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MALLARD ADVISORS LLC

Comprehensive Financial Planning & Wealth Management Solutions

THE QUARTERLY MALLARD CALL

Notices

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Mallard E-Mail Update
We strongly encourage all clients to read our E-Mail Updates (which are different from this newsletter). They may contain important information that is relevant to your situation. Just call us if you think something may apply to you so that we can discuss it.

The Ultimate Savings Machine — William D. Starnes

An **IRA or 401(k)** is a great savings vehicle because you get to reduce your taxable income when you put money into the account. However, all funds are ***taxable*** upon withdrawal. A **Roth IRA** is attractive because while you don't get an up-front tax deduction, all funds are ***tax-free*** upon withdrawal.

What if I told you there is an even better savings account available? It combines the up-front *tax deduction* of an IRA/401(k) with the *tax-free* withdrawals of a Roth IRA. This is an amazing double tax benefit within one account. Further, unlike a regular savings or investment account, all the income from the account itself is tax-deferred and is therefore *not taxed* as it builds up inside the account (just like IRAs and Roth IRAs). In other words, you get triple tax savings with this special type of savings account called a **Health Savings Account (HSA).**

The Health Savings Account (HSA) is the ultimate savings machine as it is the only type of account with these triple tax benefits.

ACCOUNT TYPE	DEPOSITS	GROWTH	WITHDRAWLS
IRA	Tax-Deduction	Tax-Deferred	Taxable Income
ROTH IRA	No Deduction	Tax-Deferred	Tax-Free
HSA	Tax-Deduction	Tax-Deferred	Tax-Free

Bill Appeared in *Delaware Today* Magazine

Bill Starnes was selected as one of five Delaware financial experts interviewed in the August edition of ***Delaware Today*** magazine.

The article, titled ***Nurture Your Nest Egg,*** addresses a variety of financial topics including estate planning, college savings, and paying down debt.

The article can be found at the ***Delaware Today*** website by searching “Starnes”.

An HSA is a special type of savings/investment account set up for the **intended purpose of paying medical expenses.** You can only open and fund an HSA if you have a high deductible health insurance plan that is specifically HSA "qualified". Usually, this is defined as having an annual deductible (for 2021) of at least $1,400 for individuals or $2,800 for family coverage.

It does not matter if your high deductible health plan comes from the health insurance exchange, an employer, or private purchase from a broker. You can personally open an HSA either with your employer's help (as you would when using a 401k) or if your high deductible health plan is not offered by your employer, by contacting a sponsoring bank directly. The account is yours and stays with you regardless of changes to your insurance plan, employer, or work status.

Getting Funds Into an HSA

If you have an employer sponsored high deductible health insurance plan, you can make contributions via pre-tax salary reduction. Some employers make contributions into their employees' HSA, and like a 401(k) match, this is not included in your taxable income. If you have a non-employer sponsored plan, you simply transfer your own funds from a checking account to your HSA in order to make your contribution. In this case, you still get your tax deduction when you file your tax return.

Just like an IRA, an HSA must be owned by only one person. There are no joint HSA accounts. Unlike an IRA, you do NOT need to have any earned income in order to make HSA contributions.

You can make contributions at any time, even up to April 15th for the previous tax year. The contributions can be spread over the year, or made in one lump sum. **You cannot contribute to an HSA if you are enrolled in Medicare.**

How Much Can I Contribute?

The IRS sets limits on the total aggregate amount you (and your employer) can contribute each year. For 2021, you can put up to $3,600 in an HSA if your insurance covers <u>just you</u>, or up to $7,200 if you have a <u>family plan</u>. There's also a "catch up" provision for those age 55 or older that allows you to contribute an extra $1,000 beyond the limits above. It's important to keep in mind that the catch-up contribution is based on the age of the person who established the account. An example would be if a 50-year-old established a family plan with their 55-year-old spouse, then the couple would be required to wait until the established account holder turned 55.

Make sure you don't overfund your HSA. The maximum contribution includes any employer provided contributions. So, if you have a family plan ($7,200) and qualify for the catch up ($1,000) your maximum contribution is $8,200. However, if your employer contributes $500, then YOU can only contribute $7,700 in order to hit the $8,200 maximum.

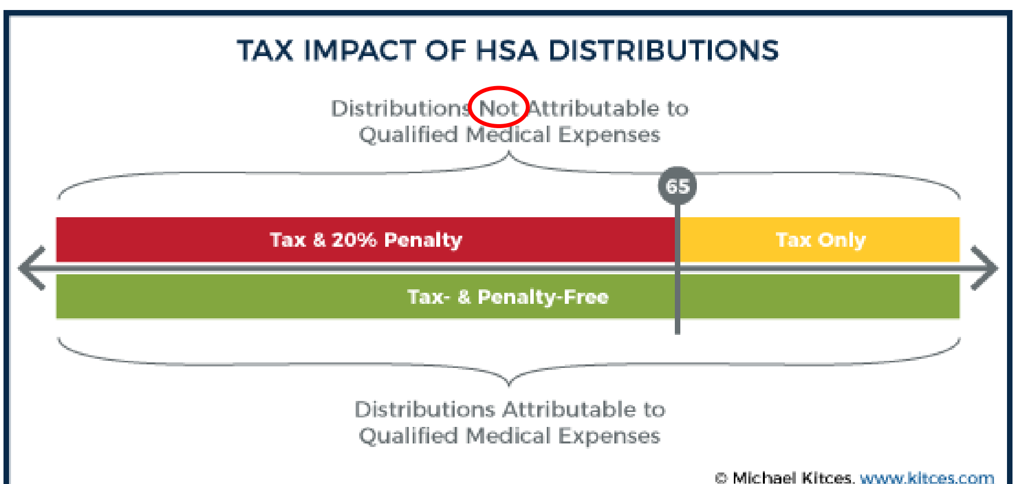
This year (2021), a family maximum contribution of $8,200 would reduce your federal tax liability by $1,800 if you were in the 22% marginal tax bracket.

Getting Funds Out of an HSA

Funds in an HSA can be used <u>anytime</u> to pay for a wide range of qualified medical expenses for yourself, your spouse, or family members. This includes co-pays, dentist visits, Medicare premiums (part A, B, and Medicare Advantage, but not for Medigap supplemental insurance premiums), prescription glasses, long-term care premiums, and even acupuncture and chiropractic care. However, you cannot take qualified withdrawals for health insurance premiums prior to age 65 (unless it is for COBRA). You can also take money from your account to reimburse yourself (or family) for past medical expenses - if they occurred ***after*** your HSA was established. However, keep proof of medical expenses in the rare event that you are audited.

Unlike an IRA, you can withdraw money prior to age 59 ½ and also unlike an IRA, there are no required distributions from the HSA account.

There is a 20% penalty (plus income taxes) paid on the full amount (contributions & earnings) you withdraw from your HSA <u>if it is used for non-medical</u> expenses **prior to**



age 65. (see the image below). You could pull money out and spend it on a vacation, as long as you had prior medical expenses after the account was opened. You could always say you are reimbursing yourself for those past medical expenses (yes, this is legal). Once you are **age 65 or older**, if you use the funds for non-medical expenses, the penalty doesn't apply; but the entire withdrawal would still be subjected to income taxes. Even in the unlikely event of taking taxable (non-medical) withdrawls after age 65, you still end up with the same great benefits as an IRA or 401(k)!

Think of it this way, **in retirement (age 65 or older) your HSA morphs into a special type of retirement account where you can take tax-free withdrawals (like a Roth IRA) for medical expenses, or take taxable withdrawals (like an IRA or 401k) for non-medical expenses.**

An HSA is NOT a "use it or lose it" type of account (like a flexible spending account). Unfortunately, this point of distinction has lead to confusion resulting in savers not opening an HSA for fear of losing their contributions if not used during the year.

What Does the Money Do While Inside the HSA Account?
An HSA operates much like a checking account with online banking features, a debit card, and little to no interest earnings. While you can let the money sit in the cash account so that it is liquid and safe, you can also invest some or all of the balance (that you don't plan on withdrawing in the short-term) in mutual funds.

For those who fund their HSA and use it for medical expenses in the same year, they should keep the money in the cash account. However, if you have little expected medical costs, or are willing to NOT tap into your HSA, the best bet would be to invest your balance. **Investing your HSA dollars is the only real way to take advantage of the back-end tax benefits: tax-free growth**. However, this would require that you not only fund the HSA, but also pay your current medical expenses out of your own pocket instead of using the HSA. This can be hard to do, but it works for those with the cash flow (or other assets) to do so.

In fact, this is the ideal scenario: fund the account; avoid withdrawals; invest the balance; and let it grow tax-free for your future retirement medical expenses.

What Happens to the Account After I Die?
Assuming you are married, and your spouse is your beneficiary, the account becomes your spouse's HSA by having the funds move into a new HSA in their name. There are no taxes or penalties to change the account over to a spouse. If you are not married, the account ceases to be an HSA upon your death. It must be distributed to the beneficiaries of the account (or your estate if you don't have named beneficiaries). There is no penalty on distribution, but *the full distribution is taxable income to the non-spouse beneficiaries*. This taxable income may be reduced for any qualified medical expenses incurred prior to your death and paid by the beneficiary within one year after your death.

While you may be inclined to leverage the tax-free nature of the HSA by NOT using it and instead allowing the tax-free growth to compound, this can be risky in the event the balance becomes so large that both of you don't end up spending the balance.

What Else Should I Consider?
As you search for an HSA provider, be sure to examine whether it offers an easy-to-use web interface, a suitable array of investment choices, low or non-existent monthly maintenance or transaction fees, and beware of minimum balance requirements. Should you wish to move your HSA in the future, it can be rolled over to a different provider. One website, www.HSASearch.com, lists several hundred providers and allows you to compare features.

In summary, the benefits of an HSA are:

- **Front-end tax break**. Your contributions are tax deductible which reduces your taxable income and your tax.
- **Back-end tax break**. The account grows tax-free as long as you spend them on qualified medical expenses.
- **Ongoing tax break**. The earnings are in the account are not taxable. In other words, you don't get a 1099 each year where you must report the earnings on your tax return.
- **You never lose funds**. They stay in the account for your entire life, with no penalty if you don't spend them.
- **Withdrawals are never taxed**, as long as you spend them on qualified medical expenses.
- **You can spend it** on yourself or your family for medical expenses.
- **You own it.** It stays with you and is portable, regardless of your employer or changes to your insurance plan.

If you're eligible for an HSA and you have the ability to fund it, you should open one right away and take advantage of the benefits of the ultimate savings machine!

Bill Starnes is the founder and senior advisor at Mallard Advisors, LLC

Market Commentary

Even with most asset classes down over the last month and pretty flat over the last quarter, investors are still quite delighted with the gains over the last year. However, there is also uncertainty about if these returns can really continue.

History shows us that it will not. Corrections and bear markets <u>come</u>. Thankfully, they also <u>go</u> as ultimately there is another recovery. Every crisis has a different cause, so it feels different every time, but the market has always delivered a positive return once things settle down. The only thing we can know for sure is that the markets have always eventually reached new highs, through the Great Depression, through two world wars and many global skirmishes, through Presidential impeachments, political uncertainty, double-digit inflation, and the most serious global pandemic in a hundred years.

Crises, by definition, are not predictable—not the timing, depth, or duration. Investors should consider recent market returns with neither excitement, nor alarm. Instead, **indifference and humility** would be a better response.

While it may be tempting to fiddle with our portfolio (perhaps by selling stock prior to the predicted downturn) or our savings strategy (perhaps holding off investing at these recent highs), the data supports that investors efforts to <u>improve</u> returns are just as likely to <u>harm</u> them. Why does this timing not work? Because the market moves on <u>new news</u>. The <u>old news</u> that everyone already knows is already baked into current prices. **The <u>new news</u> which is indeed relevant to future returns is unknowable and unpredictable**. Therefore, you must come to the unavoidable conclusion that you can't consistently (via skill) profit by trying to time these unpredictable moves.

What you can do is persist in putting your hard saved capital to use. You then can be patient as you wait for positive returns to unfold. Patience comes easily when you are committed to your investment strategy in light of any <u>new news</u> which may rock the stock markets.

Summary of Asset Class Total Returns (as of 9/30/2021)

Asset Class*	Ticker	One Month	3rd Qtr	YTD	12 Months	*Annualized* 3 Year	*Annualized* 5 Year	*Annualized* 10 Year
GLOBALLY DIVERSIFIED BALANCED PORTFOLIO**								
60% Equity / 40% Bond	DGSIX	(2.6%)	(0.6%)	8.9%	20.7%	9.4%	9.2%	9.0%
STOCKS								
Larger-Cap	VFINX	(4.7%)	0.6%	15.8%	29.8%	15.9%	16.7%	16.5%
Smaller-Cap	NAESX	(3.1%)	(2.7%)	13.3%	43.9%	11.9%	13.8%	15.2%
International - Developed Mkts	VGTSX	(3.4%)	(3.0%)	6.4%	24.3%	8.2%	9.0%	7.8%
International - Emerging Mkts	VWO	(3.3%)	(6.9%)	1.4%	18.5%	9.7%	8.7%	6.1%
Real Estate	VGSLX	(5.7%)	0.7%	22.2%	33.5%	12.0%	7.5%	11.5%
Inflation Hedges	*	(2.1%)	(1.4%)	20.4%	50.9%	9.2%	9.8%	6.1%
BONDS								
U.S. Investment Grade Bonds	VBMFX	(0.9%)	0.1%	(1.7%)	(1.0%)	5.3%	2.8%	2.9%
Global Bonds	VTABX	(1.0%)	0.1%	(2.0%)	(1.0%)	4.0%	2.7%	-

** Each asset class is represented by a relevant Vanguard Index fund except for Inflation Hedges where the Morningstar Category average for* ***"Natural Resources"*** *is used. All data is provided by Morningstar and includes reinvested dividends.*

** All returns are net of (i.e., after) fund fees, and include reinvested dividends.*

** Past performance is not indicative of future results.*

*** This portfolio is represented by the DFA Global Allocation Fund (60% Equity / 40% Bond)*