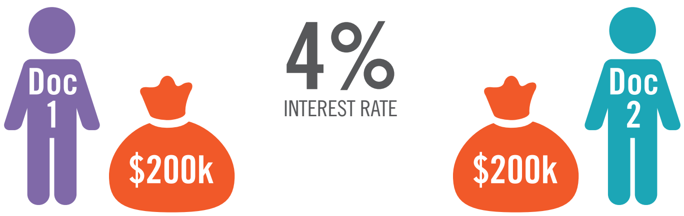


Two Doctors in Debt

Test your knowledge of the most advantageous ways to pay down debt.

CWA
CAIN WATTERS & ASSOCIATES

Two Doctors in Debt

Doc 1 and Doc 2 both owe $200,000 to the bank.

WITH A **4%** INTEREST RATE

Doc 1 — $200k

Doc 2 — $200k

YEAR ONE: Doc 1 pays $30,000 against the principal, PLUS the tax deductible $8,000 interest expense incurred. This creates cashflow income of $38,000 for Doc 1, but only the interest of $8,000 may be deducted for tax purposes. The remaining $30,000 is taxable income with a tax liability of $12,000 (at a maximum tax rate of 40%.)

YEAR ONE: Doc 2 opts to make no principal payments, but pays the tax deductible interest of $8,000, then saves $50,000 in a tax-deferred environment. With a total income of $58,000, Doc 2 deducts the interest payment of $8,000, and by having invested the remaining $50,000 in a tax deferred environment, Doc 2 will pay no taxes in the current year.

Tax Spiral

Doc 1 now has to earn another $12,000. This creates $12,000 additional taxable income. It also creates another $4,800 of tax liability, which creates more income, which creates more taxes, until it compounds.

	INCOME EARNED	TAXES PAID ON EARNED INCOME
	$30,000	$12,000
	12,000	4,800
	4,800	1,920
	1920	768
	768	307
	307	123
	123	49
	49	20
	20	8
	8	3
	3	1
	1	1
	1	0
Total	**$50,000**	**$20,000**

Doc 1 owes a total of $20,000 in taxes and the total cashflow out-of-pocket in a year is $58,000.

A Look at the Numbers

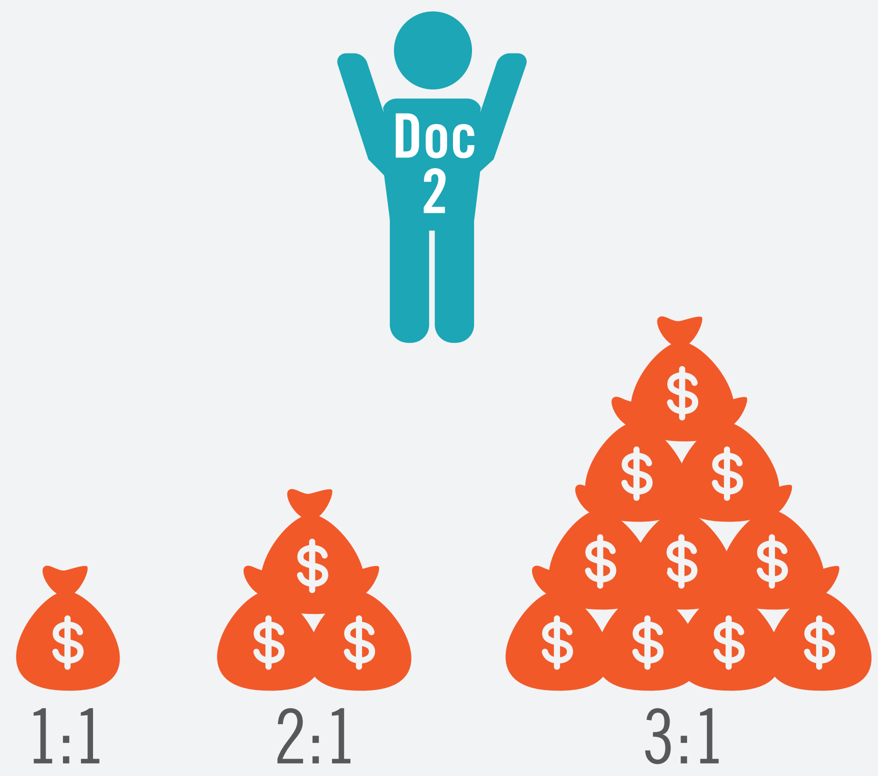
Doc 1 — **Pays Off Debt**

	PRINCIPAL PAID	TAXES PAID	INTEREST PAID	AMOUNT OF DEBT PAID	CASH ACCUMULATED
Year 1	$30,000	$20,000	$8,000	$170,000	–
Year 2	30,720	20,480	6,800	139,280	–
Year 3	31,457	20,972	5,571	107,823	–
Year 4	32,212	21,475	4,313	75,611	–
Year 5	32,986	21,990	3,024	42,625	–
Year 6	33,777	22,518	1,705	8,848	–
Year 7	8,848	5,898	354		$46,332
Year 20	–	–	–	–	$1,472,471

Tax Deferred

A Winning Strategy

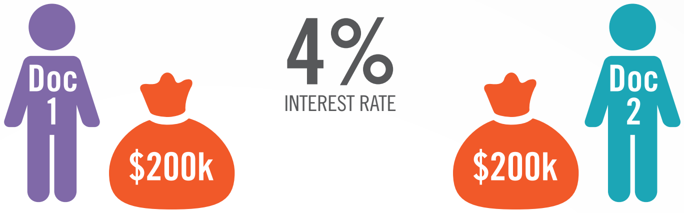
By saving money tax deferred, Doc 2 immediately starts accumulating the sum needed to reach 1:1 -- the first critical milestone on the path to finacial freeedom.



A Look at the Numbers

Doc 2 — **Pays Interest Only: Saves the other $50,000**

	PRINCIPAL PAID	TAXES PAID	INTEREST PAID	AMOUNT OF DEBT PAID	CASH ACCUMULATED
Year 1	–	–	$8,000	$200,000	$54,000
Year 5	–	–	8,000	200,000	316,796
Year 10	–	–	8,000	200,000	782,274
Year 15	–	–	8,000	200,000	1,466,214
Year 20	–	–	8,000	200,000	2,471,146
Year 21	$200,000	$133,333	–	–	$2,137,813



Test Your Knowledge

In comparing the two scenarios ask the following questions:

- What were the critical factors in reaching 1:1 faster?
- What factors contributed to a more secure path to 1:1?
- Which doctor had more options? Why?
- What led to the costly liabilities known as the “Tax Spiral?”
- Give examples of tax-deferred and tax-advantaged environments.
- Support how Doc 2’s strategy resulted in the accumulation of $650,000 more than Doc 1 over time.