Doctors Betrayed By Non-Traditional Financial Strategies

A reader sent me a link to a recent article published in Physician News Digest called “Doctors Betrayed By Traditional Financial Strategies.” I felt there were enough inaccuracies and poor assumptions in the article that it merited a discussion on the site. I apologize in advance for the length, but it was a lengthy article and contained plenty of statements worth discussing.

The basic gist of the article can be summed up in this statement:

In general, [mainstream financial media] fear that providing content generated for [a] few high-income readers will “alienate” their average readers and the advertisers who pay good money to reach a specific audience. Practically, what this means for physicians is: Financial and legal advice you get from print and online media and from large national firms is most likely not appropriate for physicians!

While there is some truth in the statement, this is usually the first sentence out of the mouth of an adviser who specializes in fleecing physicians. Sure enough, the next two paragraphs are a thinly-veiled plug for the authors’ physician-focused advisory firm. I’d like to comment on the points in the article one by one.

Ways In Which The “Average American” Is Different From The Average Physician

The authors state that:

Most legal, accounting, insurance and investment strategies
have been created for:

1. The average American family whose annual income tax liability is less than 12%.
2. The 98% of American families who will NEVER owe any estate taxes.
3. An employee, not an employer, who will likely never be sued and who has no control over the choice of legal entity or type of retirement vehicles the employer will utilize.
4. Someone whose income is based on productivity, NOT government regulation.

I’d counter with the following 4 points to this strawman argument:

1. I paid 8% in federal income tax liability last year on more than the average physician salary. Even with state taxes added in, I was only at 12%. This was using only what I would call “traditional financial planning” techniques (no fancy trusts, incorporating, or insurance-based investment products.)
2. 98% of doctors will never owe any estate taxes. Think I’m wrong? You and your spouse can die this year with $10 Million before you owe a dime in estate taxes. How close is your nest egg to $10 Million? That’s what I thought. I could retire quite well on a quarter of that, and many docs won’t even have that much.
3. Many doctors, more each year, ARE employees without a choice of legal entity or type of retirement vehicles the employer uses. Even for those who are not, the types of retirement plans available are no different for physicians than for other professionals making similar money. The scare tactic “doctors are likely to get sued” is frequently used. The authors, however, leave out the fact that in most states, most retirement plans are protected from creditors, not to mention the fact
that even in a successfully prosecuted malpractice suit (the kind most doctors are worried about), it is exceedingly rare for the physician to pay out anything beyond his policy limits.

4. This point is almost entirely irrelevant to the rest of the article, but it is still wrong. While our industry IS highly regulated, many of us are still paid on productivity. The fewer patients our partnership sees and the fewer procedures we do, the less we’re paid. I understand that many doctors are salaried or on a straight hourly rate, but there are still plenty of us paid directly for the amount of work we do.

Conventional Wisdom IS Your Friend

The authors then spend several paragraphs flattering physicians that they are so special they need specialized advice (preferably from their firm I’m sure is their hope.) The fact is that “conventional wisdom” usually is your friend. Spend less than you earn, minimize your taxes, minimize your investment expenses, insure against financial catastrophe, don’t mix investing and insurance, capture market returns, set goals and track your progress toward them. Which of these doesn’t apply to physicians? None of them. Yet I’d call them all “conventional wisdom.” With regards to personal finance and investing, 95% of advice aimed at middle class America works just fine for the average doctor, who has much more in common with the engineer down the street than with a professional athlete or CEO of a large firm.

The authors of the article give five suggestions that are counter to “conventional wisdom.” Let’s look at each of them.

You Should Incorporate To Save Taxes and Protect Your Assets

I’ve written before about how using an S Corporation can save you some money on taxes. Unfortunately, it isn’t all that
much money for most physicians, since all you’re saving is a part of your payroll taxes, 2.9% of up to half of your income. Incorporating doesn’t protect you much from malpractice suits but would protect your personal assets from any non-malpractice professional lawsuits. It would also protect your practice from any personal suits. It certainly isn’t the panacea it is often marketed as by those who profit from forming the corporation. The article suggests the typical physician can save $5-50K by incorporating. That seems a gross exaggeration to me. The average physician makes $200K and pays less than $50K in income taxes. Incorporating certainly isn’t going to wipe out your entire tax burden. Later in the article the authors discuss turning your practice into a C corp. This is inappropriate for most physicians as I’ve previously written about. If you want to incorporate, that’s fine (I think I probably will), but realize the benefits for the typical physician are pretty limited and may not be worth the hassle to you.

You Shouldn’t Own Anything In Your Name Or Jointly With Your Spouse

The authors suggest you should put all your assets into LLCs and living trusts to avoid lawsuits, save probate fees, and avoid estate taxes. Toxic assets such as rental property absolutely should be put into an LLC and using a trust does help you avoid probate. However the revocable trust you would probably use to avoid probate fees isn’t going to protect the assets inside it from lawsuits, and even if it did, you probably wouldn’t need it because malpractice and personal liability insurance will likely cover any suits brought against you. I’ve already mentioned that most doctors, even two-physician couples, are unlikely to pay any estate taxes under current law. The authors seem inappropriately attached to solutions that require an attorney to set up- the typical LLC and trust. The fact is that many assets can be transferred outside of probate by proper beneficiary
designation and titling. Remember those beneficiary designations you made for your 401K, IRAs, and life insurance? They don’t need to be in a trust. In many states, your home can be titled as “William and Sue, Husband and Wife, tenants by the entirety”, essentially protecting it from any lawsuit brought against only one of you (such as a malpractice suit.)

Don’t Waste Time And Money On Qualified Retirement Plans

The authors again argue that “doctors are different” because they will have greater taxable investments (possible, but I don’t have any significant amount)), will receive more social security income in retirement (not much more due to the progressive nature of the SS program), and may pay so much tax in retirement that they could actually pay more later than they are saving now with their pre-tax retirement contributions (highly unlikely given current savings rates among physicians and the fact that withdrawals are done at your effective rate, not the marginal rate you saved the taxes at when you contributed to the account). They further argue that qualified retirement plans (think 401K, profit-sharing plan, or defined benefit plan) are encumbered by ERISA, DOL, and IRS laws (none of which are serious hassles to most doctors). Their suggestion to avoid all these issues? A non-qualified plan.

A single click can bring
Peace of Mind
Keep your family strong and healthy with affordable Health Insurance

What’s a non-qualified plan you may ask? One which doesn’t
give you that up-front tax deduction. Why would you ever want to use one? Mostly because qualified plans have to pass the non-discrimination test, meaning you have to provide some retirement benefits to your employees. If your goal is really to pass up a current tax break in order to avoid providing any retirement benefits for your employees, then a non-qualified plan may be for you. Keep in mind that the assets in that plan are subject to the creditors of your practice, unlike a qualified plan. Once most physicians understand these plans, I think few will use a non-qualified retirement plan instead of a qualified one, although some high-income docs may choose to use both. You should be aware that many of these non-qualified plans involve purchasing expensive, complicated insurance products. It really made me chuckle when the authors suggested you could “deduct $1,000,000” using these plans. It’s like they have no idea how much the typical physician makes. They base the whole article on the assumption that doctors are vastly different from 95% of Americans, yet many of their ideas shouldn’t even be considered by 95% of physicians.

Doctors Are Giving Away Tons of Money Unnecessarily To The Taxman

After a brief discussion of how tax deductions work, the authors leave the reader with the idea that he’s leaving a ton of money on the table. Their suggestion to incorporate mentioned earlier doesn’t allow you any significant deductions above and beyond what you can take on Schedule C as a sole proprietor. Their only specific suggestion, to pre-pay your long-term care insurance premiums so you can deduct it from your business expenses doesn’t make sense for the vast majority of doctors. First, you must be a C corporation to take a significant deduction, which isn’t usually worth the additional tax cost and hassle. Second, any physician making enough money to actually benefit from a C corp can afford to self-insure against this expense. The extremely wealthy
doctors this article seems aimed at (who apparently are going to have more than $10 Million at death and so need to worry about estate taxes) can certainly fork out for long-term care (if needed) using the assets in their portfolio.

At the end of this section, the authors allude to an apparently magic retirement account that allows large contributions, can be accessed before age 59 1/2, only includes the doctor and can help with asset protection and estate planning. That sounds an awful lot like whole life insurance, but if you want to find out for sure, the authors kindly include their firm’s phone number in the next sentence. I was not surprised the authors didn’t mention all the ways you can access your money in qualified retirement plans before age 59 1/2.

Don’t Waste Money on Taxes and Term Life Insurance Premiums

In the last section the authors set the hook, unabashedly pushing cash value life insurance as the solution to your problems. “Buy term and invest the rest” is only for the “Average American” (not you.) Then they go through the usual tired arguments for why you should buy permanent life insurance. I particularly love the strawman argument set up at the beginning.

The Average American has little need for cash value life insurance [because he has] the following characteristics:

- I have no concern over lawsuits against me, my partners, my employees or my family.
- I am not worried about 23% to 47% of my investment income going to taxes.
- I don’t mind 40%-70% of certain assets in my estate going to taxes when I die.

The assumption, of course, is that physicians somehow have all
these liability risks that can’t be reduced in ways other than cash value life insurance, have all their investments in taxable accounts and will be in the highest tax bracket in retirement, and that physicians will somehow be subject to estate taxes. None of those apply to me, and I bet none of them apply to you. Of course I’m concerned about lawsuits, that’s why I spend thousands of dollars a year on malpractice and personal liability insurance. Am I concerned I’ll be sued above my limits? Not really. Not to mention almost none of my assets are reachable in a malpractice suit since they’re in IRAs, in 401Ks, or titled as tenants by the entirety.

The authors then use an example where cash value life insurance apparently allows a doctor to withdraw more money in retirement than investing in a taxable account. They assume your money in cash value life insurance will grow at 7%. Even if the dividend rate remains at 7%, which is unlikely given our low interest rate environment, that rate isn’t applied to your entire contribution, especially near the beginning of the policy. They also assume your investment tax rate is 37%, which is vastly overstated. Remember that the current federal tax rate on dividends and long-term capital gains is 15%, and that’s only on the amount above and beyond your basis. Even adding on state tax it’s quite a stretch to get to 37%. Then they attempt to suggest that the cost of term insurance should be subtracted from the investment returns, but never mention the fact that the HIGHER cost of the permanent death benefit is subtracted from your insurance returns. Nor do they mention that you get EITHER the death benefit or the loans from the cash value, NOT BOTH. Nobody making a fair comparison of cash value life insurance to the expected return from risky investments like stocks ever concludes the insurance comes out ahead as an investment.

**Conclusion**

Now don’t get me wrong. I would hope that if the average physician walked into the office of the authors that they
wouldn’t implement most of the strategies suggested in this article. Some of these strategies can make sense for very highly compensated physicians (think $750K+). However, conventional wisdom is usually right, even for physicians, and certainly for the average physician. This article unfortunately serves much more as an advertisement for the authors’ business than as a source of useful financial information for the typical doctor. If the authors would like to offer a rebuttal to my criticisms, I invite them to do so in the comments section or in a guest post.

What did you think of the article? Advertisement or useful advice?