Health Savings Account as a retirement strategy

Save it. Use it. Never lose it.®[1]

Reduce your taxable income while potentially creating a way to pay for health care costs during retirement.

Triple tax advantage[2]

- **Pretax contributions**
- **Potential for tax-free interest and investment earnings**
- **Tax-free withdrawals for qualified medical expenses**

Who is eligible to set up a Health Savings Account?

Individuals or employees who meet the following requirements on the first day of a month are eligible to set up and contribute to a Health Savings Account (HSA) during that month.

- Must be already enrolled in, or covered under, a qualified high-deductible health plan on the first day of the month.
- Must not be able to be claimed as a dependent on anyone else's tax return.
- Must currently not be enrolled to receive Medicare benefits.
- Must not be enrolled in any nonqualifying health coverage that does not satisfy the statutory minimum deductible requirements of the IRS (unless that coverage is limited to certain permitted types of coverage or insurance). If you have a Flexible Spending Account[3] or a Health Reimbursement Arrangement with your employer, or if you are covered under your spouse's Flexible Spending Account or Health Reimbursement Arrangement, you may not be eligible to open a Health Savings Account.

These conditions are subject to change.

An HSA can help you plan for a longer retirement and rising health care costs

Increasing life expectancies mean that many Americans can look forward to a longer retirement. The average U.S. life expectancy is now 78 years, and there is an 81% chance that at least one member of a healthy, 65-year-old couple will live to be at least 85.4. While that's great news, you'll need a plan to fund those extra retirement years, including paying for health care expenses.[4]

Americans are concerned that health care costs are rising faster than inflation and can pose a threat to their retirement savings. It can be challenging to estimate the costs of a long-term illness or disability. Contributions to an HSA can help to reduce the risk that your health care expenses will exceed your retirement assets.

A 65-year-old couple, both with median drug expenses, would need $283,000 to have a 90% chance of having enough money to cover health care expenses (excluding long-term care) in retirement.

Source: Employee Benefits Research Institute, October 2013. Savings Needed for Medigap Premiums, Medicare Part B Premiums, Medicare Part D Premiums and Out-of-Pocket Drug Expenses for Retirement at Age 65 in 2011–2013.

In retirement, you can use your HSA to pay for qualified medical, prescription, dental and vision expenses, including:

- Long-term care premiums, subject to internal revenue code section 213 deduction limits for long-term care insurance premiums
- Medicare premiums and out-of-pocket expenses
- Medicare Part A deductible
- Medicare Part B premiums and co-insurance
- Medicare Part D prescription drug premiums and co-insurance

At age 65 and thereafter, you can withdraw funds for nonmedical expenses without paying the additional 20% federal excise tax. However, you'll still pay ordinary income tax on withdrawals used for nonmedical expenses.

Unlike a Flexible Spending Account (FSA),[5] an HSA allows you to "use it — but not lose it," since the funds are portable when you change employers or retire.

HSA dollars roll over year to year and are not forfeited at year-end.

Unlike an IRA, the HSA enables you to save toward health costs with no required minimum distribution starting at age 70½.

Ways to maximize your HSA for retirement

- Delay withdrawing money from your HSA as long as possible, giving it potential to grow tax-free. You may reimburse yourself from your HSA at any future time to pay for qualified medical expenses you incur after you have established the HSA. Be sure to track your expenses and **save your receipts** for tax purposes.
- For HSA balances over $1,000, you can choose to invest in mutual funds that offer growth potential.
- If you haven't maxed out through payroll and employer contributions, add directly to your HSA between January 1 and April 15 of the following year.
- If you are or will be age 55 or over during the calendar year, you may also make a "catch-up" HSA contribution of an additional $1,000 annually.

How HSA savings can add up: Spender versus Saver

Delaying withdrawals from an HSA and investing in mutual funds could add up to significant savings. This hypothetical example shows how the savings could add up:

Assumptions	Spender	Saver
Annual HSA contributions	$6,000	$6,000
Annual qualified medical expenses paid with HSA savings	$5,000	$500
Federal income tax rate or bracket	28%	28%
State income tax rate[6]	0%	0%
Estimated annual interest rate or earnings*	0.2%	5.5%
Number of years to project	20	20

What happens after 20 years?

Spender

Balance after 20 years:
$20,384

Tax savings after 20 years:
$33,719

Saver

Balance after 20 years:
$191,775

Tax savings after 20 years:
$59,450

Assumes the Spender holds HSA money in a cash account nearing 0.2% annually and the Saver estimates higher earnings because she invests a portion of her HSA money in mutual funds, earning an assumed 5.5% annually. Both are saving for their family, not individual coverage.

This hypothetical illustration assumes $6,000 annual pretax HSA contributions, 28% federal tax rate and 0% state tax rate throughout participation. For the Spender scenario, this illustration assumes $5,000 annual withdrawal for qualified medical expenses and 0.2% rate of return throughout participation and does not consider any APR or effective rate of return. For the Saver scenario, this illustration assumes $500 annual withdrawal for qualified medical expenses and 5.5% rate of return on the entire balance throughout participation and does not consider any APR or effective rate of return. Calculations for total HSA balance and tax savings accumulated at the end of the 20-year period assume contributions and withdrawals are made in lump-sum amounts at the end of each year. Changes in contributions, withdrawals, tax rates and tax treatment of earnings may affect the comparative results. Please consider your time horizon and income tax brackets, both current and anticipated, when making any decision, as these may further affect the results of the comparison. Hypothetical results are for illustrative purposes only and are not meant to represent the past or future performance of any specific investment vehicle or account. If you make pretax contributions to an HSA, taxes are due upon withdrawal if assets are not used for qualified medical expenses. For amounts invested in mutual funds, investment return and principal value will fluctuate and when redeemed may be worth more or less than their original cost. This hypothetical illustration does not take into consideration any underlying mutual fund expenses.

[1] "Never Lose it" refers to account portability and for HSA accounts, the annual rollover of accumulated assets; it does not imply you cannot lose money. The investment portion of the HSA account is not FDIC insured, not bank guaranteed and may lose value. Investing involves risk, including possible loss of the principal value invested.

[2] About Triple Tax Advantage: Participants can receive tax-free distributions from their HSA to pay or be reimbursed for qualified medical expenses they incur after they establish the HSA. If they receive distributions for other reasons, the amount withdrawn will be subject to income tax and may be subject to an additional 20% tax. Any interest or earnings on the assets in the account are tax-free. Participants may be able to claim a tax deduction for contributions made to the HSA. We recommend that applicants and employers contact qualified tax or legal counsel before establishing an HSA.

[3] Please be aware that opening a Health FSA could disqualify you from subsequently establishing a Health Savings Account (HSA). However, your employer may sponsor a "limited reimbursement" Health FSA that would not disqualify you from establishing an HSA. Contact your tax advisor or employer for more information. Bank of America acts solely as claims administrator performing administrative tasks pursuant to an agreement with, and at the direction of, the employer. Bank of America does not sponsor or maintain the Health FSA, and does not provide tax, legal or accounting advice.

[4] Society of Actuaries. Annuitant Mortality Table 2000.

[5] On October 31, 2013, the IRS modified the "Use-or-Lose" rule for Health Flexible Spending Arrangements (FSAs) effective for plan years beginning on or after December 28, 2012. Health FSA plans may now be amended to permit a maximum of $500 of unused amounts remaining at the end of a plan year (including the "run out" period) in a Health FSA to be carried forward to the subsequent plan year and used for qualified health care expenses incurred in subsequent years. Any amounts remaining in the plan from the previous year that exceed the $500 maximum (or a smaller amount as per the plan document) are forfeited. This is a voluntary provision; employers do not have to offer the carryforward option or the grace period as part of their plan.

[6] State tax consequences for HSAs may vary. You should check with a qualified tax advisor for specific state tax consequences that are applicable to you.

Bank of America Health Benefit Solutions does not provide tax, legal, investment or benefits consulting advice. Any tax statements contained herein were not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties. This material should be regarded as general information on health care considerations and is not intended to provide specific health care advice.

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