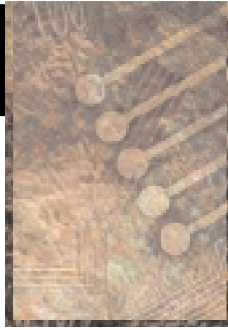

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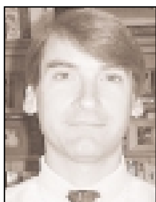
Financial Planning Sampler This well-organized physician explains the alphabet of financial planning options. Take some cues from his portfolio to create your own financial home sweet home.

BY MARC GRELLA, MD



The move to our new home late last year brought us more space, a nicer kitchen, and a much bigger mortgage. My wife and I were forced to reevaluate our long-range plans for our son's education and our own retirement, even though we expect to work for another 20 years. We looked into various types of savings strategies, both short- and long-term, and came up with a plan to cover immediate expenses, while allowing ourselves to continue our own retirement planning. Here's the plan that we decided on, and the rationale for each decision. Most of our accounts are held with Fidelity, which sponsors my workplace retirement plan.

• **401(k)/403(b)** - Since our combined income placed us in the 36 percent federal/state tax bracket, we decided to maximize our present retirement savings plans through work. This reduces our present taxable income and helps to maintain eligibility for Roth IRAs, which have income limits. It also lets us take advantage of my wife's generous workplace "match" plan. Her employer allows her to place up to 15 percent of her pretax income into a 401(k) plan, and matches an additional 25 percent of that amount. Some employers match 50 percent or more of an employee's contribution. The maximum tax-deferrable amount is currently $10,500 per year per person, with lower limits often established by employers. On withdrawal, the principal and any gains are taxable at your tax bracket at that time, which is usually lower in retirement. 1999 Federal/State tax savings: $6,480.00

The UTMA account will become the property of our son when he reaches the age of majority (19 in Massachusetts), and any money in his name could be used against his eligibility for financial aid.

• **Roth IRAs** - Our next investment choices, Roth IRAs, allow a $2,000 annual contribution which yields tax-free distributions in retirement. My wife's is invested in mutual funds, while mine holds individual stocks. Since Roth IRAs are funded with after-tax dollars, all distributions are tax-free, unlike regular IRA accounts. Roth IRAs have income limits that phase out between $150,000 and $160,000. Above that, one may still contribute to a non-deductible traditional IRA. 1999 Savings: none now, but considerable capital gains savings in retirement.

• **SEPP-IRA** - Because I also have some self-employment income, I looked into a SIMPLE and the Keogh self-employment pension plans. I

found I was ineligible for them because I already have a 403(b). However, even with a retirement plan through a full-time employer, one may have a SEPP (Simplified Employee Pension Plan). This allows about 13 percent (13.043 percent to be exact) of net "self-employed" income to be placed in another IRA—without reducing your $2,000 total IRA contribution limit. Last year I was able to contribute $1,500 to this account, which grows like a regular IRA or a 403(b) plan: tax-deferred growth, taxable upon withdrawal. This highlights a strategy for those with second (and third) jobs—being classified as a consultant rather than as a part-time employee allows you to escape taxes on a portion of that income. 1999 savings: $540.00

• **Flexible Spending Plan** - My wife's employer, like many others, allows employees to make pre-tax contributions of up to $5,000 per year to an account that can be used to pay for the care of a dependent (such as a child or disabled adult). Similar plans can be used to pay for medical expenses not covered by an insurance plan. We elected to make the maximum contribution to offset day-care expenses for our son. 1999 tax savings: $1,800.

• **Regular brokerage account** - We have an account where all of our miscellaneous income goes: overtime, expense checks, moonlighting, etc. In this account, all dividends, capital gains distributions, and interest are taxed at our full rate, so we hold only stocks in this account. Mutual funds that pay out capital gains distributions can add large amounts to your tax bill, even if the fund performs poorly, while stocks generate a tax bill only when (and if) sold at a profit.

• **College savings** - For funding our son's education, we considered many options: keeping money in our names; a UTMA/UGMA account; the Education IRA (with an annual contribution limit of $500); and my favorite, the state-sponsored college savings plans. We also try to avoid filing a separate tax return for our son, which means keeping his taxable income under $700.00 per year. The account that we opened is similar to those sponsored by many states (this one happens to be in New Hampshire). We chose this one because it allows tax-deferred growth, is held in my name, is taxed at my son's rate on withdrawal, and can be used for any accredited college in the country. A monthly "invisible" automatic transfer from our checking account funds this account, so we don't have to remember to invest regularly. 1999 taxes saved: this $5,000 account grew by about 12 percent last year, so we avoided $216 in taxes while segregating an education nest egg that won't be spent for a vacation or other short-term expense.

• **UTMA Account** - UTMA (or UGMA) stands for Uniform Transfers (or Gifts) to Minors Act. Each state has one or the other. These accounts allow gifts to be made to minors while allowing an adult to direct how the funds are invested or spent. This is our "grandparent account." Since gifts made to children must be held in their name and used only for their benefit, we decided to open this account to deposit gifts of stock, cash, etc. that are made directly to our son by generous friends or relatives. The UTMA account will become the property of our son when he reaches the age of majority (19 in Massachusetts), and any money in his name could be used against his eligibility for financial aid. We intend to use this money for short-term needs and to spend all of it for various qualified expenses (day care, high school, braces, etc.) before our son applies for college. 1999 taxes saved: hard to say, because this account is built on gifts, not earned income.

We hope that by planning ahead and weighing all of our options, we will be able to provide a good start for our son and to create reasonable expectations for our own retirement, without having to count on Social Security in 2025. ■

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