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HSAs are the New IRAs

By Matthew Hisrich

It may be time to reconsider how you save for retirement. That's because the Internal Revenue Service issued new guidance earlier this summer that makes it easier to use Health Savings Accounts, or HSAs, as a tool for savings. Using HSAs for this purpose offers all of the benefits of Individual Retirement Accounts while allowing the potential for much greater flexibility.

HSAs are already a powerful tool for consumers. They provide the opportunity to lower health coverage expenses by pairing up with insurance that primarily covers only major medical expenses but also preventive care. Individuals and families can then use that savings to build their account balances from year to year while having far more freedom than under traditional third-party insurance plans to select the care they need most.

On June 4, the IRS released notices 2008-51 and 2008-52, which discuss annual HSA contribution limits and the ability to roll IRA funds into an HSA. The notices clarify the changes made by the federal Tax Relief and Health Care Act of 2006 and are effective for tax years 2007 and later. With this new guidance, the IRS points the way toward HSAs as the first choice for savings.

Indeed, one of the primary architects of the HSA implementation argues just this point. Roy Ramthun led the U.S. Treasury Department's roll-out of HSAs after they were enacted into law in December, 2003. He then became senior health policy advisor to President George W. Bush and now serves as President of HSA Consulting Services.

"No other account has the tax advantages that HSAs do," Ramthun suggests. "Because of this, taxpayers should consider fully funding their HSAs first before other types of retirement accounts, especially if they plan to use their HSAs in retirement to pay for medical expenses."

Ramthun points to the high cost of medical care in retirement as a sobering reminder of the importance of adequate planning and saving. Fidelity Investments, for example, estimates that "an average 65-year-old should plan for at least \$551 monthly or \$6,631 annually in healthcare expenses." For a couple retiring in 2008, that can add up to \$225,000 over the rest of their lifetimes *after* taking into account all the expenses Medicare covers. The number is not likely to drop any time soon, either. In fact, over the past several years the average annual increase has held steady at roughly six percent.

"With health care costs continuing to outpace wage increases and companies trimming retiree

health benefits,” said Fidelity executive vice president Brad Kimler in a recent release, “financing health care has to be central to retirement planning.”

But even these high costs do not fully account for all possible expenses – especially long-term care. “The beauty of HSAs is that they can be used to pay Medicare premiums and out-of-pocket expenses and long-term care insurance premiums and expenses tax-free,” says Ramthun. “However, if you don’t end up incurring these types of expenses, you can still use your HSA funds for other purposes and pay only regular income tax on your withdrawals after age 65.”

What this means is that the HSA is now essentially on equal footing with the IRA from a tax perspective. But HSAs offer benefits IRAs simply cannot. As Ramthun mentions above, throughout the life of an HSA its owners can withdraw funds for medical care tax-free. An HSA, he argues, “is clearly the better choice.”

The new IRS guidance strengthens an already impressive option. Health Savings Accounts offer significant tax advantages while also allowing the potential for reduced health coverage expenses and more opportunities for consumer choice in health care. With all of these benefits, now is the time to explore whether an HSA is right for you.

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