

■ MID-CAREER PLANNERS

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EXPERT
INSIGHTS

BOOST YOUR RETIREMENT FUNDS WITH Health Savings Accounts

BY CHRISTINE BENZ

You’ve crunched the numbers and determined that in order to retire on schedule, you’ve got to kick up your retirement-plan contributions. So, you’ve dutifully been making the maximum allowable company retirement plan and IRA deposits, and you’ve even begun saving for retirement in your taxable brokerage account. But there’s one retirement wrapper that you may be neglecting: a health savings account (HSA).

True, HSAs aren’t specifically designed as retirement savings vehicles. Rather, their ostensible function is to cover the higher out-of-pocket costs that accompany being covered by a high-deductible health-care plan rather than a traditional health-care plan. But for people with limited ongoing medical expenses, an HSA can be a great piggy bank for additional retirement savings. And the tax benefits of HSAs are so generous that even people with more significant health-care costs might consider paying those expenses out of pocket, provided they can afford to do so, allowing the money can continue to compound in the HSA.

Many workers have the option to choose a traditional health-insurance plan through their employer, such as a PPO, or the high-deductible health-care plan/HSA combination. Opting for traditional insurance may seem more appealing because of its familiarity and its lower out-of-pocket costs. But the tax benefits of HSAs, which are available only to those

who are covered by a high-deductible health-care plan, are such that individuals should revisit that decision—especially if they’re already taking advantage of other retirement-savings options like IRAs and 401(k)s.

Alphabet soup confusion

Before discussing the merits of HSAs as a retirement-savings vehicle, let’s first clear up a few common points of confusion about the accounts. People often mix up HSAs with FSAs, or flexible spending accounts, and there are some similarities. But there are key differences, too.

With both account types, you don’t pay taxes on the money going into the account, and the money isn’t taxable on the way out, either, provided it’s being used for qualified health-care expenditures. Both account types cover a wide range of expenses, including deductibles and copayments, but the funds are not usable for insurance premiums in most instances unless you’re over age 65.

However, the limit on FSA contributions is lower than is the case for HSAs. For 2019, the HSA contribution limit is \$3,500 for individuals with self-only coverage through a high-deductible health-care plan and \$7,000 for those with family coverage. People over age 55 can contribute an additional \$1,000 to an HSA for 2019 (similar to an IRA catch-up contribution). Meanwhile, the contribution limit is \$2,700 for FSAs, and there are no catch-up contributions for people over 55.

The major difference between HSAs and FSAs, however, is that HSA owners have much more of an opportunity for their assets to grow over time. Flexible spending

accounts are no longer strictly “use it or lose it” as they were in the past; before the IRS changed the rules in late 2013, FSA funds not used by year-end would be forfeited. But FSA-account owners can only roll over \$500 of their unused balances from one year to the next.

By contrast, there’s no limit on the amount of unused HSA funds that can roll over from one year to the next. Moreover, HSA assets can be invested in stocks and bonds, as well as interest-bearing savings accounts, whereas monies in an FSA do not compound.

Yes, you will need the money (but it’s OK if you don’t)

Some investors considering an HSA as an additional retirement-savings vehicle may be put off by the fact that there are strictures on health-care expenses. The only way to obtain the triple tax benefit that HSAs afford—pretax contributions, tax-free compounding, and tax-free withdrawals—is to use the proceeds to cover health-care costs. But being realistic about the out-of-pocket health-care costs you’re apt to face in retirement can help you get over that hurdle in a hurry.

It’s also worth noting that at age 65, HSA investors can pull out their funds and use the proceeds on anything they like. The tax treatment isn’t as favorable as it would be if the distributions were used for qualified health-care expenditures, but it’s still decent. In fact, it’s akin to the tax treatment of assets in a traditional 401(k) or deductible traditional IRA: pretax contributions, tax-deferred compounding, and withdrawals taxed as ordinary income. From that standpoint, funding an HSA is on near-equal footing

with funding a 401(k). (If you pull assets from an HSA prior to age 65 and don’t use them on qualified health-care expenses, you’ll owe both ordinary income taxes and a 20 percent penalty.)

Which account type gets top billing?

Even HSA true believers may find themselves stumped on a few items, though. Assuming they have a finite pool of assets to invest each year, which account type should you give priority: 401(k), IRA, or HSA?

We posed that question to investment advisor Rob Morrison, president of Huber Financial Advisors in Lincolnshire, Illinois. He believes that as a retirement-savings vehicle, an HSA should come after a 401(k) or IRA mainly because early HSA withdrawals come with more strings attached. “HSAs should be funded only after 401(k)s and IRAs in most cases because access to [HSA] funds for retirement is allowable at 65 versus 59 for 401(k)s and IRAs. And the penalty is higher (20% versus 10% for IRAs and 401(k)s) for any non-medical distributions prior to [those ages],” he said.

Financial advisor Allan Roth of Wealth Logic in Colorado Springs, is of a similar mind, but thinks that savers might reasonably put an HSA further up in the funding queue under certain circumstances. “In practice, I use an HSA after all other tax-advantaged vehicles are maxed out, but there is an argument to use it even before. This is especially true if one has a lousy 401(k) with expensive options and no matching,”

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■ MID-CAREER PLANNERS: Road Map

Investment advice abounds for people just starting out in their careers, as well as for those who are getting ready to retire.

But mid-career investors, people in their 40s and 50s? Not so much. Workers at this life stage may be at their peak earnings level, and therefore may have more complex financial needs than their younger counterparts. Moreover, mid-career investors are frequently juggling the competing financial demands of college and retirement savings. That’s no small task, especially when you stop to consider the big price tags associated with each, as well as the complexities of calibrating two separate pots of money with two different time horizons.

Even so, you tend to see less information about how mid-career accumulators should invest and manage their finances differently than their younger and older counterparts. Like 20- and 30-somethings, mid-career accumulators still have a decent amount of human capital, or earnings power. And with a runway of 15 or 20 years until retirement—and perhaps 25 or 30 more years in retirement—they can usually afford to take plenty of equity

risk with their investment portfolios. What follows are some priorities to keep in mind if you’re a mid-career accumulator looking to make sure you’re on the right track with your financial and investing life.

Nurture your human capital

Investing in human capital—via additional education or training—is close to a slam-dunk for early career accumulators. If you can increase your earnings power with such an investment, you have a long time until retirement to benefit from it. The calculus isn’t as simple as you get older, which helps explain why med schools and high-priced MBA programs aren’t jam-packed with people in their 40s and older. Higher lifetime earnings may not offset the outlay of money and time for costly training later in life.

Yet mid-career accumulators should still make an ongoing investment in their own human capital—taking advantage of continuing education programs and conferences to enhance their skills, networking, and simply staying current on the latest news and developments in their fields.

Balance college funding with other goals

Balancing college funding against saving for retirement is arguably the biggest financial challenge facing many mid-career accumulators. Many parents naturally feel the tug of shouldering at least a portion of their children’s college costs.

How to reconcile these competing goals? We’d advise putting retirement readiness front and center on your financial dashboard. The reason is that if retirement is drawing close and you have a shortfall in your savings, you’ll have fewer levers available to you than is the case if your child gets close to matriculation and you haven’t socked away the tuition.

Protect what you have

The more assets you have, the more important it is to protect what you have. The same basic insurance types that were valuable in your 20s and 30s—health, disability, property and casualty, and life insurance—remain every bit as essential as you head into your 40s and 50s. Homeowners also should consider a personal liability policy to cover them in case an accident or other incident should oc-

cur on their property. Finally, the 50s are a good life stage to assess whether a long-term care insurance policy makes sense in your situation; the longer you wait, the higher your insurance costs are apt to rise and the more likely you are to encounter a health condition that could disqualify you from purchasing the insurance.

Combat lifestyle creep and step up your savings

The 40s and 50s often are considered the peak earnings years. But with higher earnings, it’s easy to let “lifestyle creep” gobble up every bit of your extra income.

One way to help ensure that your savings steps up with your income by switching on the auto-increase feature of your company retirement plan; that way your 401(k) contributions will increase each time you get a raise and you won’t have a chance to get accustomed to the higher income.

At age 50 you also can start taking advantage of what are called catch-up contributions, which allow you to steer an additional \$6,000 per year to your 401(k), 403(b), or 457 plan and an extra \$1,000 into an IRA.

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