https://blogs.wsj.com/experts/2019/07/09/how-an-hsa-can-boost-your-retirement-savings/

WEALTH MANAGEMENT

How an HSA Can Boost Your Retirement Savings

If you're maxing out contributions to tax-deferred retirement plans like a 401(k) and an IRA, then an HSA is the next logical step, says WSJ Wealth Management Expert Peter Lazaroff. PHOTO: GETTY IMAGES/ISTOCKPHOTO

By

Peter Lazaroff

Jul 9, 2019 10:10 am ET

Peter Lazaroff is chief investment officer at Plancorp and blogs at peterlazaroff.com

For years, I avoided my company's high-deductible health insurance plan with a health-savings account (HSA) because it felt scarier than simply paying the monthly premiums and predictable co-pays of a PPO health plan.

I have a hunch that many people are in the same boat—they don't bother with an HSA because of the extra legwork required and it's easier to stick with the familiar. But after taking a closer look, I realized how much an HSA had to offer and made the switch.

For many people, HSAs offer a compelling mix of tax breaks and other savings that can keep their health insurance costs down. But under the right circumstances, these accounts offer an even more powerful—and largely underappreciated—chance to boost your long-term savings and provide a nest egg to offset the rising cost of health care later in life.

With HSAs, contributions are tax-deductible, and they grow tax-free when you invest them, just like the money in your 401(k) and IRA. As long as you use the funds for qualifying medical and health-related costs, you won't pay taxes on the HSA money you use. HSAs are available when you select a qualified high-deductible insurance plan, which offer lower monthly premiums and sometimes an employer matching contribution.

A good way to determine if an HSA makes sense for you is to compare your expected medical costs against the plan's details. Add up the potential savings in premiums over a PPO plan, your potential tax break for HSA contributions, the value of the employer match, and your total deductible. If your expenses look to be higher than value of all those benefits, you're probably safer in the PPO. This may be the case if you have a chronic condition or anticipate a major medical expense like having a baby next year. But if your medical costs are likely to be lower, then you have a chance for real savings with an HSA.

And high-income earners have the chance to get even more mileage out of the plan by using it to boost retirement savings. If you're maxing out contributions to tax-deferred retirement plans like a 401(k) and an IRA, then an HSA is the next logical step. I recommend using it before non-deferred options like a Roth IRA.

The reason: If you can contribute the maximum allowable each year to your HSA (currently $3,500 for an individual or $7,000 for a family), and then can manage to pay your medical expenses out of regular cash flow, you can leave those HSA contributions invested for years to enjoy compound growth.

Of course, paying for your medical expenses without tapping your HSA savings requires not just sufficient cash flow, but also a healthy emergency fund so you have reserves on hand for large, unexpected medical expenses. You also might want to pay closer attention to the treatment you receive and what you're billed for. Many people prefer the convenience of saying yes to whatever tests the doctor wants to run and letting insurance handle the bills. But when you're paying out of pocket, you have to take ownership of your care and make cost-effective decisions.

In return for that extra effort, though, you're getting a powerful tool for retirement. By investing your HSA savings as you would your retirement savings—typically in a diversified mix of mutual funds and ETFs that offer the opportunity for long-term growth—you'll build a tax-free fund dedicated to health costs in retirement, which are likely to represent a significant portion of your future budget.

This approach to managing your health insurance won't work for everyone, but it's worth considering for those in the right financial circumstances. And even if you end up dipping into your HSA savings to cover some medical bills, you'll still receive tax breaks on your contributions and the benefit of lower monthly premiums.

Remember: The familiar path isn't always the best path. Stepping out of your comfort zone, like I did, makes sense when the opportunities are so compelling. And in this case, the chance to add another pool of tax-deferred money to your retirement savings is an advantage you shouldn't ignore.

Read the latest **Investing in Funds & ETFs**.

Read More From THE EXPERTS

HEALTH SAVINGS ACCOUNTS HEALTH-CARE EXPENSES HSA PETER LAZAROFF
RETIREMENT PLANNING RETIREMENT SAVINGS