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6 tax essentials physicians need to know

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Since 2001, the tax code has undergone 4,680 changes—an average of more than one change per day. Even worse, physicians are paying more in taxes. Because of these trends, intelligent tax preparation has become essential, not optional.

To help, some changes in U.S. tax laws are highlighted in this article. This is by no means a complete list, but identifying strategies for dealing with these areas represents a big step to creating to a solid tax strategy.

Tax challenges

On New Year's Day 2013, the Bush-era tax cuts expired. Now the rich pay more (or are supposed to.) The top tax rate for individuals earning $400,000 or more, and married couples filing jointly earning $450,000 and up, is 39.6%. This is the highest rate in nearly 15 years.

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Capital gains rates also increased under the same "fiscal cliff" deal. The wages of individuals earning more than $200,000 ($250,000 for married couples), now are subject to Medicare surtax. This will be tacked on to wages, compensation, or self-employment income over that amount. The surcharge is .9%.

There is not much to be done about these increases, which were a long time coming and received bipartisan support. While taxes can't be eliminated altogether, they can be significantly reduced with proper preparation. Such preparation may include structured trusts, limited partnerships and other legal entities.

Another tax is the net investment income tax, under which individuals earning $200,000 ($250,000 for couples) may now owe more. Taxpayers with net investment income and modified adjusted gross income (AGI) will likely pay more. Net investment income encompasses: income from a business, dividends, capital gains, rental and royalty income, and/or interest.

Depending on any business or investment activities outside your practice, there may be circumstances where you owe more. Be sure to check with a professional to assure all income outside of your medical practice is accounted for appropriately. Please note that wages, unemployment compensation, operating income from a non-passive business, Social Security, alimony, tax-exempt interest, self-employment income, and distributions from certain Qualified Plans are excluded—for now.

Next: 6 steps to improving your practice's bottom line

PRACTICE FINANCES:
SIX STEPS TO IMPROVE YOUR BOTTOM LINE

1 Find your revenue sources

Identify and review the codes you most commonly bill for. Your practice management system should be able to produce a revenue report by CPT code.

2 Identify payers

Review a billing report by payer, and identify your payer mix and reimbursement rates for each one. Consider working toward a more balanced mix to avoid a heavy concentration with one payer.

3 Review contracts

Review your payer contracts and consider possible renegotiation of reimbursement rates. Are your collection percentages in line with industry averages for your specialty?

4 Analyze your schedule

How far out are you booking appointments? Often minor adjustments can improve patient wait times and increase the number of patients you can see in a day.

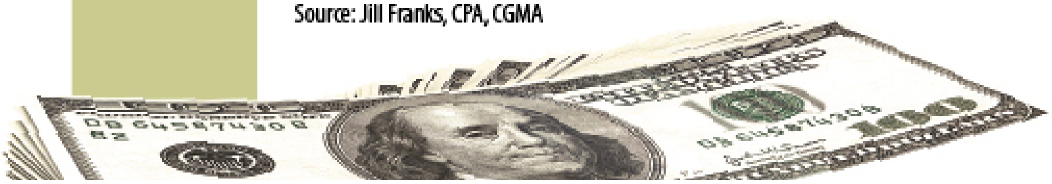
5 Review fee schedules

If your reimbursements are at or near 100%, it's likely that your fees are too low.

6 Build a budget

A budget is a good starting point to determine if your practice's expenses are in line. Consult benchmarks to determine each expense category as a percentage of practice revenue.

Source: Jill Franks, CPA, CGMA



Next: Personal exemptions

Personal exemptions

In addition, personal exemptions (PEPs) for high earners may be eliminated.

The phase-out of the personal exemption affects individuals with adjusted gross incomes of more than $254,200 and $305,050 for married taxpayers. They end completely for individuals who earn $376,700 or more and $427,550 for married taxpayers. While PEPs are generally a drop in the bucket for high earners—it was only $3,950 in 2014—it's a lost deduction that can add up over several years.

Interestingly, while the definition of marriage is decided by individual states, the Internal Revenue Service recognizes a legally married same-sex couple in all 50 states, no matter what their legal status is in their home state. This can affect tax, estate, legal, and charitable planning.

Savvy estate planning for all married couples and individuals may involve various types of trusts, such as a charitable-lead trust. When created and structured properly, the charitable-lead trust earns an immediate tax deduction, avoids taxes on appreciated assets, and may provide an inheritance for heirs later.

A charitable-remainder trust potentially avoids capital gains taxes on appreciated assets, allows you to receive income for life, and provides a tax deduction now for your future (posthumous) charitable contribution. For large, significant charitable gifts, donating appreciated stocks or mutual fund shares (provided you've owned them for over 366 days) is a way to boost your largesse.

Under IRS rules, the charitable contribution deduction is the fair market value of the securities on the date of the gift—not the amount you paid for the asset. And there is no tax on the profit. This only works for assets that have appreciated in value, not for those on which you have a loss.

Tax credit for CME

Now for the good news: You may be able to benefit from Tax-Free Education Reimbursements for continuing medical education (CME) via a Section 127 educational assistance plan, depending on the way your practice (or your employer's practice) is structured.

If you are an employee and your employer does not pay for the CME, it is considered a miscellaneous itemized deduction subject to the 2% AGI limitation. Under this scenario it is better to negotiate to have your employer pick up the costs. Then it is a deduction for the employer and nontaxable to the employee.

If your practice is a sole proprietorship or a single-member LLC, than the cost should be deducted on your Schedule C, and is a deduction from AGI (and self-employment tax). If the practice is a multi-member LLC, partnership, or S corporation, it is best for the entity to pay the expense. Doing so reduces the flow through income from the entity and effectively reduces AGI.

Under the partnership scenario (or an LLC taxed as a partnership), if the operating agreement states that the expense must be paid by the partner/member and that the entity will not reimburse the costs, then the expense can be deducted on Schedule E of your tax return (thus reducing your AGI). This treatment is not available to an S corporation.

Next: Retirement planning

Retirement planning

The conversion privilege for Roth individual retirement accounts (IRAs) continues. Converting a traditional IRA into a Roth account is treated as a taxable distribution from the traditional account with the money going into the new Roth account. The result of this conversion is a larger federal income tax hit (a larger state tax hit is also likely).

But the benefits may outweigh the extra money owed. At age 59½, all income and gains accrued in the Roth account can be withdrawn free from federal income taxes, provided at least one Roth IRA has been open for more than five years.

In the event that future federal income tax rates rise, the Roth IRA's balance isn't affected. Provided the account is over five years old, if you die, your heirs can use the money in your Roth account without owing any federal income tax. And unlike traditional IRAs, Roth IRAs are exempt from required minimum distribution (RMD) rules applied to other retirement accounts, including traditional IRAs.

Under the RMD rules, you must start taking annual withdrawals after age 70½ and pay the resulting taxes. But you can leave Roth IRA balances untouched for as long as you wish and continue earning federal-income-tax-free income and capital gains. And there is no income restriction on Roth conversions: Everyone, no matter their income, can do them.

Real estate

Selling a home may be excluded from tax. How? Suppose an individual sells a primary residence. She or he may exclude up to $250,000 of gain. A married couple may exclude up to $500,000.

There are a few caveats, however. Principal ownership of the property, for at least two years during the five-year period ending at the sale date, is required. Also, the property must have been a primary residence for two years or more during the same five years. The maximum $500,000 joint-filer exclusion requires at least one spouse to pass the ownership test; both need to pass the use test.

Regarding previous sales, if gains from an earlier principal residence sale were excluded, there is typically a wait of at least two years before taking advantage of the gain exclusion provision again. Married joint filers may only take advantage of the larger $500,000 exclusion if neither spouse claimed the exclusion privilege on an earlier sale within two years of the latter.

Dependent care credit

There is also positive news regarding the dependent care credit. If you employ child care for one or more children under the age of 13 so that you can work (or, if you're married, you and your spouse can work), you may be eligible for this credit. Affluent families receive a credit equaling 20% of qualifying expenses of up to $3,000 for one child, or, up to $6,000 of expenses for two or more. The maximum credit for one child is $600; for two or more it's $1,200.

The credit is also available to those who incur expenses taking care of a person of any age who is physically or mentally unable to care for themselves (i.e., a disabled spouse, parent, or child over the age of 13).

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