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GET TO KNOW OUR TEAM

Brittany Vollmar is a Client Relationship Consultant at Shepherd Financial, providing support and strategic direction to client relationships.

At Thanksgiving dinner, Brittany skips regular mashed potatoes so she can have double sweet potatoes.

Holly Willman is the Director of Creative and Strategic Operations at Shepherd Financial. She's been with our team since 2013, utilizing a variety of skills in different roles.

Because of her allergy to chicken, Holly couldn't eat turkey at Thanksgiving for five years.

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HEALTH SAVINGS ACCOUNTS

November 19, 2020

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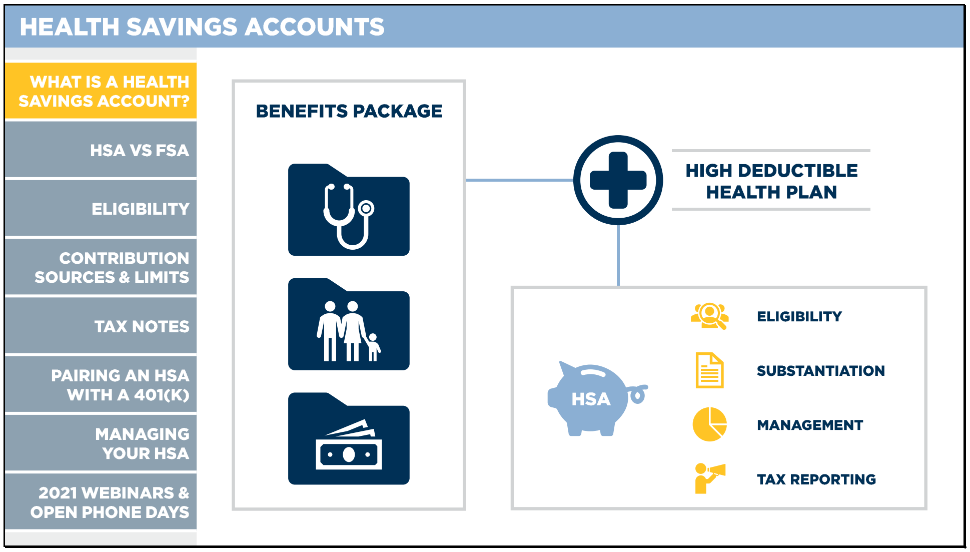

Today, you will hear us referring to both health savings accounts and HSAs. But they are the same thing. And maybe you joined us today because you have one but don't understand what all the fuss is about. I'll address these concerns by walking you through the many benefits of HSAs, like their tax benefits, portability, and how they can be used for long-term investing. It's also important to point out that while we will be talking about some tax benefits today, this is not tax advice.

And you will also want to think about your personal situation and consult with a professional. Now, we want to break everything down as simply as possible, but there are some terms you need to understand before we get too far in here. A health savings account is a tax-advantaged medical savings account – usually checking or savings – that helps people save money for current and future qualified medical expenses. Not everyone has access to an HSA – they go hand-in-hand with a high deductible health plan, or an HDHP.

A high deductible health plan is health insurance providing preventative care services at no cost, and it has lower monthly payments in exchange for higher deductibles. And a deductible is the amount you pay out of pocket for medical expenses before your insurance kicks in. These deductibles and maximum out-of-pocket expenses are set by federal guidelines. So remember, you have to be enrolled in the high deductible plan to be eligible for an HSA.

Here are some unique features of HSAs: The first feature is that an HSA is owned by the individual and established under their Social Security number, which means certain responsibilities fall on the account owner. There are four main ones - eligibility, substantiation, management, and tax reporting. We’ll get to all that in a bit. Next, HSAs are portable. As the owner of a portable account, that money is yours. And you won’t lose it at the end of the year.

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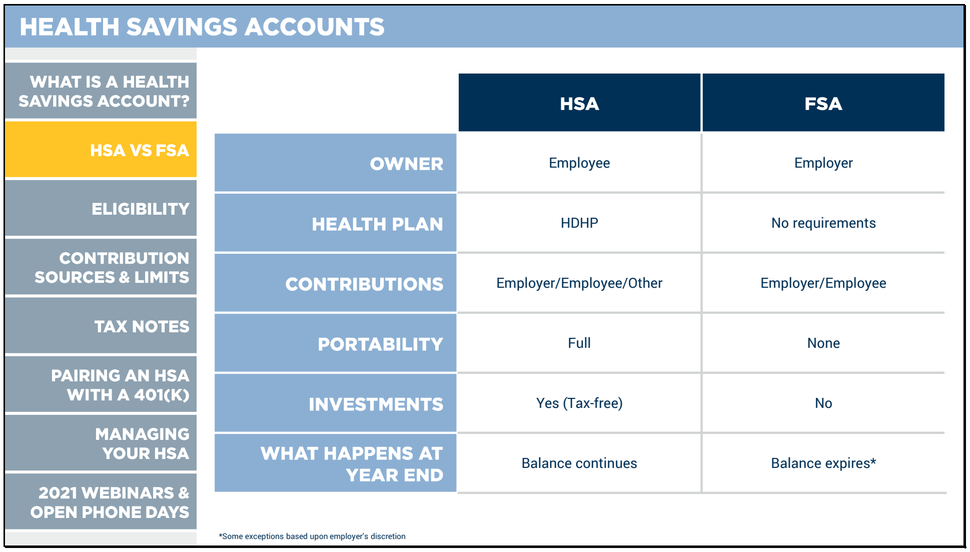

Which brings us to a comparison of another common benefit. There is a lot of confusion about HSAs and FSAs – those are flexible spending accounts. An FSA is also sometimes called a flexible spending arrangement. But you should know that HSAs and FSAs are not the same thing. While an FSA can be used for medical expenses, it's not linked to a high deductible health plan – it can be used with any health plans. Another difference is that this account is owned by your employer, not you. And since the company owns the FSA, that means the money expires at the end of the year.

There are some exceptions, but it really depends on what the employer chooses to do with the FSA. This is why you'll often hear FSAs referred to as 'use it or lose it' accounts. Now, if you don't qualify for an HSA but your employer offers an FSA, the FSA may be a good option, because it does provide tax savings. But overall, an HSA is more flexible and has even greater benefits than an FSA.

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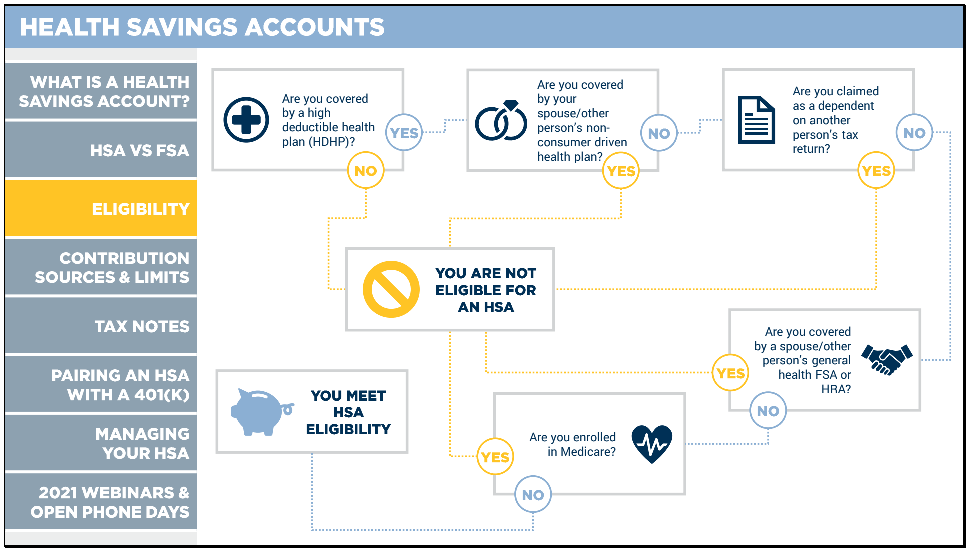

Let's dig into the eligibility rules of HSAs. You must go through this series of questions:

First – are you covered by a high deductible health plan?

Second – are you covered by your spouse's non-consumer driven health plan? Let's take a quick sidebar from our eligibility questions for some more lingo. Traditionally, we've had HMOs, or health maintenance organizations, and PPOs, or preferred provider organizations. An HMO makes you choose a primary care physician and stay within a network of providers to keep costs lower, while the PPO gives more flexibility. You pay more for the flexibility. And these traditional systems are referred to as non-consumer driven health plans, because they don't really allow an individual to control their health care dollars. So to rephrase your question, are you covered by your spouse's HMO or PPO? I hope everybody's paying attention to this question, because it means you have to consider the big picture when it comes to family insurance and health savings accounts.

Third – can you be claimed as a dependent on someone's tax return?

Fourth – are you covered by your spouse's general health FSA or HRA? An HRA is a health reimbursement arrangement. It has similarities to both HSAs and FSAs. The IRS says that FSA coverage extends tax benefits to family members as well. That's because medical expenses can be deducted for the account holder, their spouse, and their dependents.

So even if you’re eligible for the HSA and your spouse is eligible for an FSA at his company, you can’t do both. You have to pick one or the other.

And one last question: are you enrolled in Medicare?

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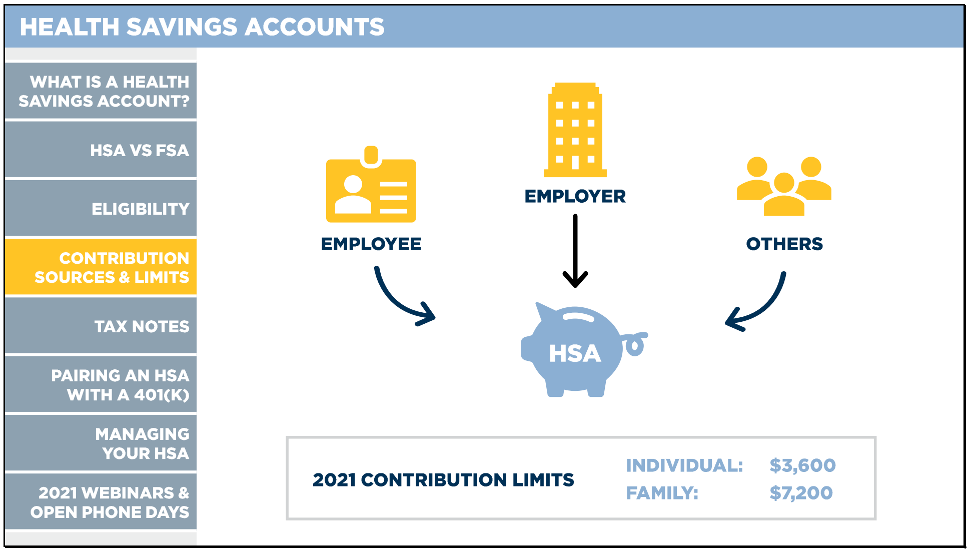

Now that we've worked through the eligibility rules, let's talk about how to fund an HSA. An HSA is generally considered established at the time of funding, and it's the HSA owner's responsibility to track this establishment date. This establishment date is important because you can pay medical expenses tax-free after that date.

As an employee, as long as you have HSA eligible health insurance during the year you wish to contribute, you can put money in pre-tax or after-tax. Pre-tax means it's coming from your paycheck – like you might do into your company's retirement plan. Many employers can set up your HSA savings election via payroll deduction. After-tax means it's coming from your bank account. And if you make an after-tax contribution, that can be taken as a tax deduction.

But the HSA account owner is not the only one who can contribute to their account. Your employer can also contribute to your account. They don't have to, but about 80% of employers make some kind of contribution to their employees' HSAs. There are a couple ways they could do it. Employers may make a lump sum contribution at the beginning of the year, or they could make contributions every payroll period.

So far, we've discussed how the account owner and their employer could contribute to an HSA. But that's not all. Believe it or not, random people can contribute to your account! Just remember that your contribution, your employer's contribution, and any other money people put in is all added together – it all counts toward your contribution limit.

Speaking of contributions, every spring, the IRS announces limits for the upcoming calendar year. The limits are different for the individual plan and the family-covered plan. And this year, individuals have a contribution limit of $3,550, while families have a contribution limit of $7,100. But since we are looking forward to 2021, we are showing the 2021 limits on the screen here - $3,600 for individuals and $7,200 for families. Don't forget – similar to 401(k) plans, HSAs have what are known as catch up contributions. So if you are 55 years or older, you can make an additional $1,000 contribution. Catch up contributions for 401(k) plans, though, start at age 50.

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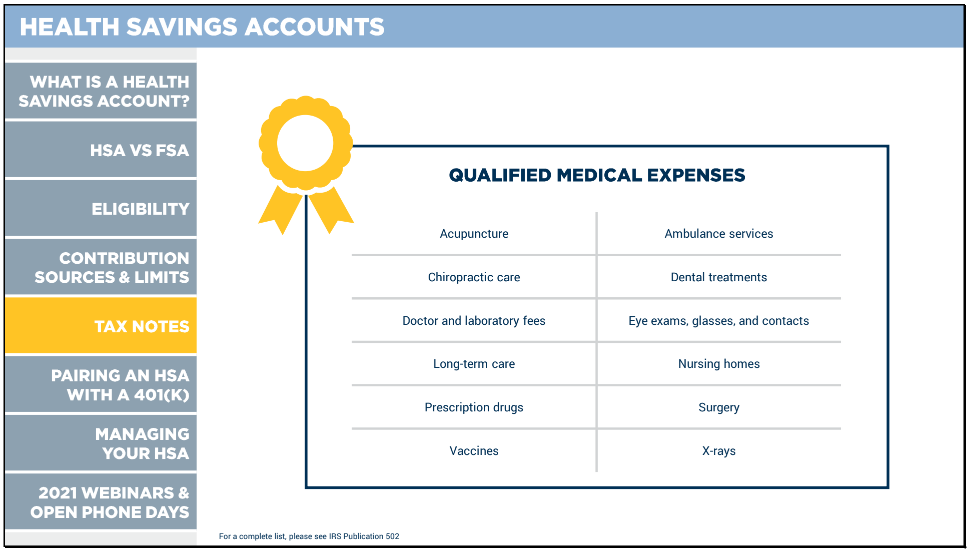

There are three tax advantages of HSAs. First of all, like your 401(k) account, you can make pre-tax contributions, which lowers your taxable income. Second, the money that's contributed grows in your account tax-free and can be invested. And third, as long as the money is used for qualified healthcare expenses, your withdrawals and any investment gains are 100% tax-free.

One more cool feature, too - after reaching age 65, you can withdraw money from your account for any reason at all – it doesn't have to be medically-related – without paying a penalty. It is considered taxable income in that case, though, so you do pay taxes on those types of withdrawals. If you withdraw money from your HSA before age 65 for any reason other than paying qualified medical expenses, you face a 20% penalty from the IRS. And it's considered taxable income.

Looking at the screen, you can see some examples of qualified medical expenses, but the list is actually much longer. Check out IRS Publication 502 for all the details. A few examples are things like dental services, hearing aids, eye exams, prescription medications, and vaccinations.

There is also something called the retroactive use of HSA eligible expenses. Let's say you're putting money in your HSA during your working years and paying your medical bills out of pocket. But you're a smart person, so you hang on to all those receipts. You can reimburse yourself later on for those qualified medical expenses. A couple of notes here. These expenses have to occur after you've established your HSA. And if you claimed those medical expenses as an itemized deduction on your taxes, you can't do the retroactive payback.

Now let’s go back to the four responsibilities we talked about at the beginning. Those were eligibility, substantiation, management, and tax reporting. We already covered eligibility. And we just covered substantiation. Substantiation means verifying that expenses are qualified. If you have an FSA or HRA, you might be asked by a third-party for this verification. But with an HSA, you’re reporting to yourself. This doesn’t mean you should spend the money on non-qualified expenses – if your taxes are audited, you will have to show proof.

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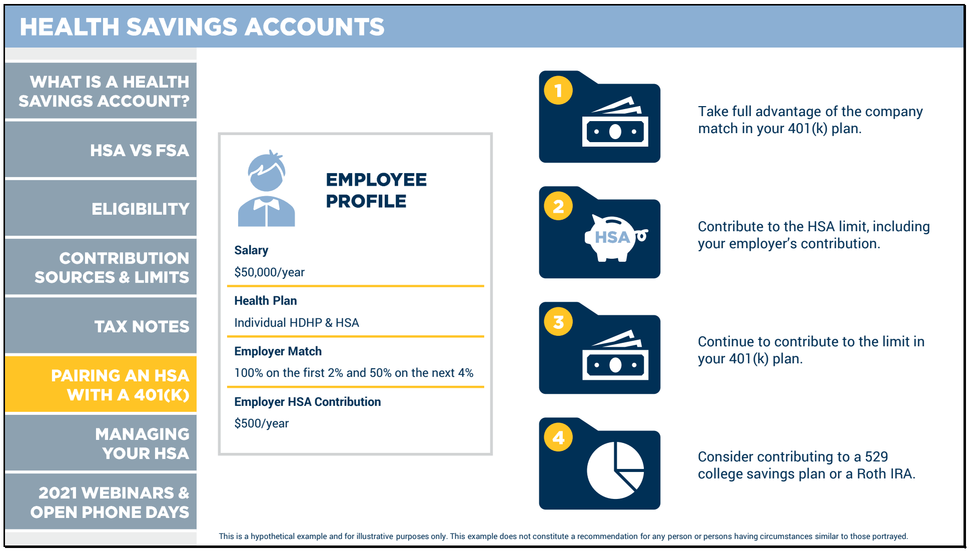

If you can't pay a medical bill out of pocket, you probably want to use your HSA to cover it, but it can be a helpful strategy, if possible, to keep money in your HSA rather than spend those dollars. Again, this is no FSA. You don't have to 'use it or lose it' at the end of each year. Instead, you can think of an HSA as a 'stow it and grow it' account. Each person's case is unique, so when we talk about different strategies, factor in your own life circumstances. We're going to cover how an HSA can be a really effective companion to a 401(k) plan in preparing for retirement.

Here's a potential flow for your dollars. Contribute to your 401(k) plan to take full advantage of your company match. In this example, the company matches dollar for dollar of the first 2% this employee saves in the plan and another 50 cents for every dollar of the next 4% saved in the plan. Which means this employee needs to save 6% to take full advantage of the company match – they put in 6%, and the company puts in another 4%, so the total 401(k) savings is 10%. Look at the screen – we're using pre-tax dollars here. This sample employee's salary is $50,000. 6% of that is $3,000.

The next stop is the HSA. Since we're almost to 2021, let's use those contribution limits. As an individual, this employee can contribute $3,600 in 2021. But remember – that includes the employer contribution. And in the example, I'm assuming this employee is single. That means if the employer is putting in $500, the employee can put another $3,100 in there. 401(k) savings of $3,000 and HSA savings of $3,100 means this employee has put $6,100 into retirement savings of some kind.

But what if he wants to save a little bit more? You can contribute to a much higher limit in your 401(k) – we’re saying our sample employee is under age 50, which means his contribution limit in both 2020 and 2021 is $19,500. So far, he’s only put $3,000 in his 401(k). This means he can contribute another $16,500 if he wants, and the employer match doesn’t count against that contribution total.

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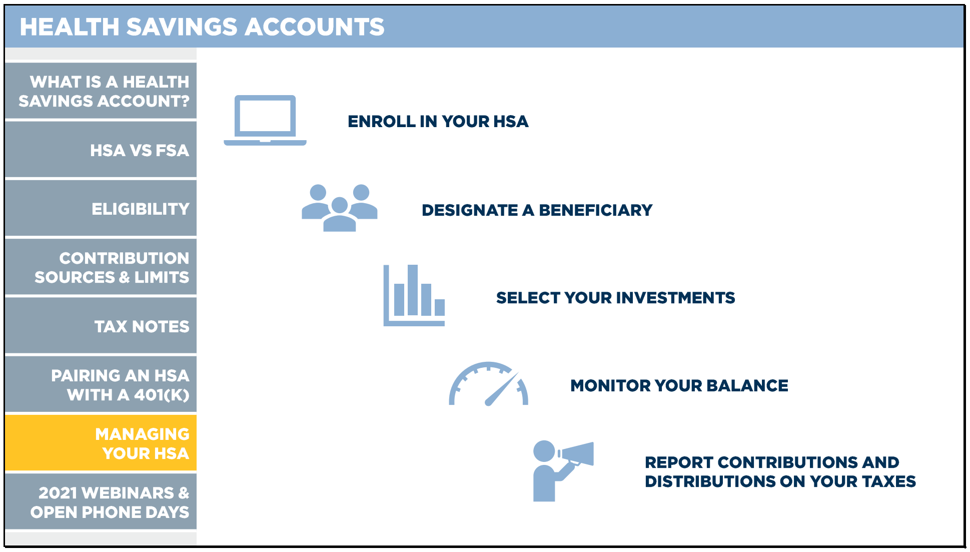

Let's talk about how you can potentially invest the money in your HSA. It depends on where your HSA is – not all providers allow you to invest. And some require a minimum balance in order to invest your money. We've talked about the portability of the HSA, so consider this: you don't actually have to keep your HSA at the institution your employer offers – you can choose any provider you want. So that may be a way to help you get around the minimum balance requirement.

Let's assume you hit that minimum balance and wanted to invest the funds in your HSA. Keep a few things in mind: like in your 401(k) account, you will probably have to pay investment fees. You may also have to pay transaction fees. Check into those details before you make an investing decision. HSA money can be placed in investments approved for IRAs, like stocks, bonds, and mutual funds, but you can't invest in life insurance contracts. And your HSA provider may also restrict you to a set of particular funds. Your investments may also earn interest, and a kind of cool tax benefit is that those earnings are then tax-free. Your investing time horizon and risk tolerance will help guide which investments make the most sense for you, but it's a helpful idea to keep at least a portion of your account in cash so that it is easily accessible if you do need to pay for medical expenses right now.

Let's talk about the two other responsibilities – management and tax reporting. So – the management of the HSA is your responsibility. And that means it's on you to monitor the balance of your account, keep the contact information up to date, select your own investments – if that's an option – and designate beneficiaries. Because this is an account with real dollars in it, it's so important to name at least one beneficiary in case something happens to you. You can also name a trust as a beneficiary. And if you don't designate your beneficiary, then the assets are distributed to your estate if you pass away.

And finally, tax reporting. You have to do this if you have any kind of contribution, including from your employer, or if you withdrew funds. You should get two tax forms – one for contributions and one for distributions. These are also both provided to the IRS. And as mentioned earlier, you need to save your receipts in case you are ever audited.

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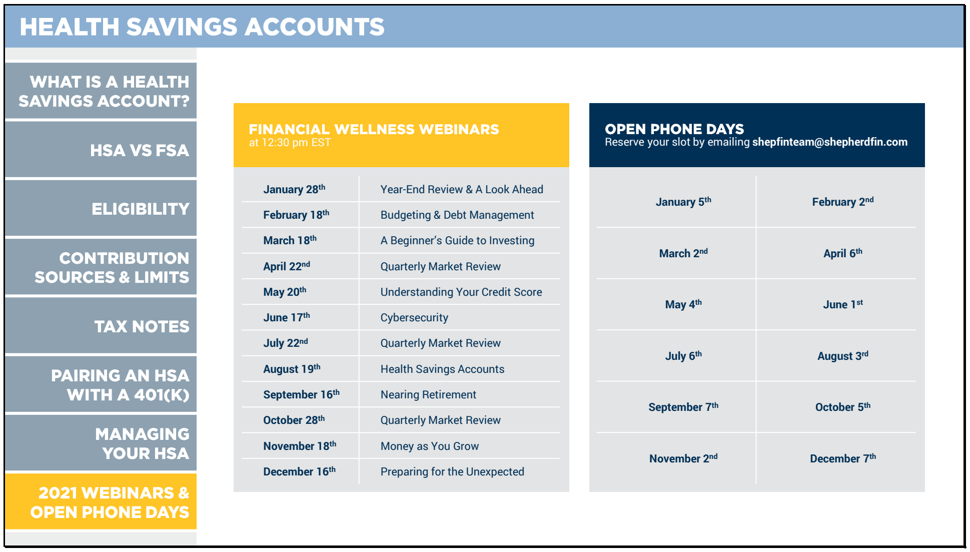

Remember, HSAs are great tools because they have triple tax savings, they're portable and can be taken from one job to another, and they're flexible – you can use them in different ways as your life and health circumstances change.

Before we finish up, I want to show our webinar and Open Phone Day schedule for next year. We really want to help you with the common things that tend to cause confusion or trip people up. Especially during this crazy time in the world, please know we are here as your resource and to answer your financial questions.

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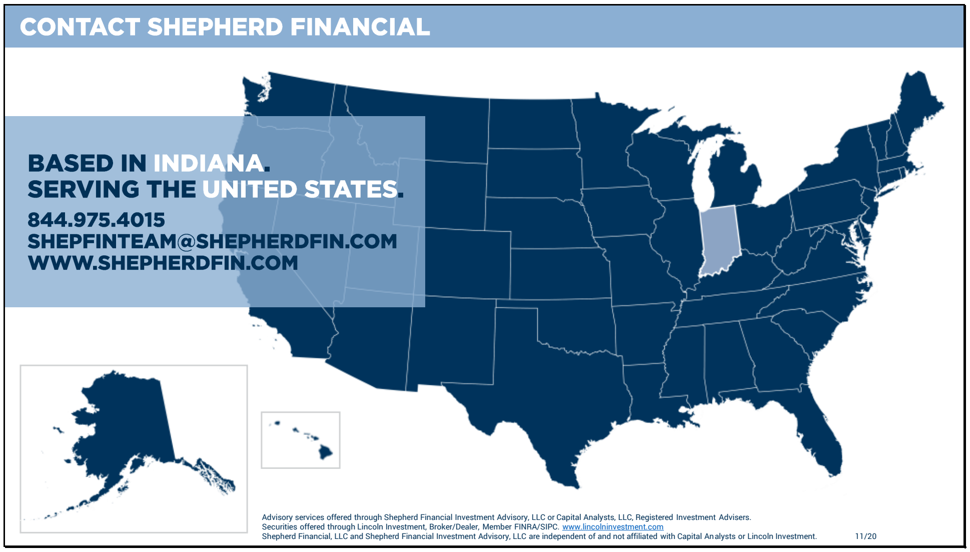

If you have more questions, feel free to give us a call at 844.975.4015 or 317.975.5033. And you can also email us at shepfinteam@shepherdfin.com.

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