ROAD TO RETIREMENT: PART I

IT'S NOT NECESSARILY THE ROAD LESS TRAVELED.

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This article is the first of a three-part series on retirement.

Probably the greatest decision a doctor makes—after selecting a spouse and deciding where to practice—is the decision when and how to leave the practice of medicine. A few decades ago, doctors worked until the day they died. Many may have literally worked themselves to death. Doctors may be forced to retire because of their own health problems or because of a contractual arrangement mandating retirement at a given age. However, today many doctors who are making the decision when to leave their practices haven't given enough thought and prepared properly for the next phase of their lives. This article addresses the basics of the retirement process and provides checklists of what needs to be done in order to leave a medical practice through the front door without having psychological, financial, or legal problems.

Psychological Preparation

Today, more physicians are disappointed by the increasingly onerous atmosphere of medical practice and are thinking of retiring at earlier ages. For most physicians, contemplation of retirement generally is not pleasant. Retirement means leaving a profession that has occupied them intellectually and emotionally for a lifetime. Physicians are fearful that there will be a void of personal gratification and validation. Physicians are concerned that retirement will create a life with nothing important to do and that boredom and deteriorating health are all that will be in store for them.

Few studies have examined the factors affecting the well-being of physicians in retirement. One study of Canadian physicians found that few doctors had hobbies, friends, or even close family relationships that might fill the void caused by retirement.[1]

Uncertainty over future Social Security benefits as baby boomers continue to retire adds to the concerns.

Financial Considerations

Retiring physicians often face unexpected expenses or find that their financial situation won't provide for the comfortable life they expected. This was all too common for many physicians with investments that all but disappeared during the economic downturn that began in 2008.

Physicians contemplating retirement within the next few years need to understand the future risks of the financial situation they may be facing. People are living longer, which means they may have to provide for a bigger cushion in retirement than they may have initially intended. In addition, uncertainty over future Social Security

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benefits as baby boomers continue to retire adds to the concerns. As a result, you could face a personal shortfall, especially if you incur unforeseen expenses from a medical condition or some other situation.

So what could/should you do? Even if retirement is imminent, you may be able to make up lost ground quickly or take other steps to protect yourself. Here are several ideas to consider:

• ***Maximize retirement savings vehicles.*** Just a few years of making contributions at or near the maximum level can significantly bolster your account. If you have any qualified retirement plans that you are not fully funding, determine if your cash flow will allow you to do so.

• ***Work on the budget.*** If a financial planning retirement needs-analysis determines that you may have a potential shortfall, you might want to dial down your expectations. Make realistic estimates about the income you expect to have coming in and the expenses going out. Although you will likely be paying less for housing (see below) and other items such as life insurance, especially if your children are already adults, consider the impact of potential increases in some expenses such as travel expenditures.

• ***Move to a smaller home or condo.*** For most people, housing is the largest overall cost, representing on average more than one-third of overall spending. If your kids no longer live with you, but you're still living in the large home where you raised them, it may be time to downsize. In addition, you might want to move to a state with a different climate, taking state income taxes into account. Of course, various other factors such as proximity to family and personal preferences will come into play.

• ***Refinance your current home.*** If you decide not to downsize, you should consider refinancing an existing mortgage if you are paying a rate higher than those currently available. At the beginning of 2013, mortgage rates had reached historic lows. Even though rates have increased slightly since then, you may save tens of thousands of dollars over time by refinancing. Keep in mind that your interest payments will generally continue to be tax-deductible.

Individual retirement accounts (IRAs) continue to make up the bulk of many physicians' retirement planning assets.

• ***Do not stop working altogether.*** Just because you have reached retirement age does not mean you have to stop working completely. If needed, you could pursue part-time employment. For some individuals, working full-time a little longer is also a viable option.

Retirement Accounts

Individual retirement accounts (IRAs) continue to make up the bulk of many physicians' retirement planning assets. They are hesitant to make any changes to these IRAs, including taking withdrawals or moving their account to another advisor, due to the perception that various taxes and penalties would be incurred. There are, however, several reasons why rolling over your IRA funds may make sense. You may be dissatisfied with the investment return from the IRA, or you may be interested in pursuing other investment opportunities.

One reason might be the need for immediate cash. Loans against an IRA are not allowed, but many investors are unaware that if you withdraw funds from an IRA, but redeposit those funds back into an IRA within 60 days, there is no current income tax ramification. When all of the requirements are met, IRA rollovers are tax-free and exempt from the usual 10% penalty on early withdrawals before age 59 1/2.

However, it is important to keep in mind that there are several potential pitfalls with IRA-to-IRA rollovers:

• ***Missing the 60-day rollover period:*** The rollover must be completed within 60 calendar days from the date

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a distribution is made from the IRA. For years, the IRS has ruled the 60-day requirement could not be waived, even when the delay was not the taxpayer's fault. Recently, the IRS has indicated that it's more willing to grant an exception or waiver under extenuating circumstances, but it is still best to play it safe and stay within the 60-day rollover period.

• ***Failure to roll over the same assets that were distributed:*** To qualify for a tax-free rollover, the cash or other assets withdrawn from the IRA must be transferred within 60 days. You are not allowed to substitute other property. For example, in a recent Tax Court case, an individual withdrew cash from his IRA and used the money to invest in common stocks. He then transferred the stocks to a new IRA within the required 60-day rollover period. The Tax Court ruled that the transfer was taxable, since there was a change in the distributed assets.

• ***Rolling over to the wrong IRA:*** The tax-advantaged rollover is valid only if you make a timely rollover to an IRA that you personally own. If you mistakenly transfer the rollover funds to your spouse's IRA, or some other account, the transfer is fully taxable.

• ***Initiating more than one rollover during the year:*** You are allowed to roll over funds from one IRA to another IRA only once a year. The one-year period begins on the date you receive the distribution, not the date on which you roll over the funds into the IRA. The one-year rollover rule applies separately to each IRA that you own. One way to avoid this restriction is to utilize a "trustee-to-trustee" transfer of IRA assets from one IRA to another IRA.

There is never a bad time to revisit the beneficiary designations you have made over the years.

• ***Rolling over a "mandatory distribution":*** The law requires you to begin minimum distributions from an IRA by April 1 of the year following the year in which you reach age 70 1/2. You cannot avoid the minimum distribution rule by rolling over the distribution to another IRA. Mandatory distributions may be avoided if the retirement plan assets are not held within an IRA, but are kept within the plan, and you have not yet retired. This exception, however, is not available for distributions made within an IRA.

• ***Rolling over IRA assets to a Roth IRA:*** In general, the rollover from a regular IRA to a Roth IRA is completely taxable.

Beneficiary Designations

There is never a bad time to revisit the beneficiary designations you have made over the years. Unfortunately, once various beneficiary forms are completed, they are often forgotten about, emerging only after the death of the account owner. In many cases, executors find that no beneficiaries have been named at all, creating confusion, anger, and time delays in settling an estate. In other cases, the named beneficiaries may no longer be members of the family due to divorce or death.

One of the main reasons for this oversight is that many of the financial accounts requiring a beneficiary designation are established earlier in life. There may be a life insurance policy that was purchased when you were first married, an IRA that you opened prior to marriage, and other such accounts.

Having a sound financial plan dictates that you ensure there are designated beneficiaries for all your retirement plan accounts, life insurance policies, and other assets, and that they are the intended recipients based on your current familial arrangement. It is often not as cut-and-dried as it first seems. The following guidelines should help you avoid the most common mistakes:

• ***Do not leave the beneficiary lines blank.*** If you don't name specific beneficiaries for your accounts, or if you name your estate as the beneficiary, your heirs will likely end up in probate court. This can be both time-consuming and costly. If assets go to your estate,

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they are subject to the reach of creditors. A better option is to choose individual beneficiaries and list them on the forms.

• ***Use trusts for beneficiaries who are minors.*** In some states, minors face restrictions until they turn 18 or 21. If you designate a minor as a beneficiary, a court will appoint a guardian to manage the funds until the child reaches the age of majority. Alternatively, you might establish a trust to handle the funds and name the trust as the beneficiary. Thus, you maintain control now and provide asset protection for minors when you are gone.

• ***Understand the key rules.*** Beneficiary designations on retirement accounts and insurance contracts will override your will. If you want someone other than your spouse to inherit retirement account assets, your spouse must sign a written waiver. Without the waiver, a non-spouse beneficiary designation will be invalid upon your death.

• ***Inform your beneficiaries.*** Do not keep your beneficiary designations a secret. Also, let the people you have designated as beneficiaries know where to find important documents and contact information for your professional advisers. On the other end, make sure your advisers have the vital contact information.

• ***Double-check names and numbers.*** Make sure they are spelled correctly and that figures are accurate. This is particularly important when listing Social Security numbers as well as telephone numbers and addresses.

• ***Use percentages instead of dollar amounts.*** For example, suppose you have an IRA worth $100,000, and you designate a nephew as beneficiary of $75,000 of that amount. If the IRA drops in value to $75,000 or below at your death, your nephew gets the entire amount—any remainder beneficiaries receive nothing. Perhaps a better way to meet your objectives is to give your nephew 75% of the overall account value.

There is no "one size fits all" answer to when you should start receiving Social Security benefits.

• ***Name contingent beneficiaries.*** If your primary beneficiary has died and you have not updated your accounts with a new primary, the assets would go to your contingent (or "secondary") beneficiaries. If a contingent beneficiary was never named, the assets are transferred to your estate (see above). Avoid potential problems by indicating contingent beneficiaries in appropriate places.

Finally, don't stuff all the paperwork in a desk or drawer somewhere and forget about it. Make the proper beneficiary designation adjustments when warranted and review these periodically with your advisor to ensure that they remain up-to-date and make financial sense.

Social Security

It is estimated that over the next few years more than 70 million baby boomers will reach age 62 and become eligible for Social Security benefits. Many are undecided between collecting Social Security benefits early or waiting until the normal retirement age of 66. Historically, many of those eligible have collected at age 62 because of financial necessity, health, and longevity concerns, or a desire to collect as much as possible from the system amidst fears of its eventual insolvency.

Retiring early means more payments from the government, but a smaller check each month for the remainder of your life. Unfortunately, there is no "one size fits all" answer to when you should start receiving Social Security benefits. The sliding scale used to calculate benefits, which pays a smaller monthly check if you retire "early" and more if you wait longer, depends on the year in which you were born. Your lifetime payout depends on how long you live. First, visit Social Security's website (www.ssa.gov/planners/calculators.html) and find out when you're entitled to full benefits.[2] If you were born from 1943 to 1954, you can start collecting benefits at age 62 but you'll only get 75% of what you'd receive if you wait until you're 66. If you wait until 67, you get 108% of your monthly benefit. At age 70, you'll collect 132% of

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the benefit amount, which is the maximum you can get by delaying or deferring benefits.

Why should you wait to take Social Security until age 66? If you plan to work and will earn in excess of the annual limit before you reach full retirement age, you may lean toward waiting until you are 66. Social Security benefits are reduced if you collect benefits before full retirement age and earn more than the annual limit. You may also consider working until you are 66 if you are single, have little in savings, or have a longer life expectancy. If your spouse is still working and has earned income, which may cause a larger portion of your Social Security benefits to be taxed, you may want to hold off until your income and tax rate are lower.

If your spouse's benefit is smaller than yours or your spouse is much younger than you, keep in mind that your combined life expectancy will be longer than either of your single life expectancies. This means that if you take social security at age 62, and your spouse's benefit is based on your benefit, it will mean a significantly reduced benefit for your surviving spouse's lifetime.

For others, it makes sense to start receiving Social Security benefits at age 62 for the peace of mind of having the money in hand, rather than waiting an extra three to five years, even if it means a reduced benefit and fewer total dollars received over your lifetime. For those who will not have earned income in excess of the annual earnings limit between age 62 and full retirement age, it may make sense to collect at 62. Collecting at 62 also may look better than 66 if you have health issues or a shorter-than-average life expectancy. Finally, if your spouse's benefit is larger than your own, you may choose an early retirement.

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Ultimately, since you don't know how long you'll live, your decision will likely have less to do with maximizing your total Social Security payout and more to do with your overall personal retirement plan and your financial objectives for retirement. This decision can be made with greater certainty and predictability for your situation with the assistance of a financial advisor.

Bottom Line: If you follow the advice we have provided and start planning for retirement early, you will find that the golden years really are available to all when you pass the stethoscope to your younger partners. Remember, with careful financial planning, the best is yet to come! **PM**

References

[1] Grauer H, Campbell NM. The aging physician and retirement. Can J Psychiatr. 1983;28:552-554.

[2] Social Security. Retirement estimator. www.ssa.gov/planners/calculators.html. Accessed March 25, 2015.

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