HEALTH SAVINGS ACCOUNTS: ADDING A PIECE TO THE RETIREMENT PUZZLE

Retirement income can be a complex puzzle. Pieces might include a pension, 401(k) or other employer-sponsored retirement plan, Social Security, individual retirement accounts (IRAs), and personal savings — not to mention everything in the "other" category, from baseball cards to real estate.

There is another piece employers should consider to help employees complete the retirement puzzle: health savings accounts (HSAs). It may come as a surprise to some people that HSAs can be a powerful way to save for the future.

WHY AN HSA

HSAs were created to help people covered by a high deductible health plan (HDHP) set aside pretax money for out-of-pocket medical expenses, and that's how most people view them. They have become popular in recent years because (surprise!) health insurance can be expensive. To offset high deductibles, employees typically follow up their enrollment in a qualifying health plan by signing up for an HSA. In a few days, a debit card arrives in the mail and, because they don't know how else the account could benefit them, the employee uses it only for medical expenses.

There is nothing wrong with that, of course. But, like the late-night television pitch says, "Wait! There's more!"

HOW HSAs HELP WITH RETIREMENT SAVINGS

The other aspect of the HSA — one that many accountholders don't fully understand — is its potential as an additional way to save for retirement. It's important to educate employees about that potential so they can make informed decisions about how to use their HSA.

Let's start with the basics.

TRIPLE-TAX BENEFITS

HSAs are unique in that, when used properly, they provide triple-tax benefits. Like any individual account plan to which employees contribute, such as 401(k), 403(b), or IRA, contributions reduce taxable income for the account owner. Also, like other individual account plans, investment earnings in the account grow tax-free (more on that later).

The difference comes when taking money out of the HSA. In a traditional (non-Roth) employer-sponsored retirement plan or IRA, withdrawals in retirement are taxable income. HSA withdrawals used to pay eligible medical expenses are tax-free. Not tax-deferred, but tax-free.

What's not to love?

Action	Traditional (non-Roth) employer-sponsored individual account plan or IRA	Health savings accounts
Early withdrawals	10% penalty tax AND taxable as ordinary income for withdrawals before age 59½. Certain exceptions to the penalty tax are available.	No taxes if used for qualified medical expenses at any age. Withdrawals for other uses before age 65 are subject to 20% penalty and included in income for tax purposes.
Contributions[1]	Not counted as income for tax purposes	Not counted as income for tax purposes — No taxes
Investment growth	Not taxable	Not taxable
Withdrawals in retirement	Taxable as ordinary income	No taxes if used for qualified medical expenses; taxable as ordinary income if used for any other purpose

HSAs OFFER ADDITIONAL BENEFITS. FOR EXAMPLE:

- Anyone may contribute to an individual's HSA if the overall amount does not exceed IRS limits. This could be the employer, a relative, a neighbor, the mail carrier — anyone.
- Contributions to the HSA are not counted as taxable income, even when the account owner doesn't itemize their tax return. That's because contributions are "top line," directly reducing income for tax purposes.
- The individual, not their employer, owns their HSA. It stays with them no matter where (or if) they are employed.
- The account owner may continue contributing to the account as long as they are covered by an HDHP, regardless of employment status or employer.

WHO MAY CONTRIBUTE

HSAs are available to those covered only by a qualifying HDHP. Individuals cannot contribute if they are covered by an additional medical insurance plan, including a medical flexible spending account (FSA), or if they change to nonqualifying HDHP insurance, but they continue to own the account. Examples of "other" insurance include Medicare, a spouse's health insurance, or lower-deductible health insurance. However, coverage in a limited benefit plan, such as cancer or hospitalization coverage, does not affect HSA eligibility. Account owners can resume their HSA contributions if they meet the requirements again.

FLEXIBILITY

Many employers offer flexible spending accounts (FSAs) for medical, dental, vision, or dependent care expenses. These accounts can help employees pay predictable out-of-pocket costs using pretax money. However, enrolling in FSAs happens during annual open enrollment, meaning employees must estimate expenses up to a year in advance and cannot change the contribution amount without a qualifying event. These funds are generally "use-it-or-lose-it." If the participant overestimates their spending for the year, leftover balances may no longer be available.

A workplace HSA provides another option. Employees can reimburse their qualifying medical expenses as soon as they have enough in the account or allow unused balances to roll over to subsequent years. Contribution amounts can be changed throughout the year.

Employers that offer FSAs and HSAs provide flexibility for their employees. This is because employees participating in a limited purpose FSA and dependent care FSA can still contribute to an HSA, allowing them to maximize tax savings.

Ninety-one percent[2] of employers offer HSAs through the workplace, and 46.7%[2] of organizations automatically enroll employees in an HSA if they select the qualifying HDHP. Contributions can then be made through payroll deduction, which simplifies saving. And if employees wish to make contributions to their HSA outside of payroll, they can do so until April 15th of the following plan year.

Regardless of which HSA provider the employer offers, the employee owns their HSA. They also have sole discretion about which provider to use and can change providers at any time.

Because HSA rules can be confusing (and costly when not followed), it's important to ensure employees have clear, current information about which medical insurance plans qualify and the amount they can contribute each year. IRS Publication 969 is an excellent resource.

INVESTING

HSA owners can always use the account to pay eligible medical expenses. Or they may choose to pay medical expenses out of pocket and continue to grow their balance. When the account reaches a minimum threshold (if one has been set), the account owner may elect to move all or part of the amount above the threshold into an investment account. Nearly 61%[2] of organizations that have an HSA program offer investment options.

Employers that allow their HSA program to offer investments have two options to avoid subjecting the program to the Employee Retirement Income Security Act of 1974 (ERISA). They may elect a default investment lineup chosen by the HSA provider, or they can mirror the employer's 401(k) or 403(b) plan menu. Employees who are already familiar with the investments in their 401(k) or 403(b) plan may appreciate that the same investments are also available in the HSA. This makes investing easier and can help align their investment goals and strategy.

WITHDRAWALS

Withdrawals from an HSA for qualified medical expenses are always tax-free. But withdrawals for nonqualified expenses before age 65 or disability are subject to a 20% penalty and are considered taxable income. Once the account owner reaches age 65 or becomes disabled, money withdrawn for nonmedical purposes is no longer subject to the 20% penalty, although it will still be considered income and taxed accordingly.

When setting up an HSA, account owners should designate a beneficiary. When the account owner's spouse is beneficiary, the account will be treated as the spouse's HSA after the original owner's death. If someone other than the spouse has been chosen as beneficiary, the account will no longer be an HSA and its fair market value will become taxable.

KEEPING RECORDS

"Used for qualified medical expenses" does not mean payments must be made directly to a medical services provider. Recordkeeping is important, though. To avoid income tax, account owners should keep all qualifying receipts from the time they open their HSA. Some use the "shoebox" method, saving all qualifying receipts together, regardless of date. In the event of an audit, they can substantiate withdrawals using any combination of the accumulated receipts as long as the date of service aligns with ownership of their HSA account. For amounts that can be verified with receipts, no income tax is required. Providers can often perform this service electronically, recording unreimbursed expenses and receipts so they can be used later.

WHO CAN BENEFIT FROM AN HSA?

- HSAs enable all employees to increase their retirement savings. Because those in higher tax brackets may have more need to reduce taxable income — and more financial ability to max out their retirement plan contributions — they can especially benefit. Not only is their taxable income reduced, but they may also invest the money in their accounts.
- The accounts may provide an opportunity for early retirement because the employee can take tax-free withdrawals regardless of age, as long as they can substantiate previously unused, eligible medical expenses.
- An HSA may allow employees to avoid retirement plan withdrawals by providing a source of emergency savings, tax-free if they have qualifying receipts to substantiate withdrawals.
- Withdrawals from an HSA may help offset medical costs in retirement, which can be substantial. Some insurance premiums qualify as HSA expenses, including long-term care insurance premiums and Medicare (but not Medicare supplement) premiums for those who are 65 or older.

HIGH-INCOME EARNERS

Lila plans to retire at age 65 in 2024. She takes full advantage of her HSA. Lila selected the self-only HDHP in 2015 and has contributed the maximum amount, including catch-up contributions, to her HSA each year since. She has not taken any withdrawals from her HSA and began investing the account after the first year. For this illustration, we assumed 3% average investment earnings credited at the end of each year.

Here is a snapshot of Lila's account:

Year	Maximum contribution	Catch-up contribution	Total contribution	Account balance	Investment earnings[3]	Total account balance
2015	$ 3,350	$ 1,000	$ 4,350	$ 4,350	$ 0	$ 4,350
2016	3,350	1,000	4,350	8,700	261	8,961
2017	3,400	1,000	4,400	13,361	401	13,762
2018	3,450	1,000	4,450	18,212	546	18,758
2019	3,500	1,000	4,500	23,258	698	23,956
2020	3,550	1,000	4,550	28,506	855	29,361
2021	3,600	1,000	4,600	33,961	1,019	34,980
2022	3,650	1,000	4,650	39,630	1,189	40,819
2023	3,850	1,000	4,850	45,669	1,370	47,039
2024	4,150	1,000	5,150	52,189	1,566	$ 53,755

Lila accumulated $53,755 to use as retirement income. That's in addition to withdrawals from her retirement plan. If used to pay current medical expenses or to reimburse herself for past eligible medical expenses, Lila will pay no taxes on this amount. Contributing to an HSA complements contributions to qualified retirement plans like a 401(k) or 403(b). It does not affect the contributions allowed to other plans.

People in lower tax brackets can also benefit from HSAs. Not only can they pay current out-of-pocket expenses with HSA funds, but they also have the potential to save even more for retirement, making these plans an important companion to workplace retirement plans and IRAs.

HOW EMPLOYEES CAN GET THE MOST FROM THE HSA

Here are a few things to consider to help employees maximize the value of their HSAs:

- Help them understand the rules and benefits through regular communication.
- Be sure the provider communicates that reimbursements of qualifying expenses are always available. That knowledge may encourage employees to start saving, even in small amounts.
- Make sure communications offered by the HSA provider are clear, understandable, and provide information that can help employees consider all the advantages these accounts offer.
- If the HSA program offers investments, communicate the advantages of investing their account.
- By coordinating the 401(k) or 403(b) plan and the HSA, employees can maximize them. It's a three-step process: First, contribute enough to the employer-sponsored plan to take full advantage of any employer matching contributions. Then contribute as much to the HSA as allowed by the IRS. And finally, if the employee can afford to contribute more, make additional contributions to the 401(k) or 403(b) plan account where higher limits are available.

Here's how Lila approaches this three-step process.

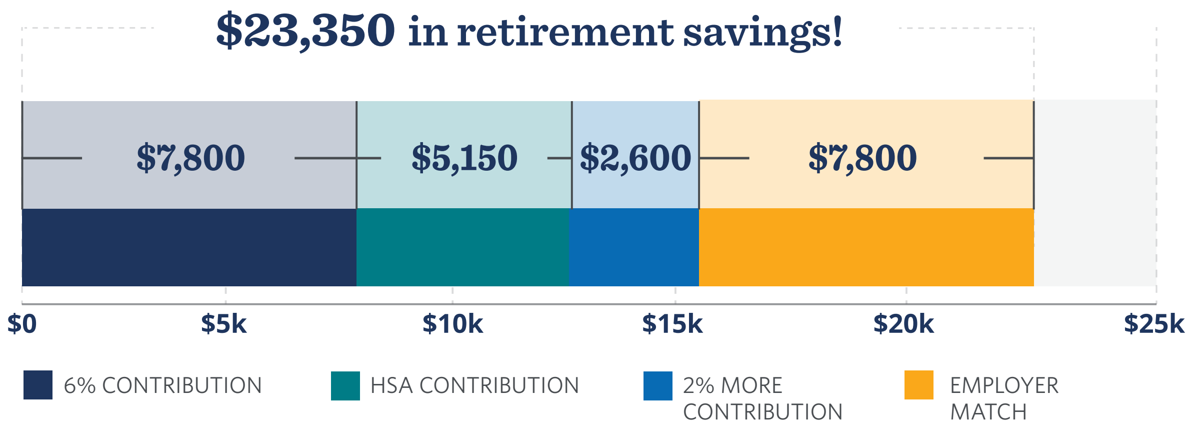
Lila's employer offers a 401(k) plan with a 100% match on the first 6% of pay she contributes from her $130,000 annual salary. To take full advantage of her 401(k) and HSA plans in 2024, Lila follows these steps:

1. Contribute 6% of compensation to the 401(k) plan . . .$7,800
2. Contribute the maximum allowed to the HSA[4]. $5,150

Lila has budgeted for retirement contributions of 12% of her pay, so she can afford to contribute an additional 2%.

3. Contribute 2% more to the 401(k) plan. $2,600

By directing her retirement savings this way, Lila will have set aside a total of $15,550 and reduced her taxable income by the same amount. She will also benefit from a matching contribution of $7,800, resulting in a total of $23,350 in retirement savings for the year.



AVOIDING ERISA

Qualified plans, like 401(k) and certain 403(b) plans, are covered under the Employee Retirement Income Security Act of 1974 (ERISA), and they come with certain fiduciary responsibilities. An HSA is not typically an ERISA-covered plan. Rather, the account owner is responsible for all decisions related to it.

But an employer can make decisions, which change its ERISA coverage. For example, the plan could become subject to ERISA if the employer (rather than the employee) determines:

- Which custodian will hold the account
- Whether or how to invest the assets
- Which expenses are paid with the money

To avoid stepping over the ERISA-coverage line, the employer must follow a few simple rules, including:

- Offering, but not dictating, which providers employees may use
- Not receiving payments from employees connected with the HSA
- Not endorsing one provider over others while supporting employees' efforts to save in an HSA by processing contributions through their payroll system to the provider the employer selects
- Not influencing or dictating any investment decisions with respect to the HSA (the HSA can offer a range of investment options, which can mirror the employer's 401(k) plan or 403(b) or be a default lineup determined by the HSA provider)

It's important that all employer, advisor, and recordkeeper communications make it clear that the employee, not the employer, is in charge and responsible for all decisions related to their HSA.

HOW TRANSAMERICA CAN HELP

By choosing Transamerica as the HSA provider, employers give their employees a variety of benefits, including:

- Easy access to all Transamerica accounts using one username and password
- Receipt "vault" where medical expenses are tracked and can be tagged as reimbursed or unreimbursed
- Robust mobile app with a user-friendly design that helps account owners log receipts quickly using the device's camera feature
- Customer service representatives who can answer questions about all our products through one phone number
- Easy medical expense payments with a debit card or through our mobile app
- Educational support for all retirement, spending, and saving products to help employees take advantage of all their employer offers
- Investment flexibility
- Investment opportunity: Over 45%[5] of assets in the Transamerica HSA are invested, compared to 27.8%[2] for the industry in general.

Employers benefit with:

- Competitive fees and simple, straightforward pricing
- Easy administration, with everything necessary to manage all Transamerica plans in one place
- Another workplace perk that can help attract and retain employees in a competitive job market

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State taxation may vary by state.

Information regarding retirement plans is general and is not intended as legal or tax advice. Retirement plans are complex, and the federal and state laws or regulations on which they are based vary for each type of plan and are subject to change. In addition, some products, investment vehicles, and services may not be available or appropriate in all workplace savings plans. Plan sponsors and plan administrators may wish to seek the advice of legal counsel or a tax professional to address their specific situations.

[1] Subject to annual limits set by the IRS

[2] "2023 HSA Survey," Plan Sponsor Council of America, November 2023

[3] Assumes 3% investment earnings on total beginning in 2016

[4] The maximum contribution shown includes Lila's catch-up contribution of $1,000. The maximum contribution in an HSA includes employer and employee contributions.

[5] Transamerica data as of February 29, 2024

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