BELTZ IANNI & ASSOCIATES

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# HSAs: A Tax Trifecta Investment Opportunity

When it comes to fiscally frugal health insurance options, health savings accounts (HSAs) aren't exactly new to the game. They've been around since 2003 and have only increased in popularity among employers, politicians and certain types of employees. In recent years, however, the growth in popularity of HSAs is due less to the accounts' function from a cost-saving benefit plan and more to its utility as a wise choice for investment opportunities.

It's time to look beyond the traditional approach(es) to planning for the financial future — and look instead toward HSAs as a saving grace for the $260,000* in health care spending individuals need throughout retirement.

**There's never been a better time to jump headfirst into a positive change for your employees. Prepare yourself and your business by hearing what we have to say on HSAs.**

**No Signs of Slowing**

HSAs were designed to help people in high-deductible health plans (HDHPs) manage their out-of-pocket expenses. Their use has been growing steadily ever since they were introduced to the marketplace. In recent years, as employers are seeking more cost-effective alternatives that enable employees to do more with their health care dollars, they've been growing by leaps and bounds and are a prominent feature of today's employee benefits landscape.

In only a few years, that growth has shown:

- Enrollment in HSA-eligible plans nearly doubled, growing from 10 million to almost 20 million enrollees between 2010 and 2015.
- The percentage of employees enrolled in an HDHP packaged with a health reimbursement account (HRA) or HSA – between 2006 and 2015 – grew from 4 percent to 24 percent.

Any plan to repeal and replace the ACA has included major changes that should greatly expand HSA usefulness and allow the accounts to spread more freely.

In short, HSAs aren't going anywhere and should only become more useful and convenient.

**Triple Tax Benefit**

What we love about HSAs – probably more than anything else they can do – is their triple tax benefit (available to anyone with qualifying HDHP coverage who doesn't have impermissible coverage):

- Contributions are tax free
- Contributions can be invested and grow tax free
- Withdrawals aren't taxed, if used for qualified medical expenses

**Good for Employers and Employees**
From the employer's perspective, a robust and effective health and wellness offering that includes an HSA helps to simultaneously attract and retain top talent and keep employees engaged in their work. While many employers offer an HDHP because it's less expensive than traditional insurance, the addition of an HSA also provides tax savings for an employer.

Neither employee nor employer has to pay payroll taxes on HSA contributions deducted via payroll (as long as they establish a valid Section 125 plan, which can be done very simply). An employer may also take a federal income tax deduction for any contributions it makes into their employees' HSA accounts.

**A Smarter Investment Vehicle**
HSAs also have the potential to be just as advantageous as 401(k) accounts or Roth IRAs for investments, in general, thanks to their tax trifecta efficiency.

The HSA is owned solely by the employee, can accept both employer and employee contributions, and is transferrable to any custodian the employee chooses regardless of employment status.

The balance can grow and carry from year to year and can also be invested. In fact, if implemented early in an employee's career and, especially if contributed to by an employer, an appropriately invested HSA can potentially build a healthy nest egg that will help with health care costs in retirement.

While HSAs certainly aren't a replacement for qualified, employer-sponsored retirement plans like 401(k)s and 403(b)s, they can certainly act as a force multiplier for retirement planning purposes when properly combined with a qualified retirement plan.

HSAs also offer employees flexibility with long-term care (LTC) insurance, as their funds may be used to pay a portion of an employee's LTC insurance premiums.

Those funds, up to the limits illustrated below, come out of the HSA tax-free:

| Attained Age During Taxable Year | 2017 LTC Insurance Premium Maximum |
|---|---|
| 40 or under | $410 |
| 40-50 | $770 |
| 50-60 | $1,530 |
| 60-70 | $4,090 |
| 70+ | $5,110 |

Source: IRS Revenue Procedure 2016-55 (for 2017 limits)

**"Health Care Costs for Couples in Retirement Rise to an Estimated $260,000, Fidelity Analysis Shows." Fidelity Investments. https://www.fidelity.com/about-fidelity/employer-services/health-care-costs-for-couples-in-retirement-rise.*

## Are Your Participants Experiencing a Fee Imbalance?

Subsequent to the 2012 implementation of ERISA fee reporting regulations (ERISA 408(b)(2) & 404(a)(5)), the Department of Labor (DOL) began to consider the appropriateness of the allocation of plan fees among participants. This is a subject that generally had not been on the radar screen of many plan fiduciaries, but once identified, tends to generate considerable traction due to its obvious validity. Ironically, advisors' diligent attention to obtaining the lowest accessible share class for new funds in plan menus has contributed to this fee imbalance among a plan's participants.

Fred Reish, a partner with Drinker Biddle in the Los Angeles office has weighed in on this issue by stating, "While there are no requirements to charge equitable fees, in Field Assistance Bulletin (FAB) 2003-03, the Department of Labor (DOL) indicated that allocating plan expenses is a fiduciary decision that requires fiduciaries to act prudently… Whatever allocation method is used, **failure by fiduciaries to engage in a prudent process to consider an equitable method of allocation of plan costs and revenue sharing would be imprudent and a breach of fiduciary duty**."

While ERISA does not prohibit the passing on of reasonable plan fees to participants, others concur with Reish that having a process to consider how fees are charged to each participant is a best practice sponsors need to consider.

Most plans contain funds in their menu that include fee ingredients, such as various revenue-sharing payments, that can contribute to participant fee imbalance. While there are some investments that do not offer a share class that has zero revenue sharing, many do. The simplest way to solve for the fee imbalance is by eliminating this fee ingredient altogether, wherever possible. But, this typically generates a revenue loss to your plan's recordkeeper that needs to be recovered in some form. This revenue loss can be offset with an alternative, and more levelized form of revenue recovery, such as a fixed dollar quarterly participant fee (which is the ultimate in simplistic fee transparency), or an asset wrap fee (fees can increase as assets grow) or some combination of both. Combining both the quarterly fixed fee and asset wrap fee becomes of interest to plan fiduciaries when they realize that the fixed fee approach advantages the high account balance participant and the asset wrap approach advantages the low account balance participant. Some plans having an ERISA budget account established can remit revenue- sharing fees back to this account. Another method is for the provider to issue fee credits to participant accounts to achieve fee levelization.

Many plans have not yet addressed participant fee levelization. Some reasons for this are lack of awareness on the part of advisors or plan fiduciaries, recordkeeper system limitations, and imperfect current solutions. Most industry people believe that participant fee levelization will eventually become ubiquitous as recordkeeper systems are adapted. Fee levelization is a difficult concept to refute as it logically makes sense and ignoring this issue may potentially lead to fiduciary liability concerns.

Most providers have been working on options that can remediate fee levelization concerns to some extent, if not fully. At this time, a prudent approach for advisors and plan fiduciaries is to investigate the appropriateness of current fee allocation structure among plan participants, consider opportunities to approach fee levelization with your current providers, and document the consideration process and conclusions.