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An Overlooked Postretirement Healthcare Strategy

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Funding postretirement medical expenses in today's marketplace is no small task, especially for the early retiree who has yet to qualify for **Medicare coverage** and may be reliant on an exchange-purchased health plan with a high deductible. VEBAs and other similarly complex structures have existed for years to help to provide additional funding, but options have evolved so that clients now have more practical and accessible solutions. By putting a traditional retirement account to work with a health savings account (HSA), your clients can take advantage of a novel and tax-preferred funding approach at a time when more arcane funding structures may be going by the wayside.

The rollover strategy

Clients with **high deductible health plans (HDHPs)** may find themselves facing fairly substantial medical bills before their health coverage kicks in, which is where the HSA strategy works to provide tax-free funding. Bringing a traditional retirement account, such as an IRA, into the mix can help clients accumulate a substantial emergency fund for medical expenses within that HSA, which can be especially useful for your clients who plan to retire before the conventional retirement age.

Once in a lifetime, a client is permitted to make a tax-free rollover of funds from an IRA into an HSA. The rollover amount is limited to the annual contribution limit for HSAs ($3,300 for individuals and $6,550 for family coverage in 2014, plus an additional $1,000 catch-up for clients 55 and older) minus any contributions that the client has already made for the year.

The rollover itself is accomplished by contacting the IRA and HSA administrators, who will complete the transaction in a direct trustee-to-trustee transfer that is tax-free. Once rolled over into the HSA, the funds can be withdrawn tax-free in order to pay the client's medical expenses or can be permitted to grow with the rest of the HSA balance from year to year.

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The client must remain enrolled in the HDHP for at least twelve months following the rollover, or the funds will be treated as though they were withdrawn directly from the IRA and will be subject to tax (and a potential additional 10 percent penalty if the client is not 59½ or older).

The fine print

Because contributions to HSAs are made on a pre-tax basis, clients who are still working may find it more beneficial to fund the HSA with earned income rather than funds already contributed to a tax-deferred savings plan in order to maximize their contributions to tax-deferred accounts and reduce taxable income.

However, younger retirees with fixed incomes might find this rollover strategy particularly valuable — especially if the client has yet to reach age 59½. If the client chose to withdraw the funds directly from an IRA in order to pay medical expenses incurred before reaching age 59½, those funds could be taxed as ordinary income and subject to the early withdrawal penalty.

Clients with both traditional and Roth IRAs should be advised that only the traditional IRA should be tapped for the HSA rollover because the Roth funds can eventually be withdrawn tax-free for any reason.

Conclusion

While the strategy is not ideal for every single client, using an IRA in conjunction with an HSA and HDHP can prove to be a powerful way for clients with fixed incomes to build up the HSA nest egg and ensure that postretirement medical expenses are met, even before penalty-free access to traditional retirement accounts becomes permissible.

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