An HSA can be a healthy supplement to your savings regimen and estate plan

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Longer life expectancies and rising health care costs make saving for retirement more important than ever before. A Health Savings Account ("HSA") can be a powerful tool for financing health care expenses while supplementing your other retirement savings vehicles. And it offers estate planning benefits to boot.

What's an HSA?

An HSA is a tax-advantaged savings account funded with pretax dollars. Funds can be withdrawn tax-free to pay for a wide range of qualified medical expenses. (Withdrawals for nonqualified expenses are taxable and, if you're under 65, subject to penalties.)

To provide these benefits, an HSA must be coupled with a high-deductible health plan ("HDHP"). For 2020, an HDHP is a plan with a minimum deductible of $1,400 ($2,800 for family coverage) and maximum out-of-pocket expenses of $6,900 ($13,800 for family coverage). In addition, you must not be enrolled in Medicare or covered by any non-HDHP insurance (a spouse's plan, for example). Once you enroll in Medicare, you can no longer contribute to an HSA, but you can continue to withdraw funds from your account to pay for qualified expenses.

Currently, the annual contribution limit for HSAs is $3,550 for individuals with self-only coverage and $7,100 for individuals with family coverage. If you're 55 or older, you can add another $1,000. Typically, contributions are made by individuals, but some employers contribute to employees' accounts.

HSAs can lower health care costs in two ways: by reducing your insurance expenses (HDHP premiums are substantially lower than those of other plans) and allowing you to pay qualified expenses with pretax dollars.

Furthermore, any funds remaining in an HSA may be carried over from year to year, continuing to grow on a tax-deferred basis indefinitely. And, to the extent that HSA funds aren't used to pay for qualified medical expenses, they behave much like an IRA or a 401(k) plan.

What are the estate planning benefits?

The estate tax implications of inheriting an HSA differ substantially depending on who receives it, so it's important to consider your beneficiary designation(s). If you name your spouse as beneficiary, the inherited HSA will be treated as his or her own HSA. That means your spouse can allow the account to continue growing and withdraw funds tax-free for his or her own qualified medical expenses.

If you name your child or someone else other than your spouse as beneficiary, the HSA terminates and your beneficiary is taxed on the account's fair market value. It's possible to designate your estate as beneficiary, but in most cases that's not the best choice, because a beneficiary other than your estate can avoid taxes on qualified medical expenses paid with HSA funds within one year after death.

A flexible tool

An HSA is a flexible tool that can be used to reduce health care costs, supplement your retirement savings, provide additional wealth for your heirs — or all three. Please contact us for additional details.

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The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com