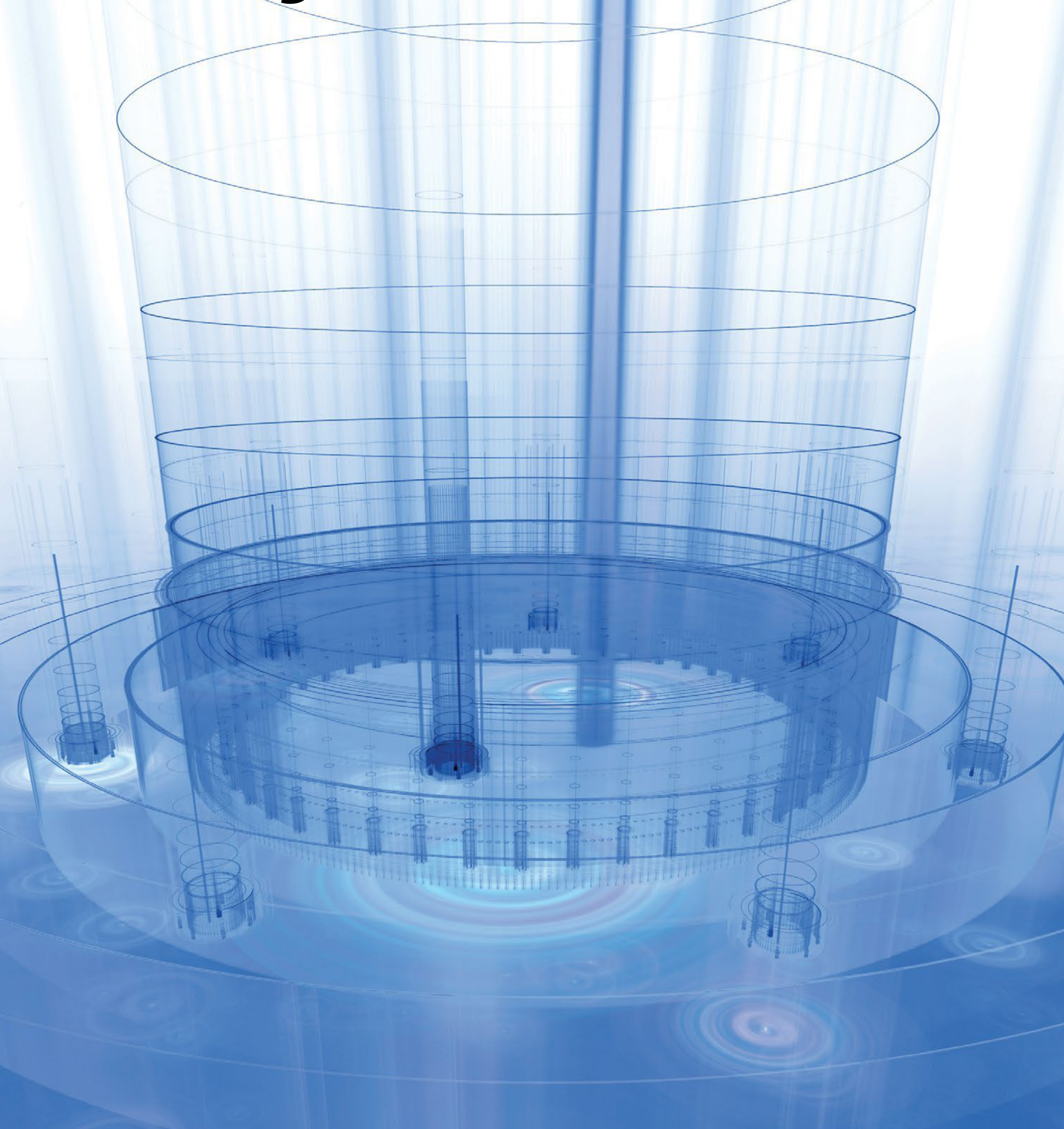
Wealth Management™

2021 Midyear Outlook



Health Savings Accounts: The Most Effective (and Overlooked) Retirement Planning Tool?

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Clients and advisors alike seem to constantly seek the next best thing in retirement planning. However, in doing so, many people have disregarded an existing tool that arguably provides tax benefits beyond many more popular strategies, including Roth IRAs. Health savings accounts, or HSAs, uniquely offer any individual taxpayer—regardless of income level—three important benefits.

First, contributions they make into the HSA reduce their taxable income. In 2021, the family contribution limit is $7,200 (with an additional $1,000 for those over age 55), which exceeds the IRA contribution limits. Second, once the funds are in the HSA, they grow tax-free. And finally, the funds can be removed from the account tax-free provided they are used for qualifying medical expenses. Although many retirement strategies offer at least two of the benefits, the HSA is one of the only ways to grow and use the benefits tax-free.

So why is it that a tool with so much to offer is still underutilized? Many advisors overlook HSAs as a savings tool and fail to educate their clients on the benefits. Consequently, huge misconceptions remain about the available options. Many clients preparing for retirement are unaware the funds can be invested or that the money in the HSA doesn't have to be spent by the end of the year as might be true with other health care savings vehicles.

Even when clients understand the rules, they may be reluctant to "lock up" the funds in an account in which the proceeds can only be used for limited purposes. Fortunately, next to death and taxes, medical expenses in retirement are close to a guarantee. The annual Fidelity study on health care costs in retirement suggests that a person who is 65 and retiring in 2021 can anticipate about $300,000 in health care expenses. That estimate doesn't even cover the costs of long-term care, which can be exponentially greater. Finding qualifying expenses should not be a challenge.

Retirement Vehicle	Contribution Limit	Reduce Taxable Income?	Grows Tax-Free?	Taxable on Distribution?
Traditional IRA	$6,000 ($7,000 if 50 or older)	Yes, with income limitations	Yes	Yes, as ordinary income
Roth IRA	$6,000 ($7,000 if 50 or older)	No	Yes	No
Taxable Savings	None	No	No	No
Health Savings Account	$7,200 ($8,200 if 55 or older)	Yes	Yes	No, for qualified expenses

The long list of qualifying medical expenses also is another surprise to clients. Not only can HSA distributions be made for traditional medical costs, like doctor visits and prescription costs, account holders can use the tax-free funds for dental expenses, Medicare premiums, health insurance premiums and even certain retirement community fees. By taking these expenses tax-free from an HSA, rather than paying them using precious monthly income, they can make cash-flow planning in retirement an easier task.

Clients often express a concern over losing the funds if they pass away before the money is exhausted. Many HSA custodians now allow a client to designate a beneficiary. This means that the retirement savings can be passed to a surviving spouse, or other family members, who can also use the remaining funds for medical expenses if they otherwise qualify. Also, unlike IRAs, the HSA does not have required minimum distributions and can continue to grow tax-free.

These are just a few reasons advisors should talk to each of their clients about utilizing HSAs as an essential element in their retirement planning. ■

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