Teresa S. Sampleton, CFP®, CPA
Vice President
Sampleton Wealth Management

230 Park Ave. West
12th Floor
New York, NY 10169

(888) 336-6884

teresa.sampleton@SampletonWealth.com
www.sampletonwealth.com

SAMPLETON WEALTH MANAGEMENT GROUP

Unintended Consequences

By Elaine Floyd, CFP®

When dealing with financial affairs, actions in one area can spill over into another. Sometimes these unintended consequences can be avoided; other times they don't reveal themselves until it's too late. Here's what you need to be aware of when it comes to Social Security and Medicare.

What do you do when a strategy or action that solves one problem inadvertently creates a new one? And what if the remedy to the new problem has the potential to cause still another problem?

This is what one client is facing. For reasons having to do with her business, the client's CPA advised her to file her taxes as married-filing-separately. This past November she got her Medicare premium notification. Because the income-related monthly adjustment amount (IRMAA) thresholds are much lower for married-filing-separately, the client and her spouse must now pay over $500 per month in Medicare premiums. This brings up two questions: 1) If the client amends her tax return and files jointly, will the Medicare premium be adjusted? And 2) If she amends her return will it increase her chances of being audited?

One of these questions is easily answered. Yes, if she amends her return she can appeal the IRMAA. Although specific life-changing events are usually the only grounds for appeal, you can also appeal the IRMAA if it is based on outdated or incorrect tax information.

If the client amends her tax return and files a transcript of the updated return with Medicare, her premiums will be adjusted.

The question not so easily answered is whether or not filing the amended return would increase her chance of being audited. An audit would cost thousands of dollars in CPA fees and the potential for additional tax liability. Then there's the reason the CPA recommended married-filing-separately to begin with. If amending the return would increase her tax liability, this would have to be balanced against the reduced Medicare premiums.

When you are dealing with complex financial affairs, actions in one area can spill over into another. Sometimes these unintended consequences can easily be avoided; other times they don't reveal themselves until it's too late.

As financial professionals, our job is to help clients identify and avoid unintended consequences to the extent that we are able. When it comes to Social Security and Medicare, here are some actions and their consequences you should be aware of.

FILING STATUS

If a client files as married-filing-jointly and her modified adjusted gross income (MAGI) is between $212,000 and $266,000, the Part B IRMAA is $74 per month (in addition to the base premium of $185. If she files as married-filing-separately but lived with her spouse at any time during the year, it's $406.90. Clearly, the government doesn't want people manipulating their filing status to get around paying higher Medicare premiums. It doesn't mean married people should never file separate returns, as there could be good reasons for doing so. But for people on Medicare, the higher premiums arising from the lower IRMAA thresholds need to be factored into the decision. (Note: the IRMAA is based on tax returns filed two years prior. The 2025 premiums noted here would be based on 2023 tax returns.)

TAX DEFERRAL

The (nearly) unassailable mantra in the tax world is to not pay taxes now when you can pay them later. But this doesn't always make sense if paying them later means paying more. "Later" does not mean "indefinitely." Most tax-deferred accounts require the payment of taxes at some point—at whatever tax rate is in effect at the time the income is reported. And because Medicare premiums go up with modified adjusted gross income (MAGI), you must add the possible IRMAA to the mix. For example, a $10,000 required minimum distribution (RMD) from an IRA could end up being "taxed" at a 31% rate if it triggers the IRMAA. These surcharges are just as real as federal income tax obligations. Clients with large IRAs may want to start drawing them down earlier than they need to in order to lower RMDs.

EMPLOYMENT

You may be familiar with the earnings test. If a client is receiving Social Security and is under full retirement age (FRA), $1 in benefits will be withheld for every $2 he earns over the threshold, which is $23,400 in 2025. However, the remedy to this consequence is not to not work. Foregoing tens of thousands of dollars in earnings in order to not have some Social Security benefits withheld is not the path to financial security. The best remedy here is to simply delay applying for benefits if a client is going to work. But if it's too late and he has already started receiving benefits when an employment opportunity comes up, encourage him to take it.

Two positive unintended consequences clients may not know about are: 1) The benefit will be adjusted at FRA to remove the reduction for those months in which he didn't get a check (making it as if he had delayed applying with respect to those months); and 2) The additional earnings could end up increasing the amount of his Social Security benefit. The obvious consequence, of course, is that the additional earnings should allow the client to add to—not draw from—retirement accounts which may generate more income in later years.

RETIREMENT

In a traditional scenario a client turns 65, retires, and enrolls in Medicare. He arranges to have his employer health insurance terminate at the same time Medicare becomes effective, the first of the month he turns 65. With a good drug plan and Medigap policy, he now has comprehensive health insurance that may actually cost him less than the cost-sharing amount he was paying under the employer plan. What could go wrong here? His 62-year-old spouse now has no health insurance. Neither does his 25-year-old son who was covered under the employer plan. They can always get insurance, of course, either through COBRA (for a while) or by buying insurance through the exchange. But it will cost them. One of the first matters a client needs to square away before retiring is health insurance for the family.

MARRIAGE

Take the case of a 57-year-old widow. Upon learning that her remarriage would cause her to lose out on survivor benefits based on her deceased husband's work record, she asked if she could divorce her new husband and remarry him after age 60, after she had claimed her survivor benefit. Of course she could do that, but why go through the trouble? Why not avoid this problem in the first place? For clients in their late 50s, it is often wise to delay remarriage until after age 60. It's clear in the case of widows and widowers, but it also applies to people who divorced after at least ten years of marriage, even when the ex is alive and kicking. Remarrying after age 60 is an insurance policy for those survivor benefits in case the ex dies.

DIVORCE

Divorced-spouse benefits are available only if the marriage lasted ten years or more. If a couple marries and divorces twice, the remarriage must have occurred before the end of the calendar year following the divorce in order for the two marriages to count toward the ten years. If clients are considering divorce, ask how long they've been married and encourage them to stick it out for at least ten years. This goes for younger clients, too, who aren't even thinking about Social Security yet. Even if a client would not be entitled to a divorced-spouse benefit because her primary insurance benefit (PIA) is more than half of the ex's PIA, there are (again) survivor benefits to think about. If the ex dies, a divorced person who has remained single or who remarried after age 60 can move up to the ex's benefit if it's higher—but only if the marriage lasted at least ten years.

In the complex world of retirement, Social Security, and Medicare, there are a lot of decisions to be made. Unfortunately, those decisions can have unintended consequences that negatively impact other areas of life and financial security. And, especially when it comes to marriage, death, and divorce, clients may not be able to dispassionately think through all of their options. It's a good idea to discuss all aspects of the situation with a financial professional versed in Social Security and Medicare before making any big decisions.

Elaine Floyd, CFP® is Director of Retirement and Life Planning for Horsesmouth, LLC, where she helps people understand the practical and technical aspects of retirement income planning.