RETIREMENT PLAN
Update

Wealth Management

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Your Challenge, Our Solutions™

Build health care expenses into your retirement planning

It's important to consider future health care expenses when planning for retirement.

Determining how much money you'll need to live comfortably after you retire is not an exact science. In general, you may need between 70% and 80% of what you were earning during your last working years to maintain the same standard of living in retirement.

However, as you age, you may find that you have to spend more on health care. How expensive could health care costs be in retirement? Very expensive, according to recent data. The Consumer Expenditure Survey* shows that average health care expenses for individuals between the ages of 65 and 74 were $6,966 in 2021 and averaged $7,123 for those age 75 and older. Of course, an individual's personal health and the cost of medical care in the particular location where the individual resides can impact the amount that will be spent.

What you can do

Planning for health care costs in retirement is critically important. Here are some steps that can help.

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Get healthy and stay healthy

Your working years are a good time to do what you can to improve your overall health. If exercise has not been a regular part of your life, start small and gradually increase your activity level over time. Eat healthfully and avoid smoking and drinking alcohol to excess. You can improve the likelihood of living a longer, healthier life.

Consider long-term care insurance

A long-term care insurance policy helps cover the costs of home health aides, nursing home care, and assisted living facilities. If you buy a policy when you are relatively young and healthy, it's likely the policy premiums will cost less than if you wait until you're close to retirement. The size of the daily benefit amount you select and the length of time you are willing to wait to receive benefits will also affect the cost of a policy. Long-term care policies can be complex, and different policies cover different benefits, so it can be helpful to work with a professional to find one that meets your needs.

Boost your savings rate

One way to blunt the impact of rising health care costs is to save more. It may be easier said than done, but you should try to maximize your savings, especially if you are at a high risk of chronic conditions because of your current health or because of your family's medical history.

Consider a health savings account

A health savings account (HSA) is essentially a medical savings account available to those enrolled in a high-deductible health plan (HDHP). It can be used to pay for a variety of health care expenses. A big plus with an HSA is that it offers tax-saving features—contributions are deductible, interest (or earnings) on contributions is tax deferred, and, as long as the medical expenses paid with HSA savings are "qualified" expenses for the individual, spouse, or dependents, HSA withdrawals are tax free.

If your employer offers an HSA, you can contribute to your account from your paycheck at an agreed-on amount. You can invest your HSA contributions in whatever option(s) the plan offers. Money that you do not spend during the year is rolled over for use in subsequent years. If you are in relatively good health, you may be able to accumulate a good-sized HSA balance over the years.

Rollover options for qualified plan loan offsets

While retirement plan participants generally are precluded from pledging retirement savings as collateral for a personal loan, federal law contains a provision allowing plan participant loans, on a tax-free basis, provided the plan loan meets certain statutory requirements and restrictions.

When a plan loan program adheres to these federal requirements and restrictions the lending plan assets to a plan participant does not create a taxable event at the time the plan loan is originated. Nonetheless, certain events—such as default—can subsequently trigger taxation. If a taxation triggering event such as a loan default occurs while the plan participant is still employed, the event will oftentimes result in what is referred to as a "deemed distribution"—a situation where the plan loan is considered a taxable distribution to the plan participant even though the plan is not able to

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settle the defaulted loan by reducing the participant's accrued benefit.

Other circumstances, however, such as plan termination or severance of employment, can trigger what is referred to as a plan loan "offset." When a plan loan offset occurs, the plan loan is settled by offsetting the outstanding loan amount against the participant's accrued benefit. While the distinction between deemed distributions and plan loan offsets may seem—at first blush—to be inconsequential, the reality is that the distinction can be crucial for plan participants looking to avoid taxation on their retirement savings.

Unlike deemed distributions, which are generally not eligible for rollover, plan loan offsets occurring due to plan termination or severance of employment are oftentimes eligible for rollover treatment. What is more, thanks to changes made by the Tax Cuts and Jobs Act of 2017 (TCJA), effective January 1, 2018, plan participants who incur a qualifying plan loan offset due to plan termination or severance of employment generally have until October 15 of the year following the year in which the loan offset occurred to roll over the loan offset amounts, thereby avoiding taxation on the plan loan offset amounts. While this rollover option opens the door for continued tax shelter, participants who are eligible to take advantage of this opportunity nonetheless face the challenge of coming up with the funds necessary to complete the rollover transaction as the loan offset event reduces the amount of funds actually distributed from the plan.

Example:

Mary, who has a vested balance of $100,000 in her 401(k) plan and a $20,000 outstanding participant loan, decides to take a new job with a different employer during 2023. Under the terms of Mary's current 401(k) plan, her participant loan is fully payable upon her separation from service. Not having the cash on hand to repay the outstanding loan at the time of her separation, Mary chooses to forego the repayment option and directs the plan administrator to directly roll over her plan balance to an IRA provider. The 401(k)-plan administrator, accordingly, offsets Mary's outstanding plan loan against her $100,000 plan balance, resulting in $80,000 being sent to Mary's IRA. If Mary does nothing further, she will be required to include the $20,000 offset amount in taxable income when she files her 2023 tax return. On the other hand, because the offset meets the criteria to be considered a qualified loan offset, Mary avoids taxation on the offset if she is able to come up with $20,000 and deposit it to her IRA by no later than October 15, 2024 as a rollover deposit of a qualified plan loan offset amount.

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*Source: Consumer Expenditure Survey, U.S. Bureau of Labor Statistics, September 2022.

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