How a Health Savings Account Can Help You Save for Retirement

If you're an employee working for a company that offers health insurance as a benefit, you often have the option to choose between two or more plans, each offering different benefits and deductibles. Increasingly popular are high-deductible health plans ("HDHP") to lower premiums, particularly for those who are healthy and do not anticipate the need for frequent medical services.

Each year, the IRS determines what qualifies as a high deductible. For 2021, a health plan with an annual deductible that is not less than $1,400 for self-only coverage or $2,800 for family coverage and has annual out-of-pocket expenses that do not exceed $7,000 for self-only coverage or $14,000 for family coverage would qualify. Out-of-pocket expenses include deductibles, co-payments, and other eligible healthcare expenses, but not insurance premiums. Eligible healthcare expenses include fees for periodic health evaluations, including tests and diagnostic procedures ordered in connection with routine examinations, such as annual physicals or ob/gyn exams; routine prenatal and well-child care; child and adult immunizations; tobacco cessation programs; obesity weight-loss programs; prescriptions; screening services for various medical conditions such as cancer, heart conditions, mental health conditions, and more. For a list of eligible expenses, refer to Publication 969 published by the IRS.

By enrolling in an HDHP, employees will generally also have the option to establish a Health Savings Account ("HSA"). An HSA is different from a Flexible Spending Account ("FSA"). HSAs are essentially savings accounts that help the employee to cover medical expenses that may fall within the deductible or out-of-pocket expense limits. In addition, HSAs offer several tax benefits.

(1) If you're contributing to an employer-provided HSA, the contributions are generally made pre-tax. That helps you to manage your income tax exposure at the end of the year by reducing your taxable income or keeping you in a lower tax bracket. If you are contributing into an HSA that you established, your contributions may be deducted on your income tax return.

(2) The money in the HSA may be invested, typically in interest-bearing accounts, mutual funds or stocks and bonds. The income and growth generated by those investments are tax-free while the assets remain in the HSA.

(3) Withdrawals from the HSA to reimburse yourself for eligible healthcare expenses are also received tax-free.

Each year, the IRS also establishes the amount that can be contributed to an HSA. For 2021, it is $3,600 for individual-only coverage, or $7,200 for family coverage.

So now you must be thinking, "This is great information, but how does this help with my retirement?" Well, if you have sufficient income or cash flow to pay these healthcare out-of-pocket expenses without resorting to using the HSA, then you might want to do that. Just continue saving your receipts and invoices for eligible medical expenses and services. The HSA will act as another tax-advantaged savings account for retirement. During retirement, when income and cash flow may be lessened, you may be able to dip into your HSA to reimburse yourself for some or all of the past accumulated eligible medical bills and services, thereby increasing cash flow. The reason you can do that is because there is no provision in the law that says you must use your HSA funds to reimburse current expenses. By waiting until retirement, you can take advantage of the triple tax advantages of an HSA previously mentioned.

The money contributed to the HSA is made pre-tax or tax-deductible. The investment growth is tax-free. And now, in your retirement days, the withdrawals from the HSA for eligible healthcare expenses are received tax-free. That money can now be used by you for any purpose you see fit.

Conclusion

In general, for those who have a high-deductible health insurance plan, contribute to an HSA, and have the means to pay eligible medical expenses not covered by health insurance, an HSA is an excellent way to supplement your retirement income in the future. Just be sure to keep all of your eligible medical bills and invoices. During retirement, just reimburse yourself for these medical expenses from your HSA, thereby providing yourself with additional cash.

Note that there are a few situations where you may not be eligible to contribute to an HSA even if you have an HDHP, but those situations are not typical. For example, some employees may be covered by an HDHP and also have a healthcare FSA or a Health Reimbursement Arrangement ("HRA") that pays or reimburses for qualified medical expenses. In those situations, consult with your company's human resources professional or your independent tax advisor.

For more information, contact:

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