Health Savings Accounts

A Health Savings Account (HSA) is a personal savings vehicle that lets you set aside money to pay for qualified medical expenses. The catch is that you must be on a high deductible health plan to contribute to an HSA. Read below for more FAQ.

What Is a Health Savings Account?

HSAs are triple tax advantaged, meaning the money you contribute to the account reduces the income you are required to pay taxes on, grows tax free, and can be distributed tax free for qualified expenses. Only employers and participants enrolled in a High Deductible Health Plan (HDHP) can contribute. These health plans are a cost-effective option for healthy individuals wanting to save money with the low monthly premiums. Once contributions are made, the funds inside the HSA are yours and are freely transferable throughout your career with no expiration. If you switch employers or health plans, the HSA is portable and goes with you.

How Much Can I Contribute?

The IRS sets a maximum contribution limit to all HSA accounts. The HSA contribution limits for 2024 are $4,150 for individual coverage and $8,300 for family coverage. Those age 55 and older can contribute an additional $1,000 as a catch-up contribution. Employer contributions will still count towards the annual maximum limit. You can no longer contribute to an HSA if you go off a high deductible health plan or once you turn age 65 and are enrolled in Medicare. You can still take distributions in both of those scenarios.

What Expenses Are Qualified?

More than you might expect! Qualified medical expenses are designated by the IRS and include various health, vision, dental, and prescription expenses. In addition to copays, deductibles, and coinsurance, other items like orthodontics, chiropractors, sunscreen, and cold medicine may be eligible. You can look up qualified expenses online and if you shop at a major retailer like CVS or Amazon, they will indicate if an item is HSA qualified and you can pay for that item with your HSA debit card.

Investment Options

Once your HSA reaches a certain threshold ($2,000 for example), you can invest the funds in your HSA the same way you invest in your 401(k) or other investment account. HSA providers typically offer several investment options including money market funds, stocks, bonds, and mutual funds. A financial professional can help determine an appropriate allocation based on your cash flow, expense needs, and risk tolerance.

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Using Your Account

You will receive a payment card to access your HSA funds. One strategy is to pay for eligible expenses with any other form of payment (cash, credit card, check) and request reimbursement from your account. Using a rewards credit card for your qualified expenses allows you to receive benefits from your credit card and be reimbursed via direct deposit. You can reimburse yourself at any point as long as the expense was after the HSA was established. It is important to keep track of your receipts through the HSA portal, a budgeting app, or a spreadsheet. If you wait until age 65 to be reimbursed, you will take full advantage of the tax-free growth inside an HSA and can withdraw funds just like a Traditional IRA. This is why these accounts can be thought of as a “Stealth IRA.” Accumulated savings inside the account are eligible to be used for you, your spouse, or eligible dependents.

If used for non-qualifying expenses, the money withdrawn from your HSA is subject to ordinary income tax rates and a 20% penalty is applied on top of the amount withdrawn. That 20% penalty is waived as soon as you reach 65 years old.

Should I Make the Maximum Contribution to My HSA or Retirement Plan First?

This will vary from family to family and depends on your medical expenses, job security, disability insurance, unemployment insurance, value of emergency fund, and investment options in your HSA vs. retirement plan. For example, if you were fired and need to use one of these accounts to pay rent or other bills, your retirement plan is more flexible than an HSA when it comes to non-qualified expenses. HSAs have a 20% penalty vs. 10% for retirement plans. 401(k)s may also offer loans and you can withdraw from IRAs for college or first-time home purchase (limited to $10,000). Starting at age 59½, you can withdraw from retirement plans for any reason and starting at age 65, you can withdraw from HSAs for any reason. Families who do not anticipate any non-qualified early withdrawals before age 65 may want to maximize their HSA first.

If you have any questions, please reach out to your D.A. Davidson financial professional.