Less Than 16% of Americans Are Taking Advantage of This Retirement Saving Secret Weapon

This often-overlooked retirement tool can help you build a much stronger nest egg.

Katie Brockman, The Motley Fool, Jan 28, 2020

Nearly everyone wants to save as much as possible for retirement, but doing so is a lot easier said than done.

Only 28% of baby boomers think they're doing a good job of financially preparing for retirement, according to a survey from the Insured Retirement Institute. Millions of workers are falling behind on their savings, and it's an understandable problem. When you have loads of other financial responsibilities on your shoulders, saving for retirement may not be your first priority.

However, not everyone is taking advantage of all the resources out there. In fact, the vast majority of workers aren't using one simple tool that can potentially supercharge your savings and help you better prepare for retirement.

The underused retirement saving secret weapon

When it comes to where you should invest your retirement savings, most people think of the two most common options: a 401(k) or an IRA. While those are great choices and each has its advantages, there's another option many workers overlook: the health savings account (HSA).

Only 16% of workers in their 40s are using an HSA to prepare for retirement, according to a recent survey from TD Ameritrade, and that percentage is even smaller among other age groups. However, this type of account is a powerful tool to have in your retirement planning toolbox, with several perks worth taking advantage of.

An HSA is an account specifically designed to help cover healthcare costs. With an HSA, you can contribute tax-deductible dollars, let that money grow tax-deferred, and then also not pay taxes on withdrawals as long as the money goes toward eligible medical expenses. In other words, there's a triple tax advantage when investing in an HSA that you can't find with your typical retirement account. Also, unlike funds in a flexible spending account that expire at the end of the year, there's no "use it or lose it" policy. Rather, an HSA is similar to a 401(k) or IRA in that you can invest the balance and let your cash grow for years before you start making withdrawals.

The tax advantages with an HSA can be incredibly helpful in paying for medical expenses in retirement. Medicare won't cover everything, and the average retiree spends nearly $4,300 per year on out-of-pocket healthcare costs, according to a study from the Center for Retirement Research at Boston College. If you tap your retirement fund to pay for those costs, you may need to pay income taxes on the amount you withdraw -- which leaves you with less disposable income. But with an HSA, you can squeeze every dollar out of your savings, so they last longer.

Lastly, you don't necessarily have to spend your HSA money on medical expenses. If you withdraw your funds for other reasons, you'll simply have to pay income taxes on the amount you take out -- as you would with a 401(k) or traditional IRA. So if your primary retirement account is starting to run dry and you need some extra cash, your money isn't trapped in an HSA; you'll just lose one of the three tax advantages by withdrawing it for nonmedical expenses.

Who is eligible for an HSA?

A major caveat is that an HSA is only available to people who are enrolled in a high-deductible healthcare plan (HDHP). As of 2020, that means you must have a deductible of at least $1,400 for individuals, or $2,800 for families to qualify. In an HDHP, your annual out-of-pocket costs cannot exceed $6,900 (for individuals) or $13,800 (for families) for in-network services.

If you're eligible to enroll, there are also limits to how much you can contribute each year. For 2020, individuals can invest up to $3,550 per year, and families can save up to $7,100 annually. Also, those age 55 and older are eligible for catch-up contributions, or an additional $1,000 per year on top of the annual contribution limits.

An HSA is a great option for those looking to build a stronger nest egg and create a cushion against skyrocketing healthcare costs, but it shouldn't be the only place you're saving. Although HSAs can function as a retirement account, they're designed primarily to cover healthcare costs. When saving for your everyday retirement expenses, you're better off using a 401(k) or IRA -- which offer their own perks, like employer matching contributions and a wealth of investment options. Investing in a 401(k) or IRA in addition to saving in an HSA, then, can create a well-rounded nest egg.

HSAs can be a powerful tool to have in your arsenal. If you're eligible to enroll in one, this type of account can be part of a balanced retirement plan and help you strategically save more for your senior years.