Use Health Savings Accounts Now to Help Pay Medical Expenses in Retirement

Submitted by Ryan Halpern on 11/27/2018 - 03:31

I work with many people in their 30s, 40s and 50s who want to make certain they choose the right medical plan while still setting aside enough money for investments. As 2019 open enrollment gets underway, I want to recommend that people strongly consider electing a high deductible health plan (HDHP) that is coupled with a Health Savings Account (HSA). HSAs have significant tax benefits and are an excellent way to sock away money now for medical expenses in retirement.

HSAs have been around for more than a decade and are designed to help offset the out-of-pocket costs associated with a HDHP. HSAs notably combine three financial benefits not found elsewhere: a tax deduction now; tax-deferred growth from money in the account, and a tax-free source of withdrawals in retirement. This so-called “triple play” has turned the Health Savings Account into a valuable investment tool that no other savings or investment account offers

Let’s start by considering whether or not a HDHP makes sense. These are medical plans with an annual deductible of at least $1,350 for an individual and $2,700 for a family, and maximum out-of-pocket expenses of $6,650 for an individual and $13,300 for a family. Note that not all HDHPs are HSA-eligible. In exchange for higher out-of-pocket expenses you may incur throughout the year, the monthly premium is usually much lower than traditional medical plans such as PPO plans or HMO plans.

A HDHP makes the most sense for families in relatively good health as they will save money by paying lower monthly premiums. So, if you, your spouse and children only visit the doctor for annual check-ups, I’d recommend looking closely at choosing this type of plan. However, people that anticipate their medical expenses will be high in 2019 may be better off with a PPO since deductibles and out-of-pocket maximums for visits to the doctor or hospital are usually lower.

For example, one of my clients recently switched his family from a PPO plan to a high deductible plan with a Health Savings Account for 2019. Monthly premiums for the PPO option were approximately $800 per month, which would have cost $9,600 for the year.

On the other hand, monthly premiums for the HDHP were approximately $500 per month, which adds up to $6,000 annually. By making the switch, he will save $3,600 in premiums next year. As long as his family’s out-of-pocket expenses are less than $3,600 during the year, the HDHP will end up being the cheaper option.

As a bonus, choosing an HSA-eligible plan generates even more savings. People enrolling in a 2019 HDHP with family coverage can contribute (and deduct on their taxes) up to $7,000 into a Health Savings Account. At a 30% tax rate, that would save $2,100 annually in taxes.

By tucking away these funds year after year, a person can build up a nice cushion to pay for medical expenses in retirement while also saving on their tax bill year after year. And, even if a medical emergency comes up and this money is needed now, the funds are available and you've already received a tax deduction for your contributions.

At age 65, most people will enroll in Medicare and are no longer eligible to contribute to an HSA. Someone age 55 years old now has 10 years to contribute money each year to an HSA and get all of these benefits.

A person that contributes $7,000 annually for 10 years beginning at age 55 will have over $88,000 by age 65 (assuming a 5% annual growth rate*).   If you get an earlier start and contribute $7,000 annually for 20 years, you will accumulate approximately $230,000.

This strategy makes sense since healthcare is one of the largest expenses in retirement. A couple age 65 today could spend $280,000 on health-care expenses in retirement, according to the Fidelity Retiree Health Care Cost Estimate.

I tell my clients that an HSA acts as a pre-paid tax-advantaged medical plan to cover those expenses. Those with the foresight to set aside funds now to pay those costs later will have enough left to help pay for other amenities that will make their retirement enjoyable, whether it's a house on the lake or contributions to a grandchild's college education fund. Smart planning now will go a long way toward achieving these goals.

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