



Securing your Financial Future

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ABSTRACT Securing one's financial future requires dedication and planning. A clear plan must be implemented and continually re-examined to assure an individual remains on track to achieve this security. True success of the plan will be dependent upon taking the appropriate steps to protecting one's assets against unfortunate events along with building assets with a clear end goal in mind. This article will cover the fundamental steps an individual can take to secure their financial future.

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Upon receiving our letter of acceptance to a dental school, many of us had a vision that our eventual diploma guaranteed financial security along with an opulent lifestyle. After all, every doctor on television always drove a luxury car, lived in an exclusive neighborhood, belonged to a country club, and never had to worry about money. Why should it be any different for us?

Unfortunately, with educational debt in excess of \$200,000 for many graduates today, the reality is their financial future has many uncertainties. Both recent graduates along with mature practitioners must take specific steps in their career to assure financial security and an enjoyable retirement. This article will focus on the various stages of practice and considerations that should be made for proper financial planning.

Stage 1: Beginning Your Career

The First Five Years of Practice

The first five years after graduation may most likely be the most important years in relation to achieving financial security. The new practitioner must take specific steps at this stage to lay the groundwork for building a strong nest egg. Many recent graduates in their mid- to high-20s feel invincible at this age and do not consider the importance of obtaining proper insurance coverage.

In order to protect the investment they have made in their education, it is imperative that recent graduates consider disability insurance and health insurance in addition to their practice liability coverage. If the recent graduate has any dependents, they should also consider purchasing adequate life insurance coverage while they are healthy. In the event

that a practitioner at stage 1 has either started or purchased an existing practice, many of the concepts presented to the stage 2 practitioner will also apply.

INSURANCES

A disability policy will help provide a source of income in the event of accidental injury or sickness. Of primary importance is that the policy should be guaranteed and renewable. In addition, it is important that the policy specifically has a characteristic of an own occupation. An own occupation statement will mean that you will receive a full monthly benefit even if you are capable of working but cannot practice dentistry.

Health coverage is also extremely important. At the minimum, the early stage practitioner must consider a policy that covers against catastrophic illness and hospital treatment associated with such illness. Many of these plans will have relatively low premiums, yet they will cover a great portion of the expenses that would be generated in a hospital stay.

In the event an individual is not covered by health insurance, treatment costs can easily reach tens of thousands of dollars and spell a serious financial setback. If an individual is to consider a health insurance policy with a high deductible, they should consider pairing it with a Health Savings Account (HSA). HSAs are essentially savings accounts that allow individuals or families to set aside funds that will specifically be used to cover healthcare related costs. HSAs offer triple tax advantages in that they allow contributions of pretax dollars, earn tax-exempt interest and investment gains, and funds can be withdrawn tax-free for qualified medical expenses.

Furthermore, HSAs are owned by the individual and are not tied to any employer or health insurance company.

In addition, HSAs roll over from year to year and are not considered a benefit that must be used within a calendar year. With prudent planning, significant tax-free wealth can be created within an HSA being that the owner of such an account can invest in various modalities, including high growth mutual funds.

BUILDING YOUR NEST EGG

Good financial habits should start as early as possible. Decreasing debt accumulation can pay tremendous dividends later in life; however, even those with a high debt load can secure

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a strong financial future. The greatest benefit at this early stage of one's career is the value of time. Numerous studies over the years have illustrated the great benefit of compounding interest and the tremendous benefit time can have on growing one's investments.

Early in one's career, income levels may be lower; however, expenses also tend to be lower as well. It is at this early stage one must structure their cash flow appropriately so that appropriate funds can be dedicated toward long-term savings. One of the primary costs for the early stage practitioner is that of servicing their student loan debt. Popular belief may be to pay the student debt off as fast as possible, but this strategy may

drastically affect long-term savings.

Many graduates will leave dental school with educational debt in excess of \$200,000. If an individual has \$200,000 of school debt with a fixed interest rate of 6.85 percent and would like to amortize this loan over 10 years, it would require a monthly payment of \$2,306.74. If the same individual decided to consolidate their loan to a 30-year payment plan with the same 6.85 percent interest rate, the payments would drop to \$1,310.52. This would increase cash flow by \$996.22 per month to invest immediately. If this amount was invested for the same 30-year period as the consolidated loan, with an assumed financial market return of 10 percent annually, the individual would have \$2,251,943.28 of accumulated wealth at the end of this period of time. On the other hand, if the individual started to save after their student loans were paid off, only 20 years of compounding would be available.

Assuming the entire sum that was once dedicated to the student loan payment is now used toward investments for 20 years, the individual would have amassed \$1,751,666.47 at the end of this period assuming the same 10 percent rate of return. This is more than \$500,000 less than the individual who was diligent about saving the difference in monthly payments derived from consolidating their student loans. In addition, one can argue that saving over a 30-year period has inherently less risk than the individual that is forced to save over a 20-year period of time.

Taking this example one step further, the individual who is paying down their student loans as fast as possible also is forced to use after-tax dollars for the entire \$2,306.74 payment. The federal tax code does not allow any student loan

interest deduction if an individual is making greater than \$70,000 in modified adjusted gross income or a couple is making greater than \$145,000 in modified adjusted gross income.¹ The real dollar discrepancy between the two strategies can be even greater if the individual who consolidated his/her loans is able to invest using pretax dollars in an employer sponsored plan such as a 401(k).

In order for the strategy to work properly, an individual must be dedicated to investing the funds properly and seeking proper financial advice. It goes without saying that if one chooses not to invest the difference in payment philosophies and spends it frivolously, the strategy will not work. It should also be understood this strategy would work best with lower-interest debt and not higher-interest debt such as credit card debt.

Stage 2: Starting Your Practice

Six to 10 Years

Many of the strategies that pertain to the early stage practitioner also apply to the practitioner who has just started his or her practice. In addition, it is at this stage of one's career that the individual should consider protecting their financial future by seriously considering the purchase of additional insurance policies, including business overhead expense insurance and employment practices liability insurance. The practitioner should also consider continuing increasing their disability insurance coverage to be in line with their current earning level as well as evaluate their need for life insurance to protect their dependents if a tragedy occurred. It is also at this stage of practice the practitioner can further secure their financial future by implementing appropriate retirement plans in conjunction with their practice.

INSURANCES

Business overhead expense insurance allows one to keep their practice open, or, at the minimum, pay for its expenses until the owner recovers from a covered disability. Expenses such as employee salaries, rent, utilities, interest on practice loans, and even the salary for a replacement dentist can be covered. Furthermore, these policies tend to be relatively inexpensive for most practitioners at this stage of their career. Most policies are meant for relatively short-term coverage; however, in the unfortunate event an individual may

EMPLOYMENT PRACTICES

liability insurance
is one policy that
tends to get
overlooked by
many practitioners.

suffer a longer-term disability, the policy may offer up to two years of coverage.

The practitioner can use this time to make a decision to sell the practice if necessary. Along the way to making this decision, the practitioner will at least be partially protected from accruing further debt related to business operations.

Employment practices liability insurance is one policy that tends to get overlooked by many practitioners. Most practitioners believe their staff would never think about pursuing legal action if they were terminated; however, wrongful termination claims are on the rise.² Many of these cases are settled out of court and an individual can incur tens of thousands of dollars in legal fees

and settlement costs. An employment practices liability policy would help cover settlements, civil damages, and defense costs that may be incurred if an employee or an applicant makes a claim.

RETIREMENT PLAN OPTIONS

In addition to protecting one's assets with the policies discussed in this article, an individual should strongly consider meeting with a financial adviser to enhance retirement savings. At this stage of one's career, defined contribution plans are probably most relevant as time is still potentially on one's side if a 20- to 25-year time frame is evident until retirement.

Generally speaking, defined contribution plans do not guarantee any fixed amount at the time of retirement. Instead, defined contribution plans typically involve an employer contribution that may or may not match an employee contribution. Defined contribution plans include 401(k), Safe Harbor 401(k), Simple 401(k), profit-sharing, money purchase plans, and, to a less advantageous extent, simplified employee pension (SEP IRA), and savings incentive match plan for employees (SIMPLE IRA).

While SEP and SIMPLE IRAs can be relatively straightforward to set up and have low maintenance costs, employee costs can be very high. In addition, there is no vesting period in place for these plans, and, upon departure, an employee is able to have access to 100 percent of the funds the employer may have deposited for the employee. Profit-sharing plans that are set up in a cross-tested manner and comply with nondiscrimination rules can allow the owner-doctor to contribute the maximum 2008 contribution of \$46,000 while potentially limiting staff contributions to 5 percent of paid wages.³ Furthermore, if these cross-tested strategies are blended with a 401(k)

safe harbor and profit-sharing plan, the percentage of dollars allocated to staff will decrease in comparison to those allocated to the doctor and employed spouse.

In many of these scenarios where strategies are combined, the owner-doctor along with their spouse can save nearly \$60,000 a year in pretax dollars. If an individual is able to save \$60,000 per year for 25 years in a tax-deferred retirement vehicle that returns 9 percent per year, this investment alone will exceed \$5 million. While this may sound like a substantial sum of money, keep in mind inflation will eat away at this amount over time. At an approximate rate of 3 percent inflation 25 years from now, \$5 million will actually be worth closer to \$2,400,000 in today's dollars.

Stage 3: Productive Years

11 to 25 Years Out

At this career stage, one is most likely performing well and considerations should be made for an eventual transition plan. A true financial overhaul should occur with professional help to confirm one is on the right track to financial security. In the event one finds their retirement savings not to their liking, the good news is financial security is still a possibility without one having to work well into their 80s. The success of this truly will be dependent on dramatically increasing one's savings rate and using current tax laws to one's advantage.

From an insurance standpoint, relatively little change may need to occur to one's plan and it is always a good idea to confirm one is adequately insured in all aspects of their life. Of key importance at this career stage is to evaluate one's overall estate and make sure a will and testament, along with a potential trust, are in place.

RETIREMENT PLAN OPTIONS

The retirement choices available to earlier stage practitioners are also available during this stage. But with a relatively limited time horizon until retirement, more strategies should also be considered. In addition to establishing and maintaining a defined contribution plan, one should also consider a defined benefit plan. Unlike defined contribution plans, defined benefit plans agree to pay participants a designated monthly income upon retirement.

Generally speaking, this amount is based on years of service to one's practice and the compensation rate of the

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employee. Defined benefit plans can provide a lifetime annual retirement up to the lesser of the highest consecutive three-year average compensation or \$185,000.⁴ To further maximize savings of pretax dollars, a defined benefit plan can be paired with a 401(k), safe harbor, and profit-sharing plan to reach savings levels of over \$100,000 per year when a spouse is also employed by the practice.⁵

To design a defined benefit program that is properly funded, it is imperative an individual seek thorough advice from a financial planner. Employers should be aware that contributions are determined each year by an actuary and they are not at the discretion of an employer. In order to embark on a plan of this magnitude,

the practice owner must be confident that a stable cash flow exists to meet all funding obligations and that the plan can be maintained for a minimum of three years. Assuming the plan creation and funding remain sound, the practitioner can expect to receive a maximum benefit level of upward of \$185,000 in addition to any income that may be generated from any potential defined contribution plans that were also set up.

Stage 4: Practicing for 20-plus Years

Two Decades-Plus in Practice

Congratulations are most likely in order after 20-plus years of practice. Assuming one has taken the necessary steps to secure one's financial future, it is time to celebrate. Any additional sum received upon sale of your practice should be considered a moderate to large bonus. If it is determined one's savings are not enough to consider retirement at this point, an individual may want to consider either working longer and rapidly implementing the strategies discussed earlier or potentially consider a practice transition rather than a complete sale. At this stage in one's career, one also should consider strengthening their insurance portfolio by adding a long-term care policy if one has not been purchased yet.

INSURANCE

A long-term care policy will generally cover, partially or completely, the cost of assistance with daily activities like dressing, bathing, eating, or cleaning that are carried out in your home. In addition, coverage for adult day care may be evident, as well as coverage for assisted-living and home nursing services. It is important to understand these types of services are generally not covered by health insurance or Medicare.

In the unfortunate event one is not insured, the out-of-pocket long-term care costs can easily deplete a lifetime of savings. When reaching middle age, one should consider purchasing a long-term care policy. If an individual waits to attain this policy until they are much older, premiums may be very high and there is a much higher risk for disqualification from any such plan as a result of a major change in health status.

RETIREMENT PLAN

At this stage of one's career it is reasonable to enjoy the fruits of one's labor. An individual must continue to evaluate their savings and lifestyle to assure themselves they will not outlive their savings. On the contrary, if a proper plan has been put in place it is very likely one's savings will outlive the individual. If one has a goal that the assets outlive them, they should put an estate plan in place that will properly transfer assets with minimal tax consequences to the individual's family and favorite charities.

The good news is that in 2008, an estate valued at \$2 million could be left to heirs tax-free. In 2009, this figure increases to \$3.5 million, and by 2010 estate tax may be repealed altogether.

In the event one's estate exceeds these exemption limits, the individual's estate may owe taxes on the order of 45 percent of every dollar over the exemption limit. Assuming an estate is worth \$5 million and this amount is transferred directly to your spouse upon your death, no federal estate tax would be due because unlimited marital deduction enables an individual to transfer assets tax-free to their spouse at the time of death.

Unfortunately, at the time of the remaining survivor's death, substantial taxes would be due in today's environment. If a \$5 million estate is trans-

ferred to someone other than a spouse, \$1,350,000 would be due in estate taxes alone in 2008. On the other hand, if the initial estate planning strategy had been set up to skip a generation, tax liabilities could be greatly minimized. A partial transfer of the estate can pass directly to the children after the death of the first parent free of estate taxes, and the second estate transfer can occur at the passing of the second parent with potentially no estate taxes due.

In the event estate taxes become repealed, this level of planning may not be necessary. However, proper estate plan-

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ning at the least will decrease the chances of government involvement. A properly developed estate plan that includes a trust as well as a last will and testament will prevent the estate from entering probate and tying up the assets one has worked so hard to accumulate with the intention of transferring them to their loved ones.

Attaining financial security is not something that was guaranteed when students received their acceptance letter into dental school. The primary reasons for acceptance into dental school were because an individual demonstrated the attributes of being dedicated and to think critically. Each and every day a practitioner is asked to think critically and invest in the well-being of their patients. In addition to taking care of patients, dentists

must also think critically about securing their own future and be dedicated to developing a plan to attain financial security. It also is important to realize that as dentists we are trained to care for patients and most of us will need professional help from trained individuals to allow proper long-term financial planning.

It is important to keep in mind the information presented in this article simply is a discussion about financial planning and should not be used as professional advice. The reader should work with their team of financial, insurance, and legal advisers to make these important decisions. ■■■■

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