# Are You Missing the HSA Opportunity?

**By Leigh Bivings, Ph.D., CFP®**

I like health savings accounts (HSAs) a lot because they are the most tax-advantaged way that investors can save. The reason is that a HSA account is the only type of savings account in which **both contributions and withdrawals are tax-free** as long as the funds are spent on eligible medical expenses. That's a great deal.

Anyone with a high-deductible plan can get an HSA[1]. (Note: Medicare is not a high-deductible plan.) For 2015, annual contributions are capped at $3,350 for an individual and $6,650 for a family. Caps increase by $1,000 for anyone 55 years or older. Money in the account rolls over year to year if you don't spend it and can be invested in stocks and bonds, just like any other investment account. Importantly, unlike other types of health spending accounts, HSAs go with you if you get a new job.

According to recent survey results, HSAs are growing rapidly and about 14 million consumers now have an account. Unfortunately, however, many qualified investors still overlook HSAs and also confuse HSAs with employer-sponsored flexible spending accounts (FSAs) for healthcare. With FSAs, annual contributions (currently capped at $2,550 per employee) are also tax-free as are withdrawals, but the big difference is that one must spend all of the FSA amount contributed over a 15-month period or risk losing the balance. HSA funds do not expire, which makes them a much better vehicle for long-term savings.

Why use a HSA for future medical costs instead of just using it for current health expenditures? With HSAs, the benefits grow over time as earnings increase on a tax-free basis. In this way, HSAs are much like Roth accounts, except better because of not having to pay taxes on contributions. Thus, just like a Roth account, the benefits of HSAs are maximized by deferring their use for as long as possible.

Keep in mind that HSAs must be used for medical expenses. If not, you'll get hit with a 20% penalty (unless you are 65 or older) and owe ordinary income taxes. But as we all know, healthcare is a major expense in retirement, even for those on Medicare, so there is little chance of owing any taxes on account balances given current contribution limits. According to Fidelity Investments, a 65-year old coupled who retire today and live another two decades will spend $245,000 on healthcare expenses, and that figure doesn't include dental and any long-term care. Moreover, there are no required minimum distributions with HSA accounts, as well as no time limits on using the funds.

Is it smarter to save with an HSA account or a 401k account? The key here is that most companies offer

[1] For 2015, the minimum deductible to be eligible for an HSA account is $1,300 for an individual and $2,600 for a family. Likewise, the total out-of-pocket can be no greater than $6,450 for an individual and $12,900 for a family.

matching contributions for 401k accounts based on participation but offer lump-sum contributions for HSA accounts. Thus, it is very important to start by contributing enough to your 401k to get the full match, especially if the match rate is high. Then, the next $3,350 -$6,650 should go to your HSA.

**The Bottom Line**

Take your HSA account, invest it for the long-term (e.g., don't fill it full of bonds), and benefit from the power of tax-free compounding. You'll be very glad you have this extra pool of savings in retirement and be even happier to not owe any taxes on your withdrawals. Alternatively, if you don't like spending after-tax dollars on healthcare at all, utilize an FSA for current expenses.

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