

## **Health Savings Accounts—Much More Than Medical Expense Accounts**

May 20, 2024

Updated: Sep 16, 2024

Written By: Ethan Green

Health savings accounts (HSAs) can be more than just a way to tax efficiently pay for qualified medical expenses; you can also use your HSA in retirement. You are eligible to make contributions to an HSA if you have an HSA eligible health plan. An HSA is one of the most powerful types of accounts.

HSAs are triple tax advantaged: Contributions are tax-deductible (there are limits), the earnings in an HSA grow without being taxed, and withdrawals can be made tax-free for qualified medical expenses.

Here is an example of the triple tax advantage: If you are in the 24% federal marginal tax bracket and contribute \$8,300 (2024 family maximum HSA contribution), you could reduce your current taxes by ~\$1,992.

If the HSA grows 5% in a year (to \$8,715) the growth of \$415 is tax-free. If you decided to spend the account on qualified medical expenses, you could do it tax-free. You could withdraw the full \$8,715 and pay no tax.

An HSA is a super combination of a pre-tax IRA and a Roth IRA. You get a tax-deduction for contributions and withdrawals are tax-free for qualified medical expenses.

You could use an HSA to pay for non-medical expenses, but distributions would then be taxable as ordinary income and may have a penalty if they occur before the age of 65.

### **Health Savings Accounts Eligible Health Plan**

The HSA-eligible health plan deductibles and maximum out-of-pocket expenses can change each year.

In 2024, the deductible must be at least \$1,600 for individual coverage and \$3,200 for family coverage. Out-of-pocket costs also can't exceed \$8,050 for an individual and \$16,100 for a family. You also can't be enrolled in Medicare or be claimed as a dependent on someone else's tax return. If you select a health plan that meets these requirements, then you may be eligible to contribute to an HSA.

### Health Savings Accounts Annual Limits

For 2024, the maximum contribution you can make is \$4,150 for individual coverage and \$8,300 for family coverage. For those who are age 55 or older, you can contribute an additional \$1,000.

You have until the tax filing deadline to contribute to an HSA. For example, for 2024, you can make contributions up until April 15, 2025.

Note: If you aren't enrolled in the HSA-eligible health plan for the full year, you may only be able to make a pro rata contribution for the months you were covered by an eligible plan. You don't want to contribute when you are not eligible as you may be subject to a 6% excise tax in the year you contributed and in every year following if you do not remove the excess contributions and its earnings.

### Health Savings Accounts as a Medical IRA

Instead of using your HSA while working, allow it to compound tax-free for years or decades and then use it. While making an HSA contribution and then immediately using it is better than forgoing an HSA (because you get the tax-deduction with the contribution), the more powerful feature of an HSA is that contributions and earnings grow tax-free.

The key to growth in your HSA is for it to be invested in a manner aligned with your goals and/or overall portfolio. Many people have their HSA in a cash account earning a minimum amount. Compare that to someone who fully invests their HSA as they would an IRA or 401k:

Say two people start with \$20,000 in their HSA through years of contributions. One person keeps it in cash and earns 0.5% per year and the other person invests and earns 6% per year.

After 30 years the person who invests has over \$108,000 while the person who keeps it in cash has just under \$23,200.

The person who took a proactive approach now has over \$108,000 that can be used for qualified medical expenses going forward, or they can reimburse themselves for past expenses (more on reimbursing past expenses below).

### Rollover May Be Necessary

One of the common issues people face is that their HSA may not have any

investment options, they are required to keep a certain amount in cash, or they have limited investment options.

However, an HSA can be moved to another HSA custodian with more investment options. You can open an HSA with the other custodian and request that your current custodian move (rollover) the funds to your new HSA.

Since these are self-directed accounts, you can usually invest in any type of investment you'd be able to through an IRA, Roth IRA, or brokerage account.

If you are still employed, you keep contributing through the custodian your employer uses and rollover the funds once a year or every few years. It's normally better to make contributions directly through payroll because those contributions avoid payroll taxes whereas contributions outside of payroll (i.e. made directly to your HSA by you) do not.

### Using your Health Savings Accounts in Retirement

In addition to qualified medical expenses, you can use your HSA for Medicare premiums, Part B and part D deductibles, copays, and coinsurance (not Medigap policies though). You can even pay for long-term care insurance premiums up to a certain amount.

### Reimburse Yourself

One strategy people use is paying with a rewards credit card for qualified medical expenses and then reimbursing themselves, instead of using the debit card that comes with the HSA. This allows them to rack up rewards on their credit card while still using the HSA.

You can use your HSA for prior expenses if the expenses were incurred after you established your HSA. For example, if your HSA was established 20 years ago, you can reimburse yourself for an expense you had 19 years ago.

The simplest way to do this is to track your expenses closely.

1. Scan or take a picture of your receipt showing the medical expense and title the file as "Year, Month, Day – Description of Expense and Amount" and save the file to a cloud folder (Dropbox, SmartVault, Google Drive, etc.). For example, it could be "2024-01-15 Eyeglasses \$300."
2. Maintain a spreadsheet of the expenses by year with a total (also saved to the same cloud folder). For example, you could have columns for the following:



1. Date
2. Amount
3. Description
4. Reimbursed (Yes/No)
5. Total by Year

This allows you to quickly know the running total of how much you could reimburse yourself for at any time, and the receipt is easily findable if you ever need to justify the expense.

## Using your Health Savings Accounts After Age 65

Another benefit of an HSA is that at 65 or older, you can use it like a Traditional IRA.

You can take withdrawals without the 20% penalty, pay ordinary income taxes, and use the funds for non-medical expenses. For example, you could take a withdrawal and use it to pay for travel expenses. Instead of the withdrawal being tax-free, you would owe ordinary income taxes on it – just like an IRA.

It's still better to use the HSA for qualified medical expenses because you can get tax-free withdrawals, even reimbursing yourself for prior medical expenses. But, if you have more in your HSA than you need for medical expenses, you can use it after age 65 for other expenses.

This is another reason why HSAs are powerful retirement tools. You have the flexibility to reimburse yourself for prior qualified medical expenses and can still use it like a pre-tax account in retirement for non-medical expenses.

## Estate Planning with an HSA

One downside to an HSA is that non-spouses inheriting an HSA must withdraw the full amount of the HSA and pay ordinary income tax on it – like an IRA. Spouses can inherit an HSA and treat it as their own, meaning they can continue taking tax-free withdrawals for qualified medical expenses or pay ordinary income taxes at age 65 for non-medical expenses.

## HSAs Provide Options

HSAs are triple advantaged tax-favored retirement savings vehicles. Many people choose to make HSA contributions and spend them, but if you have the patience and time to use them efficiently, a Health Savings Account can make a significant difference throughout retirement.



# Wealth Enhancement®

Whether you use your HSA for tax-free qualified medical expenses in the current year, reimburse yourself for prior year medical expenses, or take withdrawals and pay ordinary income taxes at age 65, you have flexibility and options to use your HSA tax-efficiently.

Talk with a CERTIFIED FINANCIAL PLANNER® professional here at Lake Tahoe Wealth Management to better understand how a Health Savings Account might be part of your financial plan.

## **Disclosure**

There can be no assurance that any particular investment objective will be realized or any investment strategy seeking to achieve such objective will be successful. Investing involves risk, including the possible loss of principal.

Content in this material is for general information only and not intended to provide specific advice or recommendations for any individual.