Doctors Have Many Options for Retirement Savings

For many people, the most important part of financial planning is preparing for retirement. Their goal is to be able to stop working yet still have enough money for a comfortable lifestyle, even if retirement stretches out for decades.

In this area, physicians may have some advantages. "Many doctors have the unique opportunity to be employed by a corporation at the same time they may have some level of private practice," says Diahann Lassus, president of Lassus Wherley & Associates, a wealth management firm in New Providence, N.J. "They may work for a hospital but have a private practice as well. If so, they may have the opportunity to participate in the corporate benefits with a 401(k) plan, profit-sharing plan, deferred compensation, and so on. At the same time, they can establish their own pension plans."

No matter where you invest, you should decide how much money you will have to accumulate for your retirement. Will $100,000 be enough? Will you need $1 million or more? When do you reach the point where you've accumulated enough wealth to support yourself comfortably without earned income?

Whether or not you can "double-dip" in this manner, there certainly are many ways in which you can save for retirement. Employer-sponsored plans allow you to save for your retirement on a tax-deferred basis; you can invest outside of these plans, too, for additional retirement funds.

No matter where you invest, though, you should decide how much you'll have to accumulate for your retirement. Will $100,000 be enough? Will you need $1 million or more? When do you reach the point where you've accumulated enough wealth to support yourself comfortably without earned income?

"You need to get an idea of what you'll want to spend," says Brent Brodeski, managing director of Savant Capital Management in Rockford, Ill. "The rest is math."

In fact, that math can be quite sophisticated. Financial planners often use "Monte Carlo simulations," putting each client's future prospects through various "what-if" scenarios, and those scenarios may be grim. "One of our clients had to go into a nursing facility after retirement." says Stuart Welch III, a financial planner in Birmingham, Ala. "Not only is he paying $6,000 a month to be there, it costs another $9,000 to hire extra help. He has assets, so he can afford it, but these are the types of negative scenarios that may occur."

Two numbers are crucial for calculating how much money you'll need to save for your retirement. First, how much money will you want to spend after you retire; second, how large an investment portfolio have you accumulated. The ratio of these two numbers generally will determine whether retirement is feasible.

Weighing multiple outcomes, including such worst-case scenarios, financial planners hope to find a confidence level of 90 percent or greater that you will be able to maintain your lifestyle to age 90 or beyond. In such calculations, two numbers remain crucial for answering the "how much is enough?" question. First, how much will you want to spend after you retire; second, how large an investment portfolio have you accumulated. The ratio of these two numbers generally will determine whether retirement is feasible.

Playing the Percentages

For some advisers, the maximum amount that a retiree should draw from his or her portfolio is 4 percent a year, assuming he or she is young and in good health. From there, you can back into a retirement goal. Someone retiring at age 70 can be a little more aggressive with the draw, because of the shorter retirement period, so this individual might go up to 6.5 percent or 7 percent.

That is, if you retire at age 60 with a $1 million portfolio, you could comfortably withdraw $40,000, assuming a 4 percent withdrawal rate, while a much older retiree might withdraw as much as $70,000 (7 percent). Retirement projections usually assume

that these initial amounts increase each year to keep up with inflation. Turning these numbers around, in order to retire comfortably, you should accumulate 15 to 25 times the amount that you wish to spend in retirement, if you want to avoid running short of money.

"If you assume a retirement in the 60-65 age range, living until the late 90s, and spending $125,000 to $150,000 per year, after-tax, and there's no pension, you'd probably need $2.5 million to $3 million," says Marilyn Bergen, co-president of CMC Advisers, a financial planning firm in Portland, Ore. She notes that the amount needed would be at the upper end of that range if the portfolio is held mainly in an IRA, because withdrawals probably would be taxable.

Calculate Your Retirement Needs

Performing a retirement savings needs calculation can positively impact retirement planning and savings behavior, according to the Employee Benefit Research Institute (EBRI), a Washington, D.C.-based research organization.

EBRI conducts an annual survey on retirement confidence. In its most recent survey, 44 percent of those who perform such needs assessments say that they have changed their behavior as a result. For example, those who make a calculation report that they're increasing their savings (52 percent), changing the allocation of their money (13 percent), starting to save less (11 percent), researching other savings methods (10 percent), reducing debt (5 percent) and opening new accounts (5 percent).

One tool to help estimate how much you'll need to save for a comfortable retirement is the "Ballpark E$timate," an on-line tool sponsored by ChoosetoSave.org and the American Savings Education Council (ASEC), both programs of EBRI. The Ballpark E$timate comes in two formats—an interactive on-line version that provides instant results and a print version that can be downloaded and printed out. Both are available free on the Web at *www.choosetosave.org/ballpark/.*

Both versions take into account projected Social Security benefits and earnings assumptions on savings. The on-line version allows individuals to customize several key factors in calculating how much they need to save for retirement: how long they think they will live, when they expect to retire and other variables as well.

Are you on track to accumulate a portfolio of $1 million, $2 million or more? And if not, what can be done for your bantam nest egg? Invest in financial stocks and REITs and domestic small-value funds and emerging markets bond funds, the top performers of the last decade, in order to juice up returns? That hardly seems prudent—you shouldn't shoot for higher returns by being too aggressive.

As Dave Foster, of Foster & Motley, a wealth management firm in Cincinnati, puts it, "You might tell yourself, 'I can retire, but in order to meet my spending goals I need to earn 11 percent a year on my investments.' That may work, but I wouldn't count on it."

Each year you continue to work is a powerful variable in reaching retirement goals—it is another year in which you can fund your retirement while you're not consuming assets. If you continue to work, the multiple of spending has to go down, when calculating how much is enough.

Instead of aiming for unrealistically high returns, you should be hardheaded about the choices you face. "It's really important in these kinds of situations to admit, 'I don't think I can retire when I'd like to retire, and live the way I'd like to live,'" Mr. Foster says.

One option that may be practical for many physicians in such a situation is to keep working. Each year you continue to work is a powerful variable in reaching retirement goals—it is another year in which you can fund your retirement while you're not consuming assets. If you continue to work, the multiple of spending has to go down, when calculating how much is enough.

Take the example of Dr. X., who first met with a financial planner about 15 years ago. He had less than $400,000 in assets, and he didn't see how he could afford to retire. So his planner encouraged him to work another year. This went on, one year at a time, for over a decade. The doctor slowly accumulated more assets while he bought some time, and eventually he could retire.

Another possible approach is to liquidate nonfinancial assets to provide additional capital. The continued strength of the housing market may mean that real estate will play a large role in some physicians' retirement plans. "We've looked at reverse mortgages and have found that they're not competitive as financ-

ing arrangements," Mr. Welch says. "However, we have a lot of clients who own two homes. Sometimes selling one of those homes will help provide money for retirement."

Doctors who own just one home also may discover retirement funds there. "We have suggested downsizing a personal residence and even moving to another area of the country where housing is less expensive," says Mr. Welch. "The tax code helps because you can sell a house and exclude some capital gains from your taxable income." This tax break, which applies to a primary residence after two years' occupancy, permits an exclusion of $250,000 for single taxpayers and $500,000 for married couples.

Not every physician will be willing or able to keep working or cash in home equity. Many doctors, though, can increase the pace of pre-retirement investing to build a larger retirement fund.

Investments Held in IRAs, by Type of IRA, 2004

(Percent of U.S. households owning each type of IRA)

	Traditional IRA	Roth IRA	Employer-Sponsored IRA*
Mutual funds (total)	**66%**	**73%**	**52%**
Stock	54	57	38
Bond	27	21	22
Hybrid	21	14	16
Money market	28	20	22
Individual stocks	**39**	**30**	**28**
Annuities (total)	**32**	**17**	**20**
Fixed	24	13	12
Variable	20	12	12
Bank accounts	**28**	**17**	**17**
Individual bonds	**16**	**13**	**13**
Other	**6**	**4**	**2**

*Includes SIMPLE IRAs, SEP IRAs, and SAR-SEP IRAs.
Note: Multiple responses included. Number of respondents varies.

Source: 2004 IRA Survey, Investment Company Institute.

Saving more now can be the difference between driving a Lexus or a Toyota after retirement.

Beyond continuing to work or selling a home, other sources of income should be recognized while seeking the how-much-is-enough number. "The biggest fallacy of using a 4-percent withdrawal rate, which is then indexed for inflation, is that everyone has some income," says Mr. Foster. "A couple might have a goal of $70,000 worth of retirement income, for example. If that couple has $20,000 coming from Social Security benefits, they only need $50,000 from their investment portfolio, and $50,000 per year from a portfolio is a much more reasonable number than $70,000."

You should avoid becoming too conservative with your retirement investments. Over long time periods, stocks have outperformed bonds, and that probably will be true in the future. Giving up on stocks can mean crimping your future lifestyle. Early in retirement, therefore, you should have a blended portfolio that includes a large portion of stocks and stock funds.

You also may rethink some of your views about retirement investing. "I try to retrain people to think about cash flow rather than income," says Eleanor Szymanski, head of EKS Associates, a financial planning firm in Princeton, N.J. "Our whole culture thinks in terms of income, of replacing income in retirement, but it's really cash flow that people need."

Is this merely hairsplitting? Not really, according to Ms. Szymanski. "When people think of income," she says, "they make the connection with fixed-income in their portfolios. They're thinking about interest and dividends, but the amounts they'll receive from those sources can be erratic. By changing the focus to cash flow, we can make them more comfortable about holding equities, where long-term returns may be greater."

On the fixed-income side, says Ms. Szymanski, she likes to construct bond ladders going out six to eight years for clients in retirement. As each "rung" of the ladder comes due, the bonds are redeemed and the proceeds are used for cash flow. In that manner, any interest or dividends generated by the portfolio can be reinvested to maintain the desired asset allocation.

"This is an emotional issue," says Ms. Szymanski. "It feels

like taking principal to the retiree. On the other hand, the retiree knows that a guaranteed amount will be available for spending cash when the bonds mature. Our educational process, which focuses on cash flow, helps prepare clients for this strategy."

Thus, you should avoid becoming too conservative with your retirement investments. "Seniors may feel that they must quickly shift their investment portfolio from stocks to bonds and other income-oriented instruments," says Bill Brennan, principal of Capital Management Group in Washington, D.C. "At age 60 or 65, your investment portfolio might have to last you for 30 or 40 years or longer. Married couples in particular face the probability that at least one spouse will live for many years."

Over long time periods, stocks have outperformed bonds, and that probably will be true in the future. Giving up on stocks can mean crimping your future lifestyle. Early in retirement, therefore, you should have a blended portfolio that includes a large portion of stocks and stock funds.

With an average risk tolerance, a 60-40 split, stocks to bonds, may be appropriate. "As you grow older," says Mr. Brennan,

Survey: One in Three Delaying Retirement

If you feel that you're not on track to retire on schedule, you're not alone. According to a recent survey by Boston-based Fidelity Investments, one in three Americans (34 percent) are delaying their plans for retirement for financial reasons.

Fidelity's survey of workers ages 25 and older found that individuals had different reasons for pushing back their retirement timetable, with 55 percent citing that they had not saved enough, 35 percent saying they had started saving too late, and 34 percent noting they are continuing to work to maintain their employer-paid health coverage.

The results also revealed that reasons for delaying retirement varied across both marital status and gender, since those delaying retirement were more often single than married and more likely to be male than female. Age was also a factor, with younger adults (25-40) more likely to cite the need to pay for a child's college education as hindering their plans to retire, while pre-retirees (ages 55+) were more inclined to attribute their delay to poor investment choices and market fluctuations.

"you might gradually tilt your portfolio towards bonds in order to reduce the risk of incurring heavy stock-market losses you won't be able to make up."

An education in realism can be helpful for wealthy doctors as well as for those of modest means. Sometimes a physician may say, "I have $1.5 million—that's a lot—how can you tell me it's not enough?" Yet someone who is used to spending, say, $150,000 per year is likely to run down that $1.5 million portfolio fairly rapidly.

At the other end of the spectrum, some doctors are far from millionaires, and not likely to reach that level. A physician who has accumulated, say, a couple of hundred thousand dollars should wait to retire at least until age 62, when some Social Security benefits become available. If possible, this doctor should wait longer and collect a larger benefit.

With competent planning, a physician can enjoy a rewarding retirement with an even smaller portfolio. "I've seen people retire with $100,000 in investment assets," says Mr. Brodeski. "They live conservatively and they're very comfortable."

Rundown on Retirement Plans

If you have your own practice, or if you're a principal in a medical group, you can choose the type of retirement plan you'll use for tax-deferred accumulation. Here are some plans you should consider:

■ **401(k)/profit-sharing combination plans.** This combination plan starts with a standard 401(k), to which employees may elect to contribute some of their compensation. Your practice may offer a matching contribution to encourage your employees to participate. In addition, a profit-sharing plan may be "wrapped" around the 401(k). With a profit-sharing plan in the mix, you and other physicians may receive contributions that total up to $44,000 ($49,000 for those 50 and over) in 2006.

"This type of plan might appeal to many types of professional firms, including medical groups," says Roger Lusby, tax partner in the accounting firm Frazier & Deeter in Atlanta.

■ **Age-weighted profit-sharing plans.** Whether or not they include a 401(k) plan, standard profit-sharing plans can be expensive. If your practice makes a contribution of, say, 15 per-

cent of pay to your own account, it will have to contribute 15 percent of pay for all eligible employees.

"If you and other physicians are older than most of your employees," says Mr. Lusby, "you might adopt an age-weighted profit-sharing plan. Older employees have fewer years to build up a retirement fund, so larger contributions to their accounts may be justified. You might be able to reduce the amounts you have to contribute to other employees."

> **"If you and other physicians** are older than most of your employees, you might adopt an age-weighted profit-sharing plan," says Roger Lusby, tax partner at Frazier & Deeter in Atlanta. "Older employees have fewer years to build up a retirement fund, so larger contributions to their accounts may be justified."

For example, suppose you're in your 50s while most of your employees are in their 20s and 30s. You might get a $44,000 contribution to your profit-sharing account this year while your young employees get only 5 percent of pay: $2,000 on a $40,000 salary, for example.

A medical practice that decides to adopt an age-weighted plan will incur some additional expenses. These plans need an actuary, and there are some documents to file with the IRS. In the right circumstances, though, the benefits to an older physician will more than pay back the extra cost.

■ **Defined-benefit (DB) plans.** Even larger contributions can be made to your retirement account with a DB plan, which is a traditional pension plan. Such plans are designed to deliver a certain amount of retirement income; actuaries determine the required contribution.

Thus, a 52-year-old physician who wants to retire at age 62 may be able to contribute (and deduct) over $160,000 this year with a DB plan. Along with generous tax shelter, DB plans have drawbacks: they are complex and expensive to administer, and they require substantial contributions year after year—for employees as well as for physician partners. These plans may be best suited for medical practices that have few employees and consistently enjoy plentiful cash flow.

■ **Simplified employee pension (SEP) plans.** As the name indicates, SEPs demand little in the way of paperwork. You merely

have to fill out a one-page form when you set up the plan. There are no further reports and no annual tax filings. The maximum you can contribute to a SEP each year is now $44,000.

SEPs are as flexible as profit-sharing plans, and they offer "look-back" deductions. "Contributions to a SEP can be made any time until the due date of your tax return, including extensions," says Mr. Lusby. "You can make a contribution to a new or existing SEP by the due date of your tax return in 2007 and take a full deduction from your 2006 taxable income. If you want to make a tax-deductible contribution for the prior year and you have not already established a retirement plan, a SEP is your only choice."

The catch? SEP plans can be costly for employers. If your company contributes 25 percent of pay to your own account, it has to contribute 25 percent of pay for your eligible employees, too. Thus, SEPs may not be appropriate for large medical groups.

However, if your practice revenue is cyclical and you're reluctant to make commitments to a retirement plan each year, a SEP may be the best bet. While some retirement plans, such as defined-benefit plans, require a certain level of funding each year, SEPs allow contributions anywhere from zero up to the maximum each year.

■ **Solo 401(k) plans.** These plans may make sense if you are the only full-time employee of your medical practice. Your spouse can be on the payroll, too.

Participants in solo 401(k) plans merely have to file Form 5500-EZ, and then only after assets in the plan top $100,000. "In many situations," says Mr. Lusby, "solo 401(k) plans permit larger deductible contributions than other retirement plans suitable for one person or one couple. That's because you make contributions as an employer as well as deferring income as an employee." In 2006, each participant's account may be able to receive as much as $44,000. If you're 50 or older, you can add $5,000 as a "catch-up" contribution, for a maximum of $49,000.

■ **Simple IRAs.** Savings Incentive Match Plans for Employees (SIMPLE) retirement plans come in two varieties, SIMPLE IRAs and SIMPLE 401(k)s. SIMPLE 401(k)s are not particularly simple, so most employers who use such plans prefer SIMPLE IRAs, where participants direct their own investments.

Again, these plans require very little administration. The main appeal: you can contribute 100 percent of your income, up to $10,000 in 2006. With a 3-percent-of-compensation employer match, the maximum amount that can go into your account this year is $20,000. Participants 50 and older can defer an additional $2,000 worth of income in 2006.

Because you can contribute 100 percent of pay, SIMPLE IRAs may be ideal if your income is relatively low, yet you want to make a sizable retirement plan contribution. They might help you shelter income from a part-time or sideline practice, a consulting business, etc.

Spending Lump Sums Can Be Costly

It would be tempting to take the money and spend it when you receive a lump-sum distribution from a retirement plan. However, according to a recent study, people who spend their lump-sum distributions entirely report their standard of living in retirement as being somewhat or much worse than that reported by those who rolled over the entire distribution.

"The consequences of spending lump-sum distributions highlight the fact that those who took a lump sum distribution and spent it entirely were approximately 50 percent more likely to describe their standard of living as being somewhat or much worse than was reported by all of those age 55 or older who rolled over their assets," states the study by the Employee Benefit Research Institute (EBRI).

According to the study, about 47 percent of those who took a lump-sum distribution through 2003 used at least some of the money for a tax-qualified savings plan—such as another employment-based plan, an IRA or an annuity. By contrast, about 22 percent used at least some of the money for consumption—such as buying a home, paying off debt or starting a business.

The average loss of retirement assets by individuals cashing out (not rolling over) their most recent lump-sum distributions by the time they reach age 65 ranges from $24,138 (assuming a 3-percent annual rate of return), to $40,972 (5 percent), to $179,483 (10 percent), the study says.

"Despite these numbers being fairly small—except for the high-rate return value—these amounts could certainly make a difference in many individuals' retirements," says the study.

■ **Roth 401(k) plans.** As of 2006, employers offering traditional 401(k) plans and other types of qualified plans can offer a Roth 401(k) plan, in addition. "They're like Roth IRAs in some ways," says Ed Slott, a CPA in Rockville Centre, N.Y. "Contributions are nondeductible, and withdrawals will be tax-free after five years and after you've reached age 59½."

In 2006, the maximum contribution is $15,000 (plus $5,000 if you're age 50 or older). This amount may be divided in any way between a traditional 401(k) and a Roth 401(k).

"Roth 401(k) may work well for highly compensated employees," says Mr. Slott. If your adjusted gross income (AGI) is over $110,000 ($160,000 on a joint return), you can't contribute to a Roth IRA.

As of 2006, employers offering traditional 401(k) plans and other types of qualified plans can offer a Roth 401(k) plan, too. "They're like Roth IRAs in some ways," says Ed Slott, a CPA in Rockville Centre, N.Y. "Contributions are nondeductible, and withdrawals will be tax-free after five years and after you've reached age 59½."

However, there are no income restrictions to Roth 401(k) contributions. High-income physicians can deposit up to $20,000 a year into an account that ultimately will generate tax-free withdrawals.

No matter which type of plan you choose, you should not abandon it prematurely. "Today many 'retirees' actually have earned income from employment, self-employment, director's fees, and so on," says Mr. Brennan. "Such earnings allow you to contribute to any of a number of retirement plans."

You may be able to put money into defined benefit, SEP, profit-sharing or solo 401(k) plans, for example. Ongoing contributions to such plans reduce the tax you'll owe today, and the resulting retirement fund will provide additional income as you grow older and cease working altogether.

Individual Retirement Account Rollovers

With all of these available options, many physicians do a great deal of retirement investing in an employer-sponsored plan. That can be the case whether you're an employee or if you have your

own practice—or if you keep a foot in both worlds.

"If you participate in an employer-sponsored retirement plan, you'll have to decide what to do with your account when you retire," says Mr. Slott. "Many people roll the balance to an IRA. Not only do you maintain tax deferral, you control how your money will be invested."

However, an IRA rollover is not your only choice. Other options include the following:

- **Take the cash.** If you do this, you'll owe income tax, but you'll also have some money to spend immediately.
- **Keep the money in your former employer's plan.** If you're permitted to do this, you may enjoy asset protection and professional money management.
- **Divide and conquer.** You can withdraw some of your retirement funds, pay tax on the withdrawal and roll the balance into a tax-deferred IRA.

There may be tax reasons to avoid an IRA rollover, too. "If

Annuity Provides Guaranteed Income

Although investing in a tax-deferred account is an excellent way to accumulate funds for a long retirement, such a strategy may not be enough. If you're concerned about outliving your assets and about the effects of inflation on your retirement income, you may want to invest even more.

One approach is to invest in various securities and eventually purchase an immediate annuity, which would deliver lifelong cash flow. Immediate annuities, though, generally require you to give up control over your assets. Another strategy is to buy a variable annuity with a rider that guarantees lifetime income via withdrawals. With such annuities, you won't lose control of portfolio assets.

Lifetime guaranteed minimum withdrawal benefits (GMWBs) are a step up from the basic GMWB, which was basically a return of principal. For example, an investor who invested $100,000 in a variable annuity with the original rider may be able to withdraw, say, up to $7,000 (7 percent of the original outlay) per year, no matter what happened within the chosen investment accounts. This guarantee would be in place until the $100,000 investment was withdrawn.

Some newer variable annuities have made this a lifetime guarantee,

you need to tap your retirement plan," says Mr. Slott, "withdrawing money from an IRA before age 59½ may expose you to a 10-percent penalty. On the other hand, you can take money from an employer-sponsored plan, penalty free, if you were at least 55 years old in the year you left your job. In between ages 55 and 59½, therefore, you're better off keeping your money in an employer plan if you expect to take distributions."

If none of the above exceptions apply to you, you're probably better off with a rollover IRA. Moreover, some physicians may find that an IRA rollover is especially appealing.

"You might be interested in a Roth IRA," says Mr. Slott. "After five years and after age 59½, all withdrawals may be tax-free. However, you must first roll over an account in a traditional employer-sponsored plan to an IRA, in order to subsequently convert to a Roth IRA."

You should keep in mind that Roth IRA conversions are permitted only if your income that year is not over $100,000. You'll

usually with a lower withdrawal percentage. Instead of being able to withdraw $7,000 for 14+ years, until $100,000 has been pulled out, an investor selecting this new rider may be able to withdraw $5,000 for 20 or 30 or 40 years or more, as long as he lives.

With such products, one fear that many retirees have—outliving their money—can be addressed. Providing some upside potential, GMWB-for-life riders also can ease retirees' other financial fear: losing ground to inflation. You may be guaranteed $5,000 withdrawals each year from a $100,000 investment; at a certain future date, if your account has grown to, say, $200,000, your guaranteed withdrawal would increase to $10,000 per year, with some of these riders.

Thus, buying a variable annuity with a GMWB-for-life rider entitles you to lifetime withdrawals, some ongoing control, and the chance to see payouts increase over time. What's the downside? The costs can be steep. The average cost of a basic variable annuity is around 2 percent a year while GMWB riders cost approximately 0.5 percent more.

The extra price is an insurance cost, in the eyes of the companies offering such annuities: the price you'll pay for making sure you never run out of money.

owe tax on all the deferred income when you convert an IRA to a Roth IRA.

"No matter what your reason, always ask for a 'trustee-to-trustee transfer' when you execute an IRA rollover," cautions Mr. Slott. "If you handle the funds personally, you'll face mandatory 20-percent withholding on the rollover. You'll have to make up the difference from your own pocket to avoid owing income taxes."

IRA withdrawals before age 59½ may be subject to a 10-percent penalty tax. Assuming you have enough other assets to leave your retirement account in place, you may prefer to use your taxable accounts for spending money before you reach age 70½, the age at which minimum distributions from retirement plans must begin.

Once you've rolled your retirement funds to an IRA, you may want to keep them intact, for ongoing tax deferral. "Many people start to withdraw funds from their IRAs and other retirement plans as soon as they retire," says Mr. Brennan. "Such withdrawals reduce the tax-deferred growth you can enjoy inside your retirement plan."

Also, withdrawals before age 59½ may be subject to a 10-percent penalty tax. Assuming you have enough other assets to leave your retirement account in place, you may prefer to use your taxable accounts for spending money before you reach age 70½, the age at which minimum distributions from retirement plans must begin.

Many retired doctors, though, must tap their IRAs for living expenses early in their retirement years. "Most of our retired clients are in low tax brackets because the days of healthy pension payments are gone," says Kathy Stepp, principal of Stepp & Rothwell, a financial planning and investment advisory firm in Overland Park, Kan. "They must live on their own assets; before Social Security kicks in, they typically have very low, if any, taxable income."

Therefore, when such retirees are between the ages of 59½ (when a 10-percent early-withdrawal penalty no longer applies) and 70½ (when minimum withdrawals are required), the tax rates set by current law present an excellent opportunity to take measured IRA withdrawals. "If they can take cash from their IRAs at 10-percent or 15-percent tax rates, we may suggest that

our clients do so before they turn 70½ and are forced to take distributions at higher tax brackets," says Ms. Stepp. "This also enables clients to balance their accounts when the IRA money far outweighs the non-IRA money, which is not unusual."

In addition, the lower rates in the new tax law make Roth IRA conversions less taxing, according to Ms. Stepp. "We may suggest to low-bracket clients that they convert enough of their IRAs to use up their 10-percent and 15-percent brackets," she says.

Suppose, for example, Dr. Al and Alice Jones are 60-year-old retirees with projected taxable income of $50,000 in 2006. The 15-percent Federal tax bracket extends to $61,300 on a joint return this year. Thus, Dr. and Mrs. Jones could withdraw $11,300 from their IRAs and owe the IRS only $1,695, at a 15-percent rate.

Alternatively, Dr. and Mrs. Jones could convert $11,300 worth of IRAs to Roth IRAs this year, fully using up their 15-percent tax bracket. Again, they would owe only $1,695, at a 15-percent rate, on that $11,300 conversion. After a five-year holding period, all of the money in those Roth IRAs can be withdrawn, tax free. What's more, similar partial conversions can be implemented in succeeding years.

If you're a retiree in that age bracket (between 59½ and 70½), you may decide to use up your 15-percent bracket each year, and perhaps your 25-percent bracket. If your income is under $100,000, and you don't need to withdraw money for spending,

2006 Federal Income Tax Brackets

	Single	Married Filing Joint Returns
10%	$0-$7,550	$0-$15,100
15%	$7,551-$30,650	$15,101-$61,300
25%	$30,651-$74,200	$61,301-$123,700
28%	$74,201-$154,800	$123,701-$188,450
33%	$154,801-$336,550	$188,451-$336,550
35%	over $336,500	over $336,500

Source: Internal Revenue Service.

you can convert enough IRA money to Roth IRAs each year to use up these low tax brackets. The low tax rates will make Roth IRA conversions less expensive.

After executing a series of partial Roth IRA conversions each year at low tax rates, you can build up a large amount in a Roth IRA. All of those funds will be available, tax free, once you're past the five-year, age 59½ mark.

Ms. Stepp cautions that this maneuver will increase your adjusted gross income and may result in more taxes on Social Security benefits, fewer itemized deductions, etc. "Typically," she says, "the AGI increase won't be a major factor, but some numbers should be crunched before irrevocable steps are taken."

Estate Planning Considerations

Retirement planning doesn't begin and end with accumulating money for living expenses. Other factors need to be considered, such as what will happen if you become incapacitated. Someone will have to make the decisions regarding your assets, including your retirement accounts.

"A power of attorney should be part of your overall estate plan," says Mr. Slott. "A power of attorney enables one individual (the principal) to give another (the agent) the ability to handle the former's financial affairs."

What if no power of attorney is in place? When one person becomes incompetent, another must petition a court to be named that person's conservator or guardian. Petitioning a court involves time and expense that can be avoided with a proper power of attorney.

A power of attorney can help to avoid such problems if it's done correctly. A general power of attorney ceases to be effective when the principal becomes incapacitated; a durable power of attorney, on the other hand, will remain in effect.

Many states permit powers of attorney to be "springing." Such powers are executed today but don't become effective until later, when a particular, specified event occurs. "For example," says Mr. Slott, "the power might 'spring' into effect when the principal's physician attests—in writing—that the principal has become incapacitated."

A springing power can pose problems: some doctors won't be

willing to go on record that someone is incapacitated, because of potential liability. However, if you are uncomfortable with the idea that an agent is empowered to act for you while you are capable of making your own decisions, a springing power probably will be better than no power of attorney at all.

"Whether or not a springing power is desired, a power of attorney should have a clause that expressly allows the agent to make decisions regarding IRAs and other retirement accounts," says Mr. Slott. Such a durable power of attorney should specify that the agent can make investment choices, make withdrawals and change beneficiary designations.

Once a power of attorney has been drawn up, signed and witnessed, according to state law, more effort may be involved. You probably should file your powers of attorney with the financial institution holding your assets and make sure the institution will accept the power. If there's a problem, and you find out in advance, you can work with the firm to get a power that will be honored.

In your will, you'll name an executor to act as quarterback for your estate. After your death, it will be up to your executor to inventory your possessions, pay bills, file tax returns and make sure that your assets are distributed according to your instructions. Therefore, you should give careful thought to choosing an executor.

As mentioned, a power of attorney should be part of your estate plan. What else should such a plan include?

- **A will.** "If you don't have a will, your state will decide how your assets will be distributed at your death," says Femi Shote, managing director of Asset Harvest Group, a financial planning and investment advisory firm in McLean, Va. "When you draw up a will, you're in control."

Your will should be prepared by a lawyer who specializes in estate planning. If you try to do it yourself by writing out your own will, you may be creating problems for your loved ones.

- **An executor.** In your will, you'll name an executor to act as quarterback for your estate. In some states, an executor is known as an administrator or personal representative.

After your death, it will be up to your executor to inventory your possessions, pay bills, file tax returns and make sure your

assets are distributed according to your instructions. Therefore, you should give careful thought to choosing an executor.

It may be a bad idea to name your spouse as an executor because he or she may be too upset to act effectively. Another relative (brother, sister, cousin) might be a better choice. If that's not practical, you can name a professional adviser, such as an accountant or an attorney. For professionals, a fee schedule should be worked out in advance.

"Whoever you choose as your executor, make sure you get his or her consent to serve before naming someone in your will," says Mr. Shote. "You should line up a backup executor, too, in case your original selection becomes unable to serve."

Then review everything with your executor. Your executor should know what your assets are and where the paperwork can be found.

- **Guardians.** As long as your children are minors (under ages 18 to 21, depending on state law), you should name guardians in your will, in case both you and your spouse die in a common disaster. Again, you should get the guardians' permission before naming them.
- **A letter of instruction.** You probably won't change your will every time you buy a new car or make new investments. Therefore, it may be useful to leave a letter of instruction in addition to your will.

In this letter you can spell out exactly what your assets are and how you'd like them distributed. Such a letter may not be legally binding, but it can help your executor locate assets and decide how to distribute them.

- **Life insurance.** Some estate-tax planning strategies involve the use of life insurance, particularly for large estates that consist of non-liquid assets such as real estate or collectibles, which your heirs may not wish to sell in order to pay estate taxes. In such cases, the proceeds of a life-insurance policy can be used to pay the estate taxes, leaving the assets intact.

Tax Law Uncertainty

Your estate planning also should include some tax planning. "Today, estate-tax planning is extremely complicated," says Marty Shenkman, an attorney in Teaneck, N.J. "There is tremen-

dous uncertainty about Federal tax law."

Under current law, there is no estate tax on amounts that pass to a surviving spouse. The individual estate-tax exemption on assets that pass to anyone else is $2 million in 2006. This exemption is scheduled to reach $3.5 million in 2009, become unlimited in 2010 (when the Federal estate tax won't be in effect), then drop to $1 million in subsequent years. Such a sequence is not likely to be played out, but no one knows when or how Congress will revise this current law. "What's more," says Mr. Shenkman, "many individual states have become much more aggressive in passing estate-tax legislation."

> **Under current law,** the individual estate-tax exemption is $2 million in 2006, $3.5 million in 2009, unlimited in 2010 (when the Federal estate tax won't be in effect), then back to $1 million in subsequent years. Such a sequence is not likely to be played out, but no one knows when or how Congress will revise this current law.

In addition, there is uncertainty about Federal gift-tax law. Giving away assets can reduce your taxable estate, so there is a tax on gifts to discourage such tactics. Under current law, each individual can give away up to $1 million worth of assets, tax free. Larger gifts, though, trigger a gift tax, at rates of 45 percent and 46 percent.

Many people are reluctant to make such gifts and, as a result, to pay gift tax. If it turns out that the Federal estate tax is repealed or eased considerably, large amounts of gift tax may have been paid for no reason.

One strategy, then, is to do no estate-tax planning at all, for fear of making mistakes. However, many physicians today are paper millionaires, just from the real estate they own. At death, your real estate alone may generate substantial estate-tax obligations, without the necessary cash to pay the bill. If estate-tax planning is complicated but vital, how should you proceed?

"Rather than give away assets you may need some day," says Mr. Shenkman, "you can make loans to your children or other loved ones." Making loans also will avoid gift-tax consequences.

With such loans, you can help your children now if they need the funds. If you need the money someday, you can get those funds back from loan repayments. In the future, if it turns out

that you truly don't need the money and won't have to worry about taxes, you can forgive the loans, essentially turning loans into gifts.

Certain formalities should be followed so that intra-family loans aren't treated as gifts by the IRS. The tax code generally requires that a minimum interest rate be charged; as long as you charge interest at the applicable financing rate (AFR) set by the IRS each month, the transaction should be approved.

The latest AFRs are approximately 4.4 percent for loans due in less than three years; 4.4 percent for medium-term loans; and 4.6 percent for loans longer than nine years. The AFR for long-term, adjustable-rate loans is around 4.25 percent. AFRs are posted regularly on the IRS's Website (*www.irs.gov*).

Another proven estate-tax planning technique is the use of a so-called "bypass trust." Many estate plans call for the amount of the estate-tax exemption to go to a bypass trust, tax free, while the rest will go to the surviving spouse. Again, there is no estate tax on amounts you leave to your spouse.

However, the estate-tax exemption is $2 million in 2006. Leaving $2 million to the bypass trust may deprive your spouse of needed assets.

One solution, then, is to name your spouse as beneficiary of the bypass trust, along with your children. "If the surviving spouse's access to the trust funds is limited to providing for her 'health, education, support or maintenance,' the trust assets probably won't be in her taxable estate," says Mr. Shenkman. Such provisions, meanwhile, may meet the survivor's needs.

Another technique, according to Mr. Shenkman, is to put a cap on how much of your estate can go into a bypass trust. For example, your estate plan may call for the exemption amount to go into a bypass trust, but not more than half of your estate. "If you leave $2 million worth of assets," he says, "$1 million can go into the bypass trust, so it won't be

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taxed in your survivor's estate, while the other half can go to your spouse."

Alternatively, you might put a dollar limit (say, $1 million) on the amount that goes into a bypass trust.

"You also can use a 'min-max' plan," says Mr. Shenkman. "You could fund a bypass trust with a minimum amount. Those assets, at least, will be out of your survivor's taxable estate."

Say you expect to leave a $2 million estate. You might leave $500,000 to a bypass trust and the $1.5 million balance to your spouse. If your spouse is concerned about leaving a taxable estate, he or she can disclaim (refuse to accept) some of those assets, which can pass to the bypass trust.

Under the current uncertain tax law, it may be necessary to plan for your own death (and your spouse's) right away. Each year, you can meet with your professional advisers and make whatever revisions have become necessary, if circumstances have changed.