Practice Operations & Personal Planning

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Learning Objectives

At the end of this lecture, you should be able to:

- Evaluate your future or existing practice options in light of the retirement plan contribution levels you choose to make;
- Identify how to protect your assets once accumulated; and
- Understand the steps necessary to direct your estate at death in accordance with your wishes.

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Purpose

The purpose of this Program is to identify what you need to know about retirement plans, asset accumulation and protection and estate planning and how these areas are interrelated.

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Designing the Right Retirement Plan For Your Practice

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Purpose

Most people will not save outside of their retirement plans. If you own your practice, you have the ability to fund your retirement plan to the maximum limits under the law. Eventually, you will work because you choose to, not because you have to, due to the compounding of contributions over time.

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Tax Advantages of Qualified Plans

- Employee contributions are deductible in the year made.
- Participants are taxed only when they receive payments from the trust.
- The retirement trust is tax-exempt and the trust funds accumulate tax-free.

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- Income tax brackets are generally lower at the time benefits are received following the participant's retirement or death.
- Qualified plans provide a means of forced savings and protection of assets from creditor's claims.
- Qualified plans generally provide creditor protection.

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Compensation Versus Retirement Plan Contribution

Compensation		Retirement Plan Contribution
$ 10,000		$ 10,000
- 4,000	Taxes	- 0
$ 6,000		$ 10,000
- 3,000	Spending	- 0
$ 3,000	Save	$ 10,000
x .1	Invest @ 10%	x .1
$ 300		$ 1,000
- 60	Tax @ 20%	- 0
$ 240		$ 1,000
+ 3,000		+ 10,000
$ 3,240		$ 11,000

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Types of Qualified Plans

- Profit Sharing Plans.
  - You can contribute up to $53,000 in a profit sharing plan in 2015.
  - Profit sharing plans and safe harbor 401(k) plans can now be combined into one plan.
  - Profit sharing contributions can be “skewed” in favor of highly compensated employees (doctor-owners) above the Social Security wage base of $118,500 in 2015.

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- Safe Harbor 401(k) Plans.
  - Use one of two safe harbors to avoid two complex texts that do not permit highly-compensated employees to make significant contributions, unless non-highly-compensated staff contribute significantly.
  - Safe harbors are 3% of compensation or up to a 4% match of compensation for employees who work 1,000 per year and have been employed for a year.

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- Employees can contribute up to $18,000 of their own pay.
- Employees over 50 years of age may contribute up to $6,000 per year in 2015 as a catch-up contribution.

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- Cross-Tested Profit Sharing Plans.
  - These plans combined age in a profit sharing plan to increase the contribution level for highly-compensated employees as a percentage of overall staff contributions.

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- Defined Benefit and Cash Balance Plans.
  - Contributions must be made for at least 5 years. Contributions are mandatory.
  - Contributions can be made up to $210,000 per year.

See: *Supplement 1-1 — Retirement Plan Option for Small Employers May Make 401(k) Plan Affordable*

Supplement 1-2 — 401(k) Examples

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Supplement 1-2

401(k) EXAMPLES

EXAMPLE I

Safe Harbor 401(k) Example (2014)

				spouse
Compensation:	$50,000	$100,000	$265,000	$25,000
	x .04	x .04	x .04	x .04
Match:	$2,000	$4,000	$10,600	$1,000
Deferral:	$18,000	$18,000	$18,000	$18,000
Subtotal:	$20,000	$22,000	$28,600	$19,000
Catch-Up (Age 50)	$6,000	$6,000	$6,000	$6,000
Total:	$26,000	$28,000	$34,600	$25,000

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EXAMPLE II

Example Of Cost Of Benefits For NHCEs Under Various Retirement Plan Options To Provide Maximum $53,000. Contribution For HCE.

a. Highly Compensated Employee (HCE)

Compensation:	$ 265,000
Contribution:	$ 53,000
Percentage:	20%

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b. Non-Highly Compensated Employees (NHCEs)

Retirement Plan Option*	Employer Contribution
1. Profit Sharing (Non-Integrated)	20%
2. Profit Sharing (Integrated)*	16.53%
3. Safe Harbor 401(k) (2015: $18,000) with Integrated Profit Sharing	9.74%
4. Cross Tested Profit Sharing (with optimal demographics)	4.20%

* Integrated at 5.4% of compensation > 80% of social security taxable wage base + $1.00

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Comparison of Types of Tax-Qualified Retirement Plans

See: *Supplement 1-3 — Comparison of Types of Tax-Qualified Retirement Plans*

Supplement 1-4 — Retirement Plan Dollar and Percentage Limits

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Key Retirement Dollar and Percentage Limits for 2015

Annual Compensation for Plan Purposes	$ 265,000
Defined Contribution Plan, Basic Limit	$ 53,000
401(k) Elective Deferrals	$ 18,000
401(k) Catch-Up Deferrals	$ 6,000
SIMPLE Plan, Elective Deferrals	$ 12,500
SIMPLE Plan, Catch-Up Deferrals	$ 3,000
IRA Contribution Limit	$ 5,500
IRA Catch-Up Contribution	$ 1,000
Highly Compensated Employee	$ 120,000
FICA Covered Compensation	$ 118,500

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Employee Census

Name	Date of Hire	Number of Hours Worked Per Week	Wage/ Salary Rate

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Miscellaneous Issues

- Plan updates.
  - Pre-approved (prototype and volume submitter plans) must be rewritten every 6 years.
- Distributions.
  - May begin at age 59½ without penalty.
  - Must be made beginning at age 70½.
- Termination — Form 5310 (formally terminate your plan upon retirement to protect contributions).

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- Rollover to IRA.
  - Stretch IRAs that can provide payments to future generations are under attack from Congress and may be limited in the future.
  - Inherited IRAs (in some cases even to spouses) are also under attack.

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Retirement Plan Summary

Save early and continuous. Never stop searching for the right practice opportunity for you. Over the long-term, don't compromise. Live your dreams!

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Accumulating and Protecting Your Assets

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Purpose

In representing dentists and dental specialists, we cannot discuss asset protection without a discussion about asset accumulation. Without asset accumulation, you will not have significant assets.

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What I Don't and Do See

I do not see creditors chasing dentists and dental specialists to attach assets. What I do see is a lack of planning to accumulate assets. If it is true that you will save only through a retirement plan and can only maximize contributions as a practice owner, it follows that unless you own your practice, it is unlikely that you will become financially independent. And accept for Federal tax liens and child support orders, assets in tax-qualified retirement plans are creditor proof.

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Biggest Challenge

Young Dentists

Challenge: Locating the right opportunity in light of school debt.

Too often, the only practice opportunity may be a corporate practice. As income rises, living expenses increase and school debt is still there. At this point, it may be difficult to own or establish a practice due to debt and living expenses.

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Solution: Recognize this challenge and save at least 10% of income in some form.

Other Challenges: High practice values in destination locations.

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Middle Age Dentists

Challenge: Messing-up a good practice by a poor decision, e.g., taking in a partner without sufficient patients.

Most dentists and dental specialists who think they need a partner really do not. As a result, they do not find this out until the partner is in place and the economics don't work and the business and tax structure is inappropriate, often after a costly relocation.

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Solution: Consult competent advisors experienced in dental partnerships. If you do enter into co-ownership, make sure a buy-sell agreement is in place for either owner to disengage, if necessary.

Other Challenges: Inadequate retirement funding.
Reduced fees.
Lack of patients.
Inappropriate relocation or existing location.

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Older Dentists

Challenge: Retirement affordability.

If you can afford to retire, congratulations! You are working because you choose to. Often, however, that's not the case due to lack of savings and the practice sale proceeds will be insufficient for you and your spouse to live on over the remainder of your lives.

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Solution: If you have five years or more to practice and sufficient profit, you can fund a defined benefit or cash balance plan up to $210,000 per year. If your practice is unsaleable, work two years longer than you had planned to, save, then walk away.

Other Challenges: Losing a lease.
Maintaining health insurance.

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Asset Accumulation and Protection Defined

Asset accumulation and protection planning is the process of accumulating, then organizing your and your spouse's assets in advance in order to guard them from loss by reason of some financial disaster in the future.

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Some Asset Accumulation and Protection Planning Goals

- Save early.
- Own your own practice in order to maximize retirement plan savings.
- Own your practice real estate.
- Plan to eliminate school debt, over time.
- Asset protection plans which are designed with a conglomeration of entities will confuse and frustrate you. A properly designed structure that functions because of its sound legal principles is more protective than one which is overly complicated.

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Pitfalls In Asset Accumulation and Protection Planning

Asset accumulation protection plans should be premised upon saving and not hiding assets or used as an excuse to defraud creditors.

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Fraudulent Conveyance Laws

Where a debtor makes a "tainted" transfer to another person or entity, a court can set aside the transfer as if it never occurred.

- If a debtor makes a transfer with intent to hinder, delay or defraud creditors, it is deemed a tainted transfer.
- For example, if you are sued on Monday and on Tuesday you transfer all your assets to your spouse, the transfer would be deemed a tainted transfer.

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- If a debtor transfers assets for less than fair consideration (e.g., a gift), that renders the debtor insolvent, it is deemed a tainted transfer.
- For example, this situation would occur where you would make a gift of all your assets to your children so that after the transfer your personal net worth would be negative.
- The timing of the transfer is an important planning issue.

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- The longer the time period between a lawsuit and the transfer the better.
- A long history of gift-giving is also helpful.

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Asset Protection Trusts

- Offshore Asset Protection Trusts.
  - With foreign trusts, what may appear to be a tax loophole really may not be what it seems.
- Even where the complex laws and treaties are complied with, your assets could be confiscated at some future date.
- Offshore Asset Protection Trusts ("OAPTs") used to be popular for jurisdictions with treaties with the U.S. to attract businesses.

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- Domestic Asset Protection Trusts.
  - Domestic Asset Protection Trusts (“DAPTs”) are self-settled, irrevocable spendthrift trusts permitted by law in some states.
  - A minority of states now have adopted statutes. My prediction is that many more states will do so in the future.
  - Ohio’s version is the Ohio Legacy Trust (“OLT”) under Ohio Revised Code (“ORC”) §5816.
  - Self-settled means formed by you, the transferor.

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- Irrevocable means that you no longer own the assets, although you may use them, e.g., a vacation home. ORC §5816.05(5).
- Spendthrift provisions restrain both the voluntary and involuntary transfer of your interest in the trust.
- A qualified trustee is required who will be a natural person or corporate trustee. ORC §5616.06.
- A solvency analysis must be conducted prior to the formation of the OLT to ensure there are no creditor claims or fraudulent transfers.

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- The transferor should sign a “qualified affidavit” that the assets transferred to the trust are not subject to any liens or claims and will not render you insolvent.
- When funding the DAPT, use a public recording.
- The creditor claim statute of limitations is 18 months. ORC §5816.07(8)(1)(A).

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- Assets in an OLT are subject to:
  - Secured creditors. ORC §5816.03.
  - Child support. ORC §5816.03(1).
  - Spousal support. ORC §5816.03(2).

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Areas of Concern

- School loans.
- Practice acquisition and real estate loans.
  - Repayment period.
  - Prepayment penalties.
  - Non-recourse loans.

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- Employees.
  - Hiring Process.
  - Addressing unacceptable performance.
  - Updated employee manuals.
  - Termination of employment.
  - Overtime.

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- Worker classification.
  - Post-retirement employment.
  - Associates.
  - Hygienists.

See: *Supplement 2-1 — Worker Classification in Professional Practices*

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- Partner disputes.
  - In appropriate or incomplete agreements.
  - Buy-sell agreements.
    - Death.
    - Disability.
    - Termination of employment.
    - Retirement as a defined term — attain a specified age and elect to retire.
    - Election to transfer.
    - Mandatory versus optional buy-out.

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- Use of insurance follows business and tax structure.
- Three business and tax structures, two of which can have possible tax problems.

See: *Supplement 2-2 — Co-Ownership — It's Taxing!*

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- Divorce, personal issues.
- Outside businesses.
- Inappropriate retirement plan funding.
- Uncompleted or outdated estate plan.
  - Failure to transfer assets.
  - Failure to change title to assets.

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Methods of Asset Protection Planning

- Some necessary insurances.
  - Health.
  - Long-term care.
  - Life insurance.
    - Protect family members.
    - Educate children.
    - Buy-sell agreement funding.

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- Disability insurance.
  - Income replacement.
  - Disability overhead.
  - Disability buy-out.
- Practice contents.
- Property and casualty.
- Employment practices liability insurance.

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- Liability insurance for malpractice.
  - Practice entity as a named insured.
- Automobile.
- Home, other real estate.
- Umbrella.

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- Entity choice.
  - Liability protection, except for your own acts.
  - Tax issues.
  - S-corporation, c-corporation, or limited liability company versus sole proprietor or partnership.
  - Practice entity, versus real estate.

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- Retirement plan assets and rollovers to IRAs at retirement.
  - For risky investments, use separate IRAs, e.g., real estate.
  - See *Clark v. Rameker*, 134 S.Ct. 2242, 573 U.S. ___ (June 12, 2014) where the Supreme Court ruled that assets in an inherited IRA are not "retirement funds" and may be subject to creditor claims.
  - However, if the heir is the owner's spouse, the spouse may "rollover" the IRA funds into his or her own IRA, thereby protecting the assets from creditor claims.

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- Prenuptial agreements — work well for second marriages.

See: *Supplement 2-3 — Entity Choice*

Supplement 2-4 — Protection From Creditors for Retirement Plan Assets

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- Holding title to and transferring assets into proper entities or trusts.
- Coordinate with estate plan.

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Asset Accumulation and Protection Summary

Focus on your practice and stay away from side businesses and risky investments. Practice through an S-corporation or limited liability company and hold the practice real estate through a separate limited liability company.

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Planning Your Estate

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Purpose

While a primary goal of estate planning was to reduce the size of a taxable estate to minimize and eliminate federal estate taxes, this is not important as it once was with the $5,430,000 per spouse ($10,086,000 per married couple with proper planning) exclusion limit at this time. What remains important is to direct the disposition of your and your spouse's assets at death and provide support to dependent family members upon your death.

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Estate Tax Update — The Good News!

The American Taxpayer Relief Act of 2012, effective January 1, 2013 ("ATRA").

- $5,250,000 credit exemption, indexed for inflation; currently $5,430,000 for deaths on or after January 1, 2015.
- Estate and gift tax rate is now 40%, above the exemption amount.
- Annual gift exclusion remains $14,000 for 2015 and indexed in $1,000 increments.
- ATRA personal spousal portability is available and is preserved by the filing of Form 706 U.S. Estate Tax Return upon the death of the first spouse.

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Estate Inventory

- Net Worth Statement.

The first step in the development of estate plan objectives is to complete a thorough estate inventory. An estate inventory is a complete list of all your and your spouse's assets and liabilities. Assets should be listed with estimated values or appraisals. Ownership information should be provided, as well as any beneficiary designations. For example, ownership could be "joint with

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right of survivorship", "in trust" or be owned individually with a "transfer on death" or "payable on death" beneficiary designation.

- Family Information.

This information is a complete list of your family tree. This should include current addresses, Social Security Numbers, telephone numbers and email addresses. Status of any particular family

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member should be provided, e.g., a special needs child or adult or estranged family member. This may include you and/or your spouse's parent(s).

- Charitable intentions.

The beneficiary of charities during lifetime or upon death should be identified. Typically, provisions for charities are provided when your primary beneficiaries are not living and assets remain. For retirement accounts (IRAs, 401(k), profit-sharing and other retirement plans), consider use of beneficiary designations on these accounts.

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- Practice Disposition.

How will your practice be disposed of? If you have a partner, do you have an up-to-date buy-sell agreement funded with life insurance? If you practice solo, designate how the practice is to be marketed for sale. If you would utilize services of a broker, designate the broker. Do you belong to a study group or coverage group who will continue to work in your practice under a coverage arrangement until the practice is sold? Do you have a current valuation of your practice?

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- Beneficiary designations.

These assets are usually life insurance policies, tax-qualified retirement plans, IRAs and deferred compensation agreements. You should bring the current beneficiary designations to your initial meeting with your estate planner to determine consistency with current Will and trust provisions. Appropriate beneficiary designations avoid the need for an executor or personal representative to be appointed by the probate court to receive benefits because beneficiaries fail to survive you or were not appointed.

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See: *Supplement 3-1 — Estate Planning Questionnaire*

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Your Will

The primary purpose of a Will is to dispose of your (and your spouse's, if married) estate in accordance with your and your spouse's wishes. The last thing you want is for a court to determine who gets your assets. You should also choose an executor to manage assets, distribute them to beneficiaries and pay taxes.

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- Information to consider in a Will:
  - Name, address and state of mind.
  - Spouse's name, names of children, stepchildren and/or other family members or partners.
  - Payment of funeral expenses, debts and taxes.
  - Distribution of all property.
  - Specific bequests.
  - Appointment of a guardian for children.
  - Care for family members with special needs.
  - Disaster provision.
  - Don’t forget about the pets.

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- Name of executor and any successor executors.
- Signature line and date.
- Witness lines and signatures of two witnesses in Ohio.

*Information contained in a Will is state specific and each state has its own requirements for a valid Will. For Ohio, see ORC §2107.

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- Additional provisions may include:
  - Provision to appoint a guardian for minor or special needs children.
  - Provision for distribution to beneficiary who is a minor or incapacitated person.
  - Provision to pour-over into revocable living trust.
  - Provision to include after-born children.
  - Provision for common disaster.

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Powers of Attorney

- Financial and health/medical powers of attorney allow the individual you appoint, e.g., your spouse, to make financial and health care decisions on your behalf if you are unable to do so.

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Non-U.S. Citizen Spouses

- The marital deduction is unavailable to a non-U.S. citizen spouse. However, a qualified domestic trust ("QDOT") is a trust that can be used to allow a non-U.S. citizen who is a spouse of a U.S. citizen to qualify for the unlimited marital deduction upon your death. See Internal Revenue Code ("IRC") §2056(d) and (A).
- At least one trustee must be a U.S. citizen or domestic corporation and distribute income, not principal, unless taxes are withheld. The trustee is permitted to make distributions of principal for hardship.

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Revocable Trusts

- Assets in a trust avoid probate and avoiding probate provides privacy and efficiency in the administrative process.
- With a revocable trust, the assets remain in your estate, but you control the assets during life and how income and assets are distributed upon your death.
- Upon your death, the trust splits into an "A" trust ("Marital Deduction Trust") for the surviving spouse and a "B" trust ("Credit Shelter Trust") for the family.

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- To qualify as a marital deduction trust, the trust must distribute all income, at least annually. There may also be a General Power of Appointment where the surviving spouse can take out principal at any time and direct distribution of the remaining assets.
- Under a Qualified Terminable Interest Property ("QTIP"), the trustee has discretion over distributions or principal. See IRC §2056(b).
- With a QTIP, the surviving spouse is given a life estate in the marital interest, takes out the income with distribution power left to the trustee, although health, education, support and maintenance can be paid.

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- QTIPs are helpful planning tools where there is a second marriage and children from a previous marriage and/or spouse from a previous marriage.
- Credit Shelter Trusts.
  - The trust is typically drafted to benefit the spouse, the children or both.
  - If the trust benefits the spouse or spouse and children, the trust is one fund.
  - If the trust is held only for children or grandchildren, the fund is split.

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- The funds can be divided as a “pot” or “separate shares” trust, both having advantages and disadvantages. However, depending upon the ages of the beneficiaries, the pot trust can be used-up where older children are educated first.
- There may be a no contest provision in the trust should a beneficiary contest its provisions.
- A spendthrift provision can provide the trustee with a mechanism to protect a beneficiary from wasting trust assets.

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- Restraint in alienation provision can provide that a beneficiary cannot use the trust property as collateral without the consent of the trustee.

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Reasons for Trusts

- Preserving family relationships/control of assets.
- Maintain privacy.
- Minimize probate and simplify the administrative process.
- Providing for special needs beneficiaries.
- Minimize estate taxes.
- Minimize income taxes.

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Points in Trust to Consider for Estate and Income Tax Reduction

- Step-up in basis — IRC §1014(e).
  - A Step-up in basis equal to fair market value at death for federal income tax purposes occurs when a surviving spouse receives property from their spouse even though no estate taxes due because of the unlimited marital deduction.
  - Very helpful for highly appreciated assets.
  - If the recipient spouse does not live for 12 months after the transfer, there is no step-up in basis.

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- Gift Splitting — IRS Form 709.
  - Husband and wife can gift split up to $28,000 per year per beneficiary, thereby reducing the taxable estate without reducing the husband and wife's combined exemption amount of $10,086,000.
  - Not as important as it once was due to the very favorable exemption amount.
  - For gift splitting, a Form 709 must be filed, although there is no payment of estate or gift tax.

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Crummy Powers and Trusts

- You may establish an irrevocable trust by placing funds in the trust for each beneficiary equal to the annual exclusion amount of $28,000 per beneficiary by husband and wife.
- The beneficiaries are notified that he or she has a right to withdraw the gift/contribution from the trust for 30 days from the date that the gift was made.
- If the withdrawal right is not exercised, the funds remain in trust. See *Crummy v. C.I.R.*, 397 F.2d 82 (9th Cir. 1968).

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- Disclaimer Trusts.
  - In order to reduce estate taxes, for a period of 9 months following the death of a spouse, a surviving spouse may disclaim assets from the estate by a written renunciation of their receipt. The beneficiary making disclaimer must not benefit from the asset or exercise control of it after death of the spouse. I.R.C. Reg. 25.2702.

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- Qualified Personal Residence Trust.
  - A qualified personal residence trust (“QPRT”) is an irrevocable trust into which you place your primary residence, and possibly a second vacation home, for a term of years, but less than your life expectancy.
  - You retain the use of the property for the term specified and, thereafter, the beneficiary(ies) own the property based upon the appraisal at the time it was placed in the trust. See I.R.C. Reg. 20.2056A.
  - This is useful where the real estate is likely to appreciate in value.

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- Intentionally Defective Grantor Trusts.
  - An intentionally defective grantor trust ("IDGT") is an irrevocable trust that freezes the value of an appreciating business or practice in an installment sale in exchange for a promissory note from the trust. See I.R.C. §673-677.
  - IDGTs are not normally used in the sale of dental or dental specialty practices because if your children are in your practice, they normally pay you its fair market value.

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- Special Needs Trusts.
  - These trusts usually refer to a beneficiary who qualifies for Medicaid or other form of public assistance.
  - The goal with these complicated trusts is to provide for the beneficiary without disqualifying this individual from public assistance. See O.R.C. §5163.21 in Ohio.

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- Education Trusts.
  - An education trust is an irrevocable trust created to educate a child or grandchild. See I.R.C. §2503(c).
  - This trust requires that all trust property and income be paid to the beneficiary upon attaining age 21.
  - While income does not need to be paid before the beneficiary attains age 21, paying out all trust property and income could be a disadvantage.

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- Generation Skipping Trusts.
  - A general skipping trust is an irrevocable trust for the benefit of grandchildren and future generations. See I.R.C. §§ 2601, 2612(a), (b) and (c) and 2651(e)(1) and other provisions.

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Estate Planning Summary

Estate planning involves periodic updates based upon personal and family changes, as well as changes in the law. Keep your estate plan updated at least every three years with counsel from your state.

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Summary and Conclusions

While tax-qualified retirement plans are regulated by Federal law under ERISA, asset accumulation and protection and estate planning is regulated by state law. All three areas are regulated by Federal tax law. In addition to having an attorney qualified in your specific state to complete this legal planning, you will probably be dealing with three attorneys, possibly all partners in the same law firm. The attorney who drafts your retirement plan is unlikely to be the attorney who forms and maintains your practice or real estate entity or who handles your estate plan.

Advance planning will give you economic freedom for life! Failure to plan is also planning. Just bad planning.

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