The Orthodontist’s Practice Financial Statements and Income Taxes
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Presented to
American Association of Orthodontists
April 2014

Outline for Today’s Program
- Current Tax Rates Provide Planning Opportunities
- Tax Buckets
- Practice Financial Statements
- Tax Reduction Strategies
- Maximize After-tax Dollars
- The Five Minute Financial Plan
- Q & A

Tax Rate Planning Opportunities

Buckets of Income
- Interest Income
- Dividend Income
- Capital Gain Income
- Tax Exempt Income
- Profit Sharing 401k
- IRA Income
- Real Estate and Oil & Gas
- Roth IRA and Insurance
- Wage and Practice Income

Practice Financial Statements
For a non-tax analysis of these financial statements see my December 2011 article in Seminars in Orthodontics: A Guide to Understanding an Orthodontic Practice Financial Statement
Office Salaries

Included in office salaries, for services rendered, are wages to the doctor’s spouse and children.

1. When the spouse qualifies for the 401k plan the majority of the spouse’s income can be shielded from income taxes by deferring the maximum allowable each year into the plan.

2. Children’s wages are shifted to lower income tax brackets than the parents.

Children’s Compensation

1. For legitimate services
2. Consider work permit
3. Use funds for extra curricular activities, like summer camp, sports activities, music lessons, private school tuition, but not for child support
4. Fund a Roth IRA
5. If incorporated will save you around 25% - 35%.
   If sole proprietor will save around 35% - 50% depending on state income tax rate
6. Deposit into Child’s bank account, not yours
7. Standard deduction for 2014 is $6,200

Staff salaries and the Small Business Health Care Tax Credit

- 2010 - 2013 Tax credit of up to 35% for employers with <26 employees and <$50,000 average annual wages
- 2014 - 2015 Tax Credit of up to 50% for eligible employers who purchase insurance through the SHOP exchange
Staff salaries and the Small Business Health Care Tax Credit, cont
• Expected that between 1.4 and 4 million small businesses would be eligible for tax credit
• In 2011, only 228,000 took the credit
• Why?
  - Limited incentives
  - Complicated
  - They don't know about it
  - And last but not least, you don't qualify

IRS Notice 2013-54 and DOL Technical Release 2013-03
Starting with the 2014 plan year, employers are not allowed to subsidize or reimburse employees for individual health insurance policies on a pretax basis

Rent Expense
1. If your practice legal entity is a S-Corporation,
2. And you own the building where you practice,
3. And the corporation pays you rent,
4. The net income from that rental activity may be subject to the new 3.8% NIIT, unless:
5. The dental and rental activities are integral to each other, either by identical ownership, or the activities constitute an economic unit;
6. You then need to group these activities and make a grouping election on your income tax return to avoid NIIT.

Depreciation and Section 179 Expensing Election
1. Dental related assets and computers depreciated over 5 years
2. Other assets, such as furniture 7 years
3. Current Section 179 limit is $25,000
4. Often, taking advantage of section 179 isn't the best tax strategy, due to basis issues for S-Corporations, and cash flow timing and retirement contributions for almost all entities
5. Significant lobbying over section 179 limits so subject to change

Telephone Expenses
1. If you are incorporated – use of cell phone for business and personal reasons is completely tax deductible.
2. If you are a sole proprietor – only the business portion of your cell phone use is tax deductible.

Laboratory Expense
Is it really a good idea to have your children set up their own lab that you pay for?
1. Income to child may be subject to self-employment tax
2. Additional record keeping and income tax returns to account for
3. Kiddie tax until age 24
4. May need to be held in trust if a minor
5. Might save $1,000 annually, but...
6. Is there a liability issue?
Office Expenses

1. Is it worth it? Buying supplies at Costco that somehow end up at home? Or a computer through the office that goes off to college with you son or daughter?

2. The case of the Rolex watch!
   - Beware the bitter spouse
   - Employee admiration
   - There is no attorney client privilege with your CPA

Doctor Wages

1. Set doctor wages so that you can maximize your retirement plan contribution
2. Additional wages increases your Medicare taxes by as much as 3.8%
3. Profits after wages can represent dividends or return of capital and avoids additional Medicare taxes for S-Corporations only
4. Maximum wages for 2014 that can be considered for retirement plan purposes is $260,000

Meetings

Included in doctor expenses are meetings for rent of the doctors home - for less than 15 days

IRC Section 280A(g)
- Special rule for certain rental use
- Notwithstanding any other provision of this section or section 183, if a dwelling unit is used during the taxable year by the taxpayer as a residence and such dwelling unit is actually rented for less than 15 days during the taxable year, then—
  - (1) no deduction otherwise allowable under this chapter because of the rental use of such dwelling unit shall be allowed, and
  - (2) the income derived from such use for the taxable year shall not be included in the gross income of such taxpayer under section 61.

Meetings continued

1. What kinds of meetings can I have at my home?
   - Christmas Party
   - Staff meetings
   - Meet with CPA or other consultant
   - Board of Director's meetings

2. How much can I charge for a meeting?

3. Does this really hold up?

Retirement Plan

1. Most doctors are interested in maximizing their contribution and minimizing staff costs, right?
2. Plan design can make a difference if there is enough difference in age between the doctor and the staff
3. SIMPLE-IRAs, SEP-IRAs, are not likely to be enough to provide you with financial freedom during retirement
4. The 401k feature increases your ability to save more for retirement, if you are married, helps to reduce staff costs, and allows staff to take some responsibility for their retirement

Net Income and S-Corp Distributions

1. In our example, Dr. Seymour had $213,876 in profits after being paid wages of $230,000.
2. In 2008 those profits were not subject to $6,202 (2.9% of profits) of Medicare taxes, in 2014 the savings would be $8,127 (3.8% of profits).
3. Dr. Seymour still paid taxes (ordinary income) on profits of $213,876.
4. When the distributions are taken does not affect the taxation of the profits.
The Five Minute Financial Plan

1. Always spend less than you earn!
2. Purchase adequate insurance
3. Be equally proud of the investments you avoid as the ones you make - Avoid Big Mistakes
4. Maximize tax deferred accounts - Profit Sharing 401k plans, etc.
5. Depending on your priorities do the following:
   a. Fund non-deductible IRAs and convert to Roth IRAs shortly thereafter,
   b. Contribute regularly to a personal investment account – 10%, if you can't do 10% then do 5%, if you can't do 5% do something
   c. College funding for children – use a 529 plan
   d. Debt Reduction – pay off the mortgage, you’ll be happier in retirement if you are debt free.
   e. One wife, one home.

Questions?

Thank You for Participating Today

Feel free to call or email me if you have any questions:

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