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A Commonly Forgotten Tool in Retirement Planning

HSA Health Savings Accounts

Many individuals are aware of IRAs, 401(k) plans, 403 (b) plans, and others when starting to build their retirement portfolio. These plans all have their benefits and drawbacks that need to be accounted for. What surprises many is there is another tool that you may be qualified for and are underutilizing. A Health Savings Accounts commonly referred to as an HSA, has some interesting possibilities that could be useful. An HSA is a type of savings account that lets you set aside money on a pre-tax basis to pay for qualifying medical expenses. While you cannot generally use this money saved to pay for health insurance premiums you can use it to pay for deductibles, copayments, coinsurance, and some other types of expenses. While many individuals say they are healthy, my comment is generally there will be a time down the road when they are not. Most farmers will need hearing aids due to years of working around loud machinery, glasses are required as our eyesight worsens, and additional care is required the older we get. This HSA can be a great tool to ensure your other retirement funds can be used for living and fun leisure activities. Here are some of the key benefits to consider:

1. The money placed in this account is pre-tax basis. The money when taken out, if used for a qualifying expense, is also tax free. Currently, as of April 2021, an individual can contribute $3,600 and a family can contribute $7,200. Amounts are adjusted annually. In addition to the annual contribution limits for those 55 and older ,you can contribute an additional $1,000 *catch-up* contribution.
2. The amount contributed rolls over each year until used. Unlike some other policies, an HSA does not have a use-it-or-lose-it mechanism. The account can also be transferred free of probate to your spouse.
3. Interest can be earned in the HSA and is not taxable. There are options to fit most risk tolerance levels on interest earnings. Most banks will offer HSA services ranging from .004% to 2% at the last time I checked. You do also have the option to invest in more aggressive manners though. Many stock market investment firms have HSA options that allow you to invest in mutual funds, stocks, bonds, ETFs, and more. With these investments, you stand to earn more over time but have a greater risk of loss in the short run.

To give you a rough idea, consider investing $3,600 a year into an HSA for 30 years. We will also assume a federal tax bracket at 24% and will be a bit aggressive with our investment shooting for a 7% rate of return. If we are mostly healthy and only withdraw $300 per year for medical expenses, what does this account look like at the end of the 30 years? Well, for starters we have $31,320 of tax savings on tax deferred growth which is always nice. The other important number is that at the end of the 30 years the HSA will have a potential balance of $333,540. This balance will again continue to grow until the money is withdrawn. Those funds as of today would be enough to roughly fund five years in a nursing home out of pocket.

Now let's assume we have a married couple and both are over the age of 55. This couple can put up to $7,200 for the family in an account. They can each also put a $1,000 catch-up contribution in an HSA. The kicker is that the catch-up cannot be placed in a *shared* account. One spouse must put their $1,000 in their account, the other spouse must maintain a separate HSA account and place their $1,000 in it. The $7,200 can be put in either account or split in any agreed-upon arrangement between the two accounts. In other words, to maximize this tool, you may want to consider having two separate HSA accounts for a married couple.

There are some items to keep in mind with an HSA. First, you must be enrolled in a high deductible health plan. Talking with your employer or insurance provider will help clarify your policy's eligibility, but in general, the minimum annual deductible for individuals is $1,400 with a maximum annual deductible and other out-of-pocket expenses of $7,000, family is $2,800 and $14,000 respectively, for 2021. You also do not qualify if you are enrolled in Medicare or can be claimed as a dependent on another taxpayers return. HSA's are not allowed if you have a flexible spending account or a health reimbursement account. The second fact is to review IRS Publication 969 on reporting contributions for your return. The goal is to contribute the funds pretax and to make sure that the crucial guidelines for this are followed. The final comment I will make is that if the beneficiary is not your spouse, say you are leaving it to your child, the account becomes taxable in the year you die.

Many tax professionals would argue that HSA's are superior to retirement plans. While both are used to reduce taxable income on the front end, they are quite different on the back end. Eventually, retirement plans will be taxed as you take distributions. An HSA, both the amount you inject and the earnings throughout the years, will never be taxed as long as the money taken out is used for qualifying medical expense.

This is a very broad overview, but I hope it is enough to get you to consider the possibilities. Talking with your employer about your company's policies and having a discussion with a financial planner and a tax accountant would be good first steps.

Austin Duerfeldt
Extension Educator
Southeast Research & Extension Center
University of Nebraska-Lincoln
aduerfeldt2@unl.edu