FOUR TACTICS TO REDUCE TAXES AND SHIELD WEALTH FROM LIABILITY


Sometimes, you can have the best of both worlds with these financial tips and tricks.

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Many physicians, including retina specialists, would rank tax reduction at the top of their financial planning goals—with asset protection not far behind. Tactics that can result in both benefits would naturally be of high interest. Here, we briefly describe four common options you can employ to reduce your taxes while also protecting your assets.

LEVERAGE THE PRIMARY RESIDENCE

If the adage is "a man's home is his castle," that castle may enjoy both asset protection and tax benefits. Regarding asset protection, nearly every state protects some, or all, of a home's equity from lawsuits and creditor claims. State laws do vary significantly here, ranging from no protection in New Jersey to protection of an unlimited amount of home equity in states such as Florida and Texas. Be sure to check with an asset protection expert to understand how your state's homestead law protects your home equity.

The tax benefits of home ownership are consistent in all states and include the ability to write off mortgage interest (with limitations), as well as a $500,000 capital gain exclusion for a married couple on the sale of a home ($250,000 for single filers). In addition, local property taxes on a primary home can be deductible against your federal income tax, although that deduction has become more limited in recent years.

FOCUS ON RETIREMENT PLANS

From a tax point of view, qualified retirement plans (QRPs) and IRAs all provide a current tax deduction against a retina specialist's income, so they are extremely attractive for tax planning. In fact, these tax deductions can range anywhere from approximately $20,000 for 401(k)s to $200,000 or more for certain types of defined benefit plans.

In terms of asset protection, these plans often have the highest level of creditor protection under state law. Of course, there is variation between all 50 states, and some states provide the highest level of protection only for a limited dollar amount. Nonetheless, for most states, this protection is at an unlimited dollar level. Check with an asset protection expert on the protections in your state.

IRAs are technically not QRPs, although they act like them in many financial and tax respects. A simplified employee pension IRA can provide the same tax deduction level as certain QRPs, while a Roth IRA has a different tax treatment but is also beneficial. A Roth acts more like a non-qualified plan in that there is no deduction for contributions, but the assets grow tax-free and come out tax-free.

DON'T FORGET ABOUT NON-QUALIFIED PLANS

Physicians use non-qualified plans less often than QRPs, which is unfortunate. When it comes to tax protection, non-qualified plans work similar to a Roth IRA: There is no deduction for the contribution, but the funds grow tax-free

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in the plan and can come out tax-free in retirement. In fact, many doctors, when asked, would like to put more into a Roth IRA-type vehicle yet fail to consider a non-qualified plan—a tool that could achieve this objective.

Non-qualified plans often fund into a permanent life insurance policy. Thus, the level of asset protection is dictated by state rules regarding permanent (also called cash value) life insurance.

The other benefit of a non-qualified plan is that it is quite flexible. Unlike a QRP, the non-qualified plan does not need to be offered to any employees. It can be completely discriminatory. In this way, a practice can sponsor a non-qualified plan just for the physicians, just for partners, or just for a few doctors who want to participate.

CONSIDER PERMANENT LIFE INSURANCE

Permanent life insurance is shielded to some degree from creditors under state law. Once again, these exemptions vary significantly between the 50 states.

From a tax point of view, the benefits are consistent throughout the United States because they emanate from the federal tax code. These include the ability for the cash value of permanent policies to grow tax-free and, if managed properly, be accessed tax-free. Death benefits paid to beneficiaries are also generally income tax-free under Section 101 of the code.

Further, the IRS allows for the tax-free exchange of these types of policies, using a like-kind exchange. You may have read about such tax-free exchanges when it comes to real estate, but life insurance is another asset class favored with this tax benefit. Using this technique can be very beneficial because you could move cash value from one policy to another over time with no taxation. This might be attractive if costs come down, new policies are more attractive, or new features of competing policies are more aligned with your planning.

THINK OUTSIDE THE BOX

If tax reduction and asset protection are important planning objectives for you, be sure to examine each of these four tactics with an experienced advisor and implement the one(s) that are best aligned with your long-term financial goals. ■

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