Health Savings Account
The Swiss Army Knife of Savings Plans

by Lauren N. Desforge, CFP®, CPA/PFS, CDFA®, AEP®

A Health Savings Account (HSA) is like a Swiss Army knife of savings plans and can be a key retirement building block. It has many benefits and is super charged when used to cover the high cost of health care expenses.

There are multiple uses for this flexible plan. An HSA is triple-tax advantaged: 1) pre-tax contributions are made, 2) interest and investment earnings build up tax-free, and 3) withdrawals for qualified healthcare expenses are tax free. There are even ways to use the savings account for non-health related expenses, discussed below. An HSA can be a very cost-effective plan for younger members and those blessed with good health.

Many individuals and families have chosen a high-deductible healthcare plan (HDHP) to reduce the cost of insurance. If you have an HDHP, you owe it to yourself to consider an HSA. Let's define the terms and requirements and then highlight the many benefits and opportunities of an HSA.

What is a Health Savings Account?
An HSA is a special savings account for individuals and families with a high-deductible healthcare plan (HDHP) that can be used to accumulate tax-sheltered cash for healthcare outlays—and more! An HDHP is a health plan that has higher deductibles and usually much lower premiums than preferred provider organization (PPO) or health maintenance organization (HMO) plans.

Who Qualifies to Have an HSA?
- Must be enrolled in an HDHP
- Cannot be enrolled in Medicare
- Cannot be a dependent on another tax return
- Cannot enroll if you or your spouse (enrolled in a family plan) is enrolled in a Health FSA (flexible spending account) unless it is a limited purpose FSA
- Cannot be covered under another health plan

How much can I contribute?
For 2019, the maximum contributions are $3,500 for individual plans and $7,000 for family plans. Individuals and employers can contribute; however, employer contributions are counted in the total HSA contribution limit. Additionally, for individuals who are age 55 or older by year end and who have not enrolled in Medicare, an additional "catch up" contribution of $1,000 may be made.

Employer and employee HSA contributions are not subject to federal income tax and are not subject to state income tax in most states. Contributions for a given year may be made up to the due date of the tax return (usually April 15) without extensions.

How can I use my HSA?

The two most common ways to use an HSA are: 1) to cover ongoing healthcare expenses and 2) to save for future health care expenses. The former way uses the HSA as a short-term strategy to cover ongoing healthcare costs, while the latter way allows you to use it as long-term savings plan, effectively leveraging your investment. To use it as a long-term savings plan, you would pay your health care expenses "out of pocket" while letting the HSA investment grow.

HSA distributions are tax-free to the extent the distributions are used to pay "qualified medical expenses" for you, your spouse, and your dependents. The definition of qualified medical expenses is defined by the IRS (See IRS Publication 969.)

But wait, what if I don't expect to have a lot of future health care expenses?

If you use your HSA funds for non-qualified expenses, there are some tax consequences.

- Taxable as ordinary income plus a 20% penalty if used for non-qualified expenses before age 65
- Taxable as ordinary income if used for anything else age 65 or thereafter

If you are blessed with future good health, beyond celebrating that fact, rest assured that you can use your HSA in some Swiss Army knife ways.

1) **To cover prior health costs.** You may have paid for your ongoing health care costs prior to retirement, allowing your HSA to grow. Your HSA can now be used for expenses other than current health related costs. Like a Swiss Army Knife with its variety of features—from bottle opener to scissors—the HSA is versatile.

   As long as you have saved your health care receipts, and your withdrawal is equal to or less than the amount of your health care expenses, you have a tax-free withdrawal. The prior health care expenses don't need to have been incurred in the year of withdrawal; you can go back years, so save your receipts! Conditions apply, such as the old medical expenses were incurred after the HSA was established.

2) **To cover any expenses after age 65.** Travel, anyone? If you are healthy enough to be footloose and fancy free and want to use the HSA funds for say, a safari, if you are past age 65, you can do that without a penalty.

   The withdrawal would be taxed similar to a withdrawal from an IRA or 401(k) plan—effectively making the HSA a flexible retirement savings vehicle. Your flexible Swiss Army knife-like plan has allowed you to benefit from having made pre-tax contributions and tax-free compounding for possibly years.

3) **To cover long-term care premiums or long-term care costs.** Depending on your age, you can use an HSA to cover long-term care premiums. The IRS sets limits on the amount you can use and updates these limits annually. If you created an HSA account in your 20s, you may be able to use it to pay long-term care premiums in your 70s or 80s. This is like using the Swiss Army knife you bought in your 20s when you are in your 80s—the benefits are still impressive and practical.

Alternatively, you can make withdrawals to cover long-term care expenses as they are incurred, which better leverages the tax-free growth potential.

Last but not least:
Your HSA has additional financial planning benefits too.

- Portability – You take your HSA account with you if you change employers.
- Transferability to a spouse – Upon death, your HSA can be transferred to your spouse tax free, just like an IRA.
- Transferability to a non- spouse – Upon death, transfers to a non-spouse would be 100% taxable as ordinary income.

If you are eligible for an HSA and want to save for the future, want to save on taxes, and plan to be around for a while, you owe it to yourself to consider an HSA. An HSA can be a key retirement building block. The rules are complex, and we recommend that you contact a tax advisor or your HSA trustee for more specific information.
