PAIN RELIEF FOR NEXT APRIL 15TH: FOUR TAX-SAVING IDEAS YOU CAN DO NOW

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As an aesthetic physician, your income likely puts you in the top marginal federal income tax brackets. This means, after the new tax increases for 2013—between income, capital gains, Medicare, self-employment and other taxes—you likely spend between 45 to 55 percent of your working hours laboring for the IRS and your state. In other words, you truly don't "take home" income until July or August… before then, you are working just to pay taxes!

Given this climate, your advisors should be providing you creative ways to legally reduce your tax liabilities. How many tax-reducing ideas does your CPA regularly provide you? If you are like most aesthetic physicians with whom we speak, you get very few tax planning ideas from your advisors.

Given these sobering facts, the purpose of this article is to show you four ways to potentially save taxes and possibly motivate you to investigate these planning concepts now, before the end of the year approaches, when it is too late. Let's examine a few possible tactics.

1. USE THE RIGHT PRACTICE ENTITY/ PAYMENT STRUCTURE/BENEFIT PLANS

These areas are where the vast majority of tax mistakes are made by aesthetic physicians today—and where many of you reading this could benefit by tens of thousands of dollars annually with the right analysis and implementations. Issues here include:

- Using the legal entity with maximum tax/benefits leverage—whether that is an "S" corporation, "C" corporation, LLC taxed as "S", "C", partnership or disregarded entity
- Using a multi-entity structure to take advantage of two types of entities and their tax/benefit advantages
- Managing the payment of salary, bonus, distribution, partnership flow-through to take advantage of maximum retirement benefits and minimize income, social security and self employment taxes
- Consider benefit plans beyond the typical profit-sharing/401(k) with which most medical practices start and end their benefit planning

2. DON'T LOSE 17-44 PERCENT OF YOUR RETURNS TO TAXES; EXPLORE INVESTMENT MANAGERS WHO MANAGE WITH TAXES IN MIND

It is generally well-known that most investors in mutual funds have no control of the tax hit they take on their funds. What you might not know is how harsh this hit can be. According to mutual fund tracker Lipper, "Over the past 20 years, the average investor in a taxable stock mutual fund gave up the equivalent of 17 percent to 44 percent of their returns to taxes." (Lipper quoted on CNN/Money.com 4/17/07). Obviously, over 20, 30-plus years of retirement savings, losing one sixth to about half of your returns to taxes can be devastating to a financial plan. Nonetheless, too many aesthetic physician-investors settle for this awful taxation.

While a 17-44 percent tax bite is dreadful, these numbers will likely be worse in 2013 and beyond, as federal capital gains and dividend rates now reach 20 percent for some taxpayers (where they were 15 percent before), and the new Obamacare tax on investments adds another 3.8 percent for high income taxpayers as well. Of course, state taxes are an addition. Such tax increases will only exacerbate the issue.

How to avoid this problem? Consider working with an investment firm that designs a tax-efficient portfolio for you and communicates with you each year to minimize the tax drag on that portfolio. In a mutual fund, you have only "one way" communication—the fund tells you what your return is and what the tax cost is. Working with an investment management firm, you may get "two way communication"—as the firm works with you to maximize the leverage of different tax environments, offset tax losses and gains, and other tax minimization techniques.

Your investment firm might also employ "tax diversification"

as part of their strategy. Tax diversification dictates the use of various "buckets" to hold investment assets—each with its own tax treatment. Some buckets enjoy tax free growth but will be subject to ordinary income taxation upon liquidation, like a 401(k). Some grow tax deferred and are subject to various types of tax treatment on exit, like an annuity. Other buckets grow with little tax but are subject to capital gains upon liquidation (like growth stocks); while others may grow tax free and can be accessed without tax (ROTH IRA). These are just a few examples that a tax-forward investment firm may implement for its clients.

3. GAIN TAX-DEFERRAL, ASSET PROTECTION THROUGH CASH VALUE LIFE INSURANCE

Above, you learned about the 17-44 percent tax hit most investors take on their investments in stock mutual funds. Similar funds within a cash value life insurance policy will generate NO income taxes—because the growth of policy cash balances is not taxable. Also, nearly every state protects the cash values from creditors—although there is tremendous variation among the states on how much is shielded. Finally, if managed properly, one can access the cash values of the policy without tax as well.

Perhaps no asset class is as misunderstood by all types of physicians as cash value life insurance. Certainly, it is not simple to implement properly because product design and customization is crucial—and a long-term investment perspective is equally important. However, with these elements in place, and a proper advisor guiding you, a cash-value life policy may be an excellent tax-favored wealth accumulation tool.

4. CONSIDER CHARITABLE GIVING, INCLUDING CONSERVATION EASEMENTS

There are many ways you can make tax beneficial charitable gifts while benefiting your family as well. The most common tool for achieving this "win-win" is the Charitable Remainder Trust (CRT). A CRT is an irrevocable trust that makes annual or more frequent payments to you (or to you and a family member), typically, until you die. What remains in the trust then passes to a qualified charity of your choice.

Another effective tax-planning tool in this arena, but little-known among physicians is the conservation easement. Donors may take a deduction for a "qualified conservation contribution" to a qualifying organization. In effect, a taxpayer can donate land for preservation and take a charitable deduction for the value of the land at its "highest and best" use. A valid qualified appraisal is required. The taxpayer can acquire a membership interest in an LLC that owns property eligible for a conservation easement. The taxpayer can then take part in the contribution of the easement and the tax benefits surrounding such a transaction. As above, proper design and implementation is crucial.

CONCLUSION

This article gives you a few ideas for how to save taxes. For larger practices with $3-5 million or more of revenue, there are additional techniques that could offer significantly greater deductions. These are outside the scope of this article, but may be the subject of future articles. If you want to save taxes, the most important thing you can do is start looking for members of your advisory team who can help you address these issues in advance. Otherwise, you will be in this same position this April 15th… and next April 15th … and the one after that. ■

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