Health savings accounts

Maximizing the potential of HSAs

$116 BILLION

of HSA assets were held across 36 million accounts at the midpoint of 2023.[1]

Health savings accounts (HSAs) were created to help address the rising costs of health care. These tax-advantaged savings accounts can help employees accumulate money to spend on qualified medical costs.

HSAs are paired with high-deductible health plans (HDHPs), which allows employers to offer lower-premium insurance plans while also helping employees cover their growing share of expenses. In this paper, we'll highlight some of these advantages and opportunities to further enhance the value of HSAs.

How do they work?

Think of a health savings account like a 401(k) for medical expenses. Both employers and employees may contribute tax-free deposits to an HSA, but the account belongs to the employee. The balance rolls over from year to year—unlike "use-it-or-lose-it" FSAs—and the account can continue to grow through interest and investing. HSAs are administered by banks, insurance companies and other third-party custodians or trustees, and in most cases, the HSA's cash value is FDIC-insured. Unlike a 401(k), withdrawals from an HSA are tax-free as long as funds are used to pay for medical expenses.

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So, while the HDHP protects the employee from major medical costs such as catastrophic illness, hospitalization or surgery, funds from the HSA can be used for additional health care expenses, including:

- Costs incurred while the employee is still under their deductible.
- HSA-qualified health care expenses that may not be covered by the insurance plan.
- Copayments and coinsurance until the employee's out-of-pocket maximum is reached.
- COBRA premiums and insurance premiums for retiree health plans.
- Medicare and employer-based coverage after age 65.

Tax-free distributions from the HSA can help pay for these expenses on behalf of employees, spouses and any dependents claimed on the employee's tax return. Plus, under special HSA rules, an individual may be treated as a dependent for qualified medical expenses even if:

- The person filed a joint return.
- The person had a gross income of $4,200 or more.
- The employee or spouse, if filing jointly, can be claimed as a dependent on someone else's return.[1]

Whether contributions to the HSA come from the employer, employee or both, these accounts can help employees manage the increasing costs of health insurance coverage.

Tax-advantaged savings

The savings accumulated in HSAs are further enhanced by the built-in "triple tax advantage" HSAs enjoy from the IRS. In fact, HSAs are the most tax-advantaged product the IRS allows. This is because:

- HSA contributions are tax-free, regardless of whether they come from the employee, employer or even as gifts from friends or family.[3]
- Employee and employer contributions through payroll are not subject to Social Security (FICA) and Medicare taxes.[3]
- HSA account and investment earnings grow tax-free.[3]

If funds are not currently needed for health care expenses, individuals can use these tax advantages to grow their account year-over-year for future use—perhaps when they're older and their health care needs increase. After age 65, funds can even be used for non-medical purposes by paying only the income tax on their withdrawals. These benefits make HSAs a unique savings solution for many employees.

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On the other hand, many employees do not have the same capacity to allocate funds to their HSA. Funds contributed by the employer may be needed right away to assist with current health care costs not covered by the HDHP. In either case, HSAs can be further advantaged by combining the HDHP with HSA-compliant supplemental coverage.

Supplementing HSAs

The IRS permits certain supplemental insurance plans to help offset the increased financial risk employees face with HDHPs. These plans include "gap" coverage such as:

- **Hospital indemnity plans:** Inpatient only, no outpatient services covered.
- **Specified disease policies:** Including cancer and critical illness.
- **Accident insurance:** Catastrophic accident (AD&D) plans and indemnity plans that pay a fixed benefit for medical treatment after an accident.

When offered as supplemental coverage to an HDHP, these plans can help employees by paying for costs that would otherwise be paid from the HSA. This can help employees who may not have significant funds in their HSA, or it can allow established savers to continue building their account balance for future use.

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Making the most of HSAs

Health savings accounts are complicated financial instruments, and these are only a few of the considerations that employers should understand before launching an HDHP with an HSA. But when properly structured and utilized, HSAs can offer significant savings advantages for employees—even beyond immediate health care needs.

To learn more, contact your group benefits representative.

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[1] "2023 Midyear Devenir HSA Research Report," published September 21, 2023, accessed January 31, 2024. https://www.devenir.com/research/2023-midyear-devenir-hsa-research-report.

[2] 26 CFR 601.602, RP 2023-23, www.irs.gov/pub/irs-drop/rp-23-23.pdf.

[3] "The Complete HSA Guidebook," accessed February 2024, http://healthequity.com/doclib/hsa/guidebook.pdf.