Season 1 – Episode 1: Understanding Health Savings Accounts (HSAs): Requirements, Basics & Investment Opportunities

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Host: Daniel J. Rohr, CPA/PFS, EA, M.S. Tax

Welcome to Tax Blueprints, a Rohr CPA's podcast. I'm Daniel Rohr, the managing shareholder of Rohr Associates, a premier CPA firm based in California. I'm a CPA Personal Financial Specialist and Enrolled Agent. I have extensive experience advising individuals and business owners with tax minimization and personal financial planning strategies. On each episode of Tax Blueprints, I delve into the intricacies of tax laws, explain the subtleties of business tax planning, and guide individuals towards the path of financial stability. If you're a business owner navigating the murky waters of taxation or an individual planning for a worry-free retirement, Tax Blueprints will provide you with the tools and knowledge you need. I hope you enjoy this episode.

Today we're going to dive into one of the most powerful, yet often misunderstood tools and personal finance, Health Savings Accounts, or HSA's. Whether you're new to HSA's or you've been using one for years, I hope this podcast will provide some valuable insights. So let's get started.

First, let's answer the question, what's an HSA? An HSA is a type of savings account that lets you set aside money. On a pretax basis to pay for qualified medical expenses. Now what makes an HSA so special is a triple tax advantage. Your contributions are tax deductible, the account grows tax-free and withdrawals for qualified medical expenses are also tax-free.

Unfortunately, not everyone can open an HSA as there are certain eligibility criteria. First, you must be enrolled in the High Deductible Health Plan and for 2023 this means a minimum deductible of 1400 for an individual. For 2800 for a family, in my experience, however, this is pretty easy hurdle to clear. And second, you can't be enrolled in Medicare or be claimed as a dependent on someone else's tax return. So you can't open these up for your kids like you can with Roth IRA's. Lastly, you can't have any other health coverage except what's permitted by the IRS like dental or vision insurance.

The annual contribution limits for HSAs in 2023. Are 3650 for an individual and 7300 for a family. If you're 55 or older, you can contribute an additional $1000 If both you and your spouse are over 55, as long as you each have your own HSA account, you can each contribute the additional thousand, giving you a total contribution for the year of $9300. It's important to note that these contributions can be made by you, your employer or both.

Now, regarding withdrawals, you can withdraw money from your HSA at any time, tax free for qualified medical expenses. The list of eligible expenses is quite broad, including things like prescriptions, doctor's visits, dental care, and eyeglasses. An extremely powerful fact of the HSA is that you can use HSA funds to reimburse yourself for all qualified medical expenses. Regardless of when you originally incurred the medical expense. Meaning you can take money out of an HSA and treat it as a reimbursement for medical costs that were incurred say 10 plus years prior. It's extremely powerful for tax reduction purposes in retirement. To be clear though, if you use the money for non-qualified expenses and you're under age 65, you will pay income tax plus a 20% penalty. And after age 65, you'll just pay regular income tax on qualified withdrawals, which is essentially A medically advantaged IRA without any requirement of distributions.

And here's where HSA's are so valuable. HSA's are not just for current medical expenses, you can also use them for a long term savings and investing, unlike flexible spending accounts or FSA's. HSA's don't have a use it or lose it policy. Your money can roll over year after year and the account can earn interest. It actually gets better though. Many HSA providers offer investment options that allow you to invest your HSA funds much like you will with a 401K or an IRA. This means you could potentially grow your HSA balance substantially over the long term.

And remember, all growth is tax-free. As long as it's used for qualified medical expenses, and if you are reimbursing qualified medical expenses for expenses you've incurred 20 or 30 years prior, as long as you have the receipts, you are not going to pay taxes on that withdrawal and you'll be able to have an invested HSA growing for a very long time. It's extremely powerful and if you think about it, healthcare costs often rise as we age. By investing your HSA funds, you can help ensure you have money to cover those costs in the future. And of course, like all investing, there's risk involved and you should consider your personal risk tolerance and investment goals before making any decisions.

It's also worth mentioning that once you're enrolled in Medicare, you can no longer contribute to an HSA, but you can still use the money in your HSA to pay for qualified medical expenses, which now include Medicare premiums except for Medigap.

Now as a CPA often get asked if I should use my HSA for current medical expenses or save it for the future. My answer is it depends and if you have the financial ability to pay for current medical expenses out of pocket and let your HSA grow, that could potentially give you a larger tax free sum for healthcare costs and retirement. However, everyone's situation is different in this approach may not be right for everyone.

Another common question is how do HSA's work exactly for my taxes? As we discussed earlier, contributions are tax deductible. For those who make contributions directly, they can deduct those contributions on their tax return. For those whose contributions are made through their employer, those contributions are made with pretax dollars and aren't included in your gross income to begin with. It's a reduction on your W2. Now for California residents, HSA's are not deductible and if you invest with your HSA like we previously discussed. The activity in the account is treated as a regular taxable brokerage account where you will pay current California taxes on dividends, interest and capital gains. So if you're investing these HSA accounts and you live in California, make sure you are giving your CPA that information from those accounts so they can accurately report on the California return, any interest or dividends, or if you sell anything inside that HSA account, any capital gains or losses. It'll be treated no different than if you have a regular brokerage account.

Another thing to remember is that you have to keep a record of your medical expenses to show that your withdrawals were used for qualified medical expenses and in case you ever get audited by the IRS. And if you have an HSA, you'll need to file the Form 8889 with your tax return. Now the expense records are extremely important, especially if you are investing the HSA holding on to it until after retirement you're going to. Want to show that you are reimbursing yourself for years and years of medical expenses? So one thing I recommend is saving maybe in One Drive or some kind of an offsite storage where you have access to those receipts scanned in over time.

Now we've covered most of the basics of HSA's, the requirements and investment opportunities, and I want to share a few tips on using HSA's. If your employer contributes to your HSA, that's considered free money and make sure you take advantage of it. So check with your HR and see if that's even an option for you now. Second, if you consider using your HSA as the backup emergency fund, well, it's not ideal to use HSA funds for nonmedical expenses. The option is there in a pinch. Just remember there's a tax and a pretty large penalty if you do end up using it as an emergency fund. Lastly, if you're in a position to do so, consider maxing out your HSA contributions before contributing to other retirement accounts like IRA's backdoor Roth because the HSA provides a triple tax advantage that other accounts don't, even nice Roth IRA accounts.

Now to conclude, HSA's are a fantastic tool. They provide a tax efficient way to pay for medical expenses both now and in the future, plus with the potential for long-term growth through investments. They can play a crucial role in your overall financial plan, and as with any financial decision, it's important to consider your unique situation and goals.

That's all for this episode of Tax Blueprints of Rohr CPAs podcast. You can find us online at rohrcpas.com/podcast. And don't forget to subscribe on Apple Podcasts or Spotify if you enjoy the show. Please consider rating or reviewing us wherever you listen. I'm your host, Daniel Rohr. Thanks for listening.

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