HSA: Health account with a powerful wealth-building benefit

KEY TAKEAWAYS

What is an HSA?

A health savings account (HSA) is a tax-advantaged account that can be paired with a high-deductible health plan (HDHP).

Why use an HSA?

An HSA has greater tax advantages, and therefore greater savings potential, than other types of savings accounts.

How do I use an HSA?

You can treat an HSA as a long-term investment account, an account for paying medical expenses, or both.

Many people think of an HSA primarily as way to offset medical costs, but you can also invest in an HSA to potentially increase your wealth. In addition to helping to offset your medical costs, HSAs can reduce your taxes, and provide you with a long-term tax-advantaged savings account. And contributions, earnings, and even withdrawals can be tax-exempt if certain requirements are met.

2024 HSA contribution limits	Individuals can contribute up to **$4,150**	Families can contribute up to **$8,300**	Age 55 or older, can contribute an extra **$1,000** *per eligible participant*

Consider these potential benefits of HSAs:

1. **Lower health plan premiums** in an HDHP can offset higher deductibles.

Traditional health plan monthy premium	**$250**
versus	
HSA-qualified health plan monthly premium	**$125**
Annual HSA-qualified health plan premium savings	**$1,500**

*hypothetical example for illustrative purposes only

2. **Employers may offer incentives** to choose an HDHP such as an employer HSA contribution and/or HSA match.

3. **Reduce your annual tax bill** with tax-deductible HSA contributions and avoid FICA payroll taxes (Social Security and Medicare). You can also convert your non-deductible medical bills into fully deductible expenses when you pay from your HSA account.

Contribute $8,300 when you are in the marginal 32% federal tax rate	**$2,656**
+	
Any potential additional state tax savings	
+	
FICA tax savings of 7.65%	**$635**
Total annual tax savings	**$3,291**

4. **No RMDs required for an HSA** and flexibility to access money for any spending needs without penalty starting at age 65.

5. **Opportunity to delay reimbursement on health care spending** in favor of tax-free account growth. Here's how:

Pay for health care now out of pocket

↓

Save your receipts

↓

Let that money grow in your HSA

↓

Reimburse yourself for those expenses whenever you want after account has grown tax-free

6. **Compound any investment and interest earnings by saving in an HSA.** The sum of the potential tax-exempt earnings and tax savings over your lifetime may exceed the extra deductible cost of your health plan each year.

Contribute family maximum $8,300 per year for 10 years at 5% annualized rate of return*	
Total HSA savings	**$109,616**

*hypothetical example assuming annual compound growth rate

Note: To access HSA funds without tax or IRS penalty, you must keep your receipts for qualified medical expenses (for years or decades). Your financial advisor may be able to offer ideas for secure, virtual, long-term document storage if you need help.

An HSA can be a powerful savings vehicle. It's also important to consider when it may not be the optimal choice.

You may not be good candidate for an HDHP with an HSA if you have:

- High immediate health care needs or chronic health conditions.
- Low income or a lack of savings for contributions.
- Signed up for Medicare (this makes you not eligible to contribute to an HSA).

Important tradeoffs to consider

- The penalty before age 65 for non-qualified expenses is 20%, versus 10% for most retirement accounts up to age 59 ½.
- You can't take loans from the account.
- There are no penalty-free distribution exceptions for things like higher-education expenses or a first-time home purchase.
- In many states, HSAs have fewer bankruptcy and creditor protections than retirement accounts.
- HSAs have less favorable estate tax treatment than retirement accounts, when assets are left to anyone other than a spouse.

Which type of account?

(Taxes now, taxes later, or taxes never)

SAVINGS ACCOUNT	CONTRIBUTIONS	INVESTMENT GROWTH	WITHDRAWALS
Health savings account	Pre-tax	Tax-deferred*	Tax-exempt*
Roth IRA or employer plan	Taxable	Tax-deferred	Tax-exempt
Traditional IRA or employer plan	Pre-tax	Tax-deferred	Taxable
529 plan	Taxable	Tax-deferred**	Tax-exempt**
Taxable investment accounts	Taxable	Taxable	Taxable gains

*Distributions must be offset by qualified expenses. For those under 65, non-qualified distributions are subject to a 20% penalty and income tax. For those 65 and older, non-qualified distributions are subject to income tax, but no IRS penalty.

**Distributions must be offset by qualified expenses. Non-qualified distributions from a 529 plan are subject to income tax and a 10% penalty on the earnings portion of the withdrawal.

Notes: When taking withdrawals from a tax-deferred plan before age 59 1/2, you may have to pay ordinary income tax plus a 10% federal tax penalty. This table does not address nondeductible contributions made to a traditional IRA or employer plan.

CASE STUDY

Evaluating a PPO plan versus an HDHP with an HSA

Jack and Jill Smith are evaluating their health care insurance options heading into their open enrollment annual election period. They are both in their 40s, in average health and have two children in elementary school.

Looking at last year's expenses, each family member got their preventative screenings and annual check-ups. In addition, the family members tended to visit the doctor four to five times a month collectively with 12 visits being to Urgent Care, 6 visits to a Specialist and 36 visits to their normal family doctors.

The Smith s are trying to determine if they are better off going with the high deductible plan and investing some of their premium savings in an HSA, even though the deductible on that plan is considerably higher than the PPO plan they have had for the past few years.

They don't expect any major health events or surgeries this upcoming year.

As an incentive for the HDHP, the Smiths can receive a $2,000 employer bonus contribution into their HSA. Since this is a family plan, they can contribute an additional $6,300 up to the family maximum contribution in the HSA if they choose to do so.

The couple is currently in the 32% federal tax bracket and live in the state of Pennsylvania with a 3.07% PA state tax rate.

Assumptions for case study

Costs for doctor's visits for the year
$150 Urgent care=12 visits
$300 Specialist=6 visits
$170 Primary care=36 visits

Math for PPO

- 10 urgent care visits x $150=$1,500
  (meets the deductible)
- Remaining two urgent care visits at $60 x 2=$120
- 6 specialist visits at $60 x 6=$360
- 36 office visits x $40 co-pay=$1,440
- Specialist + Urgent Care co-pay costs=$480

Math for HDHP

- 12 urgent care visits x $150 =$1,800
- 6 specialist visits x $300 = $1,800
- 10 doctors' visits x $170 =$1,700
  (this has now met the deductible of $5,300)
- 26 additional doctor's visits x $170 =$4,420
- 20% coinsurance=$884

For the $8,000 HSA contribution, it was assumed that the $8,000 was made at the beginning of the period for a consecutive 20 years at a 6% average annual compounded growth rate.

Source: Average costs for deductibles, premiums, and doctor's visits were pulled from KFF Kaiser Family Foundation.

Key terms

Premium
The amount you pay for health insurance every month.

Annual deductible
Until you reach the deductible, you pay for all health care services including doctor visits, hospitalizations, outpatient care, tests, and prescription drugs. Preventative visits are usually free regardless of the type of health plan selected.

Coinsurance
After reaching your deductible, cost sharing will kick in and you will owe a percentage of your costs incurred for health care.

Co-pay
Some plans have a co-pay due at the time of service. Co-pays do not count toward your deductible. Once you reach your deductible, you will still have co-pays, which only end when you reach your out-of-pocket maximum. Some plans won't charge a co-pay until after your deductible is met and your provider may charge a co-pay as well as coinsurance.

Maximum out-of-pocket limit
When you reach this amount, the insurance plan pays 100% of covered expenses. Many health plans set a total maximum out-of-pocket limit as well as individual family member out-of-pocket maximums. Co-pays, deductibles, and coinsurance all count toward this maximum. Premiums are paid above this maximum.

Let’s compare their two options and consider the potential tax benefits

HEALTH PLAN YEARLY COSTS	PPO DETAILS	PPO YEARLY TOTAL COST	HDHP WITH HSA DETAILS	HDHP YEARLY TOTAL COST
Premium	$500 biweekly	$13,000	$250 biweekly	$6,500
Family deductible	$1,500	$1,500	$5,300	$5,300
Coinsurance 80/20	Deductible, then 20%	No procedures resulting in coinsurance	Deductible, then 20%	Accounted for in doctor’s visits
Preventative visit	100% covered	$0	100% covered	$0
Specialist visits (6) or urgent care (12)	$60/visit	$480	Deductible, then 20%	Covered in deductible
Office visit (36)	$40/visit	$1,440	Deductible, then 20%	$884
Out-of-pocket maximum/per family member out-of-pocket maximum	$10,000 family max/ $5,000 per person	Plan did not meet out-of-pocket max	$16,000 family max/ $8,000 per person	Plan did not meet out-of-pocket max
Employer contribution to HSA	Not eligible	$0	$2,000 company contribution	–$2,000
Tax savings from total HSA contributions (employee contribution of $6,000 plus $2,000 employer contribution)	HSA not allowed since this is not an HDHP	$0	$8,000 total HSA contribution exempt from 7.65% FICA taxes, 32% federal taxes, and 3.07% PA state tax=total 42.72% taxes	–$3,418
Totals		**$16,420**		**$7,266**

*This is a hypothetical scenario using some average costs leveraging KFF Kaiser Family Foundation average health care costs. Please see disclaimer page for calculations.

RESULT

The Smiths decided to do the HDHP this year. They saved $8,000 per year in a Health Savings Account (HSA) by accepting the $2,000 employer contribution and added $6,000 of their own. They continue to have access to the funds to pay for medical expenses (such as the deductible cost), but they are choosing to let the investment grow tax free to fund their future retirement health care costs, including Medicare, dental, vision, and long-term care expenses.

Let's see how much they can potentially save.

If the Smith s decided to spend the money from the HSA in the current year, they would still get the immediate tax savings and lower premiums on the health plan.

Tax benefits:

$8,000/year in HSA exempt from

- 7.65% FICA taxes
- 32% Federal tax
- 3.07% PA state tax

Annual tax savings

$3,418

Long-term HSA savings:

$8,000/year saved in an HSA

- for 20 years
- at 6% growth

Total HSA savings

$311,942

(Balance can be accessed at any time tax free if used for qualified medical expenses).

Important notes when choosing a plan:

- If Jack and Jill both had a serious car accident and needed extensive health care due to injuries sustained, the PPO plan would end up costing less that year due to the maximum out-of-pocket limit being lower.
- Some families can plan for the coming year when they know they'll hit an out-of-pocket maximum with expected medical procedures and opt into the most appropriate plan.
- HSA money can be spent at any time in the future with proof of a health care expense, no matter what health plan you're currently on.
- You can only contribute to an HSA if you are actively participating in a high-deductible health plan.

For more information about your health savings accounts, contact your financial advisor.

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