal insurance and health benefits. Specifically, section 541(b)(7)(A)(ii) excludes from property of the estate "any amount withheld by an employer from the wages of employees for payment contributions to a health insurance plan regulated by State law."[8] Similarly, section 522(d)(10)(C) exempts "the debtor's right to receive a disability, illness, or unemployment benefit."[9] Likewise, section 522(d)(11)(D) further exempts "the debtor's right to receive, or property that is traceable to a payment . . . on account of personal bodily injury."[10] Since these provisions do not explicitly address health savings accounts ("HSAs"), however, courts have had to decide whether such accounts are excluded from property of the estate under section 541(b) or exempt under section 522 and/or state law.

For example, recently, in *Leitch v. Christians (In re Leitch)*, the Bankruptcy Appellate Panel for the Eighth Circuit rejected a debtor's argument that HSAs are excluded from property of the estate under section 541(b) or exempt under section 522(d).[11] According to the BAP, while there may be tax incentives for maintaining an HSA, the funds in the account were included in

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[5] *Id*. at 143.
[6] Tracey Nicolau Bosomworth, *Federal Exemptions and the Opt-Out 522: A Constitutional Challenge Provisions of Section*, 58 INDIANA L. REV. 143, 143 (1982).
[7] COLLIER ON BANKRUPTCY, ¶ 522.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009), *available at* LEXIS, 5-522 Collier on Bankruptcy P 522.01.
[8] 11 U.S.C. § 541(b)(7)(A)(ii) (2012).
[9] *Id.* § 522(d)(10)(C).
[10] *Id*. § 522(d)(11)(D).
[11] 494 B.R. 918 (B.A.P. 8th Cir. 2013).

the debtor's bankruptcy estate and were not exempt under the federal exemption. Part I of this article provides background information regarding HSAs. Part II discusses the case law addressing whether HSAs are exempt under the Bankruptcy Code or state law. Finally, Part III analyzes the *Leitch* decision.

I. Background

1. Health Savings Accounts

HSAs were created in 2003 as part of the Medicare Prescription Drug, Improvement, and Modernization Act.[12] An HSA can be a tax-exempt trust or a custodial account that can be used to pay or reimburse certain medical expenses.[13] Generally, HSAs are intended for "individuals covered by high-deductible health plans" so they may "receive tax-preferred treatment of money saved for medical expenses."[14] Holders of HSAs can claim tax deductions for contributions that they, or someone other than their employer, make to their accounts, and distributions from the accounts are tax free if the distributions are being used to pay for qualified medical expenses.[15] Contributions to an HSA can remain in the account indefinitely, and the interest and other earnings on the account are tax-free.[16] Finally, HSAs are "portable," meaning that even if the holder changes employers or leaves the workforce, the account stays with the holder.[17]

2. HSAs and the Affordable Care Act

[12] Pub. L. No. 108–173 § 1201, 117 Stat. 2066 (Dec. 8, 2003).
[13] INTERNAL REVENUE SERVICE, http://www.irs.gov/publications/p969/ar02.html#en_US_2013_publink1000204020 (last visited Feb. 18, 2014).
[14] UNITED STATES DEPARTMENT OF THE TREASURY, http://www.treasury.gov/resource-center/faqs/taxes/pages/health-savings-accounts.aspx (last visited Feb. 18, 2014).
[15] INTERNAL REVENUE SERVICE, http://www.irs.gov/publications/p969/ar02.html#en_US_2013_publink1000204020 (last visited Feb. 18, 2014).
[16] *Id.*
[17] *Id.*

HSAs were created as a tool to supplement high-deductible insurance plans and offset the out of pocket cost of medical expenses. With the implementation of the Affordable Care Act (the "ACA"), a program aimed at providing Americans with favorable, low-deductible insurance policies, HSAs may become essentially obsolete.[18] The ACA creates different levels of healthcare that must "provide a minimum amount of insurance coverage" based on a standard known as "actuarial equivalence." The lowest threshold for the least amount of coverage is 60 percent when compared to this standard.[19] The question after the ACA is "whether [a] high deductible policy that meets the standards set by the 2003 law creating HSA plans would also meet the 60 percent actuarial equivalency threshold set by ObamaCare."[20] Under the HSA law, the high deductible coverage that would make an individual eligible for an HSA just barely meets this threshold, especially since the ACA "gives health plans a little wiggle room" of plus or minus two percent.[21] Thus, HSAs technically survive the ACA, but just barely.

HSAs encourage individuals to be "value-conscious shoppers in the health care marketplace, just like they are in every other sector of the economy."[22] HSAs provide participants "with educational resources, decision-making tools and financial incentives that will lead them to make more efficient health care decisions."[23] For this reason, an increase in HSA plans slows the growth of health care spending.[24] By contrast, the ACA aims to "insulate patients

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[18] Alicia Ouellette, *Health Reform and the Supreme Court: The ACA Survives the Battle of the Broccoli and Fortifies Itself Against Future Fatal Attack*, 76 ALB. L. REV. 87, 90 (2013).
[19] FORBES, http://www.forbes.com/sites/merrillmatthews/2013/03/27/health-savings-accounts-will-survive-obamacare-at-least-for-now/ (last visited Feb. 18, 2014).
[20] *Id*.
[21] *Id*.
[22] *Id*.
[23] J.M. Razor, *Health Savings Accounts: Increasing Health Care Access in America?*, 17 LOY. CONSUMER. L. REV. 419, 442 (2004).
[24] *Id*.

from almost all costs of care . . . and then control costs by imposing price controls."[25] This kind of control removes the need for participants to be "value-conscious shoppers."[26] As such, the policies of the ACA and HSAs seem to stand at odds, and while HSAs survive for now, these competing goals may eventually be unable to coexist in the same health care market.

II. Prior Case Law

The few cases discussing HSAs may exist in a unique, several year span beginning with the creation of HSAs in 2003 and ending with their gradual phasing out in the coming years. The courts that have addressed HSAs have found that they are not exempt from the property of the estate. For example, in *In re Lombardy*, the Bankruptcy Court for the Northern District of Ohio held that an HSA was not exempt.[27] Even though Ohio has opted out of the federal exemption scheme, the court noted that Congress exercised power to preempt state court exemptions by enacting the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA")[28] and creating a category of exemption rights that may be exercised by the debtor even if that debtor's state has opted out.[29] The state exemptions that could be preempted are limited and, pursuant to section 522(b)(3)(C), retirement funds are one such exemption.[30] The debtor argued that HSAs were similar enough to retirement accounts and therefore should be similarly exempt under the federal scheme. The court opined that the debtor's "interpretation . . . essentially reads the word 'retirement' out of the phrases 'retirement account,' 'retirement annuity,'. . . and 'retirement funds'. . . ."[31] Noting that Congress intends words to have their ordinary, common meaning, the

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[25] FORBES, http://www.forbes.com/sites/merrillmatthews/2013/03/27/health-savings-accounts-will-survive-obamacare-at-least-for-now/ (last visited Feb. 18, 2014).
[26] *Id*.
[27] *See In re* Lombardy, No. 11–17737, 2012 WL 435816, at *1 (Bankr. N.D. Ohio Feb. 9, 2012).
[28] Pub.L. 109-8, 119 Stat. 23 (2005).
[29] *Lombardy*, 2012 WL 435816, at *2.
[30] *Id*. at *2.
[31] *Id*. at *3.

court determined that "the state of Ohio nor Congress intended to make a Health Savings Account a 'retirement account.'"[32] Accordingly, the court found that while retirement accounts may be exempt, HSAs are not.[33]

Similarly, in *In re Mooney*, the Bankruptcy Court for the Middle District of Georgia concluded that HSAs are not exempt under Georgia state law.[34] The *Mooney* court did not address whether an HSA is exempt under section 522(d) because Georgia has also opted out of the federal bankruptcy exemptions. The debtor argued that, under Georgia state law, her HSA should be exempt as "a disability, illness, or unemployment benefit."[35] However, the court determined that the "ordinary definitions of illness and benefit" could not be construed to include HSAs.[36] Since "nothing in [statute] *expressly* exempts HSAs" and more importantly because "the Georgia Assembly has amended the exemption statute three times since the development of HSAs," the court concluded that it was clearly not the legislature's intent to exempt HSAs from the bankruptcy estate.[37]

Likewise, in *In re Stranger*, the Bankruptcy Court for the District of Idaho held that an HSA was not exempt under the Idaho statute that exempts "health aids reasonably necessary to enable the individual or a dependent to work or sustain health."[38] There, the court relied on the maxim of statutory interpretation that all the words of a statute must be given meaning.[39] The court found that the accepted definition of "benefit" could not include HSAs.[40] Further, the provision was "designed to exempt tangible objects and devices, such as oxygen tanks and

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[32] *Id*. at *5.
[33] *Id*.
[34] *See In re* Mooney, 503 B.R. 916 (Bankr. M.D. Ga. 2014)
[35] *See id.* at 918; *see also* O.C.G.A. § 44-13-100(a)(2)(C).
[36] *Mooney*, 503 B.R. at 919.
[37] *Id*. (emphasis added).
[38] *In re* Stranger, 385 B.R. 758, 764 (Bankr. D. Idaho 2008).
[39] *Id*. at 764.
[40] *Id*.

prosthetics, not money in a health savings account."[41] Additionally, "HSAs are not insurance policies, nor are they governmental assistance programs" and, accordingly, "[e]ven under a liberal construction of the stature, the [c]ourt [wa]s not persuaded by the [d]ebtor's argument that [the money in an HSA] is equivalent to benefits under such a policy or program."[42]

III. Decision of *In re Lietch*

Recently, in *In re Leitch*, the Eighth Circuit Bankruptcy Appellate Panel also ruled that an HSA was not excluded from a debtor's bankruptcy estate.[43] Kirk Leitch, a chapter 7 debtor, asserted his HSA was excluded from his bankruptcy estate under section 541(b)(7)(A)(ii),[44] because he claimed it is a health insurance plan regulated by state law.[45] The chapter 7 trustee objected to the proposed exemption.[46] The bankruptcy court agreed with the trustee and held that the HSA was property of the estate.[47] The BAP affirmed the bankruptcy court.[48]

While the BAP noted that the Minnesota statute stated that a bank can "act as a trustee of certain types of accounts, including health savings accounts," the court found that the HSA in question did not qualify as a state regulated health insurance plan.[49] In particular, the BAP focused on the fact that beneficiary would "incur tax penalties unless the [HSA] funds are used for 'qualified medical expenses,' which are essentially costs of health care '*not compensated by insurance* or otherwise.'" The BAP further reasoned that the HSA was not a state regulated

[41] *Id*.
[42] *Id*.
[43] *See* Leitch v. Christians (*In re* Leitch), 494 B.R. 918 (B.A.P. 8th Cir. 2013).
[44] *Id*. at 919–20. Leitch argued in the alternative that the HSA was exempt from his creditor's claims as an illness benefit under sections 522(d)(10)(C) or (d)(11)(D). The BAP further concluded that the account was not exempt under sections 522(d)(10)(C) or (d)(11)(D) because access to the account was unrestricted and the funds could be used for non-medical expenses. *Id*. at 921.
[45] *Id*. at 921 (citing 11 U.S.C. § 541(b)(7)(A)(ii) (2012)).
[46] *Id*. at 919.
[47] *Id*.
[48] *Id*.
[49] *Id*. (citing MINN. STAT. § 47.75 (2007)).

health insurance plan because the debtor, as the beneficiary to the account, had "liberal access to the funds" and was "entitled to distributions from the account for *any* purpose."[50]

The BAP also rejected the debtor's claim that HSAs should be exempt because the employer withholds the funds. Section 541(b)(7)(A)(ii) provides that property of the estate does not include "any amount withheld by an employer from the wages of employees for payment as contributions to a health insurance plan regulated by State law . . . ."[51] The BAP noted that legislative intent of this section does not support a finding that HSAs should be exempt from the bankruptcy estate. The language of the provision suggests that Congress intended to "exclude the listed withholdings from the disposable income calculation under that provision."[52] The BAP noted that when Congress added section 541(b)(7) as part of the 2005 BAPCPA amendments, health savings accounts had already been created and, in fact, had existed for two years.[53] Congressional silence on HSAs is indicative of Congress's intention to not allow such accounts to be excluded from the estate. The fact that "Congress did not specifically mention HSAs in its amendments," in addition to the fact that the funds could be used for any purpose, led the BAP to conclude that Congress could not have meant for HSAs to be considered health insurance plans regulated by state law.[54]

IV. A Disappearing Issue?

The relevant cases show the courts' reliance on the language of the Bankruptcy Code and the statutory structure. The trend for the courts that have addressed HSAs is to interpret

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[50] *Id*. at 920 (citing I.R.S. NOTICE 2004-50, 2004 WL 1636921 at Q-79) (emphasis added).
[51] 11 U.S.C. § 541(b)(7)(A)(ii) (2012).
[52] COLLIER ON BANKRUPTCY, ¶ 541.23 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009), *available at* LEXIS, 5-541 Collier on Bankruptcy P 541.23. *Id*.
[53] *Leitch* 494 B.R. at 921.
[54] *Id*.

exemptions to the property of the estate narrowly and conclude that they are not exempt.[55] Applying the fundamental tenet of statutory interpretation that dictates that all the words in the statute should be given meaning, courts have held that exemptions dealing with "health aids," "health insurance," and "retirement funds" cannot be construed to include HSAs.

There are few cases addressing the exemption of HSAs that will likely exist in isolation because the issue of whether HSAs are exempt will likely stop arising. With the implementation of the ACA and an increase in low-deductible health insurance, there will likely be a decrease in the use of HSAs. As result, since fewer and fewer debtors will have such accounts, it is unlikely that debtors in the future will continue to attempt to claim these accounts as exempt. While the effect of this marked change on the health care market remains to be seen, the legislative history of both HSAs and the Bankruptcy Code indicate that health savings accounts are not exempt from the bankruptcy estate.

V. Conclusion

While there is significant case law that states HSAs are included in a debtor's disposable income,[56] there are relatively few cases that address whether HSAs are excluded from the bankruptcy estate. As discussed above, in at least four of those cases, the bankruptcy court has held that an HSA was not exempt under section 522 and/or state law.[57] Likewise, courts have

[55] *See Lombardy*, 2012 WL 435816 at *1; *Mooney*, 2014 WL 32388 at *1; *In re Stranger*, 385 B.R. 758, 758; *Leitch*, 494 B.R. 918, 918.

[56] *In re* Maura, 491 B.R. 493, 500 (Bankr. E.D. Mich. 2013); *In re* Melancon, 400 B.R. 521, 522 (Bankr. M.D. La. 2009); *In re* Harris, 353 B.R. 304, 306 (Bankr. E.D. Okla. 2006). These cases, among others, cited the specific and unambiguous language of 11 U.S.C. § 707(b)(2)(A)(ii)(I) which states that a debtor's disposable income includes "reasonably necessary health insurance, disability insurance, and *health savings account* expenses"(emphasis added). These cases addressed issues of ambiguity regarding other expenses listed within section 707 and there are few cases that address health savings accounts specifically.

[57] *Leitch*, 494 B.R. 918, 921; *Lombardy*, 2012 WL 435816 at *1; *In re Stranger*, 385 B.R. 758, 758.

refused to construe the plain language of section 541(b) liberally as to exclude HSAs from property of the estate.[58]

[58] *See Stranger*, 385 B.R. 758, 763 (2008); *Cf. Lombardy*, 2012 WL 435816 at *4.