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A Short Essay on Common Sense - Why Some of Us Have More Than Others. Why We All Have More in Some Areas of Our Lives Than Others. And How Can We Get More of It: We are constantly amazed at the foolish judgments we see from otherwise bright and sensible people. What they lack is a measure of common sense. Why? We're convinced that common sense is not much more complicated than learning the lessons of our experiences and knowing how to apply those lessons. It is not much more complicated than observing what **others** do well and what others do badly (and what **we** do well and what we do badly) - **and then remembering the differences between what works and what doesn't work**.

The key is curiosity. We all know doctors who are brilliant clinicians, but who are clueless in some areas of their nonprofessional lives. How can that be? In our practices, we are naturally curious. We examine what works and what doesn't. We apply those lessons. In the process we become better at what we do. At some point, dare we say, we may actually gain wisdom in our fields. The problem is that outside of our practices, we may not be as curious. Thus we are not as observant of what is happening around us, and we do not absorb the lessons our experiences could teach. That sets us up, in those areas of our lives, to make bad judgment after bad judgment. We're convinced that we could all increase our common sense by having the discipline to be curious. There will rarely be "eureka moments" where suddenly everything comes together as a brilliant insight. More often this is a cumulative process where observation after observation eventually convinces us that if we make a certain decision the chances are high that we will be satisfied vs. dissatisfied. The problem is that it takes discipline to be curious about things that are not interesting to us. For example, the areas of business and investing are topics many doctors would prefer to ignore. But, by not having the discipline to observe and learn in these less attractive (but essential) areas, we set ourselves up to make mistake after mistake. In the end, we're not sure common sense is much more complicated than that. If you have other opinions on this subject, we would welcome hearing from you.

The Greek Crisis, Potential Puerto Rico Municipal Bond Defaults and the Bursting of the Chinese Stock Market Bubble are Three International Situations that Have ZERO Effect on Our Investment Approach:

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Interestingly, the one that seems to be getting the most attention in the financial press is the crashing of the Chinese stock market. This will most likely go down as another media driven frenzy with little impact on the U.S. stock market. The Chinese stock market was in bubble territory, and the bursting was overdue. Over the past year, it has risen 150% as speculators piled into Chinese stocks using borrowed money (margin) thinking that the Chinese central government would continue to prop up prices.

To the extent that these external events create more volatility and lower prices for high quality stocks and municipal bonds, we view that as a buying opportunity.

From the "We Wouldn't Do This in a Million Years" Department - Buying Expensive Insurance (Especially By Someone Who Does Not Need the Additional Insurance) as an Investment Because of the Insurance's Supposed Tax Benefits: We continue to see expensive cash value type life insurance (sometimes called universal life or variable universal life, etc.) being pitched to doctors on the basis that the money building up inside the policy can be invested and withdrawn tax-free in retirement - without all the pesky non-discrimination rules required for retirement plans. Insurance as an investment has never impressed us.

For example, in a recent proposal (carefully described as hypothetical and non-guaranteed) to a doctor in his mid-50s, he would contribute for eight years and then be able to withdraw, tax-free, what appeared to be a sizable annual amount for the rest of his life (and have life insurance to boot). He said he didn't need the additional life insurance, so he was considering this for the investment and tax results. The non-guaranteed proposal assumed the underlying policy investments would earn 10% per year (the historical stock market return, the insurance agent explained). Even assuming the unlikely event that the stock market can give 10% per year for the next decade or so, the numbers in the agent's proposal had the policy's surrender value at the end of the eight years of premium payments at a level that is reached by 5.3% compound growth. In other words, of the 10% projected investment gains, almost half would be eaten up in commissions to the agent, insurance costs, etc. This made no sense to us or the doctor. Lord only knows what the results would be if the investments within the policy came in below the agent's presumed 10%!

Another thing that irritates us about this is the pitch that the policy can provide tax-free withdrawals for life after retiring. The explanation is that the withdrawals are first the tax-free return of premiums paid, and the excess is withdrawn as loans that (with the accruing interest) are paid off at death from the insurance proceeds. That's like saying that if we deposit money in a bank's savings account, the withdrawal of our deposits is a tax-advantaged transaction. No bank would have the nerve to make the claim that its savings accounts can be tax-free, yet that is essentially what the insurance agent is doing.

As to the excess funds, projecting the withdrawals to be tax-free loans requires a conviction that Congress will allow that loophole to continue for the rest of our lives. (And of course, if the projected investment returns are not attained, there will not be enough money built up in the policy to permit all the borrowing projected over the doctor's lifetime.) For us, this makes no sense at all!

Recommended Credit Cards: There is no single card that will be best for everyone, because the reward programs that are offered are tailored to different spending habits. We tend to prefer cards with cash back or airline benefits rather than cards that accumulate rewards points that can be redeemed for specific goods and services.

A good cash back card will pay us at least 1% on all of our purchases. And if we travel even slightly, then it is a tremendous convenience to have the card associated with our primary airline. We accumulate airline miles, get occasional upgrades, free bags and perhaps access to the club lounge. When using cards that accumulate redeemable rewards points, we need to pay close attention

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to the value of what we are redeeming our points for. The industry standard is 1% meaning that we can redeem 10,000 rewards points for an item worth $100. If we redeem 10,000 points for something worth $200, then it's a 2% redemption rate and a very good deal. If we redeem points for travel rewards worth a specific amount, then we can easily determine the redemption rate. However, if we redeem for specific merchandise like an Apple iPad, then we are likely getting a bad deal.

Here are some recommended credit cards listed in order of their anticipated annual rewards based on the following spending habits: $3,000 per month with $300 spent on gas, $500 on groceries, $600 at restaurants and $1,600 spent on other things. The calculations were done using the credit card website nerdwallet.com. We would like to have at least one of these cards in addition to our airline miles card.

AMEX Starwood Preferred Guest: High rewards rate of 5% at SPG hotels and 1% on all other purchases. 25,000 bonus points after spending $3,000 in the first three months; redeemable for free nights at over 1,100 hotels and resorts for a redemption rate of around 2.4%, or redeemable for airline miles generally at a rate of 1 point to 1 mile. Small $65 annual fee. This card has a foreign transaction fee of 2.7%, so it's not ideal for foreign travel. Anticipated annual rewards: $923.

Citi Double Cash: 2% cash back (1% when we make the purchase and 1% when we pay the credit card bill). No annual fee. Anticipated annual rewards: $720.

AMEX Blue Cash Preferred: Cash back card paying 6% at U.S. supermarkets up to $6,000, 3% at U.S. gas stations and certain department stores, 1% on other purchases. Small annual fee of $75. Anticipated annual rewards: $695.

Bank of America Travel Rewards: Generous flat rewards rate of 1.5 points per $1 spent on all purchases. 10,000 bonus points if you spend $500 in the first 90 days. No annual fee and no foreign transaction expenses. Anticipated annual rewards: $565.

Citi Thank You Premier: 3 points for each dollar spent on travel and gas, 2 points at restaurants and 1 point everywhere else. 50,000 bonus points after $3,000 in purchases during the first 3 months. No foreign transaction fees. $95 annual fee. Anticipated annual rewards: $558.

Discover Double Cash Back First Year: 5% cash back in rotating categories, 1% on everything else. Double cash back for cash earned during the first year only. No annual fee or foreign transaction fee. Anticipated annual rewards: $552.

PNC Cashbuilder: Earn 1.25% if you spend $2,000 or less during the billing cycle, 1.50% between $2,000 and $4,000 and 1.75% over $4,000. Great for big spenders. No annual fee. Anticipated annual rewards: $540.

Practice Sales to Doctors Looking to Build a Multi-Office Multi-Specialty Empire: We have seen examples of these doctors paying more for practices than the traditional doctor buyer. The two buyers view the purchase differently. The traditional buyer will derive all of his or her financial livelihood from the practice, so they need to feel comfortable that the price is affordable. After covering their loan payments, they need to see that there will be enough money left over to lead a comfortable existence, at least equal to what a well-paid associate might earn.

The entrepreneurial buyer has income from other sources and views the next practice acquisition more like an investment. If the return on investment looks attractive compared to other investments, then he or she will be interested. Consider a specialty practice with annual collections of $1,000,000 and profitability of $400,000 that is sold for $1,000,000 ("100% of gross"). The buyer will not operate the practice but will hire a specialist to do so. If the specialist will cost $200,000, then the owner's profit drops to $200,000 and is a 20% return on the $1,000,000 investment. The entrepreneurial buyer might pay 100% of gross whereas the traditional buyer would pay more like 80%.

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more access to cash and bank financing to be able to pay the higher price. Most banks will not lend a buyer more than 90% of a practice's annual revenue. Lastly, he or she may be planning to ultimately sell the empire to a private equity company that will pay an exorbitant price of six to seven times its total earnings, in which case "overpaying" for your practice will have been a non-issue.

Negotiating With the Entrepreneurial Buyer: It will be difficult to find a traditional appraiser to value the practice at 100% of gross, because the appraisal is typically done for the traditional buyer. As a seller you might explain that you are not interested in a traditional appraisal which is based on a different type of transaction. With taxes consuming roughly 30% of the sale price, that will leave you with too little to justify selling. If you enjoy practicing, you may as well continue doing so. Explain how a higher purchase price will be a great investment for the entrepreneurial buyer and that you might agree to stay on for a reasonable amount of time after the sale to help with the transition.

Tax Court Nixes California Attorney's Business Deductions in One of the Easiest Cases of All Time: In the recent case of Kurt Strode v. Commissioner (TC Memo 2015-117, June 25, 2015), the U.S. Tax Court denied hundreds of thousands of phony tax deductions and assessed back taxes, interest and penalties. The taxpayer, Mr. Strode, worked as a full-time staff attorney for a California health insurance company. Apparently irked that he couldn't enjoy the business write-offs that he might get in private practice, he claimed to be operating an international consulting company which, in reality, did nothing. Over ten years, the business earned a grand total of $5,000 but incurred $658,000 of business related expenses. The IRS audited him when he deducted these expenses against his wages from his real job.

This case is notable both for the taxpayer's chutzpah as well as the Court's dry sense of humor in dispatching the taxpayer's claims that he was operating a legitimate business. During his audit Mr. Strode submitted written receipts for various deductions including, among other things, paying his girlfriend a consulting salary and traveling the world with her, Scuba club membership dues, subscriptions to the L.A. Times, Esquire and Golf Digest, and cable, phone and internet service for his home. He also explained to the IRS agent that his business was a conglomerate much like Berkshire Hathaway. But, he didn't bother to show up in court to defend the deductions or explain his business or send anyone else who could. The IRS had no problem concluding that there was no business here and that he was simply looking for a way to deduct his personal expenses. Apparently, lawyers have far less fear of the IRS than doctors!

Business or Hobby? Newly retired doctors seem to be obsessed with finding ways to continue the tax-deductible perks they enjoyed throughout their career. Unless you have business income, you can no longer claim these quasi personal/business deductions. If you operate a legitimate business, then the losses it generates are tax deductible. If you merely engage in a hobby, then the losses are only deductible to the extent of the hobby income. The question of business vs. hobby boils down to the facts and circumstances, and the IRS looks at a series of factors such as the amount of time you devote, your expertise in the area, whether the activities are conducted in a businesslike manner, and whether there is an expectation of profit.

Your best protections are to operate the activity like a real business. Bunch income and expenses in such a way as to show profits often enough to avoid IRS challenge. That means managing a profit three out of every five years (two out of seven if the activity is horse breeding), and if that is not always possible, to operate in such a businesslike manner that the facts prove a profit motive. Keeping scrupulous business records certainly helps. In all cases, consult with your accountant early in the process.

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