Retirement Plan ANALYTICS

Investing Your HSA Funds

Most individuals use their HSA funds for medical expenses each year, and never build a significant balance. While this yearly funding does save on taxes, it is not the most efficient use of HSA money. For those who have the free cash flow to fully fund their HSA and pay for medical expenses out of savings, the HSA can be used as an effective retirement savingsaccount.

The HSA is a triple tax advantaged account: it can provide for tax deductible contributions, tax deferred growth, and tax-free withdrawals. Additionally, most HSA custodians allow for the money in an HSA to be invested. The key to investing this money is the ability to grow the investments in a tax deferred account, alongside of the ability to withdraw the money tax free for qualified purposes. To withdraw the money tax free, it must be used on medical expenses. This includes long term care insurance premiums after age 65 (within set limits).

Distributions that you take from your HSA after age 65 are never subject to penalty. What you use the funds for doesn't matter. However, if you take a distribution that is *not* used for qualified medical expenses, it will be taxable.

The first, and most critical step, to "supercharging" your HSA is to ensure that the maximum amount possible is contributed to your account each year (for 2022, this is an individual maximum of $3,650, and a family maximum of $7,300. Additional catch-up $1,000 for those 55+). Each dollar that you contribute from your paycheck to your HSA account provides savings on federal, state, and payroll taxes (both employer side and employee side).

The second step, and the key to effectively investing money in your HSA for the long term, is paying out of pocket for medical expenses today and allowing your HSA to grow unhindered by taxes. For this to be possible, you should have an emergency fund in place which will allow for medical expenses to be paid out-of-pocket.

What many people are not aware of is the ability to defer reimbursement from their HSA indefinitely from qualified medical expenses incurred *now* (if the expenses were incurred after the HAS was established).

If the receipt is saved from the qualifying medical expense, then you can turn in the receipt and reimburse yourself whenever you desire (if you didn't take a tax deduction for the expense)! This effectively turns your HSA balance into a bucket of tax-free money that can be tapped whenever additional funds are needed, even into retirement!

Please note that there is always the possibility for potential changes in tax law, or the loss of medical receipts. My response to these issues is twofold:

1. With the meteoric rise in medical costs, the government is unlikely to cut something which is helping individuals to afford these increases. And, if changes were to be made, there would likely be some type of grandfathering provision, or a period within which adjustments could be made prior to new legislation being put into place.
2. The risk of losing medical receipts is very real. However, if you are diligent and save these receipts to some type of online cloud storage, this risk is minimized. Additionally, since the average retired couple needs on average $280,000 in retirement, there will be plenty of opportunity to withdraw funds from an HSA, even if every receipt from pre-retirement were to be lost. There are numerous apps for your smartphone which help with receipt scanning and saving, and many HSA providers even provide online storage for receipts.

For those who wish to pursue this strategy of investing HSA funds for the long term, the investment options and account fees become more important, especially as the balance grows. To optimize the investment options and fee structure for your HSA account, a yearly transfer can be performed from your default HSA provider to a preferred HSA custodian. Several HSA providers have been created for the main purpose of providing HSA investors a better platform (such as "Lively HSA"). Websites such as "The HSA Report Card" can provide detailed analysis on the varying options available.

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