EDUCATORS HEALTH SAVINGS ACCOUNT

HSAs and HSA Contribution Limits

For those that are unaware, an HSA is similar to a flexible spending account (FSA), but better. While both provide a tax break on qualified medical expenses, the HSA has a higher annual contribution limit (for 2020: $7,100 for families, $3,550 for individuals) and it's also not subject to the "use it or lose it" provision.

Another very important difference is the freedom to invest funds in an HSA in much the same way you can invest the money in your IRA. While your employer might have a "preferred" HSA custodian (Educators Credit Union), you can actually use any custodian you want.

CONTRIBUTION AND OUT-OF-POCKET LIMITS FOR HEALTH SAVINGS ACCOUNTS AND HIGH-DEDUCTIBLE PLANS

	For 2019	**For 2020**	**Change**
HSA contribution limit (employer + employee)	Self-only: $3,500 Family: $7,000	Self-only: $3,550 Family: $7,100	Self-only: +$50 Family: +$100
HSA catch-up contributions (age 55 or older)*	$1,000	$1,000	No change**
HDHP minimum deductibles	Self-only: $1,350 Family: $2,700	Self-only: $1,400 Family: $2,800	Self-only: +$50 Family: +$100
HDHP maximum out-of-pocket amounts (deductibles, co-payments and other amounts, but not premiums)	Self-only: $6,750 Family: $13,500	Self-only: $6,900 Family: $13,800	Self-only: +$250 Family: +$500

*Catch-up contributions can be made any time during the year in which the HSA participant turns 55.
**Unlike other limits, the HSA catch-up contribution amount is not indexed; any increase would require statutory change.

A better use for our HSA?

Assuming that you can afford to pay for their medical expenses out-of-pocket and make HSA contributions, should you make claims against your HSA? Or should you leave the money in place and let it grow, completely tax free?

When you really think about it, the HSA combines the best attributes of the Traditional and Roth IRAs. That is, it combines the deductible contributions of a Traditional IRA with the tax-free distributions of a Roth IRA. Add to that the high contribution limits and you're talking about a very powerful investment vehicle.

How can an HSA help you save for retirement?

You've probably already zeroed in on this as we've talked about what an HSA is and how it works. One component of an HSA that makes it a good retirement option is that you don't have to spend all the money in one year. If you spend less on qualified medical expenses than you contribute, you just roll the remaining money over to the next year. Over long periods of time, you can roll money over from year to year and make it part of your retirement savings.

Another component that makes HSAs a decent retirement savings option is that once you hit age 65, you can spend the money on things other than qualified medical expenses without being penalized. (Remember, you do have to pay income tax for non-medical withdrawals, though.) In this sense, an HSA is very much like a pre-tax 401(k) [403(b)] or deductible IRA. The only difference is that you have to wait until 65 to use the money penalty-free, rather than 59-1/2.

That being said, the age qualification is a downside. But once you hit 65, you could look to your HSA for some retirement income. And until then, you can use it for a tax-free way to pay medical expenses.

The third thing I like about an HSA as a retirement savings vehicle is that it doesn't limit what you can contribute to your 401(k) [403(b)] or your IRA. You can max out your 401(k) [403(b)]. And if you can, depending on your income and work situation, you may be able to max out an IRA or a Roth IRA. But then you can still max out your contributions to an HSA.

In that sense, an HSA is a way to extend the amount of money you can put away for future medical expenses. But beyond that, the money in your HSA can act as income for your other retirement needs once you reach 65. So an HSA can augment what you're able to put away for retirement.

Getting your money out of your HSA

Obviously, we'll eventually want to get our money back out of our HSA. How can we do that? Simple. According to IRS Publication 969:

When you pay medical expenses during the year that are not reimbursed by your HDHP, you can ask the trustee of your HSA to send you a distribution from your HSA.

- You can receive tax-free distributions from your HSA to pay or be reimbursed for qualified medical expenses you incur after you establish the HSA… You do not have to make distributions from your HSA each year.
- If you are no longer an eligible individual, you can still receive tax-free distributions to pay or reimburse your qualified medical expenses.
- One other little safety net is that, once I turn 65, the 20% penalty for non-qualified distributions goes away.

Here's a quick translation:

- You can take distributions in return for any qualified medical expense that you incur after open your HSA
- You are free to wait as long as you want to take these distributions
- You can even take distributions after you're no longer eligible to contribute to an HSA
- You can also claim qualified expenses incurred after you lose eligibility
- Once you turn 65, you can take non-qualified distributions by paying taxes (like a Traditional IRA) without paying the 20% penalty

Of course, you'll have to save your documentation to make this happen. The good news is that you can simply scan and archive the paperwork (just be sure to keep backups!) as the IRS accepts scanned documents.