A Look at HSAs

Health Savings Accounts may provide you with remarkable tax advantages.

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Why do higher-income households inquire about Health Savings Accounts? They have heard about what an HSA can potentially offer them: a pool of tax-exempt dollars for health care, a path to tax savings, even a possible source of retirement income after age 65. You may want to look at this option yourself.

About 26 million Americans now have HSAs. You must enroll in a high-deductible health plan (HDHP) to have one, a health insurance option that is not ideal for everybody. In 2018, this deductible must be $1,350 or higher for individuals or $2,650 or higher for a family. In exchange for accepting the high deductible, you may pay relatively low premiums for the coverage.[1,2]

You fund an HSA with tax-free contributions. This year, an individual can direct as much as $3,450 into an HSA, while a family can contribute up to $6,900. (These contribution caps are $1,000 higher if you are 55 or older in 2018.) Some employers will even provide a matching contribution on your behalf.[1,2]

HSAs offer you three potential opportunities for tax savings. Your account contributions are tax free (that is, tax deductible), the earnings in your account grow tax free, and you can withdraw funds from your HSA, tax free, so long as they are used to pay for qualified health care expenses, such as deductibles, co-payments, and hospitalization costs. (HSA funds may not be used to pay health insurance premiums.)[1,3]

At age 65, you can even turn to your HSA for retirement income. Current federal tax law allow an HSA owner 65 and older to withdraw HSA funds for any purpose, penalty free. You can use the an HSA to pay Medicare premiums (other than premiums for a Medicare supplemental policy, such as Medigap) or extended-care insurance premiums. No Required Minimum Distributions (RMDs) are ever required of HSA owners. Keep in mind, however, if you take a distribution that is not used for a qualified medical expense, the money may be taxable and a penalty could apply, depending on your age.[3]

Why is an HSA less attractive for some people? Well, the first thing to mention is the related high-deductible health plan. When you enroll in one of these plans, you agree to pay all (or nearly all) of the cost of medicines, hospital stays, and doctor and dentist visits out of your pocket until that high insurance deductible is reached.[1]

The other hurdle is just saving the money. If you pay for your own health insurance, just meeting the monthly premiums can be a challenge, especially if your household contends with other significant financial pressures. There may not be enough money left over to fund an HSA. Also, if you are a senior (or a younger adult) with a chronic condition or illnesses, you may end up spending all of your annual HSA contribution and reducing your HSA balance to zero year after year. That works against one of the objectives of the HSA – the goal of accumulation, of growing a tax-advantaged health care fund over time.

If you would like to explore opening an HSA, your first step is to consult an insurance professional to see if you can enroll in a qualified HDHP, unless your employer already sponsors such a plan. Finding an HSA provider is next.

Citations.

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