HEALTH SAVINGS ACCOUNTS (HSAs) – An Underutilized Tool for Retirement Savings

Healthcare expenses have become a much larger percentage of the average household budget in the past 10 years. They nearly doubled between 2010 ($1,831 average per household) and 2018 ($3,405 average per household).[1] Many employers have been forced to put high-deductible plans in place since the cost to companies has skyrocketed as well. For 2021, high-deductible plans are defined as having a deductible of at least $1,400 for individuals or $2,800 for families.

If you are in a high-deductible plan and have no other insurance coverage, you can participate in a Health Savings Account (HSA). In 2021, you can contribute up to $3,600 for a covered individual or $7,200 for a covered family.

There are three big advantages to these contributions:

1. They are tax deductible in the year they are contributed.
2. Money in them grows annually without taxes.
3. Distributions from them can be taken tax free if used for qualified medical expenses. (These are necessary medical expenses and not cosmetic items or procedures.)

That is a triple tax benefit, which is not afforded to any other type of investment out there!

Speaking of investments, many HSAs offer investment options to participants, generally if they have over a certain balance. Unlike Flexible Spending Accounts (FSAs), HSAs are not required to be fully spent annually. You can keep the money in them and allow it to grow for future medical expenses. So, if you are nervous about future health care costs during retirement, you can save in HSAs and use it while retired. Some participants forego using HSA dollars to pay for current medical expenses to allow the investments to grow over time and offer more benefit in the future.

There are a few other benefits to HSAs. One is that they are portable if you change jobs. You can keep the old one or roll the money into the HSA offered by your new employer. Another benefit is convenience. You can get a debit card to pay your medical expenses or reimburse yourself for expenses paid outside of the HSA. However, you must keep receipts in case you are audited. Additionally, others can make HSA contributions on your behalf. Some employers even make partial contributions for employees.

I am sure you are saying that this all sounds great, but there must be a downside. The biggest downside is not using the proceeds for qualified medical expenses. If you do so before age 65, you will be charged a 20% penalty on the amount withdrawn, along with paying taxes on it. That is a hefty cost to incur. However, once you reach age 65, you can take money out of the HSA for any reason without penalty. Distributions not used for qualified medical expenses will be taxable as ordinary income, just like pre-tax traditional IRAs or 401(k)s.

Not enough people are using HSAs, though. According to a 2020 study, over 33% of people enrolled in high-deductible plans say they cannot afford HSA contributions.[2] According to the same study, approximately 55% of people with HSAs have not contributed in at least one year. If you have a high-deductible plan and are not using an HSA, it is something to seriously consider.

1. *US Bureau of Labor Statistics*
2. *JAMA Open Network*

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