PROVIDENT
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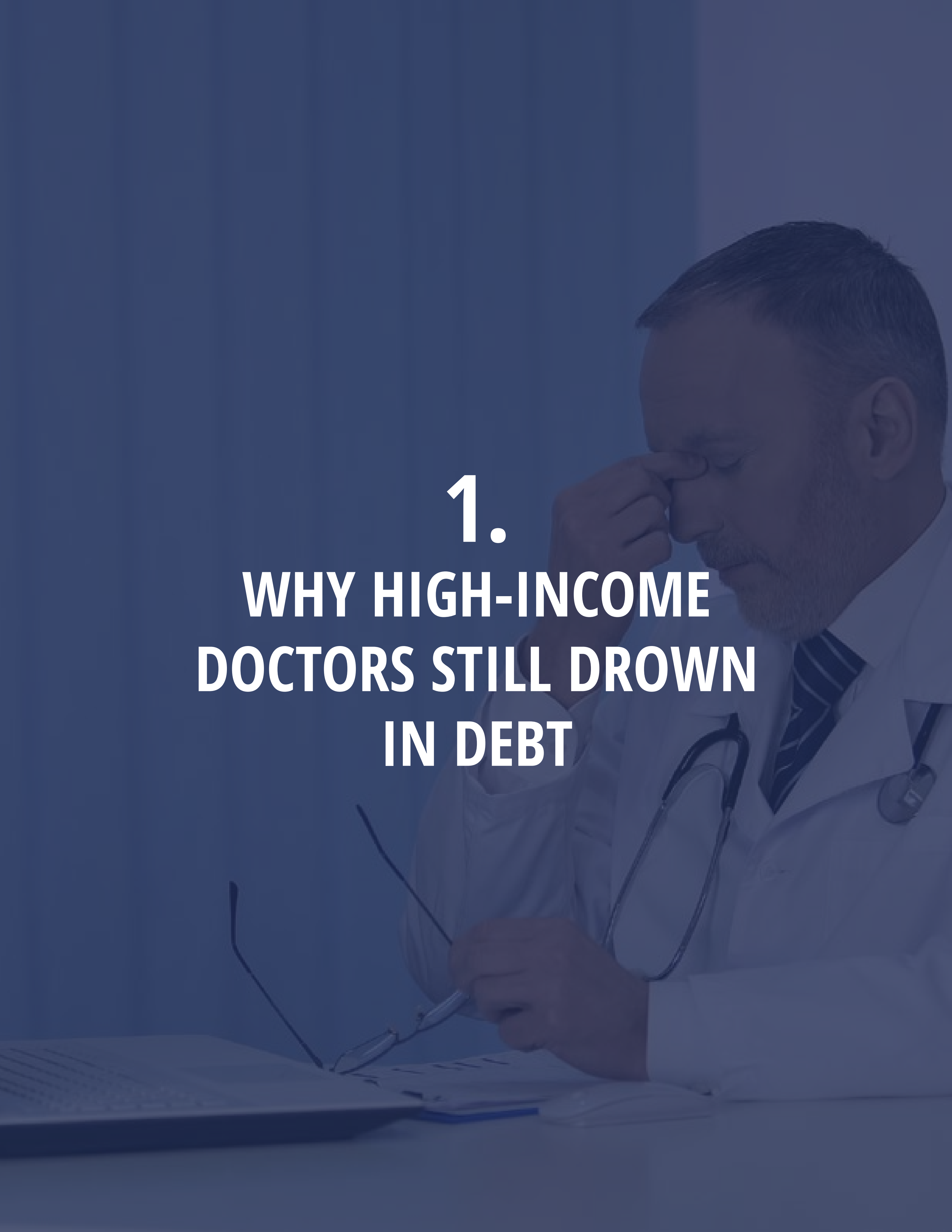
TAX AND FINANCIAL PLANNING FOR DOCTORS

Key considerations for physicians on taxes, retirement, asset protection, and debt.



1.
WHY HIGH-INCOME DOCTORS STILL DROWN IN DEBT

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In *U.S. News and World Report's* 2019 "Best Paying Jobs" list, the 11 best-paying jobs are in the medical field. But when physicians finally start to work after medical school, they continue to struggle with large amounts of debt throughout their careers. Why does this happen?

Medical school debt statistics:

Recent data from the Association of American Medical Colleges show that in 2018:

- 76% of med students graduated with debt
- The median debt was $192,000
- 21% of students graduating from private med schools have $300,000 or more in debt

The average cost of a four-year medical school program is $242,902, and private schools have a median cost of $322,767.

OVERSPENDING LIMITS THE ABILITY TO PAY OFF DEBT

Even with these high debt numbers, doctors are known to overspend, increasing the time it takes to pay off loans. What factors lead doctors to do this? Common reasons include:

- Doctors feel they have to spend to live up to the expectation that physicians have money.
- They've waited long enough to start living a normal life.
- Many doctors haven't been trained to manage their finances.

It may be easy for people to overlook the financial needs of doctors:

They make plenty of money or at least they will someday. And many physicians themselves start to believe this, so they may totally neglect good saving habits or ignore wise investment choices, including saving enough for retirement.

Individuals may not fully understand how daily spending needs to align with overall financial goals, or they may not know how to save the most on taxes. Physicians need the same financial training as the rest of us. They should look to financial programs or resources for those in medicine and establish a relationship with a professional tax advisor.

2.

7 ASSET PROTECTION MISTAKES DOCTORS MAKE

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One in three physicians has a medical liability lawsuit filed against them during their careers. But of course, any kind of lawsuit can jeopardize a lifetime of savings if assets aren't sufficiently protected. Here are eight common asset protection mistakes doctors make:

1. Underestimating the need for umbrella liability insurance. This inexpensive policy should serve as a primary layer of protection for doctors.

2. Overestimating malpractice insurance. It can take one successful claim to wipe out an entire practice.

3. Not thinking through how assets are titled. Doctors should consider how assets are titled, especially if they're married. Every car, boat, or other vehicle owned by a doctor's family should only be titled in its driver's name to avoid being responsible for something an individual cannot control.

4. Believing assets in all living trusts are protected from creditors. Revocable living trusts hold assets that can pass to heirs without probate upon death, but they are not safe from creditors. Irrevocable trusts provide asset protection since doctors no longer legally own the assets or control distribution.

5. Assuming all retirement plans are protected equally. 401(k) and defined benefit plans are protected by federal law from creditors, as well as being tax-advantaged.

6. Failing to protect practice assets. Doctors will go to great lengths to protect their personal assets from potential lawsuits, but often neglect the assets of their practices.

7. Perhaps the most overlooked asset protection strategy is not giving away too much income to Uncle Sam. A tax advisor can help devise a tax strategy — including but not limited to restructuring a doctor's employment relationship — that saves a huge amount of money.

3.

CAN PHYSICIANS LOSE THEIR HOUSE IN A MALPRACTICE LAWSUIT?

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Doctors hear all the time that malpractice lawsuits may cost them everything — their assets, savings, or even their house. While malpractice cases can be lengthy and expensive, it's actually very rare that a physician loses everything in these cases, especially with the proper insurance coverage. And the state an individual practices in can have an impact on how well they are protected.

Under Florida law, for one example, individuals actually have protection from losing their residence if they own the home they live in — aside from being responsible to creditors that hold a mortgage or lien on the home.

Malpractice claims statistics

Getting sued is a reality for a wide range of practicing physicians. Research from the American Medical Association (AMA) showed that 49.2% of physicians over age 55 have been sued at least once. And these legal battles can be expensive—the average cost of defense for a physician when dealing with a medical liability claim went up to $47,158 in 2010, which was a 62.7% increase since 2001.

However, AMA also says that 60-65% of these lawsuits are dropped or dismissed. But even when they're dropped, legal costs alone can still be high for doctors—an average of near $30,000.

What's really at risk if you're sued

There's no doubt that a malpractice payout is expensive if the plaintiff wins. Medscape says the average settlement in court is around $425,000. But that's only for the 18% of cases that actually make it that far. 90% of cases are settled out of court and 82% don't even go to trial. And most cases are settled without doctors having to spend their own money. The physician's insurer usually handles the settlement.

Malpractice insurance

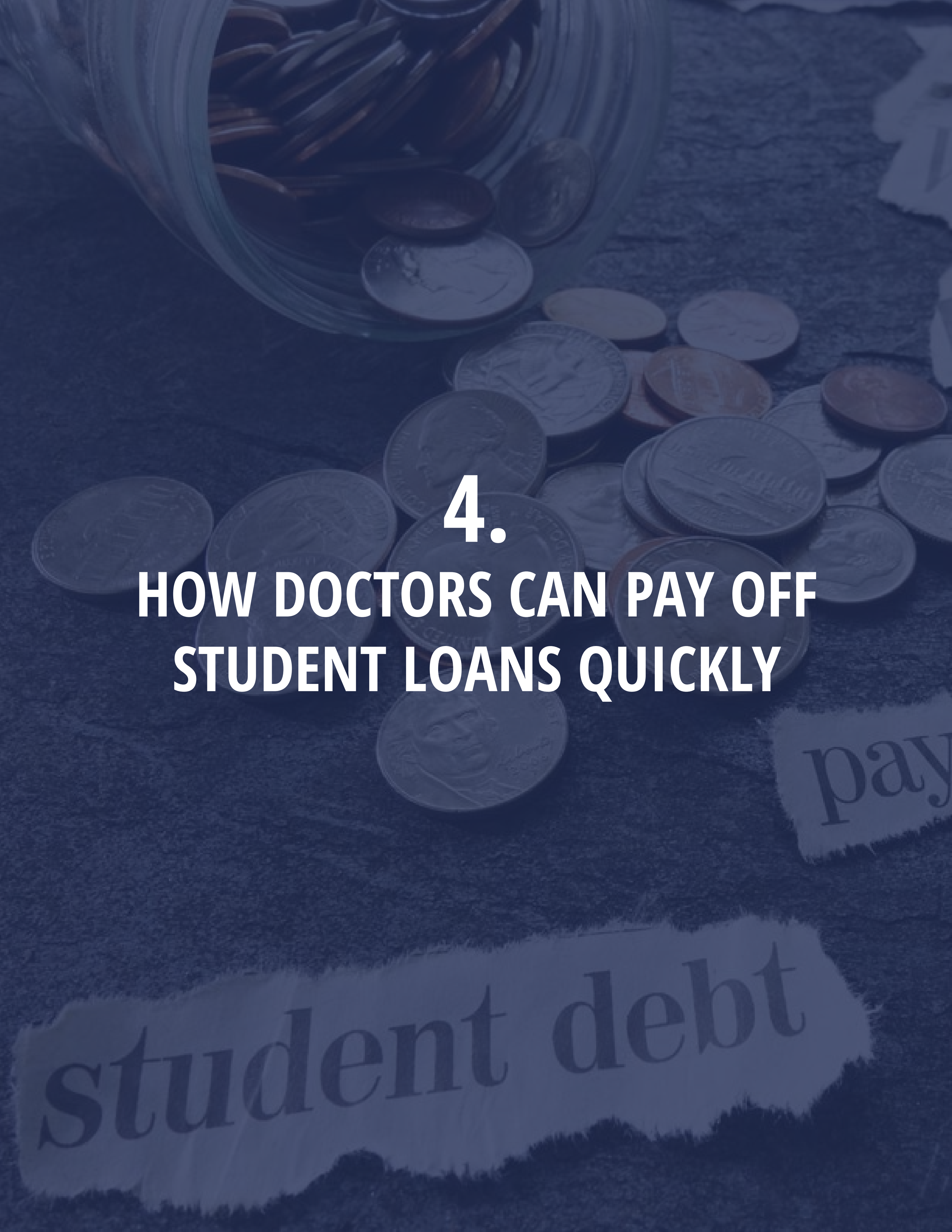
Some states across the nation don't require doctors to carry malpractice insurance. But deciding to opt out of this important coverage isn't a wise choice, considering what's at stake and how much insurers cover doctors in the long run. The cost of premiums can be pretty high and depends on a number of factors, but the average cost of malpractice insurance varies from $4,000 to $20,000 annually, depending on practice area. Internal medicine doctors see lower rates, while specialty physicians are at the top of the spectrum.

While malpractice insurance is always a good idea for physicians, keep in mind that a malpractice claim is no small matter. Some doctors experience depression, a lack of self-confidence, or fear when returning to work after a case, even if they won. They could have also lost a lot of money because they weren't able to practice when they were in court or dealing with other related matters.

Medscape documented a case study of an OB/GYN who had been sued three times. The doctor decided to settle all three because it was cheaper, but also because the emotional turmoil would have been too much to handle.

There's no easy way for doctors to protect themselves from the emotional costs of malpractice lawsuits. But they shouldn't make the process even more difficult by failing to have the proper insurance coverage.

4. HOW DOCTORS CAN PAY OFF STUDENT LOANS QUICKLY



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HOW DOCTORS CAN PAY OFF STUDENT LOANS QUICKLY

Graduating from medical school is a major accomplishment.

But for too many doctors, the celebration is dampened by the massive student-loan debt that can go hand-in-hand with a medical degree, and repayment of traditional student loans programs can drag on for 10 to 30 years.

Let's take a look at six ways to manage medical school debt while paying it down faster.

1. Refinance with a private lender. The federal student loan interest rate is 6.6% for graduate programs like medical schools for the 2018-19 school year. Student Loan Hero points to reputable student loan refinancing lenders that offer rates as low as 1.95%.

2. Consider an income-driven repayment plan. IDR plans can be a great option for residents who can't afford to make full payments. There are four federal plans that cap monthly payments at a percentage of your discretionary income, making them easier to afford.

3. Think carefully about how taxes are filed. For doctors who recently got married and are making payments on federal student loans, tax filing status as a married couple could significantly impact loan payments. CPAs can also help them take advantage of tax credits, like the student loan interest deduction of up to $2,500 on a 2019 tax return.

4. Don't assume high salaries preclude doctors from forgiveness programs. Public Service Loan Forgiveness (PSLF) offers student loan forgiveness after 10 years for physicians whose work qualifies as public service.

5. Negotiate a physician signing bonus. Medical employers often use physician signing bonuses to attract top talent—and they can offer a great opportunity to pay down a substantial chunk of debt. In 2017, the average physician signing bonus was $30,000—but the largest was $200,000.

6. Live like a resident (just a little longer). To make extra debt payments, doctors need to make them a financial priority. Prepare mentally to live like a resident for a few more years, even with a higher salary.

Medical student loan debt can feel daunting, and most physicians are anxious to get out from under the burden as quickly as possible. But practicing medicine leaves them little time to address student loan strategies—and most aren't sure of the best path forward. A skilled CPA can help you discover ideas and tax strategies that may take years off your loans, saving thousands of dollars in the process.

5.
ESTATE PLANNING FOR DOCTORS

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A detailed estate plan is especially crucial for doctors, for a few different reasons. Physicians not only need to consider protecting their often-larger estates, but they also need to ensure that their medical practice is protected along with their assets, both before and after their death.

Estate plan considerations for physicians

There are a few different purposes of creating an estate plan for doctors. These include:

- Tax planning — helping to minimize estate or inheritance taxes paid out at the time of death
- Protection of assets from the long and often expensive probate process
- Ensuring assets are distributed according to their wishes at the time of death

Another big one is medical malpractice coverage. Doctors aren't protected from this liability just by creating an LLC or corporation, unlike other businesses. When their coverage isn't enough to actually cover malpractice costs, they are personally responsible for those costs, and creditors or whomever is suing them could then go after their assets—even after they die.

What will an estate plan look like?

An estate plan sets forth a variety of wishes based on what a doctor wants to happen after they die or become incapacitated. The basic components to avoid probate include:

- Choosing and naming beneficiaries
- Appointing individuals to control assets
- Naming guardians for minor children

Also remember:

1. **A will isn't always enough.** If a family member contests it, the estate will enter probate court.

2. **Set up a trust.** Setting up a living trust, even if there is a detailed will, will help avoid probate.

3. **Compile cash and liabilities.** Create a net worth statement (a compilation of assets and liabilities) and a list of life insurance policies.

Estate planning under the new tax law

At the beginning of 2018, the Tax Cuts and Jobs Act (TCJA) was put into place, which doubled the federal estate, gift, and generation-skipping transfer (GST) tax exemptions — now up to over $11 million and double that for married couples — until the exemptions "sunset" on December 31, 2025.

Unless an estate is above the exemption threshold, a doctor will not owe federal estate tax (which is 40%). But if they do have an estate that's over the exemption amount, or if they live in a state that implements a lower exemption, there are still steps to take with estate planning to help lower taxes, including giving away assets or setting up an irrevocable trust.

6.
A DOCTOR'S GUIDE TO RETIREMENT PLANNING

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During the first 10 years of practice—when compound investment growth makes the biggest impact on retirement accounts—physicians are burdened with student-loan payments, the cost of establishing a practice, mortgage payments, and more. Thus, despite their high income, many doctors don't max out their retirement plans. Here are seven steps individuals should be taking to ensure they're ready to retire:

1. Set a realistic retirement goal
2. Track monthly spending
3. Consider other factors that will drain savings
4. Erase debt
5. Review the cost of running a practice
6. Plan for family emergencies
7. Focus on long-term benefits

Of course, a successful retirement plan not only helps doctors save money but saves taxes as well. Here are five tax-savvy options that can form the foundation of a solid retirement plan:

- **Tax-deferred retirement plans for doctors who are employees.** Physicians who receive a W2 showing wages or salary can defer income by maximizing contributions to a workplace retirement plan, such as a 401(k) or 403(b).

- **Tax-deferred retirement plans for self-employed doctors.** Self-employed individuals and those who receive income reported on Form 1099—including doctors who moonlight—have other options for retirement savings. These include SEP-IRAs and one-participant 401(k) plans.

- **Tax-qualified pension plans for physician employers.** Doctors who are self-employed may establish defined benefit (DB) plans, and those who are employees may be fortunate enough to work for an organization that offers one.

- **Tax-advantaged personal retirement accounts for doctors' families.** Physicians who receive earned income from employment and spouses who are younger than 70 ½ may contribute to an IRA.

- **Tax-efficient investments in taxable accounts.** Doctors who max out contributions to their tax-advantaged retirement accounts can still invest in securities that are inherently tax-efficient.

7.

IS THERE A MAGIC NUMBER FOR RETIREMENT?

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The thought of early retirement is appealing to most doctors, who are often overworked and exhausted. But how do you know how much money you'll need?

Here's how to figure out your number:

Determine how much you need to live comfortably. Start by tracking your spending, if you don't do this already. Aside from big monthly expenses like mortgage or car payments, where is your money going?

Factor in costs that may go up. It's crucial to realize that in retirement, you may spend more on certain things with more free time. For example, you may want to travel more, and healthcare costs will change.

Don't forget the costs that may go down. You'll no longer be contributing to retirement accounts, so you can eliminate that cost. Things like commuting will be less expensive, and you'll likely save on taxes.

Inflation changes the retirement planning numbers. When figuring out your priorities and your ideal number, don't forget about inflation. Tack on 3 to 4% annually to account for increases.

Assess your risk tolerance. One important part of reaching your retirement goals is assessing your risk tolerance. Young investors generally take more risks than those nearing retirement.

Create a realistic retirement plan. It may be tempting to predict that you need much less in retirement than is practical. But don't jump the gun. You don't want to be in a position where you regret retiring.

8.
FINANCIAL STRATEGIES FOR MID-CAREER DOCTORS

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Mid-career is the perfect time for physicians to organize their finances, prioritize their goals, and solidify the financial strategies they want to follow.

Here are seven tips for creating a financial roadmap:

1. Fix your financial mistakes. Let's face it: it's pretty certain that you've made at least one major financial mistake by the middle of your career. Now's the time to make it right.

2. Make a push to pay off your mortgage. It's wise to head into retirement with your mortgage paid off—and the sooner you can achieve that, the better.

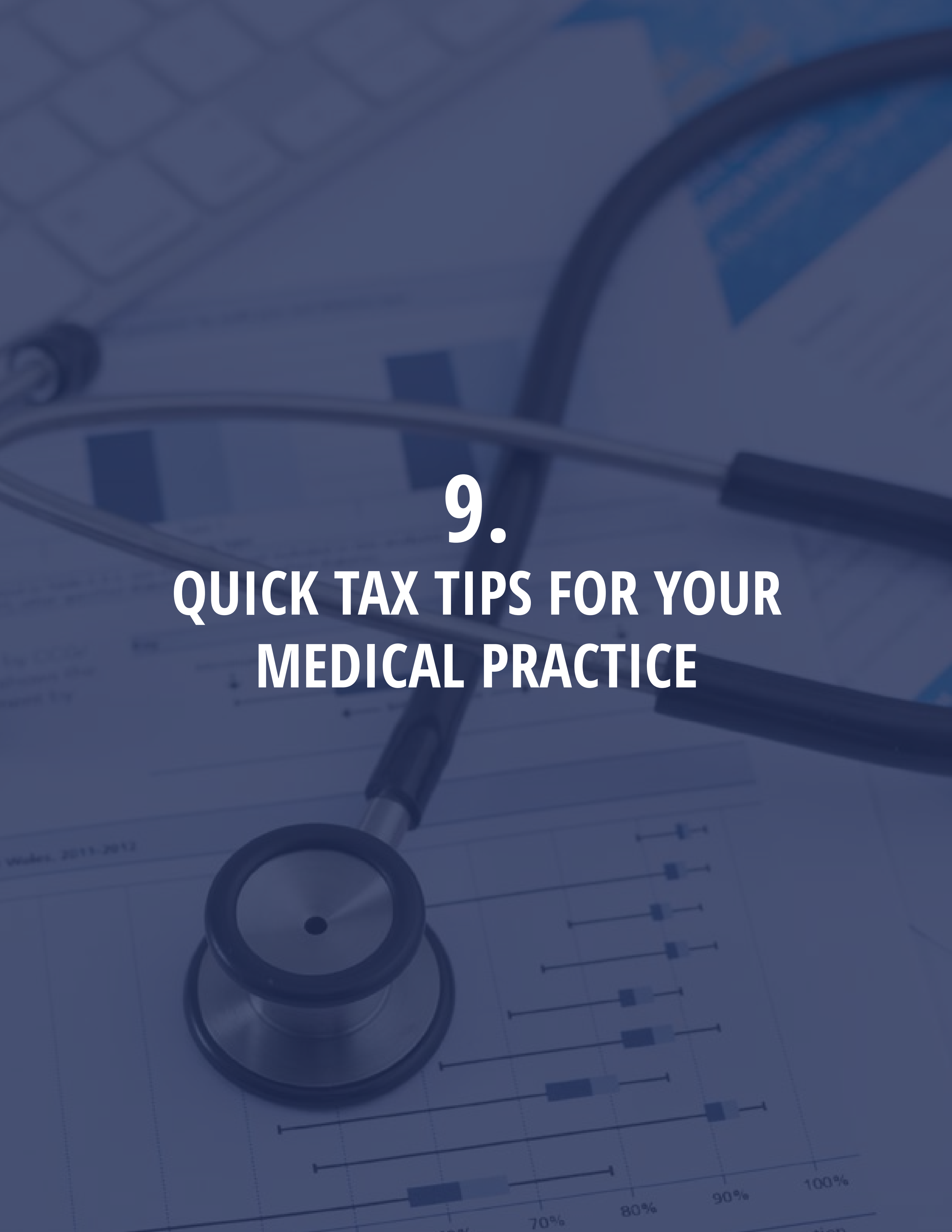
3. Keep your expenses in check. If you're not putting at least 20% of your gross income toward retirement by mid-career, it's wise to make some changes. A detailed budget brings clarity to where your money is being spent so you can make progress toward your financial goals.

4. Squirrel away cash for college. While you've hopefully been putting some money toward this goal since your kids were born, now's the time to step up your game. Remember: saving for college is a sort of like a test run of your ability to save for retirement.

5. Evaluate where you are. If you've done a great job with your finances by mid-career, you can consider early retirement, working less, taking a job you'll enjoy that pays less, or eliminating exhausting on-call shifts. But if you haven't, it's important to find ways to get your savings on track.

6. Solidify your retirement plan. Mid-career is the point where you should have a realistic retirement goal and firm up your plan for making it happen.

7. Update your estate plan. A well-crafted estate plan saves time, avoids probate, reduces or eliminates estate taxes, and eases any financial burdens for surviving family members.



9.
QUICK TAX TIPS FOR YOUR MEDICAL PRACTICE

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Here are quick tax tips to maximize potential tax savings under the Tax Cuts and Jobs Act (TCJA) of 2017:

Tax strategy for homeowners

Doctors may want to think twice before refinancing in 2019. The TCJA impacts deductions on mortgages obtained after Jan. 1, 2018, meaning only the interest on the first $750,000 of debt is deductible. But advanced tax strategy can leverage U.S. Tax Code Section 280A(g) and let you rent out all or part of your home, tax-free, for two weeks every year. The same rule allows physicians to partially or wholly rent out their property to their business, allowing for tax-free income and a business tax deduction.

How the TCJA impacts saving for children

Doctors who've opened a custodial account for their children as either a Uniform Transfers to Minors Act (UTMA) or Uniform Gifts to Minors Act (UGMA) will lose out on taxes. Opening a 529 that ensures that funds go toward your child's future education could be a suitable alternative. It's tax-free at the federal and state level and tax-deferred as it grows. The contributions themselves aren't deductible, but any expenditures for qualifying educational purposes are (up to $10,000 a year).

How to maximize charitable donations

The standard charitable deduction is currently $24,000 for married physicians. You're best advised not to make regular donations of smaller amounts to your favorite cause; rather, one large donation with a break in-between. Another option is donating securities from a taxable account. There's no capital gain on the sale and the gift is tax deductible.

Your individual needs affect your strategy

You can generally assess the TCJA's impact by using this tax calculator from the Tax Foundation which allows you to create a custom scenario to see how tax reform will affect you and your family.

10.

HOW DOES MOONLIGHTING IMPACT YOUR TAXES?

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Moonlighters are part of a huge shift in the American workforce as up to 50% of workers will go freelance within the next decade. Whatever your motivation to moonlight, here's what you need to know to file your taxable income properly.

Some important cautionary advice on moonlighting

You must first be certain that you're permitted to moonlight under your current practicing circumstances. You may incur penalties or realize that only a certain number of moonlighting hours are allowed or that they are dependent on supervision.

Moonlighting and the 1099

An important distinction here is just how you're choosing to earn the extra income. Who's paying and where makes the difference between you being classed as an employee or as self-employed.

Moonlighters often work at locations outside of their day job and for employers other than their primary one. This is known as "locum tenens" (a Latin phrase that means "to hold the place of, to substitute for"). As such, they're typically taxed under the 1099-MISC filing category.

The 1099 means you personally account for your owed taxes come April, typically via the 1040-ES filing. On the other hand, 1099 earnings do have the advantage of having certain tax deductions, provided you're working at a secondary institution. This could be a big help with things like travel costs or supplying a home office and would be filed under Schedule C.

The TCJA could also be strongly in your favor if your job allows you to work and charge independently for your services, which is discussed more in the next section of this book.

Moonlighting and the W2

The same can't be said if you do all your moonlighting at the same facility as your day practice. The TCJA is less generous to physicians who remain stationary under the same employer circumstances. You'll still be making extra money, but the results would be taxed as usual by your employer and appear on your W2 as per your standard hours.

Upsides to this include that onsite moonlighting at your usual facility removes the need to spend money on travel. Physicians who moonlight as their sole working model are also required to have pay for liability coverage insurance, which can be sidestepped by remaining onsite with your primary employer.

11.

SHOULD YOU RESTRUCTURE YOUR PRACTICE AFTER THE NEW TAX LAW?

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Since tax reform significantly reduces the tax rates imposed on C corporations' taxable income, is it beneficial to switch your structure? What about independent contractor status?

Traditionally, doctors have preferred pass-through entities, with only a quarter of medical practices filing as C corps. But the new tax reforms offer an enormous tax break for C corps—slashing the old maximum tax rate of 35% to a flat 21%. The TCJA also repealed the corporate alternative minimum tax (AMT) intended to ensure that corporations pay a minimum amount of tax by limiting or eliminating certain deductions, credits, and other tax-preference items.

Pass-through entities also received a significant tax break with a 20% Qualified Business Income deduction that reduces the top federal tax rate on their income from 37% to 29.6%. Profits from pass-through entities are taxed according to the owner's personal tax rate. But the QBI deduction is only temporary—it's on the books through the end of 2025—while the C corp tax relief is permanent.

Doctors who own medical practices can only qualify for the pass-through break if they earn no more than $415,000 a year for a married couple filing jointly or $207,500 for a single filer.

The challenges of C corps

Double taxation is important to consider. At C corp status, income is first taxed at the entity level rate of 21%, and then dividends are taxed to the individual at up to 23.8%. Once both taxes are paid, the effective tax rate of a C corp can actually be higher than a pass-through entity.

However, C corp dividends are only taxed in the year they are paid; substantial tax savings could await medical practices that convert to C corps if they invest a high percentage of profits back into the business as equipment or other property as part of a long-term strategy, instead of distributing them as dividends.

C corp structures also tend to make practice sales more problematic, however, if it is likely that your practice will be sold soon, retaining the pass-through structure may be wise. Another important consideration is that laws are never "permanent." While the reduction to the maximum corporate tax rate was written for longevity, it could change.

Legal loopholes that lower your taxes

Skilled tax advisors may be able to find perfectly legal ways to help high-income doctors qualify for the lower pass-through tax rate. For instance, they may consider converting their office building into a real estate investment trust and charging themselves rent, thus reducing their income.

There also can be workarounds to avoid the double taxation of C corps for doctors and other professional service providers whose income is too high to qualify for the pass-through deduction. One tactic, while complex, is slicing the business into two or three separate entities.

Practice owners can also extract money from a C corp by taking advantage of an array of tax-free benefits that are not generally available in pass-through entities. In a C corp, benefits such as health insurance and educational assistance are paid with pre-tax dollars.

There's also a special benefit for owners of small C corps to exclude most—if not all—gains from the sale of corporate stock. Although this perk has existed since 1993, the previously high tax rate of C corps prevented most doctors from choosing this structure and taking advantage of this benefit.

Making the change

If your practice is based in a state that allows for "statutory," or streamlined, conversions, it can take less than a week if the process goes smoothly. Only about 15 states don't allow this practice, such as Arizona, New York, and Pennsylvania. In most cases, the transformation is tax-free.

Important: The IRS only allows one change in your tax election every five years—unless the last election was for a newly formed entity or more than half of the business's ownership interests have changed.

Notes about physician groups and the independent contractor status

Inefficient corporate structure increases the tax burden

Many physician groups were inefficiently structured as corporations when they were formed, and now bounce out 100% of their taxable income to their doctors to avoid paying corporate tax. That leaves high-income doctors classified as employees facing a hefty tax bill—at the highest individual rate of 37%—with no or at least very few write-offs to offset their income. It also forces them to pay 100% of their FICA payroll tax, which eats up 7.65% of an employee's salary.

The income ceiling only applies to the 6.2% Social Security portion of the FICA tax, however. Not only is there no wage limit for the 1.45% Medicare portion of the tax, but there's an Additional Medicare Tax that high-income individuals must pay that adds another 0.9% tax to any income that exceeds a certain threshold. This limit is currently $250,000 for married couples filing joint tax returns and $200,000 for single filers.

In contrast, these same doctors allowed to contract with the physician group through their own company could reduce their tax burden by a whopping $150,000 on between $500,000 and $600,000 of income by taking advantage of the many deductions now available to them.

Other factors to consider before making a change

When you are an employee, your employer withholds taxes on your behalf and remits them back to the IRS. If you become an independent contractor, you must have the diligence to ensure that your estimated taxes are paid throughout the year. Independent contractors are also hit with a Self-Employment Tax of 15.3% that covers the 7.65% Social Security and Medicare payroll tax you would have paid as an employee, as well as its 7.65% counterpart your employer would have paid on your behalf. (You can claim a tax deduction for half of the Self-Employment Tax.)

Overcoming administrative concerns

Some physician group administrators hesitate to allow doctors to transition from employees to independent contractors out of fear that restructuring will harm the group. But contracting with doctors won't affect the group's negotiating power or control over its people; it only impacts how they are paid and enables them to do better tax planning.

A more valid concern is ensuring that doctors in the group fit the IRS framework for independent contractors. The employee vs. independent contractor designation is an area the IRS highly scrutinizes and penalties for getting it wrong are severe.

TALK TO A QUALIFIED TAX ADVISOR TO LEARN MORE ABOUT TAX MINIMIZATION STRATEGIES FOR DOCTORS.

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