High Income Planning (HIP): Healthcare

SMS Capital Management, Inc.

CASE STUDY

Situation

Katie and Eric Miller have recently retired after successful careers, and plan to begin drawing on their investment portfolio to support their living needs. Currently, they get their health insurance through a private insurer. They would like guidance on how to appropriately plan for healthcare costs during retirement.

MILLER FAMILY SNAPSHOT	
Eric / Katie's Ages	60 / 62
Annual Household Income	$250,000
Pre-tax IRA Funds	$2,500,000
Net Worth	$3,500,000

The Miller's objectives include:

- Have a retirement plan that contemplates adequate healthcare spending.
- Minimize taxes and healthcare costs in retirement.
- Evaluate long-term care options.

SMS Healthcare Planning Process

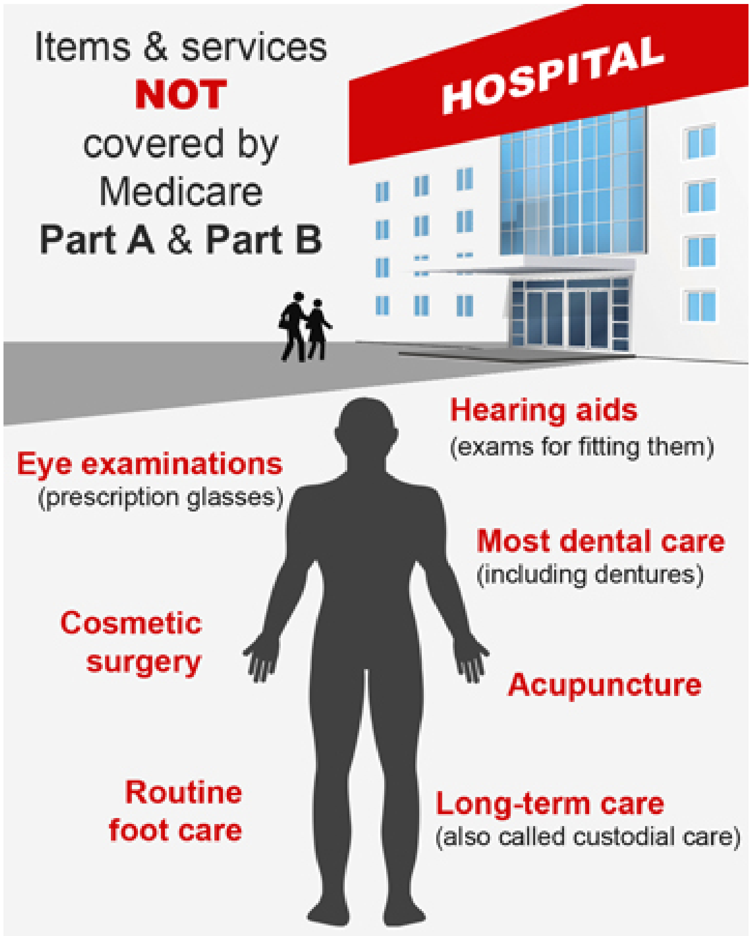
According to Fidelity Benefits Consulting, a 65 year old couple will spend $275,000 (in today's dollars) on healthcare during their retirement (excluding long-term care). Given the sizeable amount of funds required, retirees need to plan appropriately.

Prepare for Medicare

As part of their retirement goal projections, SMS works with the Millers to gain an understanding of their current healthcare expenditures as well as project their potential healthcare spending as part of their overall spending into their retirement years.

The Millers may elect to continue with their current healthcare policy until they reach 65 at which time they will individually sign up for Medicare coverage. Failure to sign up for Medicare during the proper enrollment period may result in higher future premiums.

Under Medicare, the Millers will be responsible for paying premiums for basic health insurance and will likely procure a supplemental policy that covers other common healthcare costs not provided by Medicare.



Source: www.Medicare.gov

Retirement Income Management

Higher household income will not only result in the Millers potentially paying taxes at higher rates, it may also result in the Millers paying higher Medicare premiums. Since Medicare Parts B (medical services) and D (prescription drugs) are affected by a household's Modified Adjusted Gross Income (MAGI), SMS works with the Millers to explore strategies that will effectively lower their future MAGI; thereby keeping their future taxes and Medicare premiums at lower levels.

In the Miller's situation, SMS identifies their significant pre-tax IRA funds as a planning opportunity. The period between their early 60's and age 70-½ (when Required Minimum Distributions begin) can be an opportune time for the Millers to convert some of their IRA funds into Roth IRAs. If their post- retirement income is low, the Millers can convert some of their pre-tax IRA funds into Roth IRA funds. This will result in the Millers paying less taxes than when they are in their 70's and taking RMDs as well as collecting Social Security benefits. If they convert some funds they will end up with more Roth IRA funds (not subject to RMDs) and less pre-tax IRA funds. The traditional IRA funds that are subject to RMDs will push up their taxable income and result in higher Medicare premiums.

Evaluate Long-Term Care Options

Long-term care (LTC) is a wild card that could derail the Miller's retirement. SMS will walk through and analyze the various options with the Millers which may include self-insuring, traditional LTC insurance, or hybrid policies and evaluate which would best fit their particular situation.

Planning Impact Summary

- SMS helps the Millers budget adequate healthcare spending during retirement.
- Utilizes multiyear Roth conversions to minimize income taxes and future IRA RMDs.
- Careful management of income around the Medicare income thresholds minimizes surtaxes of thousands of dollars per year.