MAKING SENSE OF HSAS AND FSAS

Health Savings Accounts and Flexible Spending Accounts can save you money on healthcare expenses.

HEALTHCARE IS EXPENSIVE. NO KIDDING, RIGHT. AND NO MATTER WHETHER YOURS IS BRONZE, SILVER, GOLD, OR EVEN PLATINUM, HEALTHCARE PLANS ARE EXPENSIVE, NOT TO MENTION OUT-OF-POCKET MEDICAL EXPENSES, SUCH AS COPAYS, DEDUCTIBLES, AND COSTS THAT ARE SIMPLY NOT REIMBURSED.

There's a way to potentially save money on your total annual healthcare costs. Health Savings Accounts (HSA) and Flexible Spending Accounts (FSA) are government programs that can cover certain medical expenses not covered by insurance, while offering tax benefits that have the potential to save you money on your healthcare costs.

Employers can generally offer both types of plans to their employees. If you are self-employed, you can enroll in an HSA but not an FSA. To be eligible for either, you must meet certain guidelines.

Below, we provide an overview of both options with their key benefits:

Health Savings Account

An HSA is offered by employees or electable by those who are self-employed in conjunction with a high-deductible health plan.

To elect an HSA, the employer or self-employed person deposits up to their entire healthcare deductible amount into an HSA account, which can cover qualified and non-reimbursable healthcare expenses.

Contributing to an HSA: After establishing an account, the account holder can add additional funds to the HSA via a payroll deduction from their gross income, which is money from pretax dollars. This reduces the federal taxable income for the person (most states also exempt the contributions from state income taxes, too). Additionally, any interest or earnings that the HSA account generates is tax-free.

You can also contribute to your HSA with after-tax money, deducting the amount from your gross income on your federal tax return, thus reducing your tax bill.

Non-account holders can also contribute to your HSA. In all cases, certain limits apply to the amount you are allowed to contribute. For instance, in 2020, the limit was $3,550 for individuals and $7,100 for families, though taxpayers 55 and older could add an additional $1,000.

Tax-free withdrawals: The IRS details eligible expenses that an HSA covers in IRS Publication 502, Medical and Dental Expenses.

Withdrawals that you make from an HAS are exempt from federal taxes and in many cases state taxes, too, if you use them to pay for qualified medical expenses.

You can also use your HSA as an investment account, providing you with the potential to increase your returns. However, this carries a risk of loss, too.

Money that is left over in your HSA at the end of the year rolls over to the following year. Additionally, the money remains available if you retire, switch health insurance plans, or start a new job.

Disadvantages: HSAs require that you have a high-deductible health plan, which has the potential to create a more substantial financial burden than plans with lower deductibles.

Additionally, some HSAs charge recurring maintenance or per-transaction fees.

Flexible Spending Account

Flexible Spending Accounts (FSAs) offer many similarities to HSAs, though they are available only through employers — self-employed individuals cannot open an FSA account.

Like an HSA, an FSA carries maximum contribution limits each year — $2,750 in 2021 — an amount that is deducted from your pre-tax income. This reduces your tax liability at the end of the year, though the true financial benefit will depend on whether you use the entirety of your FSA funds, which don't all carry over, unlike those in an HSA.

You can use your FSA funds to pay for medical expenses for you, your spouse, or dependents, as well as for adult children that are 26 and under.

You can use an FSA to pay for medical equipment, prescription medicine, birth control, mental health treatment, and even bandages.

Your employer can offer one of two options that relate to unused FSA funds. You can either carry over up to $500 to the next calendar year or receive an additional 2.5 months in the next calendar year to spend your leftover funds.

To decide whether an HSA or FSA is right for you, consult with a tax or financial professional who can help you understand the advantages and disadvantages for your unique circumstances.

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