Why More Investors are using their HSAs as Tax-Advantaged Investment Accounts

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A Health Savings Account, or HSA, is a versatile investment vehicle that can help individuals build tax-deferred retirement savings even if they have already maxed out their contributions to retirement savings vehicles such as 401(k)s and IRAs.

For high-net-worth clients looking to make the most of their tax-advantaged savings, these relatively little-used instruments can function as:

- Tax-advantaged qualified medical-expense funds
- Tax-advantaged retirement savings plans

Or they can address both needs at once, coupling flexibility with significant strategic value.

In this introduction to HSAs for sophisticated investors, we will provide additional background on them, describe their eligibility requirements, and show how they can be used to make long-term financial plans more resilient and flexible.

What HSAs are for, and how they work

As a primary function, HSAs let account holders use pre-tax dollars to offset healthcare expenses, including deductibles, copayments, medical coinsurance, and long-term care insurance. HSA savings used for these and other qualified purposes are not taxed. This bears repeating. When used to offset qualified medical expenses, HSA funds escape taxation both going in and coming out.

Besides putting pre-tax dollars -- along with related interest, dividends, and capital gains -- to work defraying qualified expenses without triggering a tax, HSAs allow for savings on tax-deferred contributions no matter how the money is ultimately spent. Non-healthcare spending from an HSA is taxed as ordinary income, just like spending derived from a 401(k) or an IRA.

As a result, some investors use HSAs to augment long-term, tax-deferred savings while enjoying the tax benefits and flexibility as better-known retirement-savings vehicles -- such as, again, 401(k)s and IRAs -- but with no mandatory minimum yearly distributions, allowing for more control over tax exposure in retirement.

On top of annual contribution maximums attached to other tax-deferred savings accounts, an HSA owner can contribute a "family" maximum of $7,500 in 2022. An HSA owner age 55 or older can add another $1,000 to that, and so can a spouse. In sum, a family can put $9,500 to work bolstering retirement and healthcare set-asides in 2022.

And as far as spending from HSAs goes, individual account holders can decide to make medical payments out of pocket, and then compensate themselves from the HSA at any later date -- or choose to leave every cent where it is for future use, whether that's to increase savings for use in retirement, for estate planning, or use the tax-advantaged money later to defray outsized medical expenses in the future.

This flexibility is handy in light of long-term care expenses that in 2021 ran to an average of $9,000 a month for a private room in a nursing home, over $5,000 a month for a trained in-home aide, and around $4,500 a month for a room in an assisted-living community.

Background and guardrails

HSAs operate as a provision of the Medicare Modernization Act of 2003. There were about 32 million HSAs holding over $100 billion at the end of 2021, according to HSA consultancy Devenir. In contrast, 401(k) plans held about $7.3 trillion at the end of March 2022, says the Investment Company Institute, while the same source pegs IRA holdings at $13.2 trillion in Q1 2022.

Though arguably underused, HSAs are on offer at most large US employers -- 80% of them, according to Willis Towers Watson, a workplace benefits consultant. But any qualified individual can open an HSA on their own.

To qualify for an HSA, the US Internal Revenue Service stipulates that individuals must:

- Be covered under a "high deductible health plan" with out-of-pocket medical expenses limited to $7,050 for individuals in 2022 and $14,100 for families
- Have no other health coverage (with exceptions)
- Not be enrolled in Medicare
- Not be anyone's dependent for tax purposes

Where these requirements are met, investors can use HSAs to participate in the broad economy through stocks, bonds, and other investments. This may not seem surprising to investors more accustomed to 401(k)s, but it's news to some that HSAs aren't strictly for setting cash aside for future healthcare expenses.

In fact, after a slow start, HSAs are gathering steam as investment vehicles. In 2008, five years after HSAs debuted, only 4% of total HSA holdings were in securities and other investments, with the rest sat in cash-equivalent deposits. But in the last five full years, securities in HSAs have gone from 18% of the total in 2017 to 35% in 2021 (a year that recorded a 45% year-over-year increase in HSA investment holdings from 2020, per Devenir).

HSAs should be viewed as investment vehicles

Still, many HSA owners simply drop money into their HSAs from payroll deductions, leaving it there to meet future healthcare needs.

For high-net-worth individuals in particular, however, bringing an investor's eye to HSAs can unlock significant value. This process starts with assessing available HSA options by asking questions like:

- Does my employer offer an HSA?
- Does this employer-sponsored HSA allow for investing? Or function strictly as a lock box for cash contributions?
- If the account allows for investing, what investments are permitted? Is there just one option -- say, a mutual fund that tracks the S&P 500 -- or an array of choices on offer?

Where the employer's HSA offering doesn't allow for investing -- or if the employer doesn't offer an HSA at all -- you may have to go shopping for one that does. But that takes you into territory where -- Fidelity Investments aside -- unfamiliar names like Lively, HealthEquity, Further, and HSA Bank hold sway, making it harder than usual to know where to start.

We can help with your HSA strategy

Of course, there are resources to help you in this quest. At Cerity Partners, for example, we specialize in matching tax-deferred investment accounts, including HSAs, to the precise needs of our clients and their families.

And it's worthwhile getting help on this, especially if you're a sophisticated investor who can afford to meet pre-retirement medical expenses as they arise. In this scenario, HSAs can add tax-advantaged resources for retirement, estate, and legacy planning that are as robust as those of any tax-deferred savings vehicle available to US taxpayers, but with unusual flexibility around end use and tax treatments.

Let's have a conversation about making strategic use of HSAs. Cerity Partners' unbiased research and time-tested due diligence, rooted in an in-depth understanding of your financial standing, plans, responsibilities, and aspirations, can help you discover new ways to build tax-advantaged savings for retirement.

Starting a conversation is as easy as reaching out to us here.