LAW OFFICE OF GERALD R. NOWOTNY, PLLC

NOWOTNY KNOWS SQUAT!

Part 4 – Using Post-Retirement Medical Plans to Raise AUM and Sell Life Insurance

My Dad, Willy Wolfgang Nowotny (of blessed memory) would have turned 87 a few days ago (March 6). In prior articles I have discussed his great adventure, not unlike many other immigrants, in coming to the United States from East Germany. He was a great athlete in his youth and was slated to compete for the U.S. in the 1956 Olympics, in Soccer, but his citizenship paperwork did not get approved in time. As a new American, he adopted a love for the national pastime, baseball, partly because my Mom and Dad lived in an apartment complex where a number of players on the Washington Senators lived.

He was part greatest fan and part greatest critic. He famously was known to say, "I know that I never played the game but..." He could be a harsh critic when I didn't play my best, but he always let you know when you had a great game. One thing that my Dad had never seen me compete in was powerlifting. In this article I would like to pontificate one last time about my lifelong love affair with the Iron.

At around age 40, I gravitated back to the one thing that I had muscle memory for, heavy squats and deadlifts. It was satisfying to achieve personal records in the gym, but I made the mistake of looking at the Masters level performance in powerlifting for my age and weight bracket and thought that I could be a contender. I picked a powerlifting meet near his home that conveniently coincided with my visit.

I had not competed in almost thirty years. I took my Dad to watch me compete and had the best meet of my career with personal bests in every lift - squat, deadlift, and bench press. I lifted more at 52 than I ever lifted at 22. The total for the three lifts placed me within the top five lifters for my age group and weight class at that time. On that day, there was no comment from Dad, "I know that I never played the game but…" Mission accomplished! Ich bin Ein Berliner, Pop!

This segment is Part IV in a series directed to life insurance agents and advisors regarding valued added strategies that are niche and powerful strategies to increase assets under management (AUM) or to sell more life insurance. These strategies are not "run of the mill" strategies that every "Tom, Dick and Harry" are using to get in the client's door in order to attract and maintain the client's interest.

This segment focuses on the 401(h) Plan for post-retirement medical expenses. The strategy is a powerful solution that is unique and rarely known and implemented as a result of its uniqueness in the small business market. This strategy will not only get you in the client's door but help you to remain in front of clients.

What is a 401(h) Plan

The reality of post-retirement medical expenses screams at us but few if any small business pension plans address this need. Only 7.5 million out of 327 million Americans (2.3%) has long-term care insurance. Over fifty percent of Americans over age 65 will need long-term coverage with the cost of the services $100,000-$300,000. From personal experience, I can tell you that the cost of nursing home coverage can range from $75,000-$125,000 per year. Very few if any successful business owners will qualify for Medicaid which requires the benefits recipient to have $200 of monthly income and $2,000 of personal non-exempt assets.

How will a business owner finance these benefits in the future without spending himself into the “Poor House?” While Alzheimer’s Disease has reached epidemic levels, the diagnosis of Autism has reached epidemic levels. How will a business owner and the spouse finance medical care for a dependent diagnosed with Autism?

IRC Sec 401(h) provides for specific accounts to be created for the purpose of paying for post-retirement medical expenses during retirement. The participant may use these benefits for sickness, accident, hospitalization and medical expenses for the participant, their spouses, and dependents. Medical benefits within a pension plan are ancillary to retirement benefits. The funds for post-retirement benefits are subordinate to pension benefits and held in a separate account from retirement benefits. The contribution to the 401(h) plan may not exceed 25 percent of the total contributions made to the pension plan including the 401(h) plan or one-third to the pension trust. The contributions must be reasonable and ascertainable. 401(h) plan assets may not be diverted from the Plan for any other purposes than the payment of medical expenses for the participant, participant’s spouse, or dependents.

The post-retirement medical plan must be attached to a defined benefit plan or money purchase plan. The 401(h) plan is funded with tax deductible contributions. This limit is $58,000 in 2021. The contributions for a key employee are subject to the defined contribution annual limits under IRC Sec 415(c). These funds may be invested on a tax-deferred basis. However, these funds, unlike retirement plan distributions may be distributed to pay medical expenses on a tax-free basis.

As of 2018, the percentage of workers in the private sector participating in defined benefit plans is four percent, down from sixty percent in the early 1980’s and we wonder why no one has enough money to retire? The planning need is enormous, and the planning opportunity is enormous. Very few small business pension plans (if any) take advantage of this planning benefit largely because most businesses adopt prototype pension plan documents that do not adopt this benefit. The plan may be restated as an individual plan and adopted. The funding level of contribution into the 401(h) plan is significant.

From a business development perspective, the discussion of the 401(h) plan is important and will be a high value planning idea. The planning discussion will separate the advisor from his competition and open the door for the discussion of other planning topics with a client or prospective client.

So, What's in It for Me?

In these times it is difficult to imagine any business owner that isn't worried about tax planning or planning for retirement. The reality of impending sickness after age 65 is front and center. The 401(h) plan is a novel but important future planning benefit that virtually no small business is currently utilizing. The Plan addresses important future planning needs while creating an additional tax deduction at a substantial level. Most business owners have either not heard of it or use a prototype pension plan document that prevents them from adding this benefit.

The solution is a simple solution. Simply restate the Plan as an individual Plan to include the 401(h) Plan. The client may need to add a defined benefit plan or change the current defined contribution plan into a Money Purchase Plan. The addition of the 401(h) Plan creates the possibility of larger tax-deductible contributions that need to be managed within the Plan by the financial advisor. Even if the client or prospect says "No," you will have engaged the client into a discussion and possibly identified other planning opportunities. Once the Client has allowed the advisor to look under the "hood" anything and everything is fair game.

Summary

Very few if any small business pension plans offer a 401(h) plan. The reason is simple. Most pension plans use "cookie cutter" prototype plans that do not offer this type of ancillary benefit which must be "snapped" onto a defined benefit plan or money purchase plan. Get out there and stir up the water and start talking to clients about the tremendous planning possibilities of a 401(h) plan. Let us train you so that you can achieve your personal best. At a minimum, this planning idea is something unique that none of your competitors is promoting in the marketplace.

The 401(h) Plan is an excellent benefit that allows a business owner to make significant additional tax-deductible contributions for post-retirement medical expenses. The contributions may be invested on a tax deferred basis. Distributions for post-retirement medical expenses receive tax-free treatment. The range of medical expenses permissible under the Plan is virtually unlimited.

Let us help you while you help others! Operators are standing by to take your call!