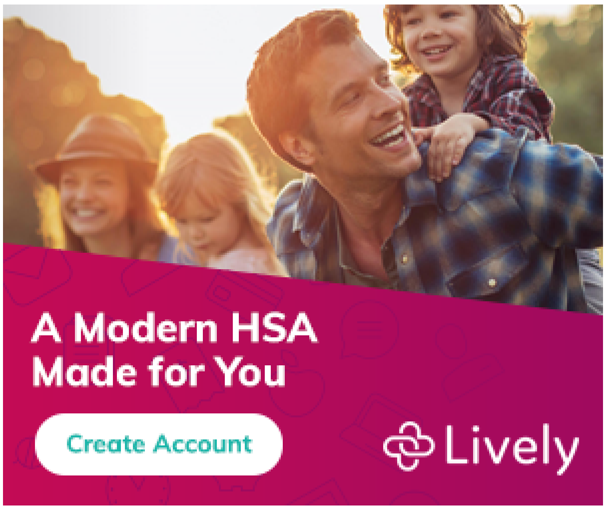
Should I Get an HDHP Just to Use an HSA?



Q.

I've heard all about using an HSA as a triple tax free account and/or a Stealth IRA and I'm excited to have some more tax-protected space. However, I have a non-high deductible health insurance plan available through my work and wonder if I should use that instead of an HDHP.

A.

I get this question a lot. It's important not to miss the forest for the trees and to let common sense prevail. However, before addressing it, let's talk a little bit about Health Savings Accounts (HSAs).

HSA Rules

HSAs are one of my favorite types of accounts. They are the only "triple-tax-free" account in that they give you a tax-deduction up-front, grow in a tax-protected manner, and then are tax-free upon withdrawal, so long as they are spent on health care. If not spent on health care, you must pay tax plus a 20% penalty on withdrawals, unless age 65 or older, in which only the tax is due, much like a traditional IRA or 401(k). In addition, if your employer makes the contribution as part of a cafeteria plan, contributions are also FICA tax-free. Self-employed folks, unfortunately, are out of luck there.

For 2015, HSA contribution limits are $3,350 ($6,550 if married) plus an additional $1,000 "catch-up" if you are 55 or older.

In order to contribute to an HSA, you need to have an approved High Deductible Health Plan (HDHP.) That is defined by the government as a deductible of at least $1,300 ($2,600 married) and a maximum out of pocket amount of $6,450 ($12,900 married). No HDHP, no HSA.

Many people don't realize you don't need to use the HSA your employer has lined up. You can contribute to any HSA you please, or transfer your money from your employer's HSA to another one. This allows you to take advantage of HSAs that may pay particularly high rates, or HSAs that allow you to invest the money in low-cost mutual funds, especially if you don't intend to spend the money for decades.

Three Good Ways and One Bad Way to Use an HSA

1) Pay Retirement Health Care Expenses

The very best bang for your buck with an HSA is to contribute now and get the tax break, let it compound for decades, and then spend it on health care in retirement. This maximizes the tax benefits of your only triple-tax-free account.

2) Pay Health Care Expenses Now

The original intent of HSAs was to enable people to have money to pay their high deductibles on their high deductible health plans. The two ways to let market forces fix our health care problem are to increase cost-sharing and to add price transparency. Well, the HDHP/HSA system does the first, even if it doesn't do the second. The tax benefits of an HSA are to entice people to actually contribute to their HSAs. Even if you turn around and spend the money a month later, it's still a pretty good deal. You basically get to pay for health care tax-free.

3) The Stealth IRA

Another great use of an HSA is to not spend it on health care at all. After age 65, it basically turns into a traditional IRA. The nice thing about this feature is it eliminates all worry of overcontributing to these accounts. If you turn out to be really healthy, and the investments grow like crazy so you have a million dollar HSA, well, you can use it to buy a boat in retirement. It's just another tax-protected retirement account.

4) Cashing Out

Really, the only bad way to use an HSA is to spend it on something besides health care before age 65. Not only will you pay tax on the money, but you are also going to pay a 20% penalty. The effective tax rate on that money will probably be somewhere between 45% and 70%, not exactly a good deal.

Answering the Question

As you can see, HSAs are pretty awesome. Because they are so awesome, some people will do anything to get one. That’s not necessarily wise. For example, if you or a family member are particularly unhealthy or take an expensive medication and are going to hit your deductible every year, you’re probably better off getting a health insurance plan with a lot lower deductible, even if the premiums are higher. Likewise, if your employer pays some or all of your health insurance premiums, it doesn’t make sense to turn that benefit down (unless you can exchange it for a higher salary) just to get a HDHP/HSA. Many times, it’s your spouse’s health care plan. A doc I know, for instance, has a spouse that works at the local university hospital. They pay almost nothing for health care. An HSA is not for them.

But in general, docs are pretty good candidates for HDHPs. They don’t tend to run in and get seen for stupid stuff. They can often take care of little things themselves. They may benefit from professional courtesy or at least a discounted rate. They have plenty of income to pay high deductibles. Plus, they’re generally relatively healthy. If you’re buying your own health insurance on the open market like I do, you might as well get a HDHP so you can use an HSA.

What do you think? Do you have an HSA? How do you intend to use it? Comment below!