The New Way to Retire in America

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By Ted Bauman
Editor, *The Bauman Letter*

PLANNING for retirement is no easy task. With the likelihood of Social Security and even pensions failing on the rise with each passing year, the burden of supporting yourself through your golden years is falling more and more on you. In fact, a GoBankingRates poll revealed that one-third of Americans have no retirement savings and 23% have less than $10,000 saved.

But many people are looking for ways to maximize their retirement savings while still getting the best tax benefits. There are, of course, the standard 401(k) and IRA savings plans … assuming that you are even eligible to enjoy the tax benefits of an IRA.

However, what if you could grow your money for retirement in a "Super IRA" that allows you to invest tax-free and withdraw the money without incurring taxes?

I know, it sounds too good to be true.

The truly remarkable thing is that this incredible retirement savings plan isn't technically meant for retirement. It's part of your health insurance.

The health savings account (HSA), or sometimes referred to as an (H)IRA, was created as a way to put more control over health expenses into the hands of individuals in hopes of bringing down costs. When it was pushed through Congress in 2003 as part of the Medicare Prescription Drug, Improvement, and Modernization Act, few realized that it provided Americans with an interest loophole when it came to their retirement savings.

A loophole that could save you as much as $591,000.

What Is an HSA?

A health savings account (HSA) is similar to a regular personal savings account that you stash away for a rainy day. The only difference is that this money is being stored for qualified health care expenses. An HSA can be established with you as the sole beneficiary, or for you plus your spouse and/or dependents.

However, to establish an HSA, you must be enrolled in a high-deductible health plan (HDHP). These HDHPs have much smaller monthly premiums than most health insurance plans, which makes them enticing to individuals who are attempting to cut down on up-front health care costs. The goal of HDHPs is to cover serious injury or illness.

But HDHPs require that you first meet your annual deductible in medical costs each year before your plan starts to pay any benefits. This is where your HSA comes in handy.

Out-of-pocket medical expenses that aren't covered by your HDHP can be funded by the savings you've stored away in your HSA.

But what if you don't use all the savings you've stored over the year for medical expenses?

The great thing about the HSA is that it's not a "use it or lose it" scenario. If you don't use all the funds that you've stored in your HSA during the year for medical expenses, then that money rolls over and continues to accumulate. Year after year. On and on and on … you can see where I'm going with this. It's just like a savings account, but better because the money that you've invested in the HSA is pretax dollars. The savings are growing tax-free. And if you withdraw the money for qualified medical expenses, you won't be taxed on those withdrawn funds either.

That's something an IRA or a 401(k) can't even claim.

The HSA Tax Advantage

The HSA is a great way to save for, as well as pay for, health care expenses, but one of the great added bonuses is that it offers some great tax advantages.

A HSA is largely funded through pretax contributions. For the most part, contributions to your HSA are made through payroll deposits (through your employer) using pretax dollars. Your employer can also make contributions on your behalf, and the contribution is not included in your gross income. As a result, you will owe fewer taxes because your gross annual income is lowered by the amount that you paid into your HSA.

Your Estimated Tax Savings

Without HSA		With HSA	
Gross annual pay (estimate)	$60,000	Gross annual pay (estimate)	$60,000
Estimated tax rate (30%)	- $18,000	Maximum annual family coverage HSA contribution	- $6,750
Net annual pay	= $42,000	Adjusted gross pay	= $53,250
Estimated current + future healthcare expenses	- $6,750	Estimated tax rate (30%)	- $15,975
Final take-home pay	= $35,250	Final take-home pay	= $37,245
		Take home this much more	$2,025

All figures in this table are estimates and based on an annual salary of $60,000 and maximum contribution limits to the benefit account. Your salary, tax rate, healthcare expenses and tax savings may be different.

What's more, contributions are not subject to state income taxes either (unless you are a resident of Alabama, California or New Jersey — these are the only states that require you to pay state income taxes on your HSA contributions).

But what if you pay into your HSA with after-tax dollars? Don't worry. You're covered. You can deduct any after-tax dollar contributions from your gross income on your tax return.

Now remember that those contributions to the HSA aren't just sitting in cash. That money can be invested in a variety of vehicles such as stocks, bonds, mutual funds and exchange-traded funds. What's more, any growth enjoyed during the year — whether through price appreciation, dividends or interest payments — is also growing free of federal taxes as well as most state taxes. Right now, the only states to tax HSA earnings are New Hampshire and Tennessee.

And finally, with an HSA, withdrawals can be tax-free. Withdrawals from your HSA are not subject to federal (or in most cases, state) income taxes if they are used for qualified medical expenses. As you can see from the table below, other retirement savings plans such as the 401(k), IRA and Roth IRA can't even claim all of those tax benefits.

	401(k)	IRA	Roth IRA	H(IRA)
Tax-Free Before Investing	✓	✓	X	✓
Tax-Free While Growing	✓	✓	✓	✓
Tax-Free Withdrawals	X	X	✓	✓

The Other Benefits of an HSA

The tax benefits of an HSA are tempting enough to entice most investors into this kind of savings plan, but those aren't the only advantages offered.

Did you know that other people can actually contribute to your HSA?

Contributions to your health care savings account aren't limited to the funds pulled from your paycheck. In fact, anyone from your employer, your spouse or a relative can add to your HSA. The Kaiser Family Foundation reports that 72% of employers contribute to HSAs — an average $920 for singles and $1,600 for families.

In addition, the funds in your HSA don't disappear at the end of the year if you don't use them. Many people have been burned over the years using flexible spending accounts to help pay for medical expenses. They would dutifully contribute to the account all year, but if they overestimated what their medical expenses would be and didn't spend all the money … Poof! Gone when the year ended.

That's not the case at all with an HSA. If you have money left in your HSA at the end of the year, it rolls over to the next year. That allows you to keep the money invested and growing for the future and your retirement.

What if you change health insurance plans?

Don't worry. The money is still yours and is available for future qualified medical expenses.

Life comes with many shifts and changes, and you need your HSA to follow you. Should you change your health insurance plans, employer or even retire, your funds will remain in your HSA to grow tax-fee.

What if you don't want to bother with mailing in copies of receipts and waiting for reimbursement?

HSAs are far more convenient than other savings accounts as most HSAs issue a debit card. This will allow you to pay for your prescription medication and other expenses right away. If you wait for a bill to come in the mail, you can call the billing center and make a payment over the phone using your debit card. You can even use the card at an ATM to withdraw cash.

The Drawbacks of an HSA

No plan is perfect, and it is critical that you understand the few disadvantages that come with an HSA.

The first and most important is that an HSA requires you to have a high-deductible health plan (HDHP). And while you may be enjoying smaller insurance premiums each month, it can be difficult — even with help from money in an HSA — to come up with the cash to meet a high deductible.

Furthermore, if you have health care expenses that surpass what you had planned for, you may find that you have not saved enough money in your HSA to cover your costs.

While you can add pretax money, allowing the fund to grow tax-free, and even withdraw funds tax-free for qualified purchases, there is a chance that you could pay taxes and penalties. If you withdraw funds for nonqualified expenses prior to turning 65, you'll owe taxes on the money withdrawn from the HSA plus a 20% penalty.

After the age of 65, you'll owe only taxes on the money withdrawn, but not the penalty. (Keep in mind that this is a bit different from an IRA, where there's no 10% penalty tax for withdraws from an IRA if you're over the age of 59 ½.)

It is important you are organized, because you will need to keep your receipts to prove that withdrawals from the HSA were used for qualified health expenses.

And finally, some HSAs charge a monthly maintenance fee or a per-transaction fee, which can vary from one institution to another. While these are usually low, they can easily eat away at the savings and growth that you've achieved.

These disadvantages are not insurmountable in the least. They simply require some careful planning, a little bookkeeping, and some research on the best place to set up your HSA to keep fees to a minimum.

Taking Advantage of Qualified Expenses

Health care costs might have finally slowed from their years of double-digit growth, but PwC's Health Research Institute is still predicting a medical-cost increase of 6.5% for 2018, which is substantially higher than our rate of inflation and economic growth in America. What's more, prescription-drug prices projected to rise12% throughout the rest of the year.

And even without an HDHP, we find ourselves paying more and more of those medical expenses out of our own pocket — and those expenses tend to skyrocket as we get older. In fact, Fidelity reports that a 65-year-old couple leaving the workforce today can expect to spend $220,000 on health care.

So why not use tax-free funds to pay for those medical expenses?

The fact is that there are hundreds of health expenses that qualify for tax-free payment from an HSA. Some of those expenses include:

- Acupuncture
- Alcoholism treatment
- Ambulance services
- Chiropractors
- Contact lens supplies
- Dental treatments
- Diagnostic services
- Doctor's fees
- Eye exams, glasses & surgery
- Fertility services
- Guide dogs
- Hearing aids & batteries
- Hospital services
- Insulin
- Lab fees
- Prescription medications
- Nursing services
- Surgery
- Psychiatric care
- Telephone equipment for the visually or hearing impaired
- Therapy or counseling
- Wheelchairs
- X-rays

What's more, health insurance premiums are not eligible as qualified medical expenses if you are under the age of 65. However, after the age of 65, you can use the fund from your HSA to pay for health insurance premiums including Medicare Part B premiums and long-term-care insurance premiums.

To see a full list of medical and dental expense that you can use tax-free with your HSA funds, please read the IRS Publication 502, Medical and Dental Expenses.

Can You Open an HSA?

So, you now understand what an HSA is, the advantages and the few disadvantages.

You've gone over your past medical expenses and made estimates on what you think your future medical needs are likely to be.

You believe that an HSA will not only fit your current medical expenses, but that it will allow you to save on taxes that you're paying right now on your income and grow a nice tax-free nest egg to help fund your retirement.

Yes, it looks like a great plan for you.

But are you eligible?

Just as there are limitations on whether you can deduct your IRA contribution due to your income levels, there are federal guidelines on whether you can open and contribute to an HSA.

To open an HSA, you must be:

- Covered under a HDHP on the first day of the month.
- Not covered by any other non-HDHP plan (with some exceptions for certain plans with limited coverage, such as dental, vision and disability).
- Not enrolled in Medicare.
- Not claimed as a dependent on someone else's tax return.

Each year, the IRS sets up guidelines for HSAs and HDHPs, based on individual and family coverage. For 2017, all HDHPs must have a minimum deductible of $1,300 for individuals and $2,600 for families. The out-of-pocket maximum (including deductibles, copayments and coinsurance, but not premiums) cannot exceed $6,550 for individuals and $13,100 for families.

As long as you can check all these boxes, you can open an HSA.

Establishing Your HSA

First step, of course, is to join a high-deductible health plan.

Then you can sign up for a health savings account. Your health insurance provider can provide you with more information on setting up an HSA through its recommended bank.

But you don't have to use the bank your health insurance provider recommends … and that might prove to be in your best interest.

Not all HSA providers are equal. Some will require that you hold a minimum amount in cash (which obviously limits the amount that you have invested and growing toward your retirement), and others will have a variety of fees that can cut into your savings.

When you're shopping for the provider of your HSA, here are some things to look for:

- No minimum balance. Most HSAs don't require you to maintain a minimum balance, but some can require that you keep a certain amount in cash to cover potential medical expenses. However, some providers may waive certain fees if you do.
- Beware of fees. Some accounts charge for monthly account maintenance, debit cards and various transactions. Carefully read all information regarding fees and ask questions about any charges that you don't understand.
- Shoot for the highest interest rate. In this environment of low interest rates, finding a good return for your investment isn't an easy task. That doesn't mean you can't find some good deals. Some accounts are similar to a regular bank savings account that pays a modest interest rate. Others have an investment option where you can choose securities, such as mutual funds or individual stocks.
- The best payment options. Look for accounts that offer both paper checks and a debit card. This will allow you to pay for medical expenses in just about any situation, either in person or online.
- Get online convenience. Use an account that you can access online for transactions, statements and records. This allows you to save time and makes electronic payments for your medical expenses.

The thing to remember is that unlike medical savings accounts or health reimbursement arrangements that are controlled by employers, an HSA belongs exclusively to you, the account holder. You can spend the funds at your discretion (though nonqualified medical expenses will result in taxes and penalties) and are free to take along with you if you change jobs.

Maximizing Your HSA

Just like with IRAs, there are limits on how much you, your employer or anyone else can contribute to your HSA each year. The IRS makes adjustments to these limits each year based on inflation calculations.

	2017	2018
Individual	$3,400	$3,450
Family	$6,750	$6,900

However, if you are 55 or older, you are permitted to contribute an additional $1,000 as a "catch-up" contribution similar to 401(k) or IRA contributions.

If you are married, and both of you are age 55, each of you can contribute an additional $1,000.

Unfortunately, it gets a little more complicated if you and your spouse aren't both 55 or older. That's because an HSA is in an individual's name — there is no joint HSA even when you have family coverage. Only the person age 55 or older can contribute the additional $1,000 in his or her own name.

If only the husband is 55 or older and the wife contributes $6,750 to her HSA for their family coverage, the husband has to open a separate account for the additional $1,000. If both husband and wife are age 55 or older, they must have two HSA accounts if they want to contribute the maximum $8,750. There's no way to hit the maximum with only one account.

You can make contributions to your HSA at any time during the calendar year and up to April 15 of the following tax year. Funds can be added to your HSA in regular amounts or in one lump sum.

One great way to fund your HSA is with a one-time tax-free transfer of funds from your IRA to an HSA. This is not like a rollover, as it counts toward your annual HSA contribution limit. It does allow you to move a small amount of money from an IRA. It's a smart move, particularly if you would have been using those IRA funds to pay medical expenses. In that case, you would have had to pay taxes on that IRA disbursement. If you take the money out of your HSA for medical expenses, you don't have to pay taxes on those funds.

Investing for Tomorrow With Your HSA

One of the key things to remember if you plan to use your HSA as a way to fund your retirement is that you must have funds left over at the end of the year to roll over into the next year. While it might seem a little counterintuitive since the HSA was designed to help cover your annual medical costs, the benefits of having a vehicle that allows you triple the tax benefits can't be overlooked when saving for your retirement.

The more you can have left over at the end of the year from your annual contributions the better. In fact, many financial planners will argue that to really grow the HSA, you could dedicate it to retirement by paying health costs with other savings. If possible, use other savings to pay for smaller expenses so that you can allow the funds in your HSA to grow.

When you are planning the investments for your HSA, be sure to carefully look over your options and make sure that your HSA custodian will meet your investing needs. Some custodians offer fewer than 20 mutual funds, while HSA Bank, for example, offers a full brokerage via TD Ameritrade, and HealthSavings Administrators lets you pick from 22 low-cost Vanguard funds.

One way to compare your options is through HSASearch.com.

Keep in mind that your HSA withdrawal strategy can influence your investment strategy. If you are planning to use your HSA to pay for current medical expenses, you may want to avoid substantial stock market investments that can decline at any time and look for liquid investments that conserve principal.

If you are planning to use your HSA more for future medical expenses during your retirement, you may have a longer time frame that will allow you to take on more risk through significant stock investments to grow your nest egg. In fact, if you can postpone accessing your HSA account until your 80s, when you might have high medical or long-term-care expenses, you would benefit from a very long investing horizon.

When it comes to funding and ranking your retirement accounts, it's important to not only take into account the tax benefits, but the potential penalties on withdrawals as well. It may be best to set your hierarchy of contribution at:

1. **401(k) or IRA up to any match**
2. **HSA to contribution limit**
3. **401(k) nonmatched limit**
4. **IRA nonmatched limit**

Building Your Retirement With Triple Tax Benefits

How does the math actually shake out for an HSA over other retirement accounts?

As an example, let's say you start out with $100,000 to invest in your retirement account.

In a Roth IRA, you will have to pay taxes on it at both the state and Federal level. For the sake of simplicity, let's assume that you pay the U.S. average of 32%, which reduces your initial investment to $68,000.

In this example, your retirement grows 10-fold, which can easily happen with a moderate 6% rate of return. As I showed earlier, a 401(k), IRA, Roth IRA and HSA all benefit from tax-free growth.

However, a 401(k) and IRA will tax you upon withdrawal. At the average of tax rate of 32%, that would leave you with $680,000 for retirement.

	401(k)	IRA	Roth IRA	H(IRA)
Tax-Free Before Investing	$100,000	$100,000	$68,000	$100,000
Tax-Free While Growing	$1,000,000	$1,000,000	$680,000	$1,000,000
Tax-Free Withdrawals	$680,000	$680,000	$680,000	$1,000,000

As you can see, the HSA is the only account that can truly grow 100% tax-free … leaving you with a $1 million retirement. That's an additional $320,000 — money you don't get to keep with an IRA, Roth IRA or 401(k).

Of course, this is a pretty simple example. It assumes you make only one initial deposit and nothing more. Most people contribute money to their retirement account on a regular basis.

Let's look at another example, where you just put an extra $5,000 into the account each year…

The total amount for each retirement plan would look like this.

	401(k)	IRA	Roth IRA	H(IRA)
Tax-Free Before Investing	$100,000	$100,000	$68,000	$100,000
Tax-Free While Growing	$1,848,810	$1,848,810	$1,257,191	$1,848,810
Tax-Free Withdrawals	$1,257,191	$1,257,191	$1,257,191	$1,848,810

As you can see, the 401(k), IRA and Roth IRA end up at nearly the exact same amount … $1,257,191.

But the HSA soars to $1,848,810 thanks to its triple tax benefit — giving you an extra $591,000 for your retirement.

None of those traditional retirement plans can give you this level of freedom.

All you have to do is put your money into an HSA … and watch it grow.

And, unlike a traditional retirement plan … you can withdraw money tax-free before you are 59 ½ for some of retirement's most worrisome and unexpected expenses … like healthcare costs.

Plus, if you don't need the extra money during retirement, you're not required to take it out. Unlike IRAs, Roth IRAs, and 401(k)s, you can leave it in and let it grow … even after you are 70 ½.

The HSA may have been born as out of a health care plan, but it has become the "Super IRA" you need to grow your nest egg and see you through a worry-free retirement.

Banyan Hill
P.O. Box 8378
Delray Beach, FL 33482 USA
USA Toll Free Tel.: (866) 584-4096

Email: http://banyanhill.com/contact-us

Website: www.banyanhill.com

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