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TELL ME SOMETHING GOOD!

Planning for Post-Retirement Medical Expenses with 401(h) Plans

Among other things, I am a big fan of soul music. I am also a big fan of gospel music, particularly the R&B influenced version of gospel music with a strong nod towards Fred Hammond, Hezekiah Walker and Kirk Franklin. I have stated previously on the record that I am also a big fan of The Godfather of Soul, James Brown. When it comes to Soul Sisters, I like Chaka Khan. The Chaka Khan song "Tell Me Something Good" is a good title for this article. Readers on social media skim over articles looking for fresh and new ideas. In my view, the 401(h) Plan for post-retirement medical expenses is a big idea. Why? Everyone, with no exception for anyone whether they like it or not, is headed towards a post-retirement with large medical expenses on their way through the Checkout line of Life. If not you individually, it will be a spouse or a dependent, or all of you. Throw a chronic illness into the mix, and the costs increase dramatically!

Barron's recently reported in an article called *The Real Cost of Healthcare in Retirement***.** The article suggests that seniors with adequate Medicare coverage will spend on average $260,000 per couple on healthcare from age 65 on. Only a third of this cost can be attributed to premiums for Medicare and supplemental insurance with the balance of the costs attributed to actual medical expenses. Healthcare Services, a firm that analyzes medical expense statistics, provided Barron's with an estimate of post-retirement, and estimated post-retirement medical expenses for high net worth couples at $565,140 in today's dollars. A senior can spend as much as $100,000 on dental care alone.

This projection does not consider costs for catastrophic illness. The cost of some prescriptions and treatments may escalate these dramatically. Prescriptions for a single specialty drug can exceed $100,000 per year for chronic conditions such as cancer, Parkinson's, and heart disease. The annual cost of care in a nursing home can cost $100,000 - $150,000 per year. The average stay in a nursing home is almost five years. These are numbers that I am personally familiar with in my family.

What is the solution for these future expenses? It is not an easy answer. Murphy's law to

elder law planning suggests that most seniors will wait until it is too late to make asset transfers to qualify for Medicaid. Consequently, many seniors will suffer the indignity of spending all their money down to the Medicaid limit of $2,000 of personal assets (not counting exempt assets) and $200 per month of personal income over a 40–50-year career. Whatever Uncle Sam did not tax you during your working years, will be left for post-retirement medical expenses.

The 401(h) Plan is uniquely qualified to meet these expenses. The 401(h) Plan is an ancillary benefit added to a qualified retirement plan. the 401(h) Plan may only be added to a defined benefit plan or money purchase plan. The Plan allows for additional tax-deductible contributions into the 401(h) plan which may only be used exclusively for the post-retirement medical expenses of the participant, participant's spouse, or dependents. The contribution limit for the participant limit in 2021 is $58,000 coupled with the participant's contribution for retirement purposes. Contributions to the Plan are flexible each year, e.g., a plan sponsor is not obligated to contribute every year. The investment earnings within the Plan are tax deferred. Plan distributions for medical expenses in the post-retirement period receive tax-free treatment.

401(h) Plan Overview

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 spouse, and dependents. 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.

Many pension administrators ask the question, "If 401(h) plans are so good, why don't more plan sponsors, big and small, adopt 401(h) Plans?” For me, the answer is straight-forward. First, most businesses offering pension plans use prototype or volume

submitter plans. The 401(h) Plan may only be adopted for a Plan that is submitted individually. Second, the 401(h) Plan as an ancillary benefit is only available in conjunction with a defined benefit or money purchase plan. Defined benefit plans, arguably the plan type that provides the largest tax-deductible contributions and guaranteed pension benefits, is only be found in four percent of plan sponsors. This statistic in my opinion is the reason why no one can afford to retire. Existing plans can be amended as individual plans to add the 401(h) Plan.

Another legitimate argument that pension administrators raise is the impact of the business owner's retirement or the sale of the business on maintaining the Plan. The 401(h) Plan cannot rollover into a personal IRA account. Therefore, the Plan must be maintained into retirement with the cost of annual administration. So What? In current dollars this may amount to a cost of $3,500 to $5,000 per year. This cost may be paid from Plan assets. How many of us maintain club dues and subscriptions that cost that much each year?

Future articles will focus on planning examples of how the 401(h) Plan can be implemented as a solution to overfunded defined benefit plans as well as the sale of the business.

Conclusion

The Bible says that are days are counted. The sand passes too quickly through the hourglass in the days of our lives. Along with death, the high cost of post-retirement medical expenses is a certainty. Modern medicine can keep us alive longer but living as medical zombies. The marvels of modern medicine come at a high price which each of us will get to pay. Throw in the possibility of a chronic illness and you will have spent everything that you worked for 30-40 years plus your children's inheritance. The 401(h) Plan is great answer to the planning problem. It offers an additional tax deduction which benefits you now while you are working and can use the tax deduction. Those funds for those future medical expenses can be invested on a tax deferred basis with the ability to distribute those funds on a tax-free basis to pay medical expenses during retirement. Tell me that you like it!