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How a Health Savings Account Can Help You Now — and Later

As befuddling, frustrating and financially taxing as it can be for consumers to navigate the world of healthcare coverage and benefits, the Affordable Care Act (ACA) era also has given Americans a uniquely versatile and potentially very valuable tool.

It's called the health savings account, a highly tax-favored vehicle that, when paired with a high-deductible health plan (HDHP), can be used not only as an account from which to pay for a wide range of near-term medical expenses, but also as a place in which to invest money that may grow over time, for use later, whether for medical/healthcare expenses or otherwise.

"Most people know you can use your HSA to pay for co-pays, deductibles, prescriptions and other medical expenses not covered by your health insurance, including expenses for dental and vision care," observes CERTIFIED FINANCIAL PLANNER™ Scott Stratton, president of GoodLife Wealth Management in Dallas, Texas. "But fewer people are aware of some of the longer-term benefits of an HSA that make it a very attractive tool to help fund your retirement."

An HSA is a dedicated savings account (typically offered and held by a bank) that houses funds to pay for qualifying medical and healthcare expenses, both immediate and in the future. An HSA must be linked to an HDHP that meets certain government parameters (such as minimum deductibles of $1,300 for an individual; $2,600 for a family).

"It's really important for consumers who want an HSA to confirm that the health plan they're enrolled in or considering enrolling in is HSA-compatible," Stratton emphasizes.

Here's a rundown of benefits, both immediate and long-term, to which HSA owners can gain access:

- **It's about as tax-friendly as a financial vehicle can be,** allowing funds to be contributed pre-income-tax (in the form of an income tax deduction) and withdrawn income-tax-free to pay eligible expenses. "It's like combining the best features of a traditional IRA and a Roth IRA," says Stratton.

  Those benefits come with limits, however. For example, HSAs carry annual contribution limits of $3,350 for an individual and $6,750 for families (limits are $1,000 higher in each category for HSA holders 55 and older).

- **People who contribute to an HSA via an automatic payroll deduction through their employer not only enjoy the income tax break on both ends, they also get a payroll tax deduction**, according to Stratton. Meanwhile, a person who contributes to an HSA directly (such as by transferring money into the HSA from a personal checking account) rather than by payroll deduction still gets the federal income tax breaks, but not the payroll tax deduction.

- **HSA funds can be used for a wide variety of healthcare and medical expenses**, including those not covered by a person's health plan (such as dental, vision and the like).

- **Money deposited into an HSA in a given year that goes unspent can be carried in the account from year to year going forward**, according to Stratton, unlike with flexible savings accounts (FSAs), which often have a use-it-or-lose-it policy where unused balances don't carry over from one year to the next. So by carrying over funds from year to year, you're essentially accumulating money on a tax-free basis to pay future medical/healthcare expenses.

- **The value of funds inside an HSA may grow over time**, as many such accounts apply interest (albeit at a very low rate, particularly in today's low-interest-rate environment). Others actually function similar to a retirement account, giving account holders investment options such as mutual funds in which they can choose to put their assets in order to gain greater growth potential than typical interest-bearing accounts provide. If you choose to invest money inside an HSA, Stratton suggests taking a conservative approach with those funds to protect against losses.

- **Funds from an HSA can be used to cover IRS-qualified medical expenses during retirement**, when those expenses can be particularly burdensome. After age 65, for example, a person can withdraw HSA funds tax-free to pay for Medicare premiums for parts A, B and D, and Medicare HMA, according to Stratton. Funds also can be withdrawn tax-free to pay long-term care insurance premiums. What's more, he notes, **people who are working beyond age 65 can use HSA funds to pay (or reimburse) the costs they incur as employees for their employer-sponsored health plan.**

- **HSAs can function as a pure tax-favored investment vehicle.** People who have maxed out their contributions to tax-favored retirement accounts [such as a 401(k) or IRA] in a given year can put money in an HSA on a tax-favored basis, up to the allowable annual HSA contribution, effectively increasing the annual amount they can contribute to tax-favored plans. And if housed in an HSA with investment options, that money functions much like funds would inside a tax-favored retirement account.

  For example, people with higher incomes may choose to max out their HSA contributions each year, while paying medical/healthcare expenses with money from outside that account, leaving the money inside the HSA untouched. If eventually they withdraw that HSA money to cover qualifying medical/healthcare expenses, it comes out tax-free. If it's withdrawn for other non-qualifying reasons, it's taxed as ordinary income, like funds distributed from a traditional IRA or 401(k).

All these features and benefits make HSAs a compelling option for many consumers, for the short term and the long haul. But HSAs aren't suited for everyone, notes Stratton. For example, families that consistently meet their HDHP's annual deductible might be better off with a low-deductible plan that lacks an HSA.

Given the variables in play with such a determination, it makes sense to talk with a healthcare plan expert (such an independent health insurance agent or broker, or someone in the HR department at work who has a strong knowledge of health plans) for help finding a plan — and perhaps, an HSA — that's well suited to your circumstances and needs.

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