# Annuity Only VEBAS
# Post-Retirement Medical Benefits

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Think of the following comments and statistics:

**Longevity**—People are living longer and many retirees are spending much of their savings for medical costs not covered by Medicare. Many people will live well into their 90s which will significantly increase the amount of money allocated to uncovered medical expenses.

**Health Care**—A 65-year old couple retiring "today" will need about $200,000 to cover health costs not covered by Medicare over their remaining lives (Medicare doesn't pay for drugs, dental or long-term care expenses).

**Long-Term Care**—One out of every two retirees will need long-term care benefits that are NOT covered by Medicare or other basic types of insurance. The average nursing home costs in 2006 is $69,000 for the year.

Whether a client is a wealthy small business owner or an hourly employee who has little retirement savings, the above statistics are troubling. Fortunately for the small business owner, he/she can take action while working to address these problems and do so in a tax favorable manner.

As alluded to above, most clients pay for their medical expenses in retirement with after-tax money out of their savings. Through a 419/VEBA Plan, small business owners can take a current income tax deduction to fund a plan where the money will grow tax-free and can come out income tax-free for qualifying medical benefits.

The ability to fund for post retirement medical expenses through such a plan is a huge benefit to those who can take advantage and is a topic that advisors who understand it can use to grow their practices and benefit their current client base.

Question—What investments should be used in a 419/VEBA plan if the main goal is post-retirement medical benefits and not death benefits? The majority of the industry will tell you that "cash value" life insurance is the tool of choice. Why? Because the money will grow tax free in a life policy and can be borrowed from the policy tax-free to pay for post-retirement medical expenses.

What's the problem with life insurance? There are significant loads (commissions). IF the client is only interested in post-retirement medical benefits, shouldn't the trust use an investment with low or NO loads? Yes. Why don't 419/VEBA

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administrators use other investments? Because the industry wants to sell life insurance whenever possible due to the fact that it is the highest commission product for advisors.

## Annuity Only VEBAs

The WPI believes that the best way to fund for post-retirement medical benefits is through equity indexed annuity. Think about it, there are no loads if not surrendered (although there are caps with most products) and there is principal protection with good upside growth potential.

Again, why are firms not touting annuity only 419/VEBAs? First, a 419 trust is usually a taxable trust which is not allowed to take advantage of the tax deferred growth of an annuity (similar to a corporately owned annuity). This is why if a client wants to use an annuity in a plan, it needs to be a 501(c) VEBA. Second, the commissions from annuities are significantly less than with life insurance.

If a client wants a death benefit and post-retirement medical benefits, it would be wise to split-fund the case.

For a recommendation to the "approved" 419/VEBA vendor for the WPI, please e-mail info@thewpi.org.

## Reduction in 401(k)/defined contribution plan contributions

If you go out into the marketplace and look at single employer 419e and single employer VEBA plans (or even multiple employer plans), you will notice that most offer some kind of "other living benefit" with their plans (vs. a death benefit only plan).

I like the sale's pitch which goes something like the following:

Advisor: Dr. Smith, would you agree with me that you will have thousands of dollars in medical bills after you retire? (For example: drug costs and other long-term care costs).

Dr. Smith: Yes, my mother and father (ages 68 and 72) paid nearly $10,000 last year for such expenses.

Advisor: How did your parents pay for their expenses?

Dr. Smith: They had no insurance coverage so they paid for them out of their checking account.

Advisor: Would you like me to show you a plan where you could take a business deduction through your medical practice today where the money contributed to a plan would grow tax-free and where you could take the money out of the plan completely tax-free for post-retirement medical expenses?

Dr. Smith: Yes, that sounds like a great idea……

The WPI likes the sale's pitch and believes clients who can fund for post-retirement medical benefits should.

As stated earlier in this material, the IRS hammered the use of 10-or-more multiple employer 419 plans. They were hammered so hard that it nearly shut down their use nationwide. The new IRS regulations on 419 plans however, did not cover single employer 419e or VEBA plans. Therefore, most of the multiple employer plans were frozen or shut down and everyone started coming out with single employer plans.

That's fine, we need to do what we need to do in order to help our clients, but what 99.9% of the readers of this material do not know is that there is a setoff against the employee's 401(k)/profit sharing plan contributions for every dollar allocated to post-retirement medical benefits purchased in a single employer 419e or VEBA. This was not an issue with 10-or-more multiple employer plans.

Why is this important? Because most people pitching single employer plans are pitching them with some element of post-retirement medical benefits (which is a good thing). The problem is that few are disclosing the fact that there is this setoff (most of the time because they are not aware of the setoff.

Post-retirement medical benefits can still be a powerful sale's pitch: Advisor: Dr. Smith, I want to remind you that every dollar you contribute to your 401(k) plan is going to be income-taxed some day. If, however, you allocated $10,000-$20,000 to a 419e or single employer VEBA plan, that money would still grow tax-deferred like a 401(k) plan, however, when the money comes out of the plan for post-retirement medical benefits, the money comes out income-tax free. Dr. Smith, wouldn't it make sense to allocate some dollars to a 419e or single employer VEBA plan? Most clients will say yes.

One last caveat, the setoff issue does NOT apply to defined benefit plans. This brings up a lot of other planning issues which I cant' get into today, but you do need to know that only defined contribution plans have the setoff issue.

## Conclusion on Post-Retirement Medical Benefits

If you have small business clients, you should be telling them about how they can purchase post-retirement medical benefits in a tax deductible manner through their companies and where the benefits will come out income tax-free for qualifying medical costs in retirement. For many clients, it will make more sense to fund through a VEBA post-retirement medical benefits even if there is a setoff due to the fact that the money coming out of the VEBA is income tax free and the money coming out of a defined contribution plan is taxable.

Full knowledge on this topic is a must and with that knowledge you can really benefit your clients and grow your practice.

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