HSA: Health account with a powerful wealth-building benefit

KEY TAKEAWAYS:

What is an HSA?

A health savings account (HSA) is a tax-advantaged account that can be paired with a high-deductible health plan.

Why use an HSA?

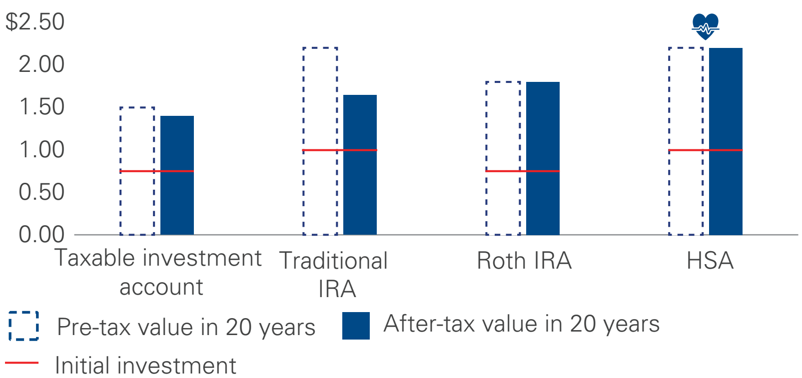
An HSA has greater tax advantages, and therefore greater savings potential, than other types of savings accounts.

How do I use an HSA?

You can treat an HSA as a long-term investment account, an account for paying medical expenses, or both.

If you have access to an HSA, you can invest in it to significantly increase your potential wealth. That's because contributions, earnings, and even withdrawals can be tax-exempt if certain requirements are met. For 2021, you can contribute up to $3,600 as an individual, or $7,200 per family; if you're 55 or older, you can contribute an additional $1,000 per eligible participant. To access HSA funds without tax or IRS penalty, it's essential that you keep your receipts for qualified medical expenses (perhaps for years or decades). I can help with some ideas for secure, virtual, long-term document storage if you need assistance.

The favored tax status of HSAs can boost long-term savings



Notes: This hypothetical illustration does not represent the return on any particular investment, and the return rate is not guaranteed. Calculations assume a 4% annual real return, a 2% annual income return, a 24% income tax rate, and a 15% capital gains tax rate. Lower tax rates may make the taxable investment more favorable and the difference between taxable and tax-deferred less. Any future changes in the tax treatment of investment earnings or a rate of return that is lower than the assumed rate of return may further affect the comparison. Investors should consider their time horizon and current and expected future tax rates before making an investment decision.

Source: Vanguard.

You can think of your tax savings on HSA contributions as a "tax-code bonus."

Which type of account?

(Taxes now, taxes later, or maybe never)

SAVINGS ACCOUNT	CONTRIBUTIONS	INVESTMENT GROWTH	WITHDRAWALS
Health savings account	Pre-tax	Tax-deferred	Tax-exempt*
Roth IRA or employer plan	Taxable	Tax-deferred	Tax-exempt
Traditional IRA or employer plan	Pre-tax	Tax-deferred	Taxable
529 plan	Taxable	Tax-deferred	Tax-exempt*
Taxable investment accounts	Taxable	Taxable	Taxable gains

*Distributions must be offset by qualified expenses.

Notes: When taking withdrawals from a tax-deferred plan before age 59½, you may have to pay ordinary income tax plus a 10% federal penalty tax. This table does not address nondeductible contributions made to a traditional IRA or employer plan.

Which to fund first?

Smart account prioritization can maximize long-term tax-adjusted growth

1. Employer plan with matching contributions
2. HSA
3. Additional tax-advantage accounts (Roth or traditional IRAs, not employer matched, 529 college savings plans, etc.)
4. Taxable accounts

Notes:
All investing is subject to risk, including possible loss of principal. The information contained herein does not constitute tax advice and cannot be used by any person to avoid tax penalties that may be imposed under the Internal Revenue Code. Each person should consult an independent tax advisor about his/her individual situation before investing in any fund or ETF.

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