

# 401(k) Vs HSA: A Showdown

I've long made the contention that a [Health Savings Account](#) (HSA) is the best investing account. Today, for the first time on this blog, we're going to put some numbers to it. We're going to throw a HSA into [the octagon](#) with a 401(k) and see who comes out on top. Two accounts go in, but only one account comes out on its feet.

## The 401(k)

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First, in the South corner wearing the red trunks we have the staple of the current American retirement system, the 401(k). Founded in 1981, it provides for tax-deferred (or [Roth](#)) employee contributions of up to \$19K per year (\$25K if 50+) plus the opportunity for employer match or profit-sharing contributions up to a total contribution of \$56K per year. It provides the largest tax break available for most doctors and protects their retirement assets from their creditors and the taxman as it grows.

Depending on the employer, it may suffer from high fees and crummy investment choices. You also may not be able to transfer the money away from the employer until you quit, are terminated, retire, or die. The 401(k) allows you to borrow up

to \$50K (or 50% of the balance, whichever is smaller) from it. Additionally, you can roll your 401(k) over to an IRA which, if left to heirs, can be [stretched for additional decades](#). Although there are a few exceptions (including [early retirement](#)) if you want to access the money prior to age 59 1/2, you will owe a 10% penalty in addition to any taxes due. Clearly, a 401(k) is a formidable champion when it comes to investing accounts.

For an individual 401(k) one option for you could be [Rocket Dollar](#). They administer self-directed Solo 401(k)s and IRAs. Because it's self-directed, you can buy real estate properties on your own or leverage RE crowdfunding platforms like [Equity Multiple](#), [RealtyMogul](#), [Fundrise](#), [Roofstock](#), [CrowdStreet](#), etc.

## The HSA

However, our challenger, wearing blue trunks in the North corner, is no slouch. Camouflaging its true purpose with the name Health Savings Account, this [Stealth IRA](#) packs a real punch. Fresh on the scene in 2004, it provides for triple tax-free contributions of up to \$3,500 (\$7,000 family) per year but does require the use of a [High Deductible Health Plan](#).

Although not the largest account out there ([neither is the 401\(k\)](#)), it is like a wolverine that punches way above its weight. Not only do you save income taxes when you contribute, but if the contributions are taken directly from your paycheck by your employer, you also save payroll taxes. In addition, so long as you spend the money on health care, you can withdraw money from the account tax and penalty-free at any age. HSAs shield investments from the taxman (although [probably not from your creditors](#)) as they grow over the years. You also can pull the money out of the account [years after the health care expenses](#) without tax or penalty as long as you keep receipts. Although the penalty for pulling money out of the account inappropriately is higher (20% for non-health care expenses

before age 65), after age 65 its tax treatment is no worse than an IRA or 401(k) (thus the term Stealth IRA.)



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It's a lousy account to leave to heirs (probably the worst thing possible tax-wise), but since it can be used to pay for Medicare premiums and the other [hundreds of thousands of dollars in health care expenses most seniors face](#), that shouldn't be too much of an issue. If your employer's provided HSA plan stinks, you can roll the money over to [your own chosen plan](#) once per year.

Let the battle begin.

## 401(k) vs HSA: the Head to Head Competition

Let's say you have \$7,000 to invest, but you're not sure whether to put it in your 401(k) or your HSA (and for some crazy reason can't max out both accounts.) Which account is going to be most advantageous to you?

### Initial Tax Break

Assuming a 35% marginal tax rate, if you contribute \$7K to the HSA, you save  $\$7000 * 35\% = \$2,450$  in federal/state income taxes. But you also save payroll taxes. For a typical employee

doctor, this is just going to be 1.45% in Medicare, or another \$102 for a total upfront tax break of \$2,552.

If you contribute that same \$7K to the 401(k), you only save the \$2,450 in income taxes. But wait, what if there's an employer match? Let's say your employer matches up to 25% of the first \$4000 you contribute to the account each year. That means there is now \$8,000 in that 401(k).

Advantage: 401(k), but only if there is a match.

## Available Investments



It might be hard to get hurt in three foot deep powder, but should it happen, you'll prefer an HSA to a 401(k).

Your unenlightened employer doesn't offer particularly good investment options or fees in either account. However, at least with the HSA, you can roll the money out of the account once a year to a [plan with better investments and lower fees](#). Let's assume the 401(k) money grows at 7.5% and the HSA money grows at 8% per year over the decades. I thought 0.5% was a reasonable average additional fee for plan fees and higher ER mutual funds. That may overstate or understate the case for

your 401(k).

Advantage: HSA, but could vary by employer

## **Need Money Now**

Uh oh. Something has come up. You need cash. Which account should you tap? Well, withdrawing from the 401(k) incurs taxes and a 10% penalty. Withdrawing from the HSA incurs taxes and a 20% penalty. You can borrow against the 401(k), but the terms aren't that hot with a fairly high interest rate. Luckily, you spent a few bucks on health care this year and have some receipts saved up, so you can actually withdraw the needed money from the HSA tax, penalty, and interest-free.

Advantage: HSA

## **Creditors Come Knocking**

There's a potential suit above policy limits. Your state protects your 401(k) in bankruptcy but provides no such protection to the HSA. Luckily, like happens almost all the time, on appeal, the judgment is reduced to policy limits and you lose no personal assets.

Advantage: None

## **Time to Withdraw Money In Retirement For Health Care**



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Now you're 70 and need to pay some health care expenses for recent cancer treatment. Where should you take the money from? If you take it from the 401(k), you'll owe taxes at your ordinary income tax rates. If you take it from your HSA, the withdrawal will be tax-free. Just how much of an advantage does the HSA have here? Let's run the numbers.

We'll add that original Medicare tax savings into the HSA total for simplicity and the match into the 401(k), then apply 30 years of compound interest.

HSA:  $=FV(8\%,30,0,-7102) = \$71,464.99$  Multiply by  $1 - 0\%$  for taxes and you end with \$71,465 to spend on health care.

401(k):  $=FV(7.5\%,30,0,-8000) = \$70,039.64$  Multiply by  $1 - 25\%$  for taxes and you end up with \$52,530 to spend on health care.

Despite the employer match, the HSA ends up with 33% more money. You can buy a lot of health care with an extra \$19K, especially if you multiply that by 20 or 30 years of HSA contributions.

Advantage: HSA

## **Time To Buy A Sailboat**

With your cancer scare over, it's time to get out on the bay in a new sailboat. Which account will provide a larger sailboat? Let's run those numbers again:

HSA:  $=FV(8\%,30,0,-7102) = \$71,464.99$  Multiply by  $1 - 25\%$  for taxes and you end with  $\$53,599$

401(k):  $=FV(7.5\%,30,0,-8000) = \$70,039.64$  Multiply by  $1 - 25\%$  for taxes and you end up with  $\$52,530$

The HSA wins, but not by much.

Advantage: HSA

## Game, Set, and Match to the HSA



As you can see, in the vast majority of comparisons, the HSA is going to come out on top as the best of the two investing accounts. Even when it is not superior, it is typically about the same as or not much worse than the 401(k). And when it is superior (paying for healthcare before or during retirement) it is dramatically superior thanks to its triple tax-free nature. That said, a 401(k) is still a very good place to invest and ideally, you'll be able to max out both and even invest in a [taxable account](#) above and beyond your tax protected accounts.

*What do you think? Which do you think is the best investing account? What is the first account you fund each year? Comment below!*