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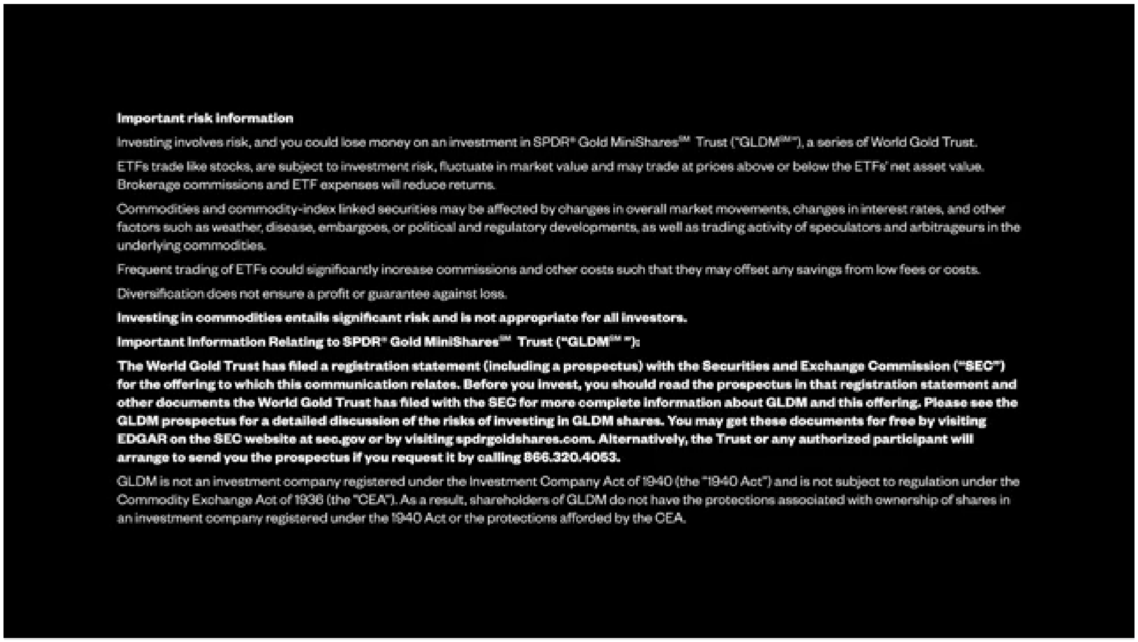
HSAs Offer Path to Tax Deduction

Christine Benz explains the tax advantages of health savings accounts, if you're eligible.



Christine Benz
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Susan Dziubinski: Hi, I'm Susan Dziubinski for Morningstar.com. At tax time, investors often rush to get money into their IRAs. But Morningstar's Christine Benz says there's another tax shelter vehicle worthy of consideration, and that's a health savings account. She's here today to discuss some considerations when funding an HSA.

Christine, thanks for joining us today.

Benz: Susan, it's great to be here.

Dziubinski: Now, let's start by talking about who is eligible to contribute to an HSA. Can anyone do this?

Benz: No, you must be covered by what the IRS considers a high-deductible healthcare plan. So, read the fine print on that. Even if your plan has a high deductible, it's not necessarily HSA eligible. You have to be covered by such a healthcare plan in order to be eligible to contribute to an HSA.

Dziubinski: And if you are eligible, why should you consider it?

Benz: The tax benefits are absolutely fantastic. Not only does an HSA give you a dedicated vehicle for funding out-of-pocket healthcare costs as you incur them, the IRS, the government, gives us good tax reasons to do so. You're able to put in pretax contributions or tax-deductible contributions depending on how you do it. You can enjoy earnings growth without owing taxes. So, if you get that money invested in something long-term and it makes money, you won't pay any taxes on that interest. And then provided you use the funds from the HSA for qualified healthcare expenses, those withdrawals are tax-free as well. So, three big tax advantages, really unrivaled in the whole tax code in terms of tax benefits for investment vehicles.

Dziubinski: Now, an HSA is not one of those use-it-or-lose-it accounts, is it?

Benz: It's not, and thank you for asking because there's lots of confusion about flexible spending arrangements that are use-it-or-lose-it. HSA dollars can roll over from one year to the next, which is why they are appropriate for long-term investment vehicles for people who choose to use them as such.

Dziubinski: Some investors who were eligible to make contributions to an HSA in 2019, who didn't do that still have an opportunity to do that until April 15. So, what are your contribution limits?

Benz: For 2019, assuming that you're still sort of working backwards, and you're trying to hit the limit for last year, it depends on whether you're covered by a single healthcare plan or whether you're covering a family or a spouse. Single-only coverage you can put up to $3,500 in the HSA for 2019. For family coverage, it's double that amount: $7,000. For 2020, those numbers are moving a little bit higher. Unfortunately, bye-bye nice round number: we're going to $3,550 for single people covered by a high-deductible plan, and up to $7,100 for people with family coverage.

Dziubinski: For many of us who are investing in an HSA, your HSA is often chosen by your employer. Is that always the best option?

Benz: Not necessarily, but it usually is the best option. If you have an HSA that is attached to your high deductible plan and you can contribute to it directly through payroll, there's some tax reasons to consider doing it that way, some tax benefits that make that more advantageous than going out on your own and contributing directly to that HSA. The other thing to know is that your employer may give you some goodies to contribute to the HSA, and you want to make sure that you're taking advantage of those. But sometimes employer-provided HSAs can be costly--not necessarily employer-provided HSAs, but HSAs in general have the potential to be costly. There might be extra levels of fees attached to them. You do want to do your due diligence on whatever HSA you're contributing to. The nice thing is that there's a little bit of a workaround. If you do your homework and find out, well, my employer-provided HSA is not that good, you can contribute to it through your payroll and then periodically transfer money out to an HSA of your choosing. Assuming the money stays within the HSA, that is not a taxable maneuver to do those transfers. So, you can kind of get into a better HSA even though you're contributing originally to the employer-provided…

Dziubinski: So, you do have a choice. In other words, it may not seem like it, but you actually do?

Benz: You absolutely do.

Dziubinski: And then, how should an investor go about selecting an HSA if you choose to sort of circumvent or go around the employer's choice?

Benz: I think you do want to think about how you're using the HSA. And our analysts, I think, have done a really good job talking about use case for HSAs. And there are really two key profiles. One is the person who's using the HSA as an ongoing funding vehicle for healthcare expenses. In that case, you want to look at how much are they paying on the short-term savings account, and also whether there are any transaction fees to use the debit card associated with that account. And so, if you're using it as a saver, or as a spender, you may want to prioritize the savings vehicle. On the other hand, if you're looking at the great long-term tax benefits that we've talked about, and use the HSA as a long-term savings vehicle, you'd want to prioritize investment choices. Certainly, costs are absolutely crucial here as well. And also, do your homework on what investment firms are aligned with the HSA account. Our analysts have initiated coverage on some of the largest health savings accounts. I just love this research that they've been doing. As of the most recent landscape report, Fidelity actually emerged as the top-performing or top recommended HSA for both savers and spenders. So, it's an easy one. For the 2019 landscape report, Fidelity came up on top, but we definitely urge people to do their homework and understand what they're doing. These tax benefits are so valuable, but you can erode them if you're in a really high-cost option.

Dziubinski: Right. Well, this is great. You've given us something else to think about before April 15, Christine. Thank you very much for your time.

Benz: Thank you, Susan.

Dziubinski: I'm Susan Dziubinski for Morningstar. Thanks for tuning in.

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