Health Savings Account 101

A Health Savings Account (HSA) is a tax-advantaged vehicle that can assist with paying medical bills and lowering income taxes.

Money contributed to an HSA is considered pre-tax, so it functions similarly to a tax deduction. For example, if Scott makes $50,000 and places $3,000 in his HSA, he will be taxed on just $47,000 that year. That $3,000 can then be spent on qualifying expenses, tax-free.

In effect, HSAs allow account holders to earn and spend money without incurring any taxes, with one key caveat: it must be used for qualifying medical expenses. On the bright side, the IRS has a wide net for what expenses qualify. The list ranges from doctor’s visits and allergy medicine to contact lenses, bandages, and much more.

Another perk — and, according to advisors, an often underutilized one — is that HSAs can be invested. Like with 401(k)s and IRAs, the gains in an HSA are not taxed. Thus, HSAs can be called triple tax-advantaged. When the qualifications are met, funds contributed, investment growth, and funds withdrawn all avoid taxes.

To be eligible for the HSA account, you must first have a high deductible health plan (HDHP). If you’re interested in opening an HSA, first be sure to check the eligibility requirements.

Advisors say the best place to start with an HSA is by seeing if your employer offers one through your employee benefits. In some cases, employers will contribute funds to an employee’s HSA to boost savings in the account.

If you are eligible and able to save in an HSA, a triple tax-advantaged vehicle is a rare investment opportunity — and one worth exploring.