What’s ahead for retirees with new health laws

By Neil Downing

The federal health-care reform law enacted three years ago this month continues to affect retirees and those nearing retirement.

The Patient Protection and Affordable Care Act ushered in sweeping changes to the nation’s health care system.

Certain elements of the law have already taken hold. But some others are kicking in this year, while others will take effect in the next few years.

Following is a summary of how some of them will affect retirees and those nearing retirement, from a cost-and-benefit standpoint. (The labels “cost” and “benefit” are solely for convenience. In reality, many of the “benefits” have costs, and vice versa.)

Cost: Medicare Part B

If you’re among the 49 million beneficiaries of the federal Medicare health insurance program, and you’re finishing up your federal income tax return right about now, the one covering 2012, take note: You may wind up paying higher-than-standard Medicare premiums next year.

“I’m finding some people are still surprised” when they find out they have to pay higher-than-standard monthly premiums, said Dr. Katy Votava, president and founder of GOODCARE.com, a consulting service based in Pittsford, N.Y., and Washington, D.C., that helps financial advisers and clients save on health care, including Medicare.

Whether you’ll have to pay higher-than-standard Part B premiums depends on your income on your 2012 tax return. (Medicare Part B generally helps cover such costs as doctor’s office visits, outpatient care, home health services, and some medical equipment.)

In general, if your adjusted gross income exceeds certain thresholds—$85,000 if you’re single, or $170,000 if you’re married and filing a joint return—you’ll have to pay a higher-than-standard Medicare Part B premium next year.

The standard premium now is $104.90. But if your income exceeds the thresholds, you may have to pay up to three times that amount.

So look at your tax return now, the one for 2012. If your AGI exceeds the thresholds, you can pretty much figure you’ll pay higher than what most people pay for Medicare Part B...
Next year. “This is the time of year (when people are doing their taxes) to be looking ahead,” and to see what steps you might take to try to lessen the impact, said Votava.

Keep in mind that the thresholds are frozen through 2019, said Mary Dale Walters, senior vice president for the Allsup Medicare Advisor, a Medicare plan selection service that provides one-on-one service to seniors and people with disabilities to help them identify Medicare plans that best match their needs. (It is offered by Allsup Inc., of Belleville, Ill.) As a result, more and more Medicare beneficiaries will face the higher Part B premiums as time goes on. The Henry J. Kaiser Family Foundation, a publisher of health policy information based in Menlo Park, Calif., estimates that between 2011 and 2019, the share of Part B enrollees subject to the income-related Part B premium will rise from 5% to 14% (from 2.4 million enrollees in 2011 to 7.8 million enrollees in 2019).

**Benefit: Preventive care**

Under the old law, a Medicare beneficiary might have paid as much as $160 in cost-sharing for some colorectal cancer screenings, according to the federal Centers for Medicare & Medicaid Services.

But coinsurance and the Medicare Part B deductible have been eliminated for purposes of recommended preventive services, including many cancer screenings, according to the CMS.

In other words, such preventive services are now “covered in full,” said Joe Baker, president of the Medicare Rights Center, of New York, a national, nonprofit consumer-service organization that works on ensuring access to affordable health care for older adults and people with disabilities.

In addition, Medicare provides an annual “wellness visit” for Medicare beneficiaries, Baker said. The wellness visit lets you develop or update a personalized plan to prevent disease and disability, based on your health and risk factors, according to CMS.

The U.S. Department of Health and Human Services said on March 18 that about 34 million Americans in traditional Medicare and in the one-stop Medicare Advantage health plans have received at least one preventive service, such as an annual wellness visit, at no-out-of-pocket cost because of the health care law.

**Cost: Medicare Part D**

Medicare Part D is prescription drug coverage that you obtain from a private insurance company. It’s subsidized by Medicare.

When Medicare Part D first took effect, in January 2006, you generally paid the same amount each month—your “premium”—as everybody else.

But the amount of your premium depends on the amount of your income. In general, the higher your income, the higher your premium.

The same income thresholds that apply for Medicare Part B also apply for Medicare Part D, said Social Security expert Kurt Czarnowski. That’s another reason to take a close look at your tax return now, the one for 2012. If your AGI exceeds the thresholds mentioned above for Medicare Part B, you can pretty much figure you’ll pay higher than what most people pay for Medicare Part D next year.

The Social Security Administration will send you a letter late this year spelling out your Part B and Part D...
premiums for 2013, said Czarnowski, who runs a Social Security consulting firm, Czarnowski Consulting, in Norfolk, Mass.

**Benefit: Donut hole**

Medicare Part D doesn’t cover everything. For one thing, there’s a built-in gap in coverage, known as the doughnut hole. In general, after you and your Part D plan have together spent a certain amount on prescription drugs, you generally get little or no coverage from your insurance. Once spending reaches another, higher level, the insurance kicks in again.

But there is help. If you land in the doughnut hole:

You’ll generally pay 47.5% of the cost of brand-name drugs this year and next year.

You’ll pay 79% of the cost of covered generic drugs this year, but 72% of the cost of covered generic drugs next year.

In other words, “You get a bit of a break,” Walters said. As the years go by, “you’re paying less and less of the cost of the drug,” she said.

Last year, more than 3.5 million seniors and people with disabilities who reached the doughnut hole received discounts on brand-name prescription drugs—discounts totaling $2.5 billion, averaging $706 per beneficiary, according to CMS. Savings for covered generic drugs for 2.8 million beneficiaries in the doughnut hole in 2012 totaled $105 million, according to CMS.

These savings will increase each year until the coverage gap is closed in 2020. Thus, the Affordable Care Act “improves overall Medicare drug coverage for folks,” Baker said.

**Cost: Medical expense deduction**

Most taxpayers claim a lump-sum deduction, known as the standard deduction.

But some taxpayers have so many expenses, they make a separate list of their deductions, through a process known as itemizing, which is done on Schedule A of your U.S. Form 1040. And among the deductions you may claim is one for unreimbursed medical and dental expenses.

There is a long-standing restriction on the medical expense deduction: you may deduct only those expenses that exceed 7.5% of your adjusted gross income, or AGI.

For tax year 2013, the hurdle is higher: It’s now 10% of AGI. “That’s a pretty big jump,” Walters said. And 10% is “a pretty high threshold,” Votava said.

Suppose your AGI is $80,000 each year. Suppose, too, that you have $8,000 in unreimbursed medical and dental expenses each year. Under the old rules in this example, your deduction was limited to only those expenses exceeding $6,000 (which is 7.5% of your AGI). Thus, your deduction totaled $2,000.

Under the new law, however, you get no deduction because your new floor is $8,000, and your $8,000 in unreimbursed medical expenses won’t exceed the new floor under the law.

The 10% limitation is in effect for 2013 and later years, so the first time you’ll see its impact is on the return you file early next year. But it’s good to know about it now, so you can plan ahead.

What if you’re 65 or older? For the years 2013, 2014, 2015 and 2016, if either you or your spouse turns 65 before the end of the taxable year, the threshold remains at 7.5% of AGI, according to Congress’s Joint
Committee on Taxation. (So, in general, the 10% threshold won’t kick in until 2017.)

**Benefit: Medicare savings**

Medicare program spending will be reduced by $716 billion over 10 years, starting this year, Baker said, citing Congressional Budget Office estimates.

The savings are from measures to control Medicare spending growth, increased benefits for people with Medicare, delivery system reforms, and new sources of revenues for the program, according to the estimates. The savings will also come, Baker said, from reductions in federal subsidies to Medicare Advantage plans.

Taken together, the savings will make Medicare more sustainable—which will translate into slower or lower increases in the premiums that Medicare beneficiaries will pay, he said. Part B premiums will continue to rise over time, with inflation in health care, but the Medicare program savings has “brought down the growth in Part B premiums for everyone,” Baker said.

Although Medicare Advantage plan premiums, coinsurance, and benefit amounts “have actually been pretty stable” in recent years, some insurance companies have indicated they may increase premiums and change benefits for the 2014 Medicare Advantage plan year, Baker said. It’s not clear whether these will bear out, but if you’re enrolled in a Medicare Advantage plan, you should “keep your eyes open” for possible changes when the annual notice of changes is mailed in September, he said. “Most of the responsible players...are really in this market for the long-term” and still plan to offer high-quality, low-cost products for the future, Baker said.

**Cost: Medicare payroll tax**

Most workers pay a Medicare tax. It’s equal to 1.45% of each worker’s pay. There is no limit on the amount of wages to which the 1.45% tax rate applies.

That hasn’t changed. However, effective for 2013 and later years, you face a Medicare surtax of 0.9% if your AGI exceeds a certain threshold, Walters said:

- $200,000 if you file your federal income tax return as “single,” “head of household,” or “qualifying widow or widower with dependent child”;
- $125,000 if you’re married and file a separate return; and
- $250,000 if you’re married and file a joint return.

**Benefit: Mental health coverage**

For years, “Medicare has discriminated against mental health benefits” by paying less for them than for physical health issues, Votava said. But the Affordable Care Act, and other federal laws and regulations, have ushered in parity.

In general, your Medicare copay was 50% for mental health care, compared with 20% “for anything else,” she said. But that is changing.

For example, assume the cost of a mental health counseling visit for depression is $200, and the cost of a doctor’s visit for blood pressure or a diabetes check is also $200.

Under the old rules, you had to pay $100 for the mental health visit, but only $40 for the blood pressure or diabetes check. Under the new rules, Votava said, your cost for the mental health visit:
- was $80 last year (because your copayment was 40%)
- is $60 this year (because your copayment is 30%)
- will be $40 next year (because your copayment will be 20%, the same as for physical issues).

As a result, Medicare is making mental health reimbursements "on a par with other medical services," she said. (In general, the changes affect those with traditional Medicare. If you’re enrolled in a Medicare Advantage plan, check your plan’s rules, Votava said.)

**Cost: Tax on investment income**

There is a new Medicare tax. It applies to your “unearned income”—in other words, your net investment income, such as taxable interest, taxable dividends, and mutual fund capital gains distributions.

The new tax took effect for this year. It’s generally 3.8% on either of the following two items, whichever is smallest:

- The amount by which your AGI exceeds the applicable threshold ($200,000 if you’re single, $250,000 if you’re married and filing jointly, $125,000 if you’re married and file separately),
- Your net investment income.

**Benefit: Exchanges**

CMS is working on building new health insurance marketplaces, known as exchanges, to which consumers and small businesses in every state will have access. (A federal exchange will operate in states that have chosen not to build their own exchange.)

They’re important “because we have not had a marketplace where people can buy health insurance,” Votava said. Through an exchange, you’ll be able to evaluate plans and compare plan prices and benefits, all in one place, and do it online, she said. You’ll also be able to find out if you’re eligible for subsidies to help you pay.

All exchanges will have open enrollment starting in October, for plan years beginning Jan. 1, 2014, Baker said. Among the potential beneficiaries: people nearing retirement, in their 50s and early 60s, who don’t now have the ability to buy health insurance—or affordable health insurance—in many states, he said.

The goal is that the exchanges will provide robust options for individuals to acquire health insurance coverage, “giving them the bridge to Medicare,” Baker said. “If you’re in your early 60s and you don’t have health insurance,” you can look for a plan starting in October, he said.

The exchanges could be valuable in situations where one spouse has reached 65 and is eligible for Medicare, but the other spouse is younger the only source of health insurance was through the older spouse’s job, Votava said.

Exchanges may also be helpful to people of any age “who want to be entrepreneurial" but who’ve remained working for an employer solely to take advantage of the employer’s health insurance, she said.

Most employers will continue to offer their own group health insurance plans, but many small businesses who don’t offer coverage will be able to offer it through the exchange, Baker said. Because some employers will drop coverage, many will continue offering it, and many will offer it for the first time, "we
actually think there will be a net gain” in the number of people covered, he said.

Cost: Flexible spending accounts

Trying to stash away some cash in a flexible spending account? You’re now limited to $2,500 a year. “They didn’t have limits before,” Votava said. Employers were free to set their own limits, but “there were no limits” under the law, she said.

These accounts are sometimes called flexible spending arrangements, health FSAs, or health-care flexible spending accounts. Whatever the name, the idea is the same: you generally can set aside money from your pay into an account, on a pretax basis. You then use that money to pay for many health-related expenses that aren’t covered by your health insurance plan—such as copays, doctor’s fees, prescriptions and such.

The lack of limits in prior years was especially helpful to those who had high health care costs, Votava said. Using an FSA is still valuable, but it’s capped now, at $2,500 per person per year, she said.

Cost/Benefit: Tax credits and penalties

Starting next year, eligible individuals and families will be able to use a new premium tax credit to help them afford health insurance coverage purchased through an exchange.

At the same time, each individual will have to either have minimum essential health coverage, or qualify for an exemption, or face a penalty. In essence, “you’re going to get a penalty if you don’t have insurance,” Walters said.

Seniors, too, will be required starting next year to have minimum essential coverage or qualify for an exemption. However, Medicare will count as “minimum essential coverage” under the provision. So, too, will retiree health plans, employer-sponsored plans, TRICARE, veterans’ health insurance program, Medicaid, and some others, the IRS says.

In general, the penalty—to be levied on your federal tax return—will amount to $95 per adult in 2014, $325 in 2015, and $695 in 2015. (Penalties will also apply for children who have no coverage, though there are per-family penalty caps, as well as a number of exceptions.)

The hope is that, with the mandate for health insurance coverage, many people will obtain health insurance—through their employers, on their own, or through an exchange, for example—and the combined purchasing power will result in affordable premiums for access, Baker said.

In summary

The federal health care legislation enacted three years ago has already had far-reaching effects on employers, employees, and retirees. But it’s not over yet. More provisions are on the way. So it’s helpful to have an idea of what’s ahead so you can plan ahead.

Other points

The sweeping changes to the nation’s health care laws are mainly the result not only of the Patient Protection and Affordable Care Act (Public Law No. 111-148), but also a related law, the Health Care and Education Reconciliation Act of 2010, (Public Law 111–152).

Come October, the combination of open enrollment for Medicare and open enrollment for the new state and federal health insurance exchanges could be “a little messy,” Walters said. “I just think there’s going to be some confusion out there,” she said.
Useful links

Internal Revenue Service’s updated list of tax aspects of the Affordable Care Act

Congress’s Joint Committee on Taxation report on tax-related provisions of the Affordable Care Act

Henry J. Kaiser Family Foundation timeline for implementation of provisions of the Affordable Care Act

IRS Notice on limits for flexible spending accounts (FSAs)

Allsup explanation of Medicare Part D

A website about the Affordable Care Act, developed by Drake Software, that includes a taxpayer credit calculator, a credit qualification calculator, a taxpayer penalty calculator, and an employer penalty calculator, along with explanations, FAQs, and links

Social Security Administration’s summary of key Affordable Care Act provisions

Federal Centers for Medicare & Medicaid Services’ 2012 report on ACA

Full text of a compilation of the Affordable Care Act and a related law

IRS’s “Tax Guide for Seniors” booklet (for tax year 2012)

Federal government information on exchanges

Henry J. Kaiser Family Foundation chart explaining penalty for not having health insurance

KFF health reform subsidy calculator

IRS booklet on health savings accounts and other tax-favored health plans

Dr. Katy Votava’s GOODCARE.com website

Allsup Medicare Advisor

Medicare Rights Center

About the author: Neil Downing, CFP is an Enrolled Agent with a master’s degree in taxation who has written three books on personal finance.

Social Security and spousal benefits

By Robert Powell, MarketWatch

Question: I am 59½ years old and have been widowed for almost 18 years. I plan to work until full retirement of 66 or beyond. However, in reading, I have discovered if I were to draw on my widow’s Social Security at age 60, it would not affect my own retirement benefits. I have two questions: 1) Am I understanding this correctly and 2) What is the amount that I can make, before the widow benefits begin to be reduced and by how much? —L.H.

Answer: Elaine Floyd, the director of retirement and life planning at Horsesmouth, said the following:

“L.H. may start his/her survivor benefit as early as age 60. However, the benefit will be reduced to 71.5% of the full amount. Even more important, it will be subject to the earnings test as long as he is under 66. The
earnings test threshold in 2013 is $15,120–$1 in benefits will be withheld for every $2 he earns over the annual threshold.

“Depending on his income, it might just make more sense to wait until age 66 to file for the survivor benefit. This will allow him to receive the full survivor benefit from age 66 to 70 while his own benefit builds 8% annual delayed credits. At 70, he can switch to his maximum benefit.”

Worth Reading

By Robert Powell, MarketWatch


Center for Retirement Research at Boston College: “Subsidies vs. Nudges: Which Policies Increase Saving the Most?”

U.S. Senate Committee on Finance Hearing Testimony: “Reforming the Delivery System: The Center for Medicare and Medicaid Innovation”

AARP: “State Studies Find Home and Community-Based Services to Be Cost Effective;” “Work-Related Travel in an Era of Extended Employment;” and “Inflation Indexation in Major Federal Benefit Programs: Impact of the Chained CPI”

Heritage Foundation: “Medicare Drugs: Why Congress Should Reject Government Price Fixing”


U.S. House Committee on Energy and Commerce, Subcommittee on Health Hearing Testimony: “Saving Seniors and Our Most Vulnerable Citizens from an Entitlement Crisis”

Alzheimer’s Association: “2013 Alzheimer’s Disease Facts and Figures”

National Bureau of Economic Research: “Can Amputation Save the Hospital? The Impact of the Medicare Rural Flexibility Program on Demand and Welfare”

U.S. House Committee on Ways and Means: “MedPAC’s Annual March Report to Congress”

Commonwealth Fund: “Paying for Value: Replacing Medicare’s Sustainable Growth Rate Formula with Incentives to Improve Care”

Center for Health Care Strategies: “Innovations in Integration: State Approaches to Improving Care for Medicare-Medicaid Enrollees”

U.S. Social Security Administration Compendium: “Expenditures of the Aged Chartbook, 2010”

Your Money: Sequence-of-returns risk
Retirees and near retirees, as discussed this week in my Retirement Portfolio column, How to Keep Stocks from Ruining Your Retirement, ought to consider ways to mitigate sequence-of-returns (SOR) risk. That is the risk that comes when you withdraw money from a retirement portfolio that’s declining in value, especially in the early stages of your retirement.

The problem, experts say, is this: Market returns can either work in your favor or against you in retirement. If you retire and the market falls during the early stages of your retirement you will be in hole that could put your standard of living at risk in the later stages of your retirement.

“Sequence-of-returns risk is also called reverse dollar-cost averaging,” said Wade Pfau, the director of Macroeconomic Policy Program and an associate professor at the National Graduate Institute for Policy Studies. “As you withdraw from your portfolio after a market decline, you are taking out money that will be gone and have no chance to rebound in value in the event of a subsequent market upturn.”

Market events in the first 10 years of retirement explain 80% of the final outcomes according to a paper authored by Pfau, “Will 2000-era retirees experience the worst retirement outcomes in U.S. history? A progress report after 10 years,” which was published in the Journal of Investing.

In my column, I outlined much of the research on the subject and offered advice on how to address this risk: You can keep setting aside two years of living expenses while in retirement; and reduce the percent you invest in stocks to less than 25%; or consider using different types of investment strategies such asabsolute return funds; or you can consider using an income annuity.

Pfau also agrees that it’s important to protect yourself from big market drops in early retirement. “This could be done partly through the use of single-premium immediate annuities, or through more complicated options strategies such as put options for one’s stock investments,” he said.

Meanwhile, David Blanchett, the head of retirement research at Morningstar Investment Management, shared these thoughts about SOR risk after the original column was published.

“There a number of common misconceptions about sequence risk. One of the most common is that it ‘goes away’ at some point during retirement such as after seven years, this isn’t true.

“For example, how is that someone who retires at age 63 would only experience sequence risk to age 70, but someone retiring at age 70 would experience it until age 77? Sequence risk is simply the idea that negative returns matter more when you first retire. This is because these negative returns impact the longevity of the portfolio during retirement, which can easily last 25 years.

“The chart on this page contains an example using a Monte Carlo simulation, where we determine the probability of a portfolio being able to sustain an initial withdrawal rate, subsequently increased by inflation, for 30 years.

For each we assume the portfolio is a 60% stock, 30% bond, and 10% cash portfolio, which is held constant through retirement, where returns and risk are based on Ibbotson’s current long-term capital market assumptions.

We also include a 1% fee on the returns. We run four different scenarios, the first scenario is where the return in each year is random, in the second scenario, third scenario, and fourth scenario we assume a -20% return in the first year, 15th year, and 30th year, respectively. Therefore, for the final three simulations in one year of simulation the return is -20% for all simulations.
"We see that the earlier (a person) receives the negative return (e.g., year one vs. year 15 and year 15 vs. year 30) the greater the impact on the likelihood the portfolio will be able to sustain the withdrawal. This is because bad returns affect portfolio outcomes more important. This is why, for example, low bond yields are so important for retirees today, because they are effectively ‘locking in’ a negative real return (after inflation). This negative real return materially affects the safety of a retirement income portfolio, especially in the context of safe start points based on past research.”

New and Noteworthy

By Robert Powell, MarketWatch

AdvisorShares plans to launch an actively managed multisector fixed-income ETF. The AdvisorShares Newfleet Multi-Sector Income ETF will invest principally in investment-grade debt but will also hold other fixed-income securities, including high-yield and emerging-market bonds. (SmartBrief/IndexUniverse.com)

Putnam Investments has introduced six mutual funds: the Intermediate-Term Municipal Income Fund, the Short-Term Municipal Income Fund, the Emerging Markets Income Fund, the Global Dividend Fund, the Strategic Volatility Equity Fund and the Low Volatility Equity Fund. (SmartBrief/InvestmentNews)

Charles Schwab plans to launch six ETFs linked to fundamental indexes, which follow techniques developed by Rob Arnott’s indexing firm Research Affiliates. The Fundamental Emerging Markets Large Company ETF, the Fundamental International Small Company ETF, the Fundamental International Large Company ETF, the Fundamental U.S. Small Company ETF, the Fundamental U.S. Large Company ETF and the Fundamental U.S. (SmartBrief/IndexUniverse.com)

Duly Noted

By Robert Powell, MarketWatch

T. Rowe Price this week launched the Social Security Benefits Evaluator, a free online Social Security calculator designed to help individuals decide what Social Security strategy may be suitable for their financial goals. According to a release, T. Rowe Price created the calculator to offer guidance on how an individual’s goals can help determine when and how to take Social Security. The calculator estimates Social Security income and presents potential approaches for taking benefits based on the users’ goals and allows them to compare results of different Social Security strategies.

Fidelity Investments this week its Income Simulator product, an online guidance tool that shows retirement plan participants how their savings translates into actual retirement income. The Income Simulator provides participants with a snapshot of how much estimated monthly income their current savings strategy may generate relative to their retirement goals. (PlanSponsor)
Two U.S. Senators introduced legislation that would give individuals who take a loan from their retirement accounts more time to repay after leaving a job. The Shrinking Emergency Account Losses (SEAL) Act, sponsored by U.S. Senators Bill Nelson (D-Florida) and Mike Enzi (R-Wyoming), would give workers who leave their jobs up until they file their federal taxes to repay money they have taken out of their company’s retirement plan. (PlanSponsor)

The Department of Labor’s (DOL) Employee Benefits Security Administration (EBSA) has resources for participants to learn about plan fees. On its “Understanding Your Retirement Plan Fees” page, the agency links to webcasts, videos, FAQs and other presentations about retirement plan fees and fee disclosures. (PlanSponsor)

A group of seven lawmakers in Hawaii are trying to get their state to offer a long-term care insurance purchase tax credit. The lawmakers have introduced state House Bill 304, a bill that would give state residents with incomes under a designated limit the ability to take a tax credit equal to up to 10% of the cost of long-term care insurance premiums. (LifeHealthPro Daily)

A staggering 1 in 3 seniors dies with Alzheimer’s disease or other types of dementia, says a new report that highlights the impact the mind-destroying disease is having on the rapidly aging population. (LifeHealthPro Daily)

Five ways retirees can cut health care costs (LifeHealthPro Daily)

Recognizing that its inability to accept all tax forms at the start of tax season is causing many taxpayers to request extensions, the Internal Revenue Service announced this week that it is waiving the late-payment penalty for taxpayers who are filing one of the 31 delayed forms and who make a good-faith effort to estimate and pay their tax when they file for an extension. (SmartBrief/JournalofAccountancy.com)