

Conventional Wisdom Can Lure Doctors

Into Asset Protection and Tax Traps

Part 1

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According to the US Census Bureau, the average American family earns less than \$49,000. That translates to an income tax liability of less than 12%. 98% of American families will NEVER be worth more than \$2,000,000 and owe an estate tax. Lastly, the average American is an employee, not an employer. As a result, most will never be sued because of work-related activities. Therefore, there is no need for most people to address protection from lawsuits. Does the situation above sound like your life? Of course it doesn't.

As authors of books and articles, we regularly interact with publishers and talk show hosts. Radio and television stations, book & magazine publishers, and internet content editors are looking for content for their "average" reader. They fear "alienating" their readers and listeners by including content for only the higher income audience. What this means for physicians is:

***Financial and legal advice you get from television, radio, newspapers and the internet
is
NOT APPROPRIATE FOR PHYSICIANS!***

By listening to this advice, you are like the patient who trusts his own self-diagnosis from his 10-minute internet search rather than trusting the experience of a specialist with decades of experience in his field.

Unless your advisors spend all of their time working with high income and high liability physicians, they won't be familiar with the techniques in our articles, free audio CDs or books (like Wealth Protection MD). These techniques are appropriate for less than 1% of the population. It is ok if they sound strange to you at first. They should. Once you embrace that you are different and you require "different" planning than your neighbors, you will be on your way to financial freedom.

A couple of mistakes many physicians make by listening to bad advice include:

- ***Mistake #1 – Listening to a CPA or Attorney who says “You Don’t Need a Corporation for Your Medical Practice.”*** Despite what the CPA says, in most cases the cost and aggravation of the corporation are far outweighed by the asset protection and tax benefits the corporation offers physicians. These are outside the scope of this brief article, but are covered in our new book, [For Doctors Only](#).

- **Mistake #2 –Owing Any Assets in Your Own Name or Jointly with Your Spouse or in Your Spouse’s Name!** We know that this is the most common ownership structure for real estate and bank accounts. This is ok for 90% of Americans. You have potential lawsuit risk, probate fee liability, and estate tax risk. If you don’t want to unnecessarily lose assets to lawsuits or taxes, you need to consider alternative ownership structures. Something as simple as a living trust or a limited liability company can often solve these problems.

These two mistakes above are commonly addressed by savvy advisors and concerned doctors. The rest of this article and the second part of the article will share three additional mistakes doctors make when they rely on planning that is appropriate for Average Americans – not planning that is beneficial to doctors who have unique needs, circumstances and goals.

- **Mistake #3 – Wasting Time and Money on Retirement Plans.**

This is perhaps the single most important area of planning for doctors to address once they understand that they are NOT AVERAGE. Typical retirement plans are great for rank-and-file employees. They are forced to put away funds for retirement. Their employees may match some percentage of those funds. The money grows for them and then is available after age 59½. When they pass away, there may be a very modest amount remaining, if any, for their heirs.

As “the employer,” you are responsible for those matching contributions. These can be very significant if you have a large employee base. You are also the person who will be responsible (in other words liable) if employees do not get the proper allocations or contributions from your practice. Even if the plan administrator made a mistake, you ultimately may feel the wrath of the Department of Labor if your employees are not fairly treated by the plan. Further, a hypothetical \$40,000 per year of pension contributions from ages 35 through 60 growing at 7% will only be worth \$2,000,000 at retirement at age 60. This may lead to lifetime income of \$12,000- \$15,000 (pre tax per month). If you factor in inflation, this income may only be worth \$6,000 to \$8,000 pre-tax in today’s dollars if you are young physician. How many 35-year-old doctors do you know who could retire on \$3,000 to \$6,000 per month after taxes? Of course, you can’t live on that little in retirement. So, you need supplemental planning to reach the retirement level you desire.

There is another problem. Let’s say that you accumulate significant non-pension assets and these assets are enough to support your quality of life in retirement. It is not unusual for a physician family to also accumulate \$1 or \$2 million of retirement plan assets that they will not spend during their lifetime. When you pass away, these plan assets can be taxed at income tax and estate tax rates. It is possible, in some states, for this “double tax” to be 70% to 80%. In other words, if your family doesn’t use this asset, they’ll lose it. I am sure you didn’t pay all that money to fund your employees’ retirement plan and to have it managed only to lose ¾ of it to taxes at death. This is yet another problem with traditional retirement planning that doesn’t impact Average Americans.

Suggestion – Do Not Rely on Traditional Retirement Planning to Support Your Retirement.

Non-traditional, non-qualified planning can offer higher income physicians opportunities to put away more annually. In addition, these plans can be much more discriminatory than traditional qualified plans. Whether you are using an executive benefit plan for doctors only or a captive insurance company, you could possibly deduct \$100,000 to \$1,200,000 annually. You won't be subject to any Department of Labor scrutiny as these plans are not subject to these regulations. Further, you will access to the funds before 59½ if you like, you will not be forced to take withdrawals at age 70½ if you don't need the money, and these plans will not be taxed at rates up to 70 or 80% when you pass away.

Non-traditional, non-qualified plans vary significantly in their design, their scope, and their applicability. Some plans work great for smaller practices with one or two partners. Others work best in practices with 3 to 20 partners. Still others may work best for the larger practices. To determine which one is right for you, contact a specialist in advanced planning for professionals. If you do not know someone in your area who specializes in non-traditional planning for physicians, please contact the authors and they will try to introduce you to someone in your area.

Don't Miss Part 2 of this Article

This is the first of a two part article. More tips on tax reduction and other elements of financial planning that are specific to physicians and unnecessary for Average Americans will come in the subsequent part of this continuing article.

The information contained in this article is general in nature and should not be acted upon in your specific circumstances without further details and/or professional advice. Contact your personal tax advisor for specific advice related to your tax situation.

Ken Vanway is a Board Certified Attorney in private law practice in Austin, Texas; He is an author, lecturer and creator of the program ... "Asset Protection for Physicians" ... presented across the State of Texas to thousands of physicians. The authors welcome your questions and Speaking Opportunities. You can contact them at ken@vanway.org, (512) 263-2886 or through their website www.kenvanway.com.

SPECIAL OFFER: For a free (plus \$7 shipping and handling) copy of [For Doctors Only: A Guide to Working Less and Building More](#), please contact the authors.

Conventional Wisdom Can Lure Doctors

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Part 2 of 2

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In Part 1 of this article, we explained that physician families have substantially greater liability risk and retirement challenges than Average American families do. This segment of our article will focus more on tax, investment and insurance issues that differ greatly for physicians and non-physicians. If you missed the previous part of the article, please feel free to contact the authors or the publisher and they will send you a copy via email or facsimile. For now, let's get right to some of the mistakes that doctors make and offer helpful hints for physicians.

Mistake #4 – Paying Full Price when the Government Offers to Pay Half. Technically, the government (Internal Revenue Service) is not paying half of anything. However, if they offer you a tax deduction and your combined state, federal and local marginal tax rate is close to 50%, you can think of your purchasing something that is deductible as being ½ as expensive because the government will allow you to deduct this purchase. This is a rather easy concept to grasp, but the application will continue below and in the next part of this article which will be in an upcoming issue.

Suggestion – Buy Long Term Care insurance (LTCi) through your Practice and let the Government Pay Half. Over 60% of American households will require some sort of long term care assistance. This can be a short relatively inexpensive proposition or this could result in years of assistance that may cost hundreds of dollars per day. In either case, without long term care insurance, you will have to pay for this assistance from your savings. If you purchase long term care insurance through your medical practice, you do not have to offer this for your employees. Further, you can cover you and your spouse through the practice even if you are not both physicians. Lastly, you get a tax deduction for 100% of the premiums if they are paid by your practice.

We understand that you will not practice medical forever. This is not a problem. You can pay your entire life's premiums over a 10 or 20 year period so that all premiums come from your operating practice – and are 100% tax deductible. This way, when you retire, your premiums are paid in full and the government subsidized all of your payments. This is one of the many tips that we offer to our clients to help reduce unnecessary tax burdens.

There are also non-traditional, non-qualified retirement plans that also allow physicians to make contributions of \$100,000 to \$1,000,000 per year, discriminate as to only include the doctors or key employees, and access the funds before age 59 ½ if that is their interest. Further, these plans can be set up to be very important pieces of a family's estate plan without sacrificing tax

deductions or control of the assets. For further information on these plans that are beyond the scope of this article, please contact the authors at (800) 554-7233.

Mistake #5 – Wasting Money on Taxes and Term Insurance Premiums.

A famous female financial advisor with her own TV show is one of many advisors to tout “Buy term insurance and invest the difference.” This is excellent advice for the “Average American” family who earns \$42,000 per year, pays 12% in federal income taxes, and has no liability or estate tax risk whatsoever. The average family pays very little tax on investment income. It is possible that their tax on investment gains ranges from 10% to 15%. The average family is not worried about having its assets taken through a lawsuit. Further, the average family buys insurance solely for temporary income protection against the premature death of the breadwinner. The average family also has no interest in long term liquidity for estate planning purposes because they will never have an estate large enough to warrant any estate tax. Does this sound like you? Of course, it doesn’t sound like you.

Suggestion – Buy Cash Value Life Insurance as a supplemental investment tool that will offer permanent life insurance protection as well. If you are skeptical of this advice, ask yourself whether you are skeptical because you did the calculations yourself (or reviewed a careful analysis by an expert) or because you have just heard this axiom enough times that you have just accepted it as fact.

Both authors have MBA degrees in finance and one has a degree in applied mathematics, so we feel our calculations are reliable in our proof that this advice is incorrect. To spare you the pain of a long mathematical proof, let us offer the following simplified analysis.

1. Mutual funds growing at 8% (taxable) are worth 5%-6% (after taxes) to high income taxpayers like you and worth 7% or more to Average Americans.
2. Investment gains (whether in mutual funds within variable policies or S&P index returns in equity indexed policies) within cash value life insurance policies are not taxed.
3. For relatively young and healthy insureds, the annualized cost of all internal expenses is 1%-2%.
4. For families in high marginal tax brackets, the cost of the insurance policy is less than the cost of taxes on the same investment gains within mutual funds.

Without even factoring in the cost of the term insurance (which would reduce the total amount in the mutual fund portfolio), the cash value insurance investment outperforms buying term insurance and investing the difference. Yet another benefit is that life insurance is protected from creditors, and even from bankruptcy creditors, in many states. This is a benefit that may interest a physician family, but be seen as worthless to average American families.

EXAMPLE: Consider a 45 year old healthy male who wants to invest \$25,000 per year for 15 years before retirement and then withdraw funds from ages 61 to 90. Assume this individual’s tax rate on investments is 31% (50% long term gains and dividends, 50% short term gains, 6% state tax). Assume the pretax return of both investments are 8% per year.

- The individual who invests in mutual funds withdraws \$37,000 per year after taxes (without purchasing ANY term life insurance)
- The individual who invests in cash value life insurance withdraws \$42,500 per year (no taxes on policy withdrawals and loans) + has **\$1,000,000** of life insurance protection.

In this situation, it is pretty hard to see how buying term and investing the difference in taxable investments made more sense than investing in tax-efficient life insurance for this highly compensated physician who is in a high tax bracket. If you have any questions about this strategy or other techniques that are appropriate for high income physicians, do not hesitate to contact the authors with your questions.

The information contained in this article is general in nature and should not be acted upon in your specific circumstances without further details and/or professional advice. Contact your personal tax advisor for specific advice related to your tax situation.

Ken Vanway is a Board Certified Attorney in private law practice in Austin, Texas; He is an author, lecturer and creator of the program ... "Asset Protection for Physicians" ... presented across the State of Texas to thousands of physicians. The authors welcome your questions and Speaking Opportunities. You can contact them at ken@vanway.org, (512) 263-2886 or through their website www.estateplanning.com/kenvanway.
SPECIAL OFFER: For a free (plus \$7 shipping and handling) copy of [For Doctors Only: A Guide to Working Less and Building More](#), please contact the authors.