CAMMACK RETIREMENT

A Closer Look at Health Savings Accounts: An Overlooked Retirement Savings Vehicle

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Welcome once again to our new feature, A Closer Look, where this time we will take a deeper dive into our Top of Mind blog post on one of the most overlooked types of retirement savings vehicles, health savings accounts (HSAs).

How many have heard of Rodney Dangerfield? Hmm....tough crowd! For the uninitiated, he was one of the greatest comedians (at least to me) when I was growing up (I'm 49) and his entire live act centered around jokes about the fact that no one respected him. Well, I feel similarly about HSAs as a retirement plan savings vehicle. You hardly ever hear HSAs brought up when discussing retirement plan savings, though that is beginning to change, as evidenced by the discussion at this summer's Redbook/MFS "A Time For You" event, featuring my colleague Emily Wrightson.

Part of the reason for the lack of publicity in the retirement world has to do with the fact that HSAs were created for health plans. Specifically, they are designed to be a method to save money for medical expenses in high-deductible health plans, where one must pay more medical expenses out of pocket, and thus can benefit from a vehicle to save for those expenses.

Though designed in a health plan context, HSAs are quite a formidable option for retirement savings as well. Here's why:

HSAs can be triple-tax-free — HSAs can not only be tax-deferred, but completely tax-free if used to pay for certain medical expenses. Thus, in such instances, the HSA contribution is not taxed, the growth is not taxed, and the distribution is not taxed! And the better news is that the types of medical expenses that can be paid is liberal, particularly for retirees. For example, the retiree's Medicare premiums can be paid tax-free from an HSA (though not premiums for Medicare supplemental insurance), as can premiums for long-term care insurance (up to certain age-based limits) and COBRA coverage. An HSA can also be used for in-home nursing care. Oddly, over the counter medications are not covered (though there is proposed legislation to change this—see below), but most other medical expenses (e.g., co-pays, deductibles and most other out-of-pocket expenses, including dental) are—and this is the case whether you are retired or not. About the only major restriction is that HSAs cannot be used to pay health insurance premiums other than those described above (e.g., Medicare).

At age 65, HSA withdrawals for non-medical expenses are taxed just like they would be in a traditional retirement plan — HSA withdrawals at age 65 are taxed as ordinary income, just like in a retirement plan such as a 401(k) or 403(b). Thus, HSAs are generally the same as a retirement plan with respect to withdrawals for any expense, except for the fact that the penalty-free withdrawal age is 65 rather than 59½, and the penalty is doubled (20%) in HSAs for withdrawals prior to age 65. (The penalty is waived in the event of disability.) Keep in mind, withdrawals for qualifying medical expenses are tax-free at any age, so even if you retire early you can use the HSA for this purpose. Essentially, HSAs are taxed like a retirement plan in retirement, with the added perk of triple-tax-free withdrawals for medical expenses at any age.

Now, to be certain, there are some drawbacks of HSAs. You must be enrolled in a high-deductible health plan (HDHP), so if your employer does not offer one you're out of luck. An increasing number of employers offer HDHP options, but some do not. In addition, the HSA can only reimburse medical expenses that were paid after the HSA was established. And once you are enrolled in Medicare, you may no longer contribute to an HSA.

If you're not relatively healthy, due to the HSAs relatively low contribution limits ($3,450 for those with individual health coverage, and $6,900 for those with family coverage in 2018, with an additional $1,000 contribution permitted for those 55 and over), you might be spending all that savings on medical expenses each year. In addition, if you have a significant amount of medical expenses it is possible that an HDHP plan is not the best option for you if your employer offers a choice of plan types, in which case an HSA would also not be available to you.

If you are healthy, you can accumulate rather large balances in these plans over time, and most can be invested similarly to a retirement plan. (You should check with your HSA provider for details.) You could certainly do worse for retirement than saving in an HSA (in particular, in comparison to, say, an IRA, though the contribution limits are slightly lower in an HSA), and such accounts should certainly be in the mix for consideration in your retirement planning.

Finally, there is the possibility that HSAs will become even more favorable as a retirement savings vehicle in the not-so-distant future. Legislation has been proposed to enhance HSA accounts to include, among other enhancements, the following features:

- **An HSA could be used to pay for over-the-counter medications.**
- **HSA contribution limits would be raised to $6,650 for individuals and $13,300 for families, which, not coincidentally, is the combined annual limit on out-of-pocket and deductible expenses under an HSA-qualified insurance plan in 2018.**
- **Individuals who are actively employed but participating in Medicare Part A and covered by a qualifying HDHP would be able to contribute to an HSA.**
- **Flexible spending account (FSA) and health reimbursement account (HRA) balances could be transferred to an HSA. Transfers would be limited to $2,650 for individuals and $5,300 for families.**
- **Individuals would no longer be barred from contributing to an HSA if his/her spouse is enrolled in a medical FSA.**

Do you think that HSAs should receive greater publicity as a retirement savings vehicle? Let me know as always on Twitter or at info@cammackretirement.com.

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