Health Savings Accounts: The Stealth IRA

Health savings accounts (HSAs) were authorized by legislation signed by President Bush in late 2003. They were an improvement over flexible savings accounts (FSAs) in some major ways.

Benefits of an HSA: Triple-Tax-Advantaged

You still get to pay for your health care with pre-tax dollars, but with an HSA, you don't lose any unspent money left over at the end of the year. Not only that, but if you leave that money in the account (where it continues to benefit from compound interest) until retirement age, you don't even have to spend it on health care. So you don't pay tax on it up front like a traditional IRA. Like both a traditional and a Roth IRA, you don't pay tax on it as it grows. In retirement, when you withdraw the money, unlike regular traditional IRAs, you don't have to pay any tax on it if you use it to pay for health care costs in retirement, a time when you'll likely be less healthy and have more need for those health care dollars than now. So this account is TRIPLE-TAX-ADVANTAGED if you use the money for health care. (Compare to other retirement accounts here.) But even if you don't need it for health care, you can treat it just like a traditional IRA once you hit age 65. But it is even better than a traditional IRA for two reasons: First, there is no income limit on deducting your contributions. The contributions are deductible even if you make a million dollars a year. Second, the contribution limit can be higher than the $5000 limit on traditional or Roth IRAs-$6150 ($3050 for individual coverage) for 2011.

Downsides of an HSA: The High Deductible Health Insurance Plan

So what are the downsides? The main one is that you have to have a high deductible health insurance plan. This is defined for 2011 as a deductible of at least $2400 ($1200 for individual coverage) and a maximum out of pocket cost of at least $11,900 ($5950 for individual coverage). At least you'll usually save some money on the health insurance premiums to make up for that. Plus, you're a doctor, and much less likely to waste health care dollars. Not only can you take care of a lot of little stuff yourself, but you're much more likely to get a break from colleagues or your hospital as a professional courtesy.

Lastly, you're less likely than most patients to demand unnecessary tests. So, unless you or a family member has an expensive chronic condition, or you have access to a particularly low-cost standard health insurance plan) I think you are far better off getting a HDHP and an HSA. Then, when you do have health costs, pay for them out of your regular earnings, or in the event of catastrophe, your emergency fund (you do have an emergency fund of at least $12,100, right?) That way your HSA will grow and grow until retirement, gradually becoming your stealth IRA. $6150 a year for 35 years at 5% real is equal to over $556,000.

My recommended provider for an HSA is Health Savings Administrators, which features many of the Vanguard funds you probably already hold in other investment accounts. (Disclosure- I'm not paid to make that recommendation, but if someone would like to, you know how to contact me.)

Update: 2018 contribution limits are $3450 (individual) and $6900 (family). 2018 required deductibles are $1350 (individual) and $2700 (family) and the maximum out of pocket limit is $6650 (individual) and $13,300 (family.)