

Things to Know About Your Finances

FINANCIAL PLANNING BRIEF FOR **BIGLAW PARTNERS**

Concert Financial Planning is uniquely positioned to understand the specific financial challenges and opportunities that BigLaw Partners face. This brief explores those challenges and opportunities and provides actionable recommendations to be carefully considered.

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More information about the author and Concert Financial Planning can be found on page 11 of this brief and at www.ConcertPlanning.com.



1 / What is Unique About Your Financial Situation?

Your career launched like a rocket ship in terms of both income and work load. Continuing your academic success, you hustled through the Associate years and have now reached the pinnacle of success in your field. As a BigLaw Partner, however, you may have been surprised by some of the changes to your income, benefits, and taxes that were not explained to you until you “joined the club”. Some things that make Partnership unique are:

YOU ARE A BUSINESS OWNER IN MANY WAYS, AN EMPLOYEE IN OTHERS

One great example is your 401k. You may have been familiar with your ability to choose a deferral amount to your 401k plan each year as an Associate. However, as an **owner** of the firm, you may be **required** to make **employer** contributions to your 401k in addition to the voluntary **employee** deferrals you are used to. You may also find that these required contributions are significantly higher than the voluntary deferrals at a time when your cash flows are lower than they were as a Senior Associate!

YOUR EARNINGS ARE COMPRISED OF DRAWS, DISTRIBUTIONS, AND UNCERTAINTY

You no longer have a salary and bonus, you have a target comp(ensation). However, you are not paid that target comp in equal installments throughout the year. In fact, you may only be paid around 60% of your target comp in the form of monthly “draws”, which are claims against your future profit distributions as an owner of the firm. The rest of your target comp comes via lumpy distributions, which are often used to make estimated tax payments, and a final “true-up” distribution in the following year. Oh, and your full-cost benefits are deducted from your draws along the way.

YOU ALWAYS SEEM TO OWE A LOT OF MONEY

You owe estimated taxes, capital contributions, and the full brunt of your benefits that are no longer subsidized by your employer: Health insurance, life insurance, disability insurance, 401k matching/profit sharing, and maybe more. It can become frustrating to find that with the increasing face amount of your target comp, comes the feeling of a higher sticker price.

Keeping these and other important factors in mind, this “brief” is meant to be a guide – pointing out both the opportunities to take advantage of and pitfalls to avoid.

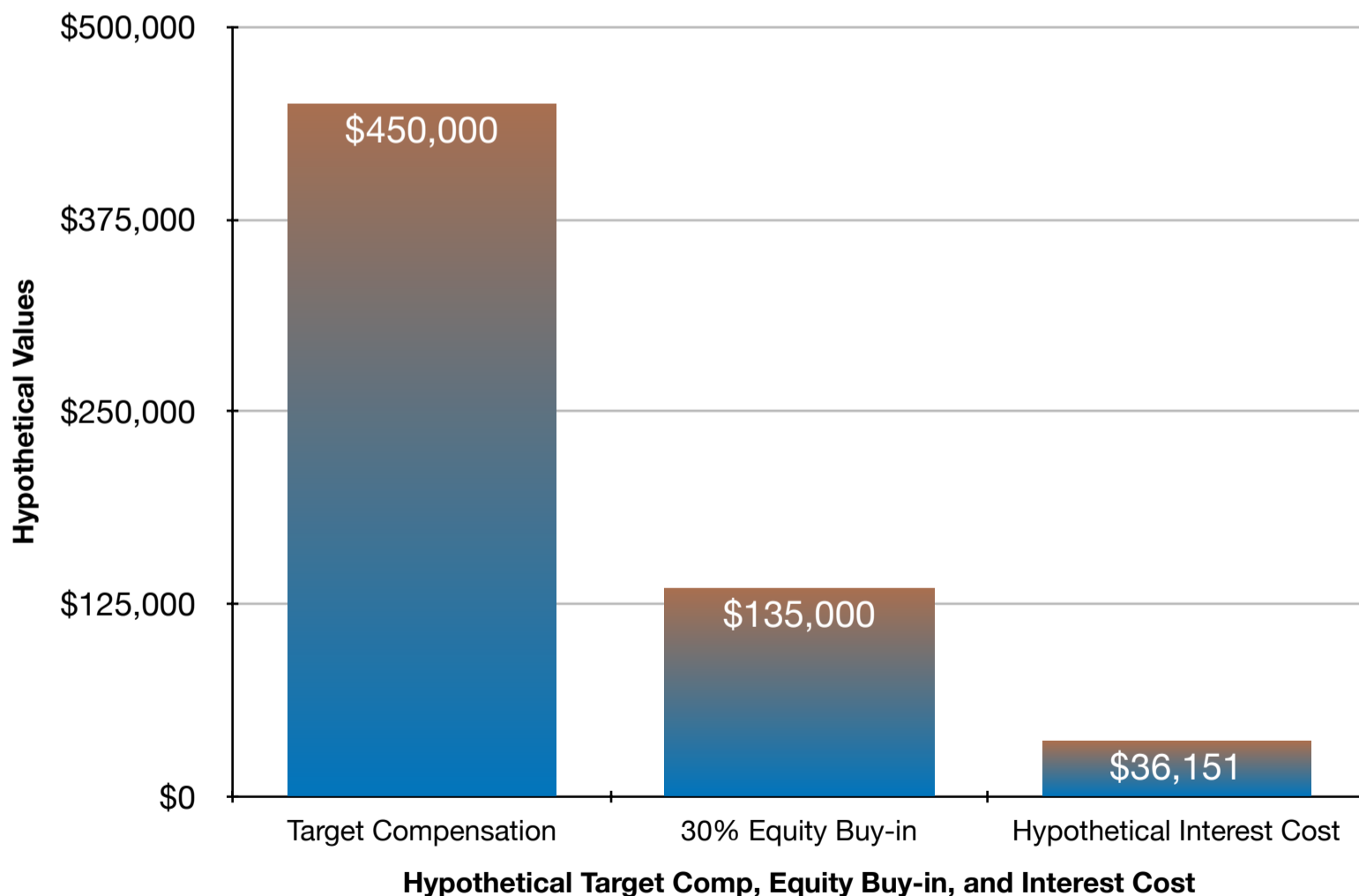
2 / Equity Buy-in

For those attorneys who are invited to become an equity partner in the firm, there is typically a buy-in for your equity stake. As a rough estimate, you might expect to pay 30% or more of your target compensation to buy your equity share. If we assume a \$450k target comp and a 30% buy-in for the purpose of our example, this amounts to \$135k that you need to come up with!

As you will learn in the Lending section of this Brief, there will likely be banks at the ready to help you make this commitment, at potentially favorable interest rates. However, given that the equity you own in your firm is not expected to grow at a rate comparable to traditional public stock investments, it may be ideal to pay this amount from pre-planned savings rather than finance it. You might think of the financing as a sunk cost if we assume that the equity value will not grow significantly beyond your distributions.

Finally, note that as your target compensation increases, your required equity in the firm may also increase. These increases are likely to be funded from your year-end distribution.

Hypothetical Equity Buy-in



Hypothetical based on \$450,000 target compensation, 30% equity buy-in, and total interest paid based on a \$135,000 loan at 7% interest for 7 years. Note that the actual loan terms may be significantly different from those illustrated here.

3 / Draws and Distributions

Given that you are now an equity owner of your firm, you are no longer paid a traditional salary like you were as an Associate. In fact, your income will likely depend entirely on the success and/or failure of the firm, from a financial perspective. Given the uncertainty of net income to the firm, and therefore the owners, the firm has to be conservative with payouts prior to income coming in the door. Therefore, the firm will likely separate your income payments into two categories: draws and distributions.

DRAWS

Draws may be thought of as advance payments on your share of the profits of the firm during the year. In an effort to minimize the risk that you could be overpaid during the year as a result of the firm's poor financial performance, your draw amount may be 60% or less of your target compensation throughout the year. Sticking with our \$450k target compensation example, this could amount to \$270k in gross payments during the year, from which many of your traditional benefits will be paid. This means your cash flows may be very tight, especially when compared to your experience as a Senior Associate.

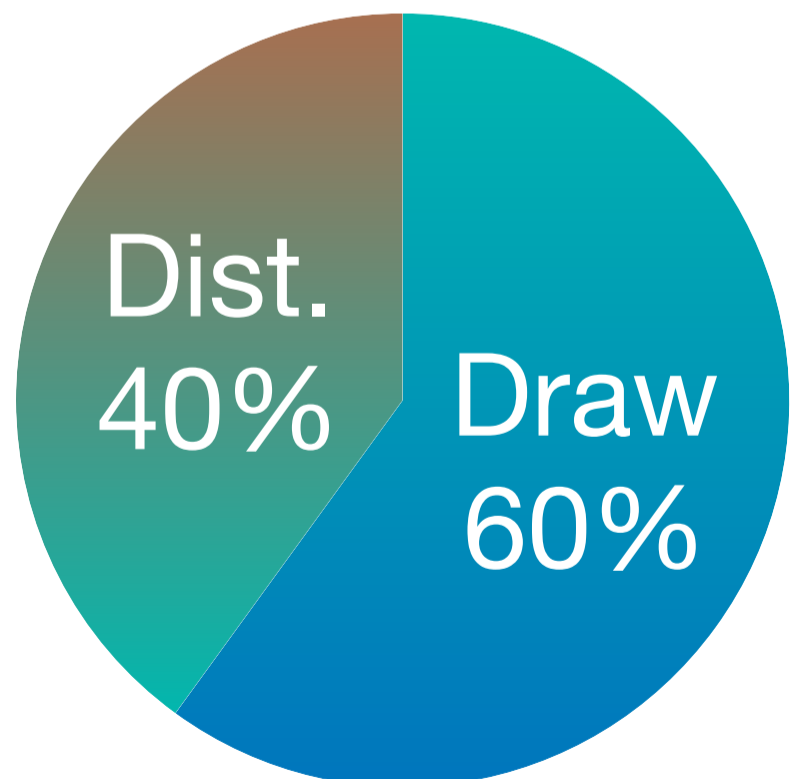
In the example described above, your \$270k annual draw may amount to \$22,500 per month in payments (your pay is typically monthly now, instead of semi-monthly or every other week). These draws are then typically reduced for voluntary 401k contributions and benefits costs (health insurance, life and disability insurance, parking, etc.).

DISTRIBUTIONS

Distributions represent your actual share of the firm's profits, and are net of the draws you have already received. The timing of distributions throughout the year can be sporadic, but most firms typically try to make distributions in time for quarterly estimated tax payments (see the Taxes section of this Brief).

Often, distributions throughout the year should first be earmarked for tax payments, whereas the final payment for the year is the largest and gets you to your target comp, assuming the firm has met its annual budget and revenue goals for the year.

However, the final distribution may also be used to make mandatory 401k contributions (see the 401k section of this Brief) and purchase additional required equity in the firm.

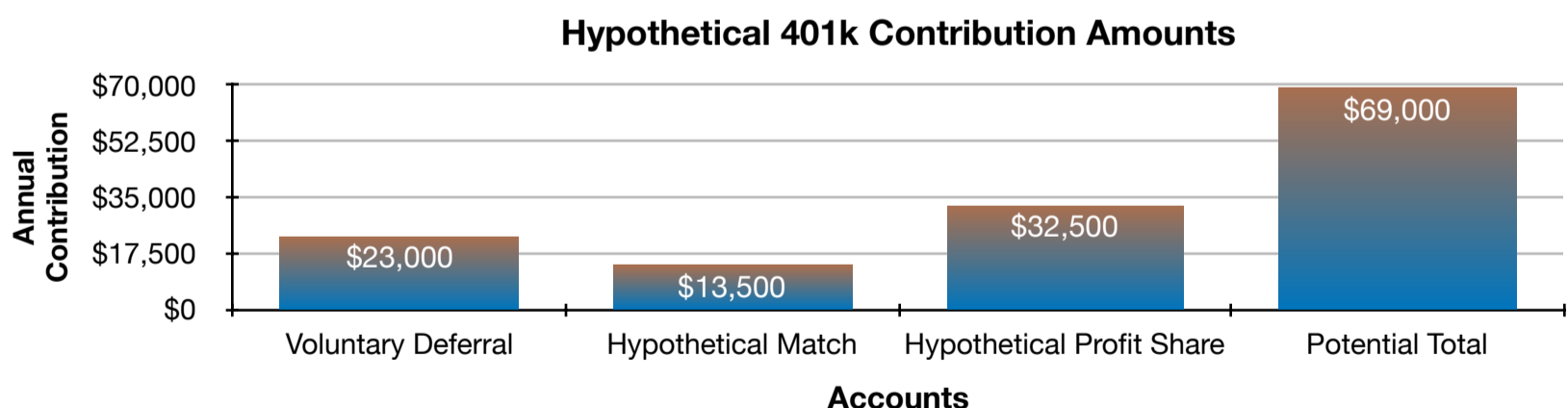


4 / Mandatory 401k Savings

As a BigLaw Associate, you were likely used to the voluntary contributions you could make to your firm's 401k retirement savings plan. Now, as an owner of your firm, you need to become aware of the other components of a 401k plan; namely, the employer match and/or profit sharing portions of a plan, and whether there are mandatory contributions to your 401k plan.

THE THREE COMPONENTS OF A 401K PLAN

- **Employee Deferral** - Many people are familiar with this part of a 401k plan, if you're familiar with any parts at all. This is the part of the plan with an annual deferral limit and the option to elect pre-tax and/or Roth contributions via your HR portal. This voluntary deferral usually remains a voluntary option even in Partnership.
- **Employer Match** - Your firm may or may not have an Employer Match as part of your 401k plan. If you do, it may be something like, "The firm will match 100% of the first 3% of your salary you defer." If your firm has an Employer Match, you are now the employer and will likely be required to make these contributions to your account.
- **Employer Profit Sharing** - Your firm may elect to share some of the firm's profits into employees' 401k accounts, beyond or despite any Employer Match. Even if your firm does not traditionally do this for Associates, "profit sharing" may now become a required contribution for you as an owner of the firm. The profit share is often the difference between the maximum allowable participant limit to a 401k plan and the maximum voluntary deferral.



Based on 2024 Limits with No Age 50+ Catch-Up. Hypothetical 100% Match to 3% of \$450k Target Comp.

Your traditional voluntary deferrals into your 401k account will likely come from your monthly draw. In the likely event that you do have mandatory 401k contributions, they may be taken from your final annual distribution, which may also be used to pay estimated taxes and to replenish your capital account. It is important to plan your cash flows accordingly!

5 / Benefit Cost Increases

NO MORE SUBSIDIES

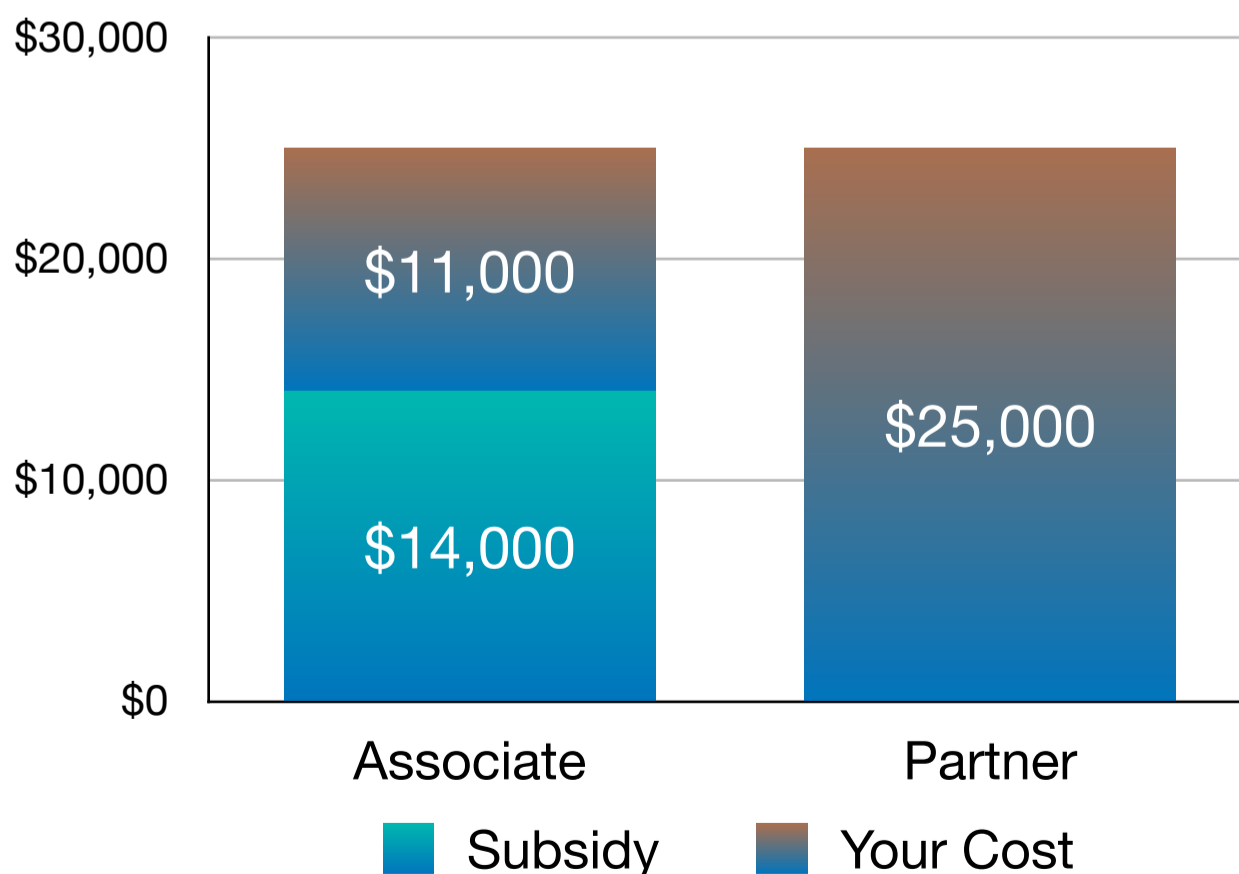
As an Associate attorney and salaried W-2 employee, you likely enjoyed the benefit in shared costs for things like health insurance, life and disability insurance, and others. As an owner of the firm, those subsidies will likely go away and you will pay the full cost for the benefits. In most cases, the benefits are not optional and, in fact, there may be new requirements for additional insurance coverage and/or additional retirement savings beyond the 401k plan. These costs can add up, and typically reduce your net payment from your monthly draw.

USE A SPOUSE'S BENEFITS, IF APPLICABLE

Acknowledging that this may not be an option for many readers, it's worth pointing out the potential to plan in advance to use a spouse's benefits through their employer, if their benefits are more cost-effective for a similar set of coverages. In particular, health insurance coverage can be especially pricey for families when you are both the employee and the employer and must pick up the full tab.

In cases where this option is not available, and/or the spouse's benefits are unattractive or not comprehensive, you need to plan in advance for how to handle the reduced cash flow that results from the combination of low monthly draws relative to your target comp, as well as the increased cost of your benefits.

Hypothetical Annual Health Insurance Cost



Hypothetical Health Insurance Cost Sharing Based on \$25k Annual Premiums.

6 / Taxes

ESTIMATED TAXES

As an owner of the firm, you are no longer a salaried employee. Therefore, you no longer receive a traditional paycheck and your taxes are no longer withheld on your behalf, except in the case of some state taxes (see below). Because of this, it is now your responsibility to pay “quarterly” estimated taxes, although the schedule of payments is not actually on a quarterly basis. Typically, the payments are required in mid-April, mid-June, mid-September, and mid-December. This is one of the many reasons it is highly advisable to work with a professional tax advisor who is fluent in BigLaw Partner attorneys’ tax situation. Generally, your firm will provide you with the necessary information to determine your income, but it is up to you to determine how much taxes are owed.



Estimated Tax Payment Due Date Timing

1. Mid-April
2. Mid-June
3. Mid-September
4. Mid-December

In all cases, seek the advice of a qualified tax advisor. Concert Financial Planning does not give legal or tax advice.

COMPOSITE TAX FILING

One of the choices you may be faced with if your firm conducts business across multiple states, is whether to elect “composite filing” for states in which you may owe taxes as an owner of the firm. The decision of whether to elect this filing and for which states is beyond the scope of this brief, but suffice it to say that there are pros and cons in terms of explicit costs, opportunity costs, and hassle.

Very generally speaking, electing to participate in your firm’s composite filing may allow you to avoid filing individual income tax returns in each state where you may owe taxes, but it may also expose you to overpayment of taxes during the year. On the other hand, electing to file individual state income tax returns can be a costly endeavor in terms of both explicit costs (paying a tax preparer for each return) as well as hassle.

7 / Lending

As a Partner at a BigLaw firm, you will find that you have ample attention from banks, financial advisors, financial planners, insurance salespeople, etc. It can be very difficult to know who to trust or what to believe. However, it has been our experience that bank lenders who are “partnered” with your firm can be an excellent resource for *lending products*, such as mortgages, capital loans, and lines of credit.

RETURN ON HASSLE

One significant benefit we’ve seen from clients working with bank lenders that have established relationships with the law firm is that these relationships typically allow the banker to reduce the amount of paperwork you have to complete to obtain a loan or a line of credit. For example, income verification for people with K-1 “self-employment” style income can be difficult for some traditional lenders who do not have special programs.

When you are perceived as being a business owner, this can introduce significant hurdles and additional scrutiny from the average lender who is used to focusing on W-2, salaried employees. A lender who specializes in helping Partner attorneys can make the process much easier for you, including getting into direct contact with the people in your firm that can provide them the documentation they need without asking you to take ownership of that task.

LENDING PRODUCTS

There are a wide variety of ways that bank lenders can assist you with your needs, and each category typically has multiple options, but the three most common that we see are:



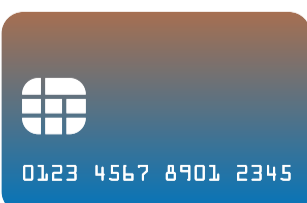
Mortgages

- Potentially favorable interest rates
- Potentially favorable equity requirements
- Potentially easier process



Other Loans

- Personal Loans for personal use
- Capital Loans for equity buy-in
- Real estate construction



Lines of Credit

- HELOC (Home Equity Line of Credit)
- Personal
- SBL (Securities-Based Lending)

8 / Planning Opportunities

EQUITY BUY-IN

Depending on where you are in your career when you read this, you may have an opportunity to plan in advance for an equity buy-in and avoid a potentially high interest rate loan on a stagnant asset. With funds saved and earmarked in advance to make your first capital contribution, you can feel confident in your optionality to use those funds if lending rates are high, or to finance the buy-in and redeploy your savings elsewhere if rates are attractive.

CASH FLOWS

One of the toughest parts of becoming a Partner is surviving the first eighteen months or so from a cashflows perspective. In all likelihood, your net take-home pay will be lower than it was in your last year as an Associate until you receive your final distribution for your first year, which will likely occur in the first quarter of your second year in Partnership. Planning in advance to fund this time period through savings can be a huge win for you in terms of financial security and your own peace of mind.

BENEFITS

Understanding your potential increased costs for health insurance, life and disability insurance, and mandatory retirement plan contributions can head off an unpleasant surprise. If available, a spouse's benefits package may be an attractive alternative to your firm's benefits. In other cases, planning to budget for these increased expenses can help your financial commitments remain smooth as you embark on your first year of Partnership.

TAXES

Your taxes are likely going to go from "very high" to "very high and very complex". It is of paramount importance that if you do not already work with a tax advisor who is qualified to advise BigLaw attorneys, that you find one to work with now. From quarterly estimated taxes, to K-1 partnership income, to composite filing elections - you need the help. Save yourself the time and trouble and outsource this complexity to a professional.

LENDING

Financial salespeople have been emailing and calling you at your desk since your first days as an Associate. If you have successfully avoided the life insurance pitches and investment gurus, kudos. However, at this stage of your career, we have found that bank lenders who have established relationships with your firm can truly deliver value in the form of lending products like mortgages, loans, and lines of credit.

About the Author

Matt Smith is the Founder and Lead Advisor of Concert Financial Planning (“CFP”), which is a ***Fee-Only, Fiduciary, and Independent*** Registered Investment Advisor in Houston, TX. CFP focuses on helping BigLaw Attorneys organize and optimize their financial life. Most of our client families have at least one attorney spouse, and of course we serve the whole family regardless of profession.

Matt earned his B.A. in Economics from the University of Texas at Austin in May 2004 and has earned a series of licenses and accreditations including the Series 65 License, the Chartered Financial Analyst (CFA®) designation, and the Certified Financial Planner (CFP®) designation, among others. You can find a full list of Matt’s credentials at www.ConcertPlanning.com/Credentials.

Matt founded CFP in 2019 after spending 14 years working for two large asset managers, where he developed an expertise in investment analysis, portfolio construction, and financial planning. During this period, Matt consulted with and educated hundreds of financial advisors across the central U.S. on his companies’ funds, economic and market outlook, and investment strategies.

Matt also saw how the financial services industry works from the perspective of a product developer whose clients were distributors – a/k/a “financial advisors”. He saw an antiquated business model that relies on selling financial products for commissions that are often hidden from client view, and/or focusing attention on retirees that have built up a large nest egg from which to draw management fees.

Matt decided to launch his own firm to serve his contemporaries, and to do so in a modern way. He is compensated in a ***Fee-Only*** manner, meaning no commissions, kick-backs, or product sales; he acts as a ***Fiduciary***, meaning he is bound legally and ethically to act in the client’s best interest at ***all times***; and he is ***Independent*** of shareholders or other stakeholders whose interests may not align with those of his clients.

MATT IS A MEMBER OF THE FOLLOWING PROFESSIONAL ORGANIZATIONS:

NAPFA / Fee-Only Network / XY Planning Network / CFA Society of Houston / CFA Institute

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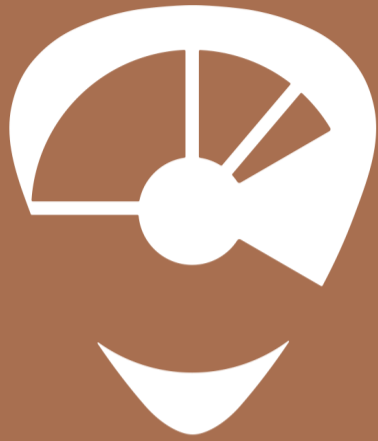
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