University of Michigan Medical School

Personal Financial Planning for Medical Residents

January 24th, 2017

Agenda

- Introduction
- Your Goals During Residency
  - **Live within your box**
  - **Build a solid credit profile**
  - **Build savings**
  - **Protect for important new expenses**
  - **Smart tax planning**
- Wrap-Up

A Few Basic Facts…

Working for you:

- **Long-term earning potential**
  - A 22 year old graduate earning $60,000 and receiving 3% annual raises will, by age 65, earn a total of $5.3 million with average earnings of $121,000
  - A 30 year old Attending Physician with first year earnings of $200,000 and 3% annual increases thereafter will by age 65 earn a total of $12.7 million with average earnings of $352,000
- **Steep earning curve**
  - Earnings can increase at a dramatic pace over the next several years

Working against you:

- **Time**
  - A 22 year old will need to save $10,536/year earning 7% annually to accumulate a $3 million nest egg by the time she's 65
  - To reach the same $3 million, a 32 year old would need to save $21,860/year
- **Age**
  - Increased life insurance and disability income premiums due to higher age and potential for health issues during residency

…And A Couple Big Unknowns

The Future of the ACA

- Full *Repeal* or *Repeal and Replace*?
- Replaced by what?
- Death by a thousand cuts?
- Tinker around the edges?
- What does it mean for hospitals, group practices and sole practitioners?

Income Taxes Under ACA

- additional 0.9 percent Medicare tax on earnings

  ($200k S / $250k MFJ)
- Additional 3.8 percent tax on net investment income ($200k S / $250k MFJ)
- Phaseout of Personal Exemptions and Deductions beginning at $250k (S) and $300k (MFJ)

So what can and should you do as a House Officer to set yourself up for success?

Your Primary Goals During Residency

1. live within your box
   -know your paycheck
   -budget of expenses
   -keep personal distractions out of your professional life

2. build a solid credit profile
   -prudent use of revolving and installment credit
   -pay your bills on time

3. begin to build emergency and long-term savings
   -contribute to your 401(k)/403(b) and/or IRA

4. protect for important new expenses
   -disability income insurance
   -life insurance
   -student loan payments

5. smart tax planning
   -tax opportunities
   -tax pitfalls

How Big is the Box You Must Live In?

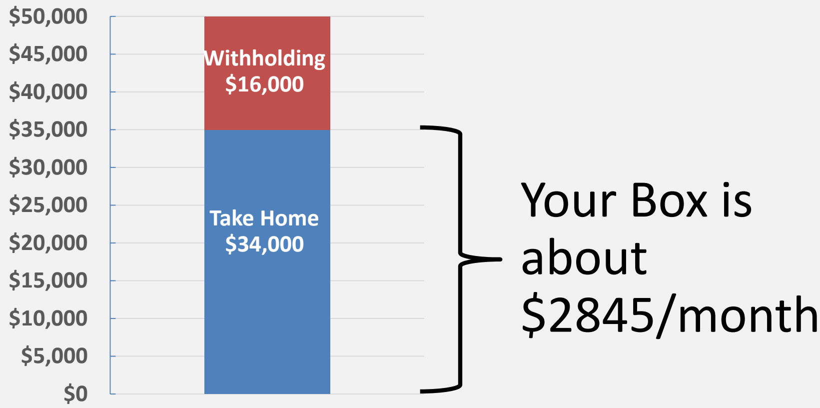
Understand Your Paycheck

	Per Month	
Gross Pay	**$4167**	**Assume $50,000 annual**
FICA (Social Security)	($258)	Fixed 6.2%
Medicare	($60)	Fixed 1.45%
Federal Income Tax	($625)	Target 15% Effective
State and City Income Tax	($229)	Estimate 5.5%
Elective Benefits	($150)	Health Insurance, etc.
Net Pay	**$2845**	**Approx. Deposit to checking**

You will likely take home about 70% of your gross pay

Check out: paycheckcity.com

Make Your Personal Life Fit Within Your Box



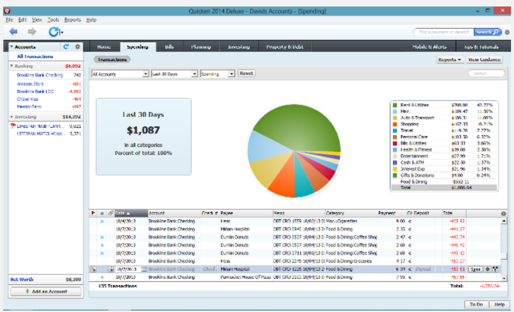
Always Know Where Your Money is Going!

You have several options available to you to automatically:

•track and categorize your spending

•aggregate and update financial accounts

•alert you to potential shortfalls



Quicken

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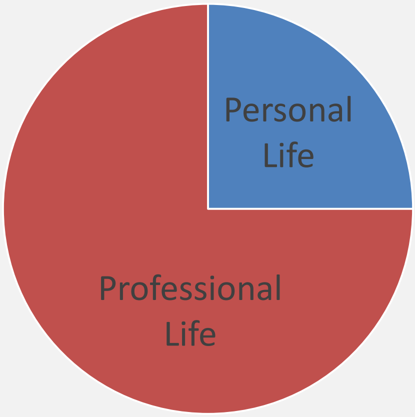
Keep Distractions From Affecting Your Professional Life



How?

Prioritize! Don't Overfill Your Box!

Reduce Your Financial Footprint!

Prioritizing Needs vs. Wants – How Much Can I Fit?

Needs
- -Rent
- -Student Loan
- -Food
- -Transportation
- -Professional Costs
- -Gas/Electricity
- -Cell Phone
- -Emergency Savings

Wants
- -Internet/Cable
- -Streaming Services
- -Starbucks
- - …

How Can You Reduce Your Financial Footprint?

- Set a rent budget and stick to it
- Keep your old car, or if you can't…
- …Public transportation/Uber/Zipcar instead of a new car
- Cancel memberships you no longer use
- Don't trade up your cell phone after it's paid off
- Automatic bill payment instead of "receive and react"
- Use your hospital's shredder or secure document disposal
- **Don't use credit cards to increase the size of your box**
- **Ignore the Jones family**

Is Renting *Really* Throwing Your Money Away?

Assume $150,000 30-year mortgage at 7% ($998/month), $300/month taxes and insurance

	Payments	Balance
After 1 Year	$15,575	$148,476
After 2 Years	$31,151	$146,842
After 3 Years	$46,726	$145,090
After 4 Years	$62,302	$145,090

6% Commission ($160,000 Selling Price)	$9,600
New Roof	$12,000
Sewer Replacement	$15,000
Sidewalk Replacement	$2,500

This Guy Needs Your Undivided Attention

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Bad Credit Uses Up Some of Your Box

Some potential costs for not maintaining good credit:

	Penalty for <u>Poor Credit</u>
Car Payment	extra $75/month
Credit Card Interest	extra $100/month
Car Insurance	extra $40/month
Total Extra	**$215/month**

- Pay your bills on time
- Don't carry a balance of more than 20% of your available credit

Know What Credit Bureaus Are Saying About You

TransUnion. EQUIFAX Experian A world of insight

Check your credit reports regularly

•Get a report from <u>each</u> bureau at least once annually.

•Check all three <u>scores</u> at least once annually

You are guaranteed by law one free credit report from each credit bureau once per year

AnnualCreditReport.com

AnnualCreditReport.com was established by the three primary credit reporting agencies and is the only truly free service to obtain your free reports

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Employer-Sponsored Retirement Plans

I. 401(k): For-profit employer
II. 403(b): Schools and colleges, hospitals, religious, and other non-profits

- Your most important retirement investment vehicle as a W-2 employee
- Deducted from your paycheck before federal income taxes assessed
- Contribute up to $18,000 of salary into a tax-deferred account
- Employer will frequently match contributions up to a maximum $ or %
- Under most circumstances, withdrawal before age 59 ½ results in 10% penalty
- After-tax accounts (Roth) now available with many 401(k) and 403(b) plans

Strategy during residency:

1) If your employer matches your contribution (some will, even as a resident), budget to contribute at least the minimum required to obtain the full employer match

Example: A Tale of Two Savers

- Annual earnings of $50,000
- Marginal federal income tax of 25% (pretend federal income tax is the only deduction)
- Defer 5% of salary ($2500)
- Employer matches first 5% 1-for-1

Saver A does not use 401(k)/403(b)

Gross Earnings	$50,000
Employee Contrib.	($0)
Taxable Earnings	$50,000
Income Tax	($12,500)
Net income	$37,500

Saver B uses her 401(k)/403(b)

Gross Earnings	$50,000
Employee Contrib.	($2500)
Taxable Earnings	$47,500
Income Tax	($11,875)
Net Income	$35,625

401(k) or 403(b) Account:

Employee Contrib.	$2500
Employer Contrib.	$2500
Account Balance	$5000

Individual Retirement Accounts

IRA Type	Tax Treatment	2017 Contribution Limit	2017 Income Limit
Traditional IRA	•Pre-tax Contributions •Grows Tax-Deferred •Taxed at personal rate when withdrawn	•$5,500/ year	•Single:$62,000-$72,000 •Joint :$99,000-$119,000
Roth IRA	•After-tax Contributions •Grows Tax-Deferred •Tax-free withdrawals •Contributions can be withdrawn tax-free and penalty free (<u>NOT earnings</u>!)	•$5,500/ year	•Single:$118,000-133,000 •Joint: $186,000-196,000

➔ **You can contribute to both a Traditional and a Roth IRA, but only to a *combined* limit of $5,500**

➔ **Under *most* circumstances, you will pay a 10% penalty if you withdraw funds from your IRA prior to age 59 ½**

Afraid to Take on Risk?

Goal: $5 million retirement savings in 35 years

How much do you need to save each year?

Rate of Return*	Annual Contribution
.02% (6 month CD)	$142,371
3% (Conservative Bond Fund)	$82,585
6% (Blend of Stocks and Bonds)	$44,695
9% (Aggressive Stock Fund)	$22,999

***Returns not guaranteed**

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Income-Driven Student Loan Repayment

Income Based Repayment (IBR): **15% of Discretionary Income**
Pay as You Earn (PAYE): **10% of Discretionary Income**

Discretionary Income is the difference between your income and 150% of the poverty guideline for your family size and state of residence.

For a single person in the 48 contiguous states and Washington D.C., 150% of the poverty guideline is $18,090

Therefore, if your Adjusted Gross Income is $50,000, you should budget:

Repayment Plan	AGI	150% of Poverty Guideline	Discretionary Income		Required Annual Payment	Monthly Payment
IBR	$50,000	$18,090	$31,910	x 15% =	$4,787	$399
PAYE	$50,000	$18,090	$31,910	x 10% =	$3,191	$266

Disability Income Insurance

Why Might I Want My Own Disability Income Policy as a House Officer if Coverage is Already Provided by the Hospital?

As a House Officer, you will receive Group Long-Term Disability coverage. Typical coverage is 60% of your gross income, and you will pay income tax on the benefit.

$50,000 x 60% = $30,000 = ~ $27,500 after tax

⇒ **Your "Box" Shrinks from $2,886/month to ~ $2,250/month**

Disability Income Insurance

But my student loans will be discharged if I become disabled…

…Possibly (high hurdle)

What happens if they aren't discharged?

And if they are discharged?

Disability Income Insurance

How do I show that I am totally and permanently disabled?

You can show that you are totally and permanently disabled in one of the following three ways:

1. If you are a veteran, you can submit documentation from the U.S. Department of Veterans Affairs (VA) showing that the VA has determined that you are unemployable due to a service-connected disability.
2. If you are receiving Social Security Disability Insurance (SSDI) or Supplemental Security Income (SSI) benefits, you can submit a Social Security Administration (SSA) notice of award for SSDI or SSI benefits stating that your next scheduled disability review will be within five to seven years from the date of your most recent SSA disability determination.
3. You can submit certification from a physician that you are totally and permanently disabled. Your physician must certify that you are unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that

- Can be expected to result in death,
- Has lasted for a continuous period of not less than 60 months, or
- Can be expected to last for a continuous period of not less than 60 months.

Source: studentaid.ed.gov

Disability Income Insurance

Benefits of an Individual Disability Policy as a House Officer

- benefit of $5000/month free of income tax
- Future Purchase Option of additional $12,000/month with guaranteed insurability
- permanent "True Own Occupation" coverage
- affordable graded premium option

Helps you afford loan payments if a discharge is denied, or to pay the IRS if a discharge is approved.

Life Insurance as a House Officer

Typical Group Life	$30-$50,000 provided free of charge by your employer with option to buy additional coverage

Probably enough for final expenses, but consider:

- Will a dependent suffer from the loss of your income?

- Did someone cosign for your student loans?

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Tax Opportunities

1. **Contribute to your 401(k), 403(b), or Traditional IRA**

   -Directly reduces AGI (the earnings your income-based loan payment is calculated against)

2. **Deduct up to $2500/year of student loan interest you <u>paid</u> *(per tax return)***

   - Reduces AGI

   - This deduction **<u>not</u>** permitted for married filing separately and income limits apply

3. **If you buy a house or condominium during residency…**

   -Mortgage interest and property taxes are deductible expenses

4. **Moving Expense Deduction**

   -your new workplace must be at least 50 miles farther from your old home than your former workplace was from your old home

   - Reduces AGI

Michigan Homestead Property Tax Credit

The Michigan Homestead Property Tax Credit helps low income individuals offset a portion of their property taxes incurred as a homeowner or as a renter.

- **The credit is worth up to $1200 annually**
- **You are NOT required to file an income tax return to claim the credit.**
- **You CAN be claimed as a dependent on someone else's tax return and still qualify to claim the credit.**

Michigan Homestead Property Tax Credit

You are permitted to file retroactively for FOUR TAX YEARS (same as calendar years).

Until April 18, 2017 you may file to claim:

- **2016**
- **2015**
- **2014**
- **2013**
- **2012**

After April 18, 2017 you may only claim back to 2013.

Again, these are calendar years, not academic years.

Tax Pitfalls

1. **Be aware that most deductions and credits come with income limitations**

   -Spousal earnings can prevent you from qualifying

2. **<u>Almost</u> no case can be made for Married Filing Separately**

   -MFS disqualifies you from many credits and deductions

   -Can work to your advantage if trying minimize your income-driven loan payment

3. **You will probably not qualify to deduct job hunting expenses**

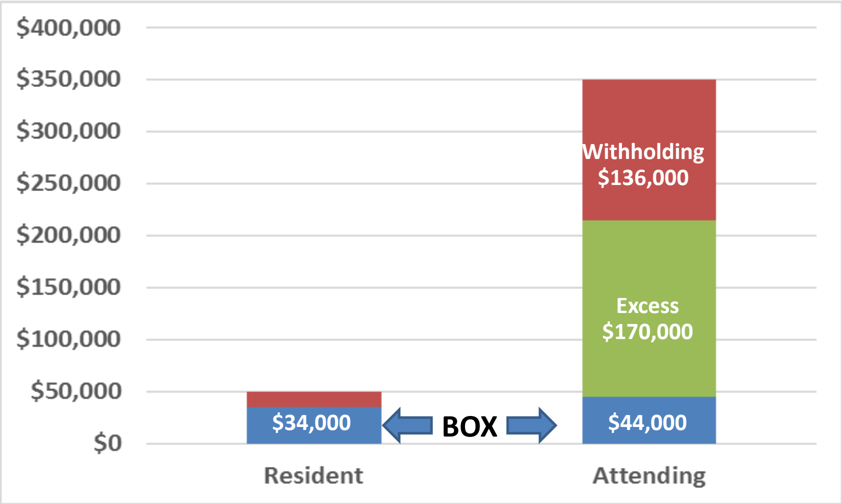
   -Not available to individuals seeking their first job or a job in different field

5. **The big one -- Moonlighting**

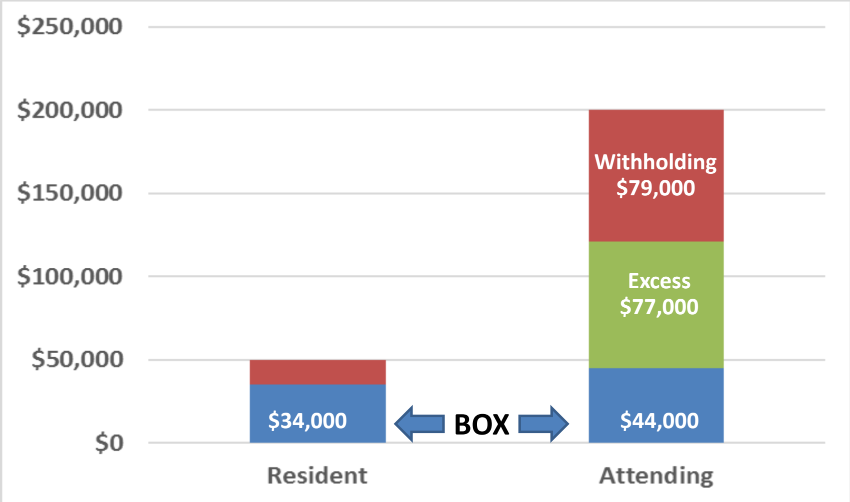
   -Prepare to send 40-45% of your moonlighting income to the tax authorities.

   -Must be submitted quarterly

Client Success Story – Emergency Medicine



But I'm Going Into Family Medicine



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