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SUREVEST

WEALTH MANAGEMENT

Health Savings Accounts (HSA)

This week, one of my clients asked me to write about Health Savings Accounts (HSAs), so here's the scoop.

HSAs help people reduce their health insurance costs and save money on taxes. So far, so good, right? However, you can only open an HSA account if you also have a high deductible health insurance plan (HDHP). The threshold to qualify as "high deductible" is at least $1,350 for a single person or $2,700 for a family (as of 2019).

You must work for an employer who offers high deductible health insurance and HSAs as an option or be responsible for purchasing your own health insurance so you can choose an HDHP.

Many people feel they only need health insurance for catastrophic events. That type of bare bones coverage (a high deductible plan) costs less than a lower deductible plan. The HSA gives you the option to save some of the money you might have spent on better (more expensive) health insurance in a tax-advantaged manner.

Tax Benefits of HSAs

You do not pay tax on income you contribute to your HSA. The way this works is you get a tax deduction equal to your contribution amount. This is true even if you take the standard deduction and don't itemize. You can also deduct the amount you contributed on your state tax return, unless you live in California or New Jersey.

Funds can be withdrawn from your HSA at any time (tax-free) to pay for eligible medical expenses such as deductibles, copays, coinsurance, or other out-of-pocket expenses (including vision and dental). What you don't use in a given year will stay invested and continue to grow tax-free.

Withdrawals for non-medical purposes will be taxed—*and* if you are not yet 65, you'll owe a 20% penalty too. Ouch!

Some people confuse HSAs with FSAs (Flexible Spending Accounts). The FSA is similar, but funds cannot be rolled over from year to year, with limited exceptions (use it or lose it).

The 2019 contribution limit to an HSA is $3,500 if you have individual coverage under your HDHP, and $7,000 if you have family HDHP coverage. If you're 55 or older, you can contribute an extra $1,000 a year. You can also use the account to pay for the medical expenses of a spouse or dependent, even if they aren't covered by your HDHP.

HSAs After Age 65

You are no longer eligible to contribute to an HSA once you are enrolled in Medicare. However, funds in your HSA can remain invested and withdrawn tax-free to pay for qualified medical expenses. Withdrawals for non-medical expenses after age 65 will be subject only to ordinary income tax (just like an IRA).

Some People Think HSAs Are Great Because:

- The government is giving a tax incentive to encourage people to shop around and make more educated spending decisions regarding their medical care because they are paying out of pocket (or out of their HSA).
- You can invest funds and growth is tax-free. Just be careful, because you should not take a lot of investment risk when you have a short-time horizon before withdrawal.

The Rap Against HSAs Is:

- They disproportionately benefit higher income families who can afford medical bills that may occur with a higher deductible health plan and can afford to invest $3,500-$7,000 per year. The tax break is also more valuable to folks in higher tax brackets.
- HSAs are a better deal for the younger, healthier crowd who will not have a lot of medical bills and may be able to let the HSA funds compound for many years. The HSA is less attractive as you become older or sicker.

- HSAs complicate your life just a bit because you need to keep track of your medical expenses (at least those paid for with your HSA funds) because HSA contributions and withdrawals need to be reported on tax form 8889.

The Mechanics of Setting Up an HSA:

HSA accounts are typically set up at banks or credit unions. You then instruct your employer, or yourself if you are self-employed, to transfer some of your gross pay (up to the limits) to your HSA account. Most HSA providers offer a debit card for you to pay your health care expenses. Some HSAs also let you pay by check or online bill pay and may use a smartphone app to help you manage your account. Another nice feature to look for when picking an HSA provider is automatic sweeps of excess funds into the investment options you've chosen.

You'll need to keep your receipts for qualified medical expenditures—in case the IRS audits you. Some providers keep digital records for you or allow you to upload copies of your receipts for recordkeeping.

The Bottom Line:

There is no downside to using an HSA if you are comfortable with a HDHP. However, it does complicate your life in terms of tracking and reporting your medical expenses. For example, suppose you are in a 25% combined (state and federal) marginal tax bracket and you can contribute $7,000 per year. You would save $1,750 in taxes ($7,000 x 25%) in exchange for using a HDHP, you will just need to keep track of your medical expenses, pay for them from your HSA account, and report those expenses on IRS form 8889 with your tax return.

Do you have an HSA? Let me know what you think.

Also see: Top HSA Providers from HSAsearch.com and 10 Best HSA Providers for 2019 from *Investors Business Daily*.

- Jeremy Kisner, Director of Financial Planning and Senior Wealth Advisor