THE HILL

Health Savings Accounts best 401(k)s and the rest

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For ObamaCare enrollees, federal employees, and many others with job-based coverage, it's open enrollment season. Open enrollment is the time of year when households can choose a new health plan. Many workers can also make changes to their retirement accounts and other benefits. So it's a good time to highlight the tax advantages of health savings accounts (HSAs).
HSAs have been around for nearly 20 years. Many people know they can reduce your premiums, reduce your taxable income, and allow you to pay for medical care with pre-tax dollars. Yet many still do not know HSAs offer greater tax advantages than 401(k)s, 403(b)s, traditional IRAs, Roth IRAs, and other savings vehicles.

HSA-qualified high-deductible health plans generally have lower monthly premiums than more comprehensive health insurance. Enrollees can channel that premium savings into an HSA.

Contributing to an HSA reduces your taxable income. In 2022, individuals who have HSA-compatible health plans can contribute up to $3,650 tax-free. Families can contribute up to $7,300 tax-free. Contributions that workers make via payroll deduction escape both income and payroll taxes. Contributions an individual makes out of her take-home pay escape only income taxes.

HSA holders pay no taxes on the growth in their accounts.

Account holders can withdraw funds whenever they wish. (HSAs belong to the account holder just like any other savings account.) When account holders withdraw funds to purchase qualified medical expenses, those withdrawals are tax-free. When they withdraw funds for non-medical expenses, they must pay income taxes on those funds (plus a 20 percent penalty before age 65).

Taken in combination, these features allow HSAs to be much more than a piggybank for paying health care expenses. Some investment advisors say HSAs are the best retirement-savings vehicle because only HSAs allow the trifecta of tax-free contributions, earnings, and withdrawals.

While other retirement-savings vehicles offer tax advantages, Congress still taxes them at one point or another. Congress does not tax 401(k), 403(b), or traditional IRA contributions. Nor does it tax the growth in those accounts. But it does tax withdrawals. It also forces these account holders to begin withdrawing money-to make "required minimum distributions"-when they reach their 70s.

With Roth IRAs, Congress does not tax growth or withdrawals but does tax contributions. Only HSAs combine tax-free deposits, tax-free growth, and tax-free withdrawals for qualified medical expenses. HSAs also have no minimum-distribution requirements.

These features make HSAs an exceptional retirement-savings vehicle. In essence, an HSA can operate like a 401(k) but with the additional flexibility of withdrawals for tax-free medical purposes and no mandatory withdrawals.

HSA holders who pay their out-of-pocket medical expenses without dipping into their HSA have even more flexibility. They can use their HSA exclusively as a retirement-savings vehicle.

Plus, to the extent HSA holders use after-tax dollars to pay for out-of-pocket medical expenses, they can later make tax-free withdrawals and spend the money on *non*-medical items. Suppose an HSA holder purchases $1,400 of physical therapy with after-tax income. Ten years down the road, she can reimburse herself by withdrawing $1,400 from her HSA and then use that money to pay for a hot water heater. (As with all tax-free HSA withdrawals, she would want to save her physical-therapy receipts in case the IRS came snooping around.) In the meantime, that $1,400 would earn 10 years of tax-free interest.

How can this be? Congress does not require that tax-free HSA withdrawals occur at the same time the account holder incurs a qualified medical expense. It only requires that tax-free withdrawals not exceed the total amount of qualified medical expenditures the HSA holder has made since establishing the account. HSA holders can continue making such delayed withdrawals, tax-free, even after disenrolling from an HSA-qualified health plan.

Critics complain the tax advantages of HSAs are *too* attractive, particularly for high-income earners. If so, it is because HSAs mimic the tax exclusion for employer-paid health insurance premiums, which offers even greater tax advantages to high-income earners. Open enrollment is a good time to remind Congress that it should eliminate the exclusion and all tax preferences for health-related uses of income.

Until then, HSAs can limit those tax preferences and the distortions they cause, plus offer many households an even better way to save for retirement.

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