The Power of an HSA

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I recently met my mother downtown for lunch when we ran into one of her friends, (let's call her Helen) and they started chatting. Tax season had just ended and she was telling my mother about what a tough year it was for her. Listening to them talk got me thinking, people always look at 401(k)'s, Roth IRA's, and annuities as ways of potentially saving money on taxes, whether that be today or in the future. Perhaps a vehicle that rarely makes it in the discussion but deserves some attention is a Health Savings Account (HSA). HSA's are unique in that they allow you to reduce your taxable income today, as well as provide for tax-free withdrawals tomorrow for qualified medical purposes.

First things first, making sure an HSA is right for you. Before getting too far ahead, make sure you're asking yourself, "Do I qualify?" According to Vanguard's resources, there are three major qualifications to join an HSA,

> To qualify for an HSA, you:
> 1. Must be enrolled in a high-deductible health plan (HDHP) that doesn't cover all medical expenses.
> 2. Can't be covered under Medicare or another health insurance plan, with certain exceptions.
> 3. Can't be claimed as a dependent on someone else's tax return. [1]

It's important to make sure you qualify so you can begin to decide whether or not you can start identifying all of HSA's benefits and whether or not they fit into your financial plan.

How can you strategize your HSA? When you sign up for an HSA, you can now use these funds to make tax-free withdrawals for qualified medical purposes. Until then, you have the opportunity to invest the money, similar to your 401(k). One thing to note is that the amount you contribute annually depends on you as an individual. According to a publication by the IRS on HSAs, "The amount you or any other person can contribute to your HSA depends on the type of HDHP coverage you have, your age, the date you became an eligible individual, and the date you cease to be an eligible individual." [2] Everyone's contribution amount may look different, and you and your financial advisor can detail exactly what you should contribute.

How you can reap the benefits of what you sow in your HSA. You've put in the strategy and funds into your HSA, but now you need it. As mentioned earlier, if it is a qualified medical expense as detailed in your HDHP you can take the funds out tax-free. So let's think about this for a moment, we were able to take a tax deduction on our contribution and we are able to withdraw it tax-free. Let's compare this to both a 401(k) and Roth IRA. With a 401(k) we get a tax deduction today, but have to pay taxes when we pull the money out. With a Roth IRA we get to take money out tax free, but get zero tax deduction today. With proper planning an HSA could prove to be one of the most beneficial pieces to your retirement puzzle because we are getting tax benefits on the way in as well as the way out, something that our 401(k) and Roth IRA cannot provide.

Maybe, you're thinking to yourself, "I don't see many opportunities for medical expenses over the years, what if I need it now?" Unfortunately, if you're younger than 65 years old, the money you remove from an HSA is subject to a penalty. However if you are age 65 or older, you can remove the money from your HSA a your current tax rate. If you find yourself in a similar situation to Helen and need to find more "tax advantaged" solutions, don't forget about the HSA. It could be the piece to the puzzle that you have been missing that could provide the benefits you've been looking for.

[1] https://personal.vanguard.com/us/whatweoffer/overview/healthsavings

[2] https://www.irs.gov/pub/irs-pdf/p969.pdf