Do HSAs Come to Mind When Planning for Retirement? Well, They Should!

Background & Opportunity

Congress created Health Savings Accounts (HSAs), to help individuals and families covered by high-deductible health plans (HDHPs) cover out-of-pocket medical costs. These were introduced in 2004 as part of the Medicare Prescription Drug, Improvement and Modernization Act.

These medical savings accounts are 'triple tax advantaged':

- Contributions – tax free
- Account balances – tax-free growth
- Qualified expenses - tax-free withdrawals

For 2021, the IRS defines an HDHP as any plan with a minimum deductible of at least $1,400 for an individual or $2,800 for a family. An HDHP's total yearly out-of-pocket expenses (including deductibles, copayments and coinsurance) can't be more than $7,000 for an individual or $14,000 for a family for in-network services.

There are annual contribution limits ($3,600 for individual and $7,200 for family coverage in 2021) on the amount that can be contributed to an account depending on the type of coverage (individual or family) a person has. HSAs also allow for catch-up contributions (age 55+) of $1,000 in 2021.

Expenses eligible for tax-free reimbursement from an HSA account currently include out-of-pocket costs for doctor visits, prescription drugs, hospital stays, diagnostic services, vision care, dental care and hearing aids, to name a few.

Health Savings Accounts present a great opportunity to add another tax advantaged investment vehicle thereby increasing your retirement savings in a highly tax-efficient manner.

State taxation of HSAs varies, and the savings discussed here is focused on federal income taxes.

Top 10 Things You Need to Know About HSAs

1. **You must be enrolled in a high-deductible health plan (HDHP) to make contributions to an HSA.** If you are over 65, you also can't be enrolled in Medicare Part A or Part B.
2. **You can contribute to an HSA even if you aren't working.** Unlike other tax favored accounts that require earned income to contribute, the only requirement to contribute to an HSA is that you have the appropriate HDHP medical insurance.
3. **HSA funds can remain in the account.** Unlike FSAs, there is no 'use it or lose it' with HSAs. You can roll the funds in your account over from year to year for as long as you like.
4. **You can invest your HSA funds.** Once your HSA reaches a certain level, you can shift the majority of the funds out of your HSA cash account into an HSA investment or mutual fund account if you are with an administrator or bank that provides that option.
5. **HSAs are yours even after you leave a job.** You own the account, not your employer, so the account is portable and stays with you from job to job and after you retire.
6. **HSAs can pay for Medicare premiums and COBRA.** Generally, health insurance premiums aren't qualified medical expenses, however for those that are currently relying on COBRA, those premiums are allowed. Like the COBRA exception, HSAs can reimburse Medicare Part B, Part D and Medicare Advantage premiums for those over 65.
7. **No time limit on reimbursing qualified expenses.** You can wait until a future year to withdraw funds to reimburse qualified medical expenses that were paid in any year after you established your HSA. Just remember you need to have documentation to support the expense in the year of withdrawal. In other words, keep good records of eligible expenses during the years you don't need to dip into your HSA. Then you can begin reimbursing yourself at any time that you need to access the funds, up to and after 65, essentially getting tax-free, penalty-free income for an emergency or retirement.
8. **Starting at age 65, non-qualified distributions are penalty-free.** Like a traditional IRA, the funds go in pre-tax, grow tax deferred and are ultimately taxed as ordinary income when taken out. However, remember if funds are used for non-qualified expenses prior to age 65, they are taxed as ordinary income and are subject to a 20% penalty on withdrawals unless you have receipts as noted above. For healthy people with little to no out-of-pocket qualified medical expenses, this is a great way to save even more for retirement.
9. **No required minimum distributions.** Unlike traditional IRAs and 401(k)s that now require distributions starting at 72, HSAs don't have this requirement thus providing additional retirement planning flexibility.
10. **Question to ask.** Can I afford to use non-HSA funds to pay for current out of pocket medical expenses? Remember, even if you can't keep the entire amount in the account, every dollar that you leave in the HSA can remain invested and grow tax deferred.

Contact an expert!

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Our professionals have the right depth of experience, coupled with the capacity and desire to focus on your needs.