PRG
Principal Resource Group

Top 10 Myths and Misconceptions about Health Savings Accounts (HSAs)

HSA experts explain the ten most misunderstood HSA facts

Myth #1: FSAs and HSAs work the same way

We are not going to get into all differences between these two different tax codes, but one quick key to understanding the difference between HSA and FSA is focusing on the "S." An FSA is a Flexible Spending Account, while the HSA is a Health Savings Account.

- An FSA balance is designed for anticipated spending so that participants can avoid paying taxes on out of pocket health care expenses for the current year. FSAs are notorious for the "use it or lose it" provision.
- While the HSA can also be used for current year expenses, it doesn't have to be, and is designed for individuals to accrue monies in their Savings Account to be used in the future for large medical expenses. The contributions made to the plan can be carried over from year to year, and there is no current time limit on reimbursements.
- Many participants, upon realizing the potential impact that an HSA can have on offsetting future unexpected expenses (including Medicare and long-term care premiums), elect to stop using their HSA for small expenses such as co-pays and over the counter medicine and instead allow their balances to accrue. This is a best practice for participants who can afford their day-to-day medical expenses out of their regular spending.

Myth #2: My HSA is controlled by my employer

Once the funds go into the account, the employer does not control the HSA and the account owner can transfer it or spend it as they see fit. While employer-provided plans that are paired with HSAs typically require participants to open their HSA with the provider that the employer has chosen, there is no law that prevents account holders from immediately moving their funds to a different HSA provider of their own choosing, even while still employed with the plan sponsor.

So while payroll deductions and employer-provided deposits must be deposited with the vendor selected by the plan sponsor, funds can be transferred at any time to a different vendor, provided that the funds are going to another eligible HSA account. Keep in mind that a transaction fee may be imposed when transferring balances, so it's wise to account for this fee when making this decision.

Myth #3: HSA contributions must always be used for eligible health care expenses

False! The truth is that you can spend your HSA account on anything you want, but if you use it for a non-medical expense before the age of 65, tax and a tax penalty may apply. Many people don't know that after age 65, withdrawals for non-medical expenses are not subject to a penalty, (but they are subject to tax) making them much more like 401(k) withdrawals, which helps to overcome the concern that some participants have about over-funding.

Myth #4: HSA contributions can only be made through payroll deduction

Not true! Making HSA contributions through payroll leverages the maximum tax savings (FICA, Federal, and State). If you want to make contributions directly from your own pocket, you can do so, but you will miss out on the FICA savings. You currently have up to the tax filing deadline to make prior year contributions, making it a great option for people who missed out on maximizing their HSA contribution in the prior year.

Myth #5: HSAs don't earn anything

This is often true when just starting an account, as some vendors do not pay any interest on cash balances (others do), but many people don't realize that you can invest your HSA in the market once you reach a certain balance. We've generally seen that most vendors require a minimum balance of $1,000 be maintained before any excess can be invested, which is a best practice anyway so that participants have some cash available in case of emergency.

However, we have found that the most fee efficient way to manage an HSA with the more common vendors is to maintain a balance of $5,000 in the cash savings account, while investing any excess in low-cost mutual funds or other vehicles. This avoids most monthly maintenance fees as well as any monthly "investing" fees that are charged, which would eat into potential returns gained from investing.

Myth #6: HSAs have high fees

Once you consider the facts in #5, our experience is that this is generally false. Most plan sponsors pay the monthly administration fees for active employees, which are typically similar to FSA administration costs.

Where the greatest misconception comes in is when HSA investment options are compared to 401(k) investment options. Your HSA might have a higher fee than your 401k due to significantly lower average balances in HSAs, however, many HSA vendors include access to low cost funds. We are also finding brokerage accounts are being made available as the HSA industry grows. The great news for participants is that they are free to shop for the HSA of their choice and can transfer their balance if they find a more attractive price in the marketplace.

Myth #7: HSAs limit portability

Unlike many other employer plans such as qualified retirement savings plans, HSAs are fully portable at any time – moving funds to another provider does not require termination of employment or the attainment of any other event. Additionally, any funds left in a participant's account upon termination remain property of the employee. Be sure to ask the vendor what fees might apply when transferring funds. Typically, the fee is $20 or less per transfer.

Myth #8: HSAs are only for healthy people

Because HSA eligibility rules require account holders to be enrolled in a high deductible health plan to make contributions, many people erroneously believe that HSA-eligible plans are really only cost-effective for super healthy people. While that may be true in cases where a high deductible would cause a financial hardship for the participant, it's not always the case even for participants with a chronic health issue.

It's important to look at the total picture:

- Low deductible plans typically have higher premiums than a HDHP.
- Many employers make a contribution into the HSA, which is free money to participants and can help cover high costs if necessary.
- HSAs allow you to contribute significantly more than an FSA plans, allowing greater tax savings.
- HSA-eligible plans may offer better coverage of preventive prescription drugs, which can significantly lower out of pocket costs.
- HSA-eligible plans may offer access to a greater choice of in-network providers.

Every situation and plan is different, but run the numbers before you make a decision.

Myth #9: HSAs are just a way for employers to lower costs

Many employers will see significant savings by offering HDHP health plans to their employees. Smart employers are passing along the savings to employees by offering employer matching contributions into HSAs. Currently over 80% of employers are making employer contributions to HSAs.

Myth #10: There is a time limit on when I can be reimbursed for my expenses

As of today, there is no time limit on when a HSA holder can reimburse him or herself for previously incurred expenses, which means that participants who choose to use non-HSA funds to pay for eligible medical expenses may go back and reimburse themselves years later, should they need the funds in the future but not have an eligible medical expense to fund. This makes the HSA a powerful way to save for retirement.

Picture this: throughout 20 years, you accumulate a 6-figure balance in your HSA by paying medical expenses with non-HSA funds, but save the receipts for those expenses, which total $25,000 over the years. In your first year of retirement, you can choose to reimburse yourself for ALL of those expenses and effectively give yourself $25,000 of tax-free income in that one year. Now THAT'S a triple-tax-free benefit!

Authors:

Karin M. Rettger, MBA, AIF, President, Principal Resource Group

Kelley Long, CPA/PFS, CFP®, Financial Planner, Financial Finesse

Reprinted with Permission

Published by Defined Contribution *Insights Magazine*, Plan Sponsor Council of America, Spring 2018