



Navigate Financial

Nancy LaPointe, CFP®, ChFC®,
CLU®, RICP®
Financial Planner, Wealth Manager
3663 College St. SE, Ste. B
Lacey, WA 98503
360-628-8175
nancy@navigatefinancialnw.com
navigatefinancialnw.com

It's fall again already! With the changing of the leaves, I always feel like I should be starting something new. I guess the feeling is left over from so many years of starting a new school year every fall. New beginnings and new adventures! Time to act and to learn something different. Keep learning and growing is a personal motto.

Taxes, Retirement lessons, saving for health care

Five Retirement Lessons from Today's Retirees

Balancing 401(k) and HSA Contributions

What health services aren't covered by Medicare?

How much will health care cost?

Navigate Financial

Charting Your Journey

Federal Income Tax: How Did We Get Here?



April 16, 2019 was an important day for many of us. But do you know why? It was Tax Freedom Day — the day when the average American theoretically earned enough to pay his or her tax obligations for the year. According to the Tax Foundation, Americans will pay \$3.4 trillion in federal taxes in 2019, more than they spend on food, clothing, and housing combined.* But it wasn't always this way. In fact, income taxes are a fairly new development in the overall history of America. So how did we get to this point?

In the beginning...

The United States was founded, in part, on the premise that colonists didn't want to pay taxes without representation, which led to the famous tossing of tea into the Boston Harbor and the American Revolution. However, not long after the colonies gained their freedom from England, Congress passed the Stamp Act of 1797, which essentially was our nation's first estate tax. Otherwise, from the early 1790s to 1802, the U.S. government was supported by taxes on such items as spirits (alcohol, not the ghostly kind), sugar, tobacco, and corporate bonds.

Wars played a big part in the history of taxation in this country. To fund the War of 1812, Congress taxed sales of gold, silverware, jewelry, and watches. In 1817, tariffs on imported goods provided the main source of revenue to run the government.

With the onset of the Civil War, Congress enacted the nation's first income tax law, the Revenue Act of 1861, which included a flat tax of 3% on annual incomes exceeding \$800 to help pay for the costs of the war. That tax law was repealed and replaced by the Revenue Act of 1862, which established the Office of the Commissioner of Internal Revenue (forerunner to the Internal Revenue Service), levied excise taxes on most goods and services, and replaced the flat tax with a progressive tax.

The 16th Amendment

However, it was not until 1913 with the adoption of the 16th Amendment to the Constitution, that the income tax became a permanent fixture in the American tax system. Congress now had the authority to tax income of both individuals and corporations. It didn't take the IRS long to start inundating us with forms, beginning in 1914 with the introduction of the first income tax form, the dreaded Form 1040. Enactment of the Revenue Act of 1916 introduced tax rates and income scales.

Tax rates

Here's a sobering fact: In 1913, the top federal income tax bracket was 7% on all income over \$500,000, and the lowest tax bracket was 1%. During the Great Depression, Congress raised the highest tax bracket to 63%. Wars can be expensive, as evidenced by the jump in the highest tax rate to 94% during World War II. In 2018, the highest income tax rate was lowered to 37%.

Trying to get it right

Over the years, there have been frequent attempts to reform the tax law in some manner. We've seen the adoption of the alternative minimum tax, Social Security tax, taxes on cigarettes and alcohol, gasoline taxes, aviation taxes, property taxes, telecommunication taxes, not to mention state and local taxes. To quote Will Rogers, "The difference between death and taxes is death doesn't get worse every time Congress meets."

Tax laws are always changing and will likely remain a political hot potato. Only time will tell what changes are ahead, but there is no doubt that through taxation, what the government giveth, it inevitably taketh back again.

**Tax Freedom Day 2019 was April 16, as calculated by the Tax Foundation, taxfoundation.org.*

Five Retirement Lessons from Today's Retirees



EBRI consistently finds that setting a savings goal increases the level of confidence among today's workers. Despite that fact, just 42% of survey respondents have tried to determine a total retirement savings goal, and less than one-third have tried to calculate how much they may need for medical expenses. Of those who have calculated a total savings goal, 34% have found they will need \$1 million or more to retire comfortably.

Source: 2019 Retirement Confidence Survey, EBRI

Each year for its Retirement Confidence Survey, the Employee Benefit Research Institute (EBRI) surveys 1,000 workers and 1,000 retirees to assess how confident they are in their ability to afford a comfortable retirement. Once again, in 2019, retirees expressed stronger confidence than workers: 82% of retirees reported feeling "very" or "somewhat" confident, compared with 67% of workers. A closer look at some of the survey results reveals various lessons today's workers can learn from current retirees.

Current sources of retiree income

Let's start with a breakdown of the percentage of retirees who said the following resources provide at least a minor source of income:

- Social Security: 88%
- Personal savings and investments: 69%
- Defined benefit/traditional pension plan: 64%
- Individual retirement account: 61%
- Workplace retirement savings plan: 54%
- Product that guarantees monthly income: 33%
- Work for pay: 25%

Lesson 1: Don't count on work-related earnings

Perhaps the most striking percentage is the last one, given that 74% of today's workers expect work-related earnings to be at least a minor source of income in retirement. Currently, just one in four retirees works for pay.

Lesson 2: Have realistic expectations for retirement age

Building upon Lesson 1, it may benefit workers to proceed with caution when estimating their retirement age, as the Retirement Confidence Survey consistently finds a big gap between workers' expectations and retirees' actual retirement age.

In 2019, the gap is three years: Workers said they expect to retire at the median age of 65, whereas retirees said they retired at a median age of 62. Three years can make a big difference when it comes to figuring out how much workers need to accumulate by their first year of retirement. Moreover, 34% of workers reported that they plan to retire at age 70 or older (or not at all), while just 6% of current retirees fell into this category. In fact, almost 40% of retirees said they retired before age 60. The reality is that more than four in 10 retirees retired earlier than planned, often due to a health issue or change in their organizations.

Estimating retirement age is one area where workers may want to hope for the best but prepare for the worst.

Lesson 3: Income is largely a result of individual savings efforts

Even though 64% of current retirees have defined benefit or pension plans, an even larger percentage say they rely on current savings and investments, and more than half rely on income from IRAs and/or workplace plans. Current workers are much less likely to have defined benefit or pension plans, so it is even more important that they focus on their own savings efforts.

Fortunately, workers appear to be recognizing this fact, as 82% said they expect their workplace retirement savings plan to be a source of income in retirement, with more than half saying they expect employer plans to play a "major" role.

Lesson 4: Some expenses, particularly health care, may be higher than expected

While most retirees said their expenses were "about the same" or "lower than expected," approximately a third said their overall expenses were higher than anticipated. Nearly four out of 10 said health care or dental expenses were higher.

Workers may want to take heed from this data and calculate a savings goal that accounts specifically for health-care expenses. They may also want to familiarize themselves with what Medicare does and does not cover (e.g., dental and vision costs are not covered) and think strategically about a health savings account if they have the opportunity to utilize one at work.

Lesson 5: Keep debt under control

Just 26% of retirees indicated that debt is a problem, while 60% of workers said this is the case for them. Unfortunately, debt can hinder retirement savings success: seven in 10 workers reported that their non-mortgage debt has affected their ability to save for retirement. Also consider that 32% of workers with a major debt problem were not at all confident about having enough money to live comfortably in retirement, compared with just 5% of workers who don't have a debt problem.

As part of their overall financial strategy, workers may want to develop a plan to pay down as much debt as possible prior to retirement.

Balancing 401(k) and HSA Contributions



For more information on qualified medical expenses, review IRS Publication 502. For help with your specific situation, consult a tax professional.

Asset allocation is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

¹ Survey of Adults with Employer-Sponsored Insurance, Kaiser Family Foundation/LA Times, May 2, 2019

² 2019 HSA Survey, Plan Sponsor Council of America, June 4, 2019

If you have the opportunity to contribute to both a 401(k) and a health savings account (HSA), you may wonder how best to take advantage of them. Determining how much to contribute to each type of plan will require some careful thought and strategic planning.

Understand the tax benefits

A traditional, non-Roth 401(k) allows you to save for retirement on a pre-tax basis, which means the money is deducted from your paycheck before taxes are assessed. The account then grows on a tax-deferred basis; you don't pay taxes on any contributions or earnings until you withdraw the money. Withdrawals are subject to ordinary income tax and a possible 10% penalty tax if made before you reach age 59½, unless an exception applies.

You can open and contribute to an HSA only if you are enrolled in a qualifying high-deductible health plan (HDHP), are not covered by someone else's plan, and cannot be claimed as a dependent by someone else. Although HDHP premiums are generally lower than other types of health insurance, the out-of-pocket costs could be much higher (until you reach the deductible). That's where HSAs come in. Similar to 401(k)s, they allow you to set aside money on a pre-tax or tax-deductible basis, and the money grows tax deferred.

However, HSAs offer an extra tax advantage: Funds used to pay qualified medical expenses can be withdrawn from the account *tax-free*. And you don't have to wait until a certain age to do so. That may be one reason why 68% of individuals in one survey viewed HSAs as a way to pay current medical bills rather than save for the future.¹ However, a closer look at HSAs reveals why they can add a new dimension to your retirement strategy.

HSAs: A deeper dive

Following are some of the reasons an HSA could be a good long-term, asset-building tool.

- With an HSA, there is no "use it or lose it" requirement, as there is with a flexible spending account (FSA); you can carry an HSA balance from one year to the next, allowing it to potentially grow over time.
- HSAs are portable. If you leave your employer for any reason, you can roll the money into another HSA.
- You typically have the opportunity to invest your HSA money in a variety of asset classes, similar to a 401(k) plan. (According to the Plan Sponsor Council of America, most HSAs require you to have at least \$1,000 in

the account before you can invest beyond cash alternatives.²)

- HSAs don't impose required minimum distributions at age 70½, unlike 401(k)s.
- You can use your HSA money to pay for certain health insurance costs in retirement, including Medicare premiums and copays, as well as long-term care insurance premiums (subject to certain limits).
- Prior to age 65, withdrawals used for nonqualified expenses are subject to income tax and a 20% penalty tax; however, after age 65, money used for nonqualified expenses will not be subject to the penalty [i.e., HSA dollars used for nonqualified expenses after age 65 receive the same tax treatment as traditional 401(k) withdrawals].

The bottom line is that if you don't need all of your HSA money to cover immediate health-care costs, it may provide an ideal opportunity to build a separate nest egg for your retirement health-care expenses. (It might be wise to keep any money needed to cover immediate or short-term medical expenses in relatively conservative investments.)

Additional points to consider

If you have the option to save in both a 401(k) and an HSA, ideally you would set aside the maximum amount in each type of account: in 2019, the limits are \$19,000 (plus an additional \$6,000 if you're 50 or older) in your 401(k) plan; \$3,500 for individual coverage (or \$7,000 for families, plus an additional \$1,000 if you're 55 or older) in your HSA. Realistically, however, those amounts may be unattainable. So here are some important points to consider.

- 1) Estimate how much you spend out of pocket on your family's health care annually and set aside at least that much in your HSA.
- 2) If either your 401(k) or HSA — or both — offers an employer match, try to contribute at least enough to take full advantage of it. Not doing so is turning down free money.
- 3) Understand all HSA rules, both now and down the road. For example, you'll need to save receipts for all your medical expenses. And once you're enrolled in Medicare, you can no longer contribute to an HSA. Nor can you pay Medigap premiums with HSA dollars.
- 4) Compare investment options in both types of accounts. Examine the objectives, risk/return potential, and fees and expenses of all options before determining amounts to invest.
- 5) If your 401(k) offers a Roth account, you may want to factor its pros and cons into the equation as well.

Navigate Financial

Nancy LaPointe, CFP®,
ChFC®, CLU®, RICP®
Financial Planner, Wealth
Manager
3663 College St. SE, Ste. B
Lacey, WA 98503
360-628-8175
nancy@navigatefinancialnw.com
navigatefinancialnw.com

The accompanying pages have been developed by an independent third party. Commonwealth Financial Network is not responsible for their content and does not guarantee their accuracy or completeness, and they should not be relied upon as such. These materials are general in nature and do not address your specific situation. For your specific investment needs, please discuss your individual circumstances with your representative. Commonwealth does not provide tax or legal advice, and nothing in the accompanying pages should be construed as specific tax or legal advice. Securities and advisory services offered through Commonwealth Financial Network®, member FINRA/SIPC, a Registered Investment Adviser. Fixed insurance products and services offered through CES Insurance Agency or Navigate Financial.



What health services aren't covered by Medicare?

Original Medicare — Part A hospital insurance and Part B medical insurance — offers broad coverage, but many services are not covered.

Some may be fully or partially covered by a Part C Medicare Advantage Plan, which replaces Original Medicare, or a Medigap policy, which supplements Original Medicare. Both are offered by Medicare-approved private insurers. (You cannot have both a Medicare Advantage Plan and a Medigap policy.)

Whether you are looking forward to Medicare in the future or are already enrolled, you should consider these potential expenses.

Deductibles, copays, and coinsurance.

Costs for covered services can add up, and — unlike most private insurance — there is no annual out-of-pocket maximum. Medicare Advantage and Medigap plans may pay all or a percentage of these costs and may include an out-of-pocket maximum.

Prescription drugs. For coverage, you need to enroll in a Part D prescription drug plan or a Medicare Advantage plan that includes drug coverage.

Dental and vision care. Original Medicare does not cover routine dental or vision care. Some Medicare Advantage and Medigap plans may offer coverage for either or both of these needs. You might also consider private dental and/or vision insurance.

Hearing care and hearing aids. Some Medicare Advantage plans may cover hearing aids and exams.

Medical care outside the United States. Original Medicare does not offer coverage outside the United States. Some Medicare Advantage and Medigap plans offer coverage for emergency care abroad. You can also purchase a private travel insurance policy.

Long-term care. Medicare does not cover "custodial care" in a nursing home or home health care. You may be able to purchase long-term care (LTC) insurance from private insurers.

A complete statement of coverage, including exclusions, exceptions, and limitations, is found only in the LTC insurance policy. It should be noted that LTC insurance carriers have the discretion to raise their rates and remove their products from the marketplace.

How much will health care cost?

Retirement health-care costs will vary depending on your health and longevity, but it may help to have a guideline. These are the estimated savings required for an individual or couple who turned 65 in 2019 to have a 90% chance of meeting expenses for Medicare Part B health insurance, Part D prescription drug coverage, Medigap Plan F, and out-of-pocket drug costs, assuming median prescription drug expenses.* These estimates do not include services not covered by Medicare or Medigap.



*Medigap Plan F is used for these estimates because it is the most comprehensive coverage available and simplifies the calculation. However, this plan may not be available for new beneficiaries after January 1, 2020. Current enrollees may keep Plan F, and most other plans will remain available for new enrollees.

Source: Employee Benefit Research Institute, 2019