*Your* FINANCIAL HEALTH

A digest of money management tactics for the family physician June 2002

# How the new tax law benefits you

"The Economic Growth and Tax Relief Reconciliation Act of 2001" did more than cut tax rates. Especially if you're over age 50, it created a window of opportunity to boost your retirement savings and improve your qualified plan distribution options. Plus, new qualified plan distribution rules make it easier to take your retirement money without penalty.

The new law raises contribution limits across the board, and adds "catch-up" provisions for men and women age 50 or older, says Anne Shropshire, CLU, Associate Publisher with Dearborn Financial Services, Inc. "There are opportunities to take advantage of now and over the next decade," she said in an interview with *Your Financial Health*.

**First, pump up your IRA contributions.** All eligible individuals can gradually increase contributions from last year's $2,000 maximum to $5,000 by 2008. Plus, if you are over age 50, you can make "catch-up" contributions into your IRA, starting with $500 in 2002, up to $1,000 by 2006.

| YEAR | IRA MAX CONTRB | CATCH-UP CONTRB (AGE 50+) |
|---|---|---|
| 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 |

**Second, take advantage of employer-sponsored plan "catch-up" provisions.** If you're over age 50, the catch-up provisions increase the annual limit on elective deferrals to qualified cash or deferred arrangements — which include 401(k) plans, 403(b) plans, and section 457 plans sponsored by state and local governments (though not tax-exempt organizations) — by $1,000 a year, beginning in 2002, reaching $5,000 a year in 2006.

**"To say the least, this is a huge benefit for affluent individuals..."**

**How these numbers can add up:** Let's say you are 50 and plan to retire at age 65. Here are the before-and-after numbers:

**HOW AN IRA WILL GROW FROM AGE 50 to 65, ASSUMING MAXIMUM ANNUAL CONTRIBUTIONS**

| | OLD LAW | NEW LAW |
|---|---|---|
| TOTAL CONTRIBUTIONS TO AGE 65 | $30,000 | $79,000 |
| TOTAL ACCOUNT VALUE AT AGE 65 | $52,236 | $134,422 |

Assumed average rate of return: 7.5%, compounded annually. Also assumes maximum contribution limits will continue beyond 2010. This example is hypothetical only and not indicative of any particular product performance.

Contributions under the new law include $66,000 in standard IRA contributions plus $13,000 in "catch-up" contributions over 15 years. The payoff: more than $82,000 in additional money waiting at age 65.

For SIMPLE plans, the limits increase annually by $500, starting in 2002, until the catch-up amount reaches $2,500 in 2006.

Once again, these increases are on top of general plan increases for all qualified individuals. Under these increases, contribution limits for 401(k) plans, 403(b) plans and salary reduction SEPs go from $10,500 to $15,000 by 2006. Additionally, maximum annual deferrals to SIMPLE plans will increase from $6,000 in 2001 to $10,000 by 2005.

*continued inside*

*For the private and group practitioner:*

# Practice overhead coverage makes good business sense

**If you're in solo or small group practice,** you're both a doctor and a business person. You must know how to read a balance sheet as well as an x-ray report; diagnose an employee's job performance in addition to a patient's illness; understand the risks and rewards of your financial decisions as clearly as those associated with your medical decisions.

**Just as important, you rely on insurance** as a cost-effective tool to reduce risk. That's why, you carry malpractice insurance, medical insurance, property and casualty insurance, and life and disability coverage. These coverages will replace income and reduce losses if the unexpected occurs.

**Still, you should consider one more issue: What would happen to your office if you became disabled?** In all likelihood, your individual or group's income would be reduced or stop immediately, while the overhead expenses of running the office would continue. Your disability insurance, medical insurance or property insurance will not pay these practice overhead expenses.

**Where would you find the money** to meet the payroll? Would you be forced to let employees go? How long would you be able to keep paying the rent or mortgage? What would happen to your patients? What would happen to your employees? What would happen to the practice you may have spent years building?

**You could shut down temporarily**, with the intention of rebuilding — possibly from scratch — when you're able to return to work. However, while this decision would definitely cut your expenses, it would also throw your employees out of work and tell your patients that your practice is closed. The hard fact is that, if you shut down your practice, the odds are that you will never return to private practice again.

**You could shoulder the cost of keeping it open from your personal savings...**and hope you're back on your feet before you're out of cash. Remember, however, that you are disabled and unemployed, and the cost of keeping your practice open can run well over $100,000 a year, depending on its size. In all likelihood, you need to conserve your resources, not continue paying thousands of dollars of monthly expenses. No matter how well-intended, this "solution" could easily lead to financial ruin.

**You could ask other doctors to come in**, perhaps on a rotating basis, to see your patients. This might work, but generally as a last resort. Like you, most doctors are already busy to the point of overwork. Such a jerry-rigged solution might work for a month or two at best. While you will most likely want to refer patients to associates during your disability, they would most likely prefer to see them in their own offices, using their own staff. In short, you have not solved the problem of keeping your office up and running.

**You could purchase practice overhead insurance coverage**, which can pay all or a portion of the expenses of keeping your office open and functioning, awaiting your return. This is generally the most practical, cost-effective solution to the problem.

**Among the benefits of a quality practice overhead policy** are the following:

• Premiums are based on age and health and can be as low as several hundred dollars a year. Plus, they are fully tax deductible as a business expense.

• Benefit payments can be arranged to cover up to 100 percent of your office expenses, with cash to pay your office rent or mortgage, staff salaries, utilities, loans for equipment and more. Benefits can also pay professional dues, property taxes and your malpractice insurance premiums.

• Benefit periods of up to several years in many cases are common.

**The bottom line:** With the right practice overhead coverage, your practice may not have to shut down if you are laid up.■

**Check out your Academy's Practice Overhead Insurance Plan** featuring attractive rates underwritten by New York Life Insurance Company, NY, NY 10010 on Policy Form GMR. For details, **contact AAFP Insurance Services at (800) 325-8166**. We'll mail you information about the policy's features, costs, eligibility, renewability, limitations and exclusions. That way, you can make your own informed decision in the privacy of your home or office. There is no cost or obligation.

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# Children and WORK

**Millions of teenagers join the work force each summer.** Some end up in situations that are illegal, could cost them money or, worst of all, put them in physical danger.

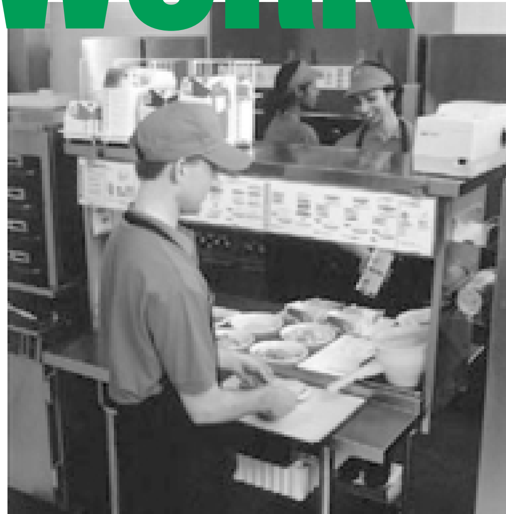
**The problem:** Many teenagers, their parents, even their employers, don't know the ins and outs of their state's child labor laws.

**How can you protect your children** as they begin their summer jobs this year? The laws vary from state to state, but here are some guidelines:

• **Learn about your state's child labor laws.** Federal and state laws regulate the types of work children under 18 can perform, the machinery they can use, maximum hours, breaks, etc. Federal law, for example, prohibits minors from driving vehicles as part of their jobs. Some states also require work permits for minors. Contact the Department of Labor for the specifics in your state.

• **Make sure it's on the books**...and on the up and up. Some employers may want to pay cash, off the books, to keep their records simpler. But that's illegal. Worse, if your child is hurt or causes damage, he or she may not be covered under the employer's insurance.

• **Have your child get all terms in writing**... including wages, first and subsequent paydays, and, if possible, a job description. Many teens won't ask these kinds of questions. As a result, they may go weeks before they know their hourly wage.



• **Review your child's pay and check stubs** for all deductions from wages. Employers cannot unilaterally take deductions for a broken dish, a cash register that comes out short, or an accident in the company car...even if the employee is at fault. Nor can employees be shorted if they quit. They **must** be paid for all hours worked. Also make sure proper taxes are being taken out of the paycheck.

• **On the clock means just that.** Employees cannot be asked to work after they've punched out. This is the most common complaint registered against employers.

• **Talk to the boss** about missunderstandings... sometimes they don't know the laws themselves.

**The bottom line:** Just because a child is old enough to work doesn't mean that he or she knows the laws. Parents usually teach children their obligations as workers; for their own sakes, they also need to learn about their rights as employees.■

## Financial Footnote

**Even teenagers can set up IRAs**, provided they have incomes. This is a good way to build long-term security on a tax-deferred basis. This year, they can contribute the lesser of their total annual earnings or $3,000 to a traditional or Roth IRA. If they don't have the cash, you as a parent or grandparent can make all or part of the contribution for them in their names.

## New tax law *Continued from the cover*

Plus, beginning in 2002, the limit on annual additional payments to a defined contribution plan will increase to $40,000 (from $35,000), while the annual limit on benefits paid under a defined benefit plan will rise to $160,000 (from $140,000).

In short, between the "catch-up" provisions for IRAs and employer-sponsored plans, the increased numbers become fairly significant, creating a golden opportunity to help pump up retirement savings.

**Third, IRS minimum distribution regulations were changed.** If you are at or beyond age 70 ½, you need to review your qualified plan distribution options. Under the old regulations, you had to select your Required Minimum Distribution (RMD) option before your distributions began. Once elected, your option was locked in for good, even if your beneficiary died or you divorced, explains Shropshire. "The rules were complicated and difficult. Most of all, this caused major problems at death."

"That has all changed," says Shropshire. "Now, there are no more elections. Your minimum distribution is based on a uniform distribution table." (There are some exceptions, such as if your spouse is more than 10 years your junior.) "For the majority of people, this means that, while you can take as much as you like, your required distribution is less every year."

**More on distribution rules:** In the past, says Shropshire, qualified money was distributed at death. "Now, however, distributions can be stretched over the life of the beneficiary. If you make your granddaughter the beneficiary of your qualified money, she can receive benefits over her entire life."

**"To say the least, this is a huge benefit** for affluent individuals," stresses Shropshire, "creating a need for post-death planning in many cases."

**One word of caution:** All the provisions of the 2001 law are scheduled to "sunset" at the stroke of midnight on December 31, 2010. While nobody really knows what will happen between now and then, it is important to take advantage of these provisions while they are the law of the land to salt away as much money as possible between now and then for your retirement.

**Recommendation:** Contact your accountant for details about the new contribution limits and distribution rules.■

# *Your* FINANCIAL HEALTH

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*J. Thomas Koch, President, AAFP Insurance Services*

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Thank you for the opportunity to be of service to you.

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