

Your FINANCIAL HEALTH

A digest of money management tactics for the family physician

Spring 2002

2002-2010 Profiting from the decade of opportunity

We could be entering the most confusing decade in the history of tax and estate planning this country has ever seen, courtesy of “The Economic Growth and Tax Relief Reconciliation Act of 2001.” Fortunately, along with the confusion come opportunities. But, quite literally, you need to make hay while the sun shines.

That’s because the new law included a “sunset” provision. This means that, unless Congress takes action, all the new law’s tax cuts and qualified plan increases – everything – will expire at the stroke of midnight on December 31, 2010, when the clock rolls back to 2001 levels.

The good news is that we have several years of opportunity to boost savings and take advantage of reduced taxes to enhance our financial positions.

The bad news is that taxes and contribution limits keep changing...and changing. Look at IRA and qualified plan contributions, for example. Under the new law, maximum IRA contributions steadily increase from \$2,000 per person per year in 2001 to \$5,000 per person in 2008. There are also increases for 401(k), SEP and SIMPLE plan contributions, plus additional amounts that can be contributed under “catch-up” provisions for men and women over age 50. Then, suddenly, on January 1, 2011, all the increases disappear.

Estate taxes pose a unique set of problems. The top rate for estate taxes in 2001 was 55%, with a \$675,000 exemption. The rate gradually drops and the exemption rises. So, in 2009, the top rate is 45% and the exemption is \$2 million. Then in 2010, poof! The estate tax drops to zero, disappears completely. BUT the next year, 2011, the new law sunsets, returning the maximum estate tax rate to 55%.

FEDERAL ESTATE TAX RATES

YEAR	TOP RATE	EXEMPTION
2001	55%	\$ 675,000
2002	50%	\$1,000,000
2003	49%	\$1,000,000
2004	48%	\$1,500,000
2005	47%	\$1,500,000
2006	46%	\$2,000,000
2007	45%	\$2,000,000
2008	45%	\$2,000,000
2009	45%	\$2,000,000
2010	ZERO	NOT APPLICABLE
2011	55%	\$675,000 or \$1,000,000

So, as the law appears to stand, if a person with a large taxable estate dies on December 31, 2010, there will be zero estate tax consequences. However, if that person lives just one more day – dying on January 1, 2011 – there could be a massive estate tax liability.

However, “what will actually happen is hard to predict,” stresses Leo C. Hodges, JD, CLU, ChFC. “Between now and then, we will have five Congresses and two or possibly three presidents.” Hodges is Executive Vice President and Director of Advanced Underwriting for the Pentera Group, Inc., an organization that provides training, education and marketing materials for the insurance industry.

In the meantime, Hodges points out, you can expect some confusion. “For instance,” he explains, “there are different interpretations over the estate tax exemption. No one seems to know for sure whether it will return to \$675,000 or \$1 million in 2011. This creates uncertainty, since the estate planning rules, for example, are in a state of flux.”

As a result, Hodges concludes, “An estate plan that was appropriate today or even several years from now may not work at all ten years in the future. This throws a wrench into the whole concept of long-term planning.” As a result, estate planning has to go pretty much year by year.

How can you profit from this decade of opportunity? Consider the following:
1. Take advantage of the increasing contribution limits for IRAs. Make the maximum contribution allowed each year.

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What's your doomsday date?

How financially secure is your life-style... your family's standard of living? The answer has little to do with how much you earn or the size of your house. Instead, it can be determined by the following simple formula:

$$\text{Cash \& Liquid Assets} \div \text{Monthly Expenses} = \text{Doomsday}$$

The result is your **DOOMSDAY DATE**, the exact time in the future, measured in months, when – if your income stopped *today* – you would be broke; unable to pay your bills without dramatically altering your lifestyle.

Example: If you have \$16,000 in cash, savings accounts, money market accounts, etc., you may feel you have a respectable chunk of change for emergencies and major expenses. But if your household expenses each month come to \$8,000, your Doomsday Factor is 2...meaning your family has enough cash set aside to survive 2 months.

The point: What if you had a major emergency, became disabled...or died? Your family's standard of living, which has taken you years to achieve, could disappear almost overnight.

What to do:

1. Start building up your savings today ...a little at a time. A Doomsday Factor of 3 to 6 is a reasonable, safe goal. This has nothing to do with long-term accumulation such as that associated with retirement planning and college education funding. Call it cash flow management...and the payoff is that, by building up a cash cushion, your household will become more financially stable.

To calculate your current Doomsday Factor, add up your total household expenses. (If you have a budget, take that bottom-line figure; if not, use this process as the starting point for developing one...killing two birds with one stone.) Next, add up all your cash and semi-liquid assets.* Then calculate your Doomsday Factor and translate it into an actual date. (If your Doomsday Factor is 2 as of April 1, your Doomsday Date is June 1.)

2. Own adequate disability insurance.

Cash on hand can only take your family so far. That's why insurance is so important... to back up your savings and carry you through a long-term disability.

3. Purchase Practice Overhead Insurance if you are self-employed or have partners. This coverage will help you meet your professional expenses if you become disabled.

4. Don't forget the need for life insurance to replace your income and take care of your family if you die during your income-earning years.

Carrying out these steps can push back your Doomsday Date well into the future. But more than that, it lays the foundation for your family's comprehensive, long-term financial security...no matter what the future may be. ■

*Liquid assets include emergency funds, savings and other assets that can easily be converted to cash to meet expenses.

Decade of opportunity *Continued from the cover*

If you're age 50 or older, use the IRA catch-up provisions. Make your contributions early in the year, so your investments have the maximum time to grow.

IRA MAX CONTRIBUTIONS (AGE 50+)		
YEAR	CONTRB	CATCH-UP CONTRB
2001	\$2,000	ZERO
2002	\$3,000	\$500
2003	\$3,000	\$500
2004	\$3,000	\$500
2005	\$4,000	\$500
2006	\$4,000	\$1,000
2007	\$4,000	\$1,000
2008+	\$5,000	\$1,000

2. Annually review and revise your estate plans, urges Hodges. Routinely schedule a meeting with your attorney and/or tax advisor so your plan can keep pace with the year-by-year changes under the existing law.

3. Watch for new changes in the coming years, as Congress tinkers with, cancels or extends the provisions of the 2001 law.

The bottom line: "All of us can applaud the sunset concept in theory," says Hodges, since its original intent is to show fiscal responsibility. "However, failing to keep abreast of changing limits and legislation can cause major problems for taxpayers." ■

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Divorce can be a financial disaster. Generally, when the decision is made to call it quits, the focus can quickly shift to money. The result can be a financial slugfest, even in so-called amicable breakups. Everybody loses, except, perhaps, the attorneys.

It need not be that way. Few people would ever find the divorce process fun. Nonetheless, it need not turn people's lives into a financial wasteland.

Divorce is expensive, as many of the more than one million couples who call it quits each year will tell you. Exact figures are difficult to come by, says Lynne Diamond, president of a consulting firm called Divorce Wizards. "By best estimates," Diamond told *Your Financial Health*, "the average cost is about \$18,000 a person." That's just for legal fees.

High-conflict divorces, in which large assets are involved, can push the price through the roof, says Laura Johnson, family law consultant and author of *Divorce Strategy: Tactics for a Civil Financial Divorce* (Broken Heart Publishing, 1998). According to one example she cited, the final price tag came to more than \$200,000. Worse, the conflict can go on for years.

Why does divorce cost so much?

One recognized factor is the connection between the emotional pain of divorce and its impact on finances. Divorce can lead to mental depression and emotional instability. In fact, the rate of depression is nearly three times higher among divorced men and women than with married couples who have never divorced, according to a "Fact Sheet On Divorce in America," by Glenn T. Stanton.¹

Additionally, it is not uncommon for job performance and productivity to fall off dramatically between stress, lawyer meetings and time taken to build a new life. This is perhaps why, "If you hire a divorce lawyer today, there is a good chance you will hire a bankruptcy lawyer within two or three years," says Diane Sollee, with the Coalition for Marriage, Family and Couples Education.²

• **Speed.** They rush the process. Either husband, wife or both are so eager to end the marriage or end the pain of divorcing that they make rash, hurried decisions, often with terrible consequences down the road.

• **Delegation.** They let the lawyers run the show. Many attorneys will attempt to wage a paper war. This can pump up their fees, at the expense of the divorcing couple.

There are ways to help keep your costs under control.

While divorce, almost by definition, creates an adversarial situation, it need not become a financial disaster.

1. "Try to cooperate with each other," says Diamond. "No matter how painful it may be, try to reach your own deal, which the attorneys simply implement."

2. Try collaboration. "Collaborative law is an innovative approach by lawyers to remedy some of the divorce litigation process," says Matlock.³

3. At the same time, unless you have few assets and no children, don't try to do it yourself. Use attorneys, says Diamond. In some states, mediators can be hired. They can save you money.

4. Put everything in writing. Make no verbal side deals.

After the divorce, there are things you should do to protect yourself financially. These include:

1. Revise your will. In some states, a divorce automatically voids a will. Regardless, meet with your attorney and update your will so it reflects your current situation.



The finances of divorce

Among other reasons for the high cost of divorce:

• **Anger.** "There is an attitude of I-will-divorce-you-to-death," says Diamond. "They try to destroy each other. The result is mutual self-destruction."

It's not uncommon for "divorcing spouses to lose sight of the fact that severing marital ties and dividing the marital estate is the purpose of the divorce process," Robert J. Matlock, Dallas-based marital law attorney, explained in an interview with *Your Financial Health*. "They hope to use the divorce suit as a means of meting out punishment."

• **Ignorance.** Not understanding the process, the couple make expensive mistakes.

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¹ "Why Marriage Matters: Reasons to Believe in Marriage in Post-Modern Society," (Pinon Press, 1997).
Web site: http://www.smartmarriages.com/divorce_brief.html.

² "After the Split," *The Kansas City Star*, August 16, 1998.

³ For additional information on collaborative law, visit www.dallascollaborativelaw.com.

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Financial Footnote

Is a college degree worth the cost? You bet it is. Median earnings for men and women with high school diplomas are \$17,148, reports the U.S. Bureau of Census, 1997 (latest figures available). Earnings for those with a bachelor's degree are more than double that figure – \$36,525.

Divorce *Continued from the inside*

2. Update your life insurance and pension beneficiary designations. Make sure all the names are right. Especially if you have children, your responsibilities to them continue, and you may need additional insurance.

3. Get disentangled credit-wise. Be sure all joint credit cards have been cancelled and new ones issued in your name only. Otherwise, your liability for your ex-spouse's bills will continue.

4. Review your retirement assets. It is not uncommon for a judge to divide IRAs and pension money right down the middle. Over night, your retirement assets could be cut in half.

There are very few winners when a couple divorces. The cost in emotional pain and suffering, as well as dollars and cents, can be extreme. The process can also go on for years. Still, by cooperating and learning the "rules," you both can come out in reasonably good shape. ■

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