The taxman cometh: File wisely, secure the most from practice deductions

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Effective Mar 9, 2023

Published Mar 13, 2023
Last Reviewed Mar 9, 2023

Practice management

April is tax time, and practice owners should be attentive to changes in the tax environment — including increased legal and IRS attention and a few wrinkles in the tax code that medical personnel tend to miss.

While the annual ritual is mainly a nuisance for filers within and outside medical practice, for some it's a downfall. On Feb. 22, the U.S. Justice Department announced Michigan endocrinologist Bashar Kiami had been sentenced to eight months in prison and fined a quarter of a million dollars for understating his taxable income — declaring $7,628 in 2017, for example, when prosecutors found it to be $442,476 — and for "concocted" expenses.

While details in the Kiami case are scant, in general experts say tax mischief can be something that creeps up into fraud. Lou Filippelli, MST, CPT, CVA, a partner in the Westminster Advisory Group of Warwick, R.I., says "fraud normally starts when they try something one year and decide they'll try a little more next year. And there's doctors' lounge talk too: 'So-and-so doesn't report that or he deducts that, why can't I?' But every [filer's] situation is different."

Filippelli reminds you that "the law is that the practice owner has the ultimate responsibility for the correctness of the filings," and just because your accountant says something is legit doesn't necessarily mean it's so. He bids you remember that a good working definition of fraud is "either understating income or overstating deductions to a level that is more than an error in judgment or accounting errors."

Plus you really should be able to do your taxes properly without going broke. Tom Wheelwright, CPA, CEO of the Tempe, Ariz., tax consultancy WealthAbility and author of *The Win-Win Wealth Strategy*, says, "it's a shame that anybody feels like they have to cheat on their taxes because there are so many tax benefits in the law that you should never have to cheat to reduce them."

Looking for money

Experts direct your attention to opportunities for deductions that even practice owners who are otherwise savvy business people often miss. For example, Wheelwright says, M.D.s often overlook their potential to declare a home office deduction even if they maintain a business office. "They've been told that if they have an office in their practice they can't have a home office, which is not true," Wheelwright says.

Louis Vlahos, a partner in the tax practice at Rivkin Radler in Uniondale, N.Y., says that he gets a lot of questions from physicians about this. "COVID restrictions applied very differently to doctors because they don't have the luxury of working from home, but many of them shifted their office functions offsite," he says.

The home office must be legit, of course — something you actually devote to, and perform, practice-related business in — and you can't then file as an employed physician, only as the business owner. "You have to dot your I's and cross your T's," Wheelwright says, "but that's actually a very, very big deduction — because not only do you get a portion of your home deducted, you also can deduct travel between your home and your practice offices. Your automobile expenses deduction probably doubles or triples if you have a home office — so that's actually a bigger deduction than the home office itself."

Also, perhaps due to anxiety over the reporting of meals in other contexts, such as anti-kickback laws, physicians can be shy about expensing business meals (*PBN 2/7/19*). But Wheelwright says meals at which you legitimately discuss business and which you properly document can certainly be deducted — even if it's with the physician's spouse.

Wheelwright cautions that you can't expense the meals if business was just casually mentioned. "There must be a business purpose, the expense must be ordinary — that is, typical — and the expense must be necessary. to produce income or increase market share," he says.

Similarly, you can deduct business travel 100% within the U.S., and "proportionately" outside — that is, Wheelwright says, the amount of time you spend on business versus the total amount of time you were traveling is the proportion of those expenses you get to deduct. This too has to be legitimate: five days away from home in which you spend four or five hours a day at a conference will fly, but five days within which you have a three-hour meeting probably won't. And while you may be aware that physicians can expense medical equipment, you may not know that they can sometimes expense cars if they're used for business. *(See our related blog post at https://pbn.decisionhealth.com/Blogs/.)*

Some drawbacks

Note that while business meals are 100% deductible in 2022, in 2023 the deduction goes down to 50% by law. Tax laws aren't static and you should be aware of the changes.

For example, Vlahos says, the so-called enhanced IRS exemption for gift and estate tax planning — the gift tax exclusion of $17,000 and the gift and estate tax exemption of $12.92 million — is going to be reduced by 50% come 2026, "unless something changes with the 2024 election."

Also, remember that the travel, car, meals and home office deductions are for business owners, not employed physicians who are resimbursed by their employer for these expenses.

Don't get greedy

Some physician owners may be advised to exponentiate the advantages of owning their business by employing cooperative family members. "You hear from so many accountants who advise doctors, 'Why don't you hire your spouse or your kids?'" Vlahos says. "'You'd have another individual in the family who's going to get the benefit of the 401k account. Why not hire your kids to perform some small functions after school and shift the income to someone who's in a lower bracket than yourself?'"

But, he cautions, "these are in fact business functions, and they should not be paid more than what is reasonable for that function. So, if you're a part timer who only comes in after school to take care of the filing system or return calls, you should not be paid something that is unusually large for the value that you're providing. It has to be commensurate with the service."

There are more arcane but legitimate instruments for wringing extra dollars out of your business structure. For example, Vlahos says, practice owners often pay themselves a large salary at the end of the tax year after other payroll and other expenses to zero out their corporation's income. But that salary is subject to employment taxes. You may find it more advantageous to take a reasonable salary and pay taxes on that, and consider the remainder as a shareholder's distribution — which is not subject to employment taxes. But this is something on which you should first seek counsel from a tax accountant.

Resource

- DOJ Office of Public Affairs, "Michigan Doctor Sentenced to Prison for Tax Evasion," Feb. 22, 2023: www.justice.gov/opa/pr/michigan-doctor-sentenced-prison-tax-evasion