ADAM SMITH INSIGHTS: *Published by President & Investment Advisor, Keith Tufte and Investment Advisor, Conner Kolodge with insights on investing and wealth management.*

INVESTING QUOTE OF THE MONTH:

"Three rules of financial planning: save more, spend less, and don't do anything stupid."
—Dick Wagner (financial planning pioneer)

HEALTH SAVINGS ACCOUNTS (HSAs) – TRIPLE TAX-FREE SAVINGS

Health savings accounts (HSAs) are a very attractive tool to save for your current and future medical costs. They offer "triple tax-free" savings because you get a tax deduction for the contribution into the account, the money grows tax-free while in the account, and it comes out of the account tax-free if used for healthcare expenses. As arguably the most tax advantaged account available, why doesn't everyone contribute to an HSA? To start, in order to be eligible to contribute to an HSA you must have a high deductible health insurance plan (deductible of at least $1,350 per year for single, and at least $2,700 for a family in 2018), you must not be covered by another healthcare plan including Medicare, and you must not be a dependent on someone else's tax return. As more health plans gravitate from the traditional co-pays to high deductible plans (HDHPs), more people are able to take advantage of the benefits of an HSA account.

It is open enrollment season for signing up for 2018 benefits, and we think many people should consider using HSA accounts and possibly increasing their contributions to these plans. The most an individual can contribute to an HSA account in 2018 is $3,450, while a family can stash away $6,900 per year. HSA owners (individual or family) can save an additional $1,000 annually if they are over age 55.

POSITIVES OF HSA ACCOUNTS

- Triple tax-free savings (tax deduction going in, tax-free growth, tax-free withdrawal). No other account offers this.
- Money not used during this year can be carried forward to future years indefinitely. This is not true for Flexible Savings Accounts (FSAs).
- HSA dollars can be used throughout your life for healthcare costs, including in retirement after age 65. A lesser known benefit is that HSA dollars can be withdrawn after age 65 for any reason (including non-medical costs) as long as you pay tax on the non-medical withdrawal amounts (similar to a traditional IRA account).
- HSA accounts do not have required minimum distributions like IRA accounts at age 70.5.
- Your employer may offer matching contributions, like in a 401(K) account.
- You can cover your healthcare costs out-of-pocket if you want, and let your HSA balance grow.
- Contributions to your HSA typically result in a tax deduction for federal tax, state tax, and also are not subject to the FICA (Social Security/Medicare) tax of 7.65%. 401(K) and IRA contributions are subject to FICA tax.
- HSA accounts are portable. You can take it with you if you change employers or retire. It is always your money.
- HSA accounts are convenient. You typically get a debit card linked to the account which makes it very easy to spend the account on medical costs.

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- If your company does not offer an HSA account you can set one up on your own at a bank or other financial institution that offers them. Some large providers of HSA accounts are Health Equity, Optum Bank, Fidelity Investments, HSA bank, SelectAccount, and Bank of America.
- There are no restrictions to using HSA accounts for those with high incomes, like there are for some IRA accounts.

There are two primary ways people use HSA accounts. The first is transactional, where they just put enough into the HSA account (and get the tax deduction) to cover their estimated annual out-of-pocket medical costs from their deductible. For example, if your deductible is $2,500 per year, and you estimate you will spend $2,000 out of pocket on healthcare costs, you might contribute $2,000 to your HSA account each year. This is a smart thing to do, but it does not allow you to take full advantage of tax-free growth in the account. The second way people use HSA accounts is for both transactional uses and as an investment account. They do so by overfunding (or maxing out) their HSA contributions compared to their estimated healthcare costs, and they let the excess dollars grow tax-free in the account.

The HSA is the most tax-favored savings vehicle in the tax code." – Morningstar

Saving in a 401(K) plan with a 50%-100% match is still probably the best place to start with your overall savings. After you are saving enough to get the full match in your 401(K) plan, saving your next dollars into an HSA account could be the next best place to contribute due to the triple tax-free nature of the HSA account. Another way to accelerate the growth of assets in your HSA account is to max out your contributions to the account, and then pay for some or all of your medical costs out-of-pocket rather than from your HSA account.

HSA ACCOUNT CONSIDERATIONS

- Age limit—You cannot contribute to an HSA after age 65. However, you can still use the account.
- Recordkeeping—You must keep records and receipts to prove that your spending from the account was actually spent on qualifying medical costs.
- Fees—Some HSA accounts have fees to be aware of and ask about.
- Investment Options—Some plans have excellent, diversified, low cost funds available in the plan and others do not. Often your plan balance must be over $1,000 to invest in funds other than a money market fund.
- Taxes and penalties—Money spent on non-medical expenses before age 65 is subject to income taxes and a 20% penalty. If you are over age 65, there is no penalty for non-medical spending from an HSA but you will be required to pay income taxes at your regular tax rate.

Please contact us with questions, or to discuss how you might make the best use of an HSA account.

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Adam Smith Advisors, LLC (ASA) provides unique wealth management services for a select group of client families to help give them peace of mind. Please FORWARD this e-mail to friends/relatives/business associates that you think may have an interest.

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