Ep:11 Optimizing Cost Saving Opportunities with The Affordable Care Act

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PATTI BRENNAN: Hi everybody, welcome back to the "Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best life.

With me today, once again, is Eric Fuhrman, our Chief Planning Officer. The topic today is on the Affordable Care Act. One of the things that I will tell you about Eric Fuhrman is this is a man who takes a subject and takes it deeper, and deeper, and deeper than anybody I know.

When he does this, and the benefit that we get, and hopefully you get, we learn things and are able to apply these concepts to your day to day life. I mean, it's just incredible. Wait until you hear about some of the things that we would like to see many of you benefit from this year.

ERIC FUHRMAN: Wow. [laughs] Thank you, Patti. I appreciate it. Most people that know me would say I'm usually one that is not for a lack of words. That's very nice of you. I think anyone that's listening to these podcasts would know that I am absolutely delighted to be here and can't wait to dive into another.

What we believe is a really interesting topic that can have a real impact for those out there in our audience.

PATTI: The reason this became really evident is that what we have found over the last few years as we do our year end tax planning and financial planning initiatives is that we've discovered a subset of clients who are covered under the ACA, receiving or anticipate signing up for it.

Whether those people had retired early or maybe widowed or separated. As we were learning more about the ACA, we realized there are unique planning opportunities that a lot of people may not realize. Basically, today we're going to talk about the Affordable Care Act and some statistics, and then explain how the premium is actually calculated.

We're going to go over some investment in tax strategies that you got to be careful about because they might have some unintended consequences, and then really hone into the sweet spot. What are the steps that you can take to capture the best premium credit?

ERIC: Patti, I think it's so interesting, just to fill out the narrative there, is that, as we were going through your tax planning, we really just stumbled over this because normally we're engaged and thinking about how can we do a Roth conversion or maybe do some really interesting tax strategies?

The focus is always on taxable income. We realized these folks out there and our client base that are on the Affordable Care Act, taxable income is not the number that you want to focus on and they really need some unique planning strategies.

PATTI: It's an important point, Eric. Why don't you explain to our listeners exactly how that's calculated, because it's very different than how you would normally figure out adjusted gross income, for example?

ERIC: Yeah, I would love to. For those of you out there, you might be hearing this term Affordable Care Act. You are probably wondering what's that. Is that some new law? No, this is what is known as Obamacare. It was branded that way. That's not the official name of the law.

We're not here to pass judgment on the merits of the law or issue any kind of opinion, one way or another. Just to explain what it is and those of you that have health insurance for the market place to be sure...more so than anything being aware of how your income can affect your premium tax credit.

Basically, this is a law that was very controversial, but the key provision is really to extend coverage to millions of uninsured Americans, as a means to lower cost and eliminate some industry practices like denying people on the basis of preexisting conditions.

What we're going to talk about today is really how is the premium taxed credit, the subsidy determined, as well as cost sharing subsidies depending on the type of plan you select. Patti, why don't you bring us into the next part about some stats?

PATTI: I think it's really important that people understand, that this is affecting a lot more pre retirees than I think people realize. For example, close to 12 million people who are under the ACA, 29 percent of those people are 55 years and older.

There's this subset of people who again may have retired early or may be widowed or widowers etc., who are receiving the benefits of the ACA. We're going to talk about some strategies so that you get a higher premium offset from the subsidies. Eric, why don't you take us through exactly how the calculation...How that's determined?

ERIC: It certainly came as a surprise to us, that assets have no impact whatsoever on your eligibility to get a premium tax credit under the Affordable Care Act. Neither does your 2018 income. It has absolutely nothing to do with it. It doesn't matter how much money you've made.

PATTI: In other words, if you made, for example, a million dollars in 2018, and if you have $5 million sitting in retirement account and another $2 million in a regular account, those people can qualify for the ACA with a significant premium offset?

ERIC: They can. I still remember this day when we made the phone call to healthcare.gov. I almost fell out of my chair when it came to that realization that that's how it was done, but you're absolutely right.

When open enrollment happens, which is November 1st until December 15th...Unfortunately, open enrollment is over for 2019. What happens is if you're a new enrollee or an existing enrollee in the Affordable Care Act, you basically have to provide an estimate of what your 2019 income is going to be.

A lot of the websites will tell you to use last year's adjusted gross as a starting point, but if you've gone through some kind of life change or so forth, that may or may not be a good starting point. It's a recommendation.

It's based on your estimate because what happens is when you give that estimate, that income number will determine if and how much of a premium tax credit you get. That tax credit is advanced right from the beginning of the year, and you'll get that all throughout the entire year.

PATTI: Let's you and I try to gain the system, all right? Let's gain the system and say, "Why don't we go ahead and estimate an income of $40,000 so we get this juicy tax credit so that we don't have to pay as much money for our medical insurance?"

ERIC: Patti, I love that you went into it and said it that way because I'm going to quote this right now. For those of you out there, sorry, we'll get a little technical here but it's Form 8962. That's where you file and have this premium tax credit.

This is verbatim from the instruction's page from the IRS. It says, "Reckless disregard for the facts." That will disallow you for the premium tax credit.

What happens is you can tell them whatever number you think, but at the end of the year on Form 8962, you are going to reconcile what your estimated income was versus your actual income. That tax credit is either going to be adjusted upwards or it's going to be reduced.

If you actually made more income than you estimated, the premium tax credit will be reduced, and you'll owe more or have to pay it back and vice versa. If you actually made less than what you estimated, you will get more of the premium tax credit, and you'll get a higher refund or less taxes out.

PATTI: The one thing we don't want to have happen is you estimate too low, and all of a sudden, you're getting a big fat surprise in April of the following year.

ERIC: I would say I'm going to put a little plug in here that's why it's so important to work with a qualified accounting professional and a good financial advisor.

PATTI: Exactly. For those financial advisors who are listening today, this is a wonderful, wonderful benefit that you can provide to your clients. It's a really big deal. The key here though is let's talk about how is that modified adjusted gross income calculated because it's very different than the way you would normally do your taxes.

ERIC: Modified adjusted gross income sounds scary, but it's not as bad as you think.

PATTI: Not nearly as bad. Also, when it's calculated for this purpose, it's even calculated differently than, for example, how you would calculate how much of your social security is taxed.

The way it works is you figure out your adjusted gross income, which is the number on the bottom of the first page of your 1040, and then you add back three things. Number one, your tax exempt interest. Number two, any foreign income, and number three, the nontaxable portion of social security if you're even receiving it.

Modified adjusted gross income is we're basically adding back a few things. For most people, it's probably going to be tax exempt interest. The most important thing that I want you to get from this part of it is that if you have a rental property and you're showing losses, you don't have to add that back in. That comes off of your income like it does for normal tax purposes.

Here's where the real strategic planning comes. Capital losses also stay in. You can do some interesting things at the end of the year, or even throughout the year, to increase your capital losses to keep that modified adjusted gross income lower.

ERIC: It's so interesting too because we had many phone calls over the past two months before the end of the year. A lot of accountants too were not exactly sure how they arrive at modified adjusted gross. What we're talking about is literally on...What is it, page six of the instructions, I think it is, for how you figure this out.

What came to light as we went through this is that modified adjusted gross income is not always defined exactly the same way. Again, the Affordable Care Act seems to do it a little bit differently.

We would always recommend that anytime you're doing this, it's really important to work with a qualified accounting professional to do these calculations and make sure that you're doing the things the right way.

PATTI: OK, folks, did I warn you or did I warn you? He gets into detail. We're talking page six of this big booklet, and Eric actually reads every paragraph of all of those forms. It's important, because again, this is where these opportunities bubble up.

With that in mind, Mr. Detail, let's go through an example for our listeners just so that they can get a feel for, gee, if I'm a single person, how much income can I still show and still get this premium tax credit?

ERIC: There's really, when you do it, and we're going to give an example here. We're in Pennsylvania but you can go on the healthcare.gov website and there's a calculator on there that will help you estimate and figure out all this stuff.

PATTI: Believe it or not, that calculator is actually easier to use even though it was created by the government, a lot easier than most people might think.

ERIC: It's pretty intuitive in going through it, but basically there's a couple of income tiers that you have to be aware of. All these tiers are based on the federal poverty limit.

That's a whole another thing. We're not going to dive into. If you were a single, one person household with no dependents living in Pennsylvania, if your income is below $16,753, and again that's modified adjusted gross, you'd be basically in Medicaid territory.

Ideally, in a lot of cases, anything above $16,753, now you're going to start to get the premium tax credit. The way it works out is if you're above $16,753 but below $48,560, you're going to get some amount of premium tax credit. The moment you go over $48,560 of income, there is no premium tax credit, it goes away.

It's an all or nothing thing, but within that band, there's a sliding scale. The closer you are to the lower end, the greater the premium credit. The more you get towards the higher end, the less of a credit there is.

PATTI: The key here with this is, to keep in mind, it's based on the number of people in the household. For example, we have a husband and wife who are looking to qualify under the ACA for some of these wonderful credits. For a household of two, that band is wider so that you can show income of $22,800 on the low side all the way up to $65,840.

Just round it off to, say, $22,000 to $66,000. That's the sweet spot where you can qualify for premium tax credit and maybe even additional subsidies through the cost sharing.

ERIC: Those cost sharing subsidies are only if you're on a silver plan that they come through.

When we're thinking about it, and how about you walk us through an example? The things that we can really control on our end would be things like how the investment portfolio is structured, and so forth.

There're certain elements you've got to be aware of that we're going to dive into here in a minute.

PATTI: Exactly, and as we go into this, we're focusing on the silver plan because it does seem to be the most popular plan. The nurse in me is going to come out, and I'm going to say to all of you, you got to really make sure that that's the right healthcare plan for you and your family. You got to really make sure that that's going to cover the things that you need covered.

For purposes of today, we're going to take the silver plan, and what we're looking at is a female aged 60. We're in Pennsylvania, so if this woman, for example, has a modified adjusted gross income of $18,000, she's getting a subsidy of $1,244 per month.

As the income increases, let's say that we go to $45,000 of that MAGI. We're still looking at a subsidy of $910. That's a big benefit. We don't want to lose that through some of the other things that we create in unintended consequence.

ERIC: It's really important, especially as you come to the year end, that there are certain things you can do depending on how your investments are structured and certain decisions you make, to ensure that you're getting the best benefit of that tax credit. When we think about this, things that we can control as it relates to our client.

There are certain investment decisions that we can control. There's also certain tax strategies that seem common sense and are widely recommended, but may actually diminish or undermine the credit if you don't pay close attention.

PATTI: Exactly. For example, on the investment decisions, if in the non retirement accounts, we've got too much of an emphasis on income producing investments, which by the way, does include your tax exempt interest, because that gets added back. If we've got too much of an emphasis on that, that may take away this subsidy.

You got to look out for things like frequent trading, lots of turnover, capital gains. Also, if you're retired or you're receiving cash flow from your portfolio, you want to make sure you want to minimize capital gains. Don't sell those highly appreciated assets, let's go somewhere else.

Last but not least, something that we were able to do last year and we were able to preserve or create a significant credit for our clients was taking advantage of the unfortunate circumstance we had in the fourth quarter of 2018, with a big, big loss in portfolios.

I say big, 20 percent on the SNP, international markets even more. To take advantage of tax loss harvesting opportunities. Those strategies, again, don't create too much income, etc., avoid frequent trading. They can really impact or diminish whether you get a credit at all. Eric, why don't you go into the tax strategies?

ERIC: I will, and just as an add on to that last point, because I think it's so critical, is the tax lost harvesting. Not only did that allow us to basically preserve a credit for so many of our clients by doing tax lost harvesting, but in certain cases, that created a carry forward that then gives us a reserve that we can work with in future periods, say in 2019 and beyond.

It gives a lot more flexibility to the client, which was huge.

PATTI: Great point. That is a really important point. That's a juicy opportunity. Unfortunately, these things happen, but boy, what can we do to make sure we capture that deduction, not only for 2019 but for many years? Again, good news, bad news, for years to come.

ERIC: Common tax strategy, so this is actually how we stumbled across this. You learn a lot of things as you go along, but we were looking, in our focus, how can we take advantage of Roth conversions, or maybe accelerating capital gains and get a zero percent tax rate for our clients?

Again, that focus is purely on taxable income, which is after you factor in your standard deduction and anything else.

PATTI: It's important, let's do a sidebar conversation. Under the new tax law, the people that are 12 percent bracket is actually wider than ever before and we're finding more people, if we do some planning, can actually land in that 12 percent tax bracket.

If you're in the 12 percent tax bracket, I got news for you, folks, if you didn't listen to the other podcast, which I hope you did, on tax planning strategies at year end, if you're in that 12 percent bracket, guess what? Capital gains are taxed at zero. That is a huge perk.

We were looking at ways of , gee, A, who's in the 12 percent tax bracket, because we've got real awareness of that opportunity. Should we be creating some gains in that calendar year or in years to come so that, gee, we pay no capital gains tax?

As we were looking into this, that subset of clients who were also receiving premium tax credits under the ACA, there was the unintended consequence. If we did that, then they might lose their subsidy.

ERIC: That was a real aha moment where we sat there and are giving ourselves a pat on the back thinking we've done a great job shifting income from a high period to a period of relatively low marginal tax. It suddenly dawned on us that, "Hey, we are jeopardizing this significant premium tax credit," that these people who are basically not old enough for Medicare, they're in the Affordable Care Act.

We're going to lose because of that activity. That's what really led to this podcast, this emphasis on really focusing on how can we plan for the Affordable Care Act, making sure we're doing the best job for our clients.

PATTI: The same thing goes for the Roth conversions. Roth conversions, in certain situations, are a great strategy. Just because it may not work, either this or the Capital Gains Strategy, may not be the ideal thing to do right now in that period of life while you're on the ACA.

Keep in mind that once you go on Medicare at age 65, chances are your tax bracket is going to be about the same. These opportunities are not evaporating. We're just delaying them. Until you can get on Medicare, you're going to be in a low tax bracket, then we'll go back to looking at can we take some capital gains at zero percent or do a Roth conversion?

ERIC: You know what? I'm going to steal word that you use all the time, but it's about optimization. We're looking at the phases. Here's another one of your words, the seasons of life. What's important is in this season, for people that are on the Affordable Care Act, great, you could do a Roth conversion. Maybe save some taxes, but the greater opportunity is preserving the tax credit.

We're always looking at the season of life. What's the optimal way to preserve the best benefit that's out there during that period?

PATTI: I'll take it one step further. You know me. I am very big on running the numbers. When you run the numbers, it's black and white. It tells you what's the ideal option.

Again, many of you listening may not have access to the software. Hopefully some of the people listening, our financial planners, you're running numbers for clients. This is another scenario that you need to consider.

ERIC: For those of you listening out there, I've worked for Patti for 15 years. I can say 100 percent accurate that we exhaust every possibility we run, every scenario it seems. That's how these things come to bubble to the surface.

PATTI: To the nth degree.

ERIC: That's right.

PATTI: That's why we exist really.

ERIC: That's right.

PATTI: All right. Let's take a look at what are those step by step? What are the real key takeaways from this? Number one, you want to take a look at last year's tax return. Get a sense of what your modified adjusted gross income would have been and what you're projecting it out to be.

Again, understand, you may have had that life event where last year's tax return is just not relevant.

ERIC: Absolutely. The next would be is to really find the sweet spot. This is if you were one household or one member of the household, and you're applying for it under a silver plan, if you're between $16,753, and I believe it's $30,350, that's the sweet spot.

If you're on a silver plan, that's where you're going to get the most generous tax credit. You're going to get the cost sharing subsidies, which means lower deductibles and minimum out of pocket. That's the real sweet spot to target if you can.

PATTI: Again, sweet spot or the range for married couples would be about $22,000 to $66,000 is the wide range of when you can qualify for something.

ERIC: Yeah, great point. Depending on the members of your household, that will increase the range that you have to target.

PATTI: The other important thing is you want to consider re balancing your non retirement accounts away from income producing investments.

As always, you want to talk to your investment professional, your financial planner, before you do any of this to make sure it's really appropriate for you because there are other issues such as your total return that you need to earn on your portfolio, your risk tolerance, and any other tax implications in doing so.

ERIC: Absolutely. The next step would be, and this is not advocating for passive over active management. As it relates to your non retirement accounts, really look at very tax efficient funds to keep not only the capital gains distributions down, that's the big one, which is really unpredictable from year to year.

Basically using index funds or active funds that have low internal turnover, that's going to make sure that you can hopefully control or keep or minimize the capital gains distributions on your taxable accounts.

PATTI: If you're taking cash flow out of your portfolio, you want to use investments that have the smallest unrealized capital gains. We'll get technical here on you. Prioritize your tax lots by using the last in first out wherever possible. You really want to look at your tax planning strategy so that you maintain these premium tax credits.

ERIC: Next, I would say, stop trying to time the market. The critical piece about all this that we found is that you want to preserve flexibility. The more you're buy and hold, the less activity that you're taking, more unlikely the more flexibility you're preserving for year end where you can take tax losses or do other things that can help preserve the credit.

PATTI: To your point, Eric, you really want to be proactive with that process. In 2018, we did not wait for the end of the year to take tax losses. We did it after February also. You don't have to wait till the end of the year to harvest those losses, because they just build on top of each other.

Whenever possible, make sure that you or your advisor is looking at the portfolio for those opportunities.

ERIC: Another point is you have to be very careful about, the conventional wisdom of doing Roth conversions are taking capital gains at zero percent, if you're somebody that's on the Affordable Care Act, doing these things.

While they may appear to be good, it can be very bad for the tax credit that you're actually currently receiving. They could really undo a lot of good other tax credit. You're not going to know that until you file your taxes for that tax year.

PATTI: Exactly. The takeaway from this podcast is, again for those of you who are considering getting on the ACA, there are wonderful plans that are out there. No pre existing conditions, limitations, etc. You want to make sure that you're choosing the plan that's right for you.

As you do that, also consider how can you structure your income in such a way to optimize those premium tax credits and the cost sharing reductions. Those cost sharing reductions are your deductibles.

When you visit the doctor, how much you have to pay versus how much the government is paying. Whenever possible, these are...it's not just a deferral. These are complete avoidance of significant costs for medical care. With that in mind, that's it for today's show.

Thank you so much for spending some time with us. If you want to learn more about the ACA and how to optimize your income to qualify for more tax credits, just head over to the website at keyfinancialinc.com. You're welcome to give us a call, schedule a meeting.

We can do some brainstorm on these ideas and any others. Also, be sure you hit the subscribe button. If you liked today's episode, share it with others. That's why we exist, is to share this information. Again, as Eric and I both said, we stumbled across this.

A lot of advisors don't have an Eric firm that's doing these deep dives, but they can be significant when you're doing your planning.

ERIC: A lot of advisors don’t have a Patti Brennan either.

[laughter]

PATTI: Again, thank you so much, Eric.

ERIC: Thank you.

PATTI: Thank you so much for joining me today. You always lighten it up and add color. Until next time, I’m Patti Brennan. Thank you so much for tuning into the Patti Brennan Show. We’ll see you in the next episode.