Paying for Healthcare in Retirement

LPL Financial

PERSONAL FINANCE EDUCATION

Medicare Won't Cover It All

According to a 2023 study[1], an average retired couple age 65 may need approximately $315,000 saved (after tax) to cover retirement healthcare expenses. Causes of rising healthcare costs include inflation in the broader economy, provider labor shortages, expensive treatments and technologies, an aging population living longer, and more.

Of course, the amount you'll personally need will depend on when you retire, how healthy you are (and remain), and how long you live. According to recent polling by the Kaiser Family Foundation, 50% of adults say it is difficult to afford healthcare costs. Medicare will help pay for some of your future medical expenses, but not all. If you have access to a Health Savings Account (HSA) through work, it offers an excellent opportunity to save for future healthcare costs.

Health Savings Accounts

Key Features and Benefits

An HSA is a unique, tax-advantaged account that can be used to pay for current and future healthcare expenses. When combined with a high-deductible health plan, it offers savings and tax advantages that a traditional healthcare plan can't match. With an HSA, individuals have:

- **A tax-advantaged** savings account. You can use the money to pay for eligible medical expenses, as well as deductibles, co-insurance, prescriptions, vision expenses, and dental care.
- **Unused funds roll** over year to year. There's no "use it or lose it" penalty like Flexible Spending Accounts (FSAs).
- **Potential to build** more savings through investing. Individuals can typically choose from a variety of self-directed investment options.
- **Additional retirement** savings. After age 65, funds can be withdrawn for any purpose without penalty, but may be subject to income tax if not used for IRS-qualified medical expenses.

IRS Limits for HSA Contributions

The IRS sets limits each year for maximum HSA contributions:

	Single Plan	Family Plan
Maximum Contribution Limit*	$4,150	$8,300
Catch-up Contribution (55+)	$1,000	$1,000

* Employer plus employee

The triple tax-free advantage

HSAs also offer three key tax benefits. Money goes into and comes out of an HSA tax-free as long as funds are used to pay for qualified medical expenses. No other employee benefit has this significant tax benefit:

1. Contributions to HSAs are not subject to federal income taxes, lowering your taxable income the same way as your contributions to a 401(k).*
2. Earnings from investments are tax-free.
3. Distributions from an HSA for qualified medical expenses are tax-free.

In addition, unlike your 401(k) savings, there are no Required Minimum Distributions (RMDs) associated with HSAs once you reach a certain age.

* Federal tax savings are available regardless of your state. State tax savings may not be available in every state.

1. 2023 Fidelity Retiree Health Care Cost Estimate.

What Can You Expect from Medicare?

Medicare helps make health insurance coverage more affordable in retirement. But only the most basic form of Medicare (Part A, referred to as "hospital" insurance) is free for most. You pay for Medicare plans that cover doctor visits, clinic services, prescription drugs and surgical procedures. And in many instances, you may also face out-of-pocket expenses.

When you get close to age 65, spend time reviewing and considering all your Medicare options. You'll need to know about Medicare Parts A, B, and D, as well as Medicare Advantage and "Medigap" supplemental insurance plans. Here's a brief overview:

Medicare options

- Part A covers hospital costs after you meet a deductible. It covers most of the costs of a stay in the hospital, as well as some follow-up costs after time in the hospital. Part A also pays for some other outpatient medical services, including some home healthcare, usually for no more than 100 days.
- Part B is optional coverage intended to help pay doctor's bills for treatment in or out of the hospital. It also covers many other medical expenses you incur when you are not in the hospital, such as the costs of necessary medical equipment and tests. If you elect Part B, a monthly premium is automatically deducted from your Social Security check. The amount depends on your income.
- Part D is for prescription drug coverage and you need to watch out for the "donut hole." That's when you start to pay 25% for your prescriptions, so add up your prescription expenses before signing up. It may be the other plans following are a better option.
- Medicare Advantage plans are all-in-one managed care plans that provide the services covered under Part A and Part B of Medicare and may also cover other services like prescriptions, hearing aids, and other costs. Besides being affordable, these plans have an out-of-pocket maximum of $8,850 for in-network expenses.
- Supplemental policies, referred to as Medigap policies, are offered by private insurance companies to supplement expenses Medicare Parts A and B do not typically cover. These plans have no required provider network but have higher monthly premiums than Medicare Advantage plans.
- It's important to note that you can switch Medicare plans as you age and as your situation changes.

How an HSA and Medicare Can Work Together

If you plan to retire prior to age 65, you may still need private health care coverage to help you bridge the gap to Medicare eligibility at 65. HSA savings can help bridge that gap. In addition, you can use your HSA to pay certain Medicare expenses, including premiums for Part B and Part D prescription-drug coverage and Medicare Advantage, but not Supplemental (Medigap) policy premiums.

See following page for important disclosures.

Sources: Investopedia.com, "What's a Health Savings Account?" (HealthCare.gov); IRS Publication 969; "Health Savings Accounts and Other Tax-Favored Health Plans" (IRS.gov); "Medicare and You 2023" published by the United States Centers for Medicare and Medicaid Services (CMS); "The Pros and Cons of Medicare Advantage" (Consumer Reports)

This material was prepared by LPL Financial, LLC.

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