Five things to know about HSAs

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One of the most powerful accounts for helping you cover health care costs is the humble Health Savings Account (HSA). What most people don't understand is it can also be a savings tool for retirement. Here are five things to know about these unique accounts.

1. Not everyone can contribute to an HSA ...

To contribute to an HSA, an individual must meet certain requirements, including:

- Must be enrolled in a qualified high-deductible health plan
- Cannot be enrolled in Medicare
- Cannot be claimed as a dependent on another person's tax return
- Cannot be enrolled in another health insurance plan other than those permitted, such as dental, vision, long-term care and disability insurance

HSA contribution limits

Coverage	2024	2025
Individual	$4,150	$4,300
Family	$8,300	$8,550
Catch-up (age 55 and older)	$1,000	$1,000

Note: You have until the tax-filing deadline to make annual contributions to your HSA (e.g., for the 2024 tax year, you can contribute until the deadline in April 2025).

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2. ... but if you can, you should!

When used as intended, there's no other account type quite as tax favorable as an HSA. *They're triple-tax exempt:*

- Allowable contributions are exempt from federal and most state income taxes, and when deducted directly from your paycheck, they also are free from payroll tax.
- Any earnings growth is tax free.
- Distributions are tax free when used for qualified medical expenses.

Qualified medical expenses generally mirror the description of tax-deductible medical expenses that can be claimed as an itemized deduction. They include things like copays and deductibles for doctor and hospital visits, dental expenses, vision expenses and prescriptions.

3. HSAs provide added flexibility in retirement.

Health care is likely to be one of your largest expenses in retirement. Tracking back to their tax treatment, HSAs are particularly helpful once you retire. Distributions used for qualified medical expenses aren't included in income, so HSAs can help you control your taxes. For instance, you may want to keep your income below certain levels to fall into a lower tax bracket, lower your Medicare premiums and/or avoid net investment income tax.

In retirement, qualified medical expenses could include:

- COBRA premiums before you become eligible for Medicare
- Medicare premiums, copays and deductibles for parts A, B, C and D (but not Medigap premiums) once the account owner reaches age 65
- Qualified long-term care insurance premiums up to federal tax-deductible limits
- Dental expenses, vision expenses, qualified long-term care services and other IRS-qualified medical expenses that aren't covered by Medicare

Tax treatment of retirement accounts

	Traditional retirement	Roth retirement	HSA
Contributions	No income taxes	**Income taxes apply**	No income or FICA taxes
Earnings growth (within account)	Tax deferred	Generally tax free	Tax free when used for qualified health expenses
Distributions	Income taxes apply	Generally tax free	Tax free when used for qualified health expenses
Impact on taxable income	Increases, potentially increasing Social Security tax and Medicare premiums	Generally none	None if used for qualified health expenses

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And there's an extra benefit to HSAs once you reach age 65. Before age 65, distributions not used for qualified medical expenses are generally taxed as income and subject to a 20% penalty. Once you reach age 65, the penalty for non-qualified distributions no longer applies, and HSAs act much like a traditional retirement account when used for reasons other than qualified medical expenses.

Since you will have funded the account with pretax dollars, distributions not used for qualified medical expenses will be treated as income, and thus subject to income tax, but no penalty — the same as a traditional IRA or 401(k). Keep in mind that distributions used for qualified medical expenses will continue to be free of penalties and taxes. So, if you're concerned you might "over-fund" your HSA and have money left over after paying for health care, take comfort that this money can be used for other retirement expenses penalty free.

HSA distribution penalties and taxation

	Younger than 65	65+
Qualified medical expenses	No penalty, no income tax	No penalty, no income tax
Non-qualified expenses	Generally 20% penalty + income tax	Income tax

How to prioritize your retirement savings

When it comes to how you prioritize your retirement savings each month, we generally recommend the following order, starting with your HSA:

1. Contribute enough to your HSA to get any employer match that's available.
2. Contribute enough to your employer's tax-advantaged retirement plan (e.g., 401(k), 403(b)) to get any employer match that's available.
3. Max out your contributions to your HSA.
4. Max out your contributions to tax-advantaged retirement accounts.

4. If you can afford to, save your HSA contributions, don't spend them.

Many people use their HSA as a spending account, taking advantage of the tax-free contributions and distributions, when used for qualified medical expenses. But this approach limits the possibility of tax-free earnings growth.

To really maximize the benefit of this account, consider paying for medical expenses with after-tax, not HSA, money where your budget allows, using the HSA only when necessary. Once you have enough cash to cover your out-of-pocket maximum, consider investing the remainder of the balance. By turning this account into a savings account, you're taking full advantage of all the tax benefits and increasing your ability to cover health care costs in the future, including in retirement.

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5. There are some trade-offs to consider when funding an HSA versus a retirement account.

In addition to their being triple-tax exempt, other benefits of an HSA include:

- Funds are available throughout your life without penalty, provided they are used for qualified medical expenses.
- All assets in the account are always fully vested, meaning you have 100% ownership, and cannot be forfeited.
- There are no required minimum distributions at any age.
- You aren't required to have taxable compensation to contribute.
- There are no phaseouts for higher income levels.

For an account that often doesn't receive much attention, an HSA can be a powerful tool for covering health care costs throughout your life and helping you save for your future. Hopefully this helps you understand some important features and how your HSA might fit into your financial plan.

That said, there are some ways that HSAs are less favorable than other types of retirement accounts:

- The penalty for non-qualified distributions is higher — 20% for HSAs versus 10% for most retirement accounts — and generally exists until age 65, rather than age 59½.
- Unlike with many employer retirement plans, you can't take loans from the account.
- Unlike IRAs, HSAs don't have penalty-free distribution exceptions for things like higher education expenses or a first-time home purchase.
- In many states, HSAs have fewer bankruptcy and creditor protections than retirement accounts.
- HSAs have less favorable estate tax treatment than retirement accounts, when left to anyone other than a spouse.

If those features are important to you, a retirement account may be better suited for saving any amount that exceeds your expected qualified medical costs.

Edward Jones currently does not offer a Health Savings Account, so we cannot open or hold an HSA. We're providing this information solely for educational purposes because we believe HSAs are a helpful tool in saving for health care expenses.

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