

# Improving Your After-Tax Financial Efficiency

By Carole C. Foos, CPA and David B. Mandell, JD, MBA

Most physicians, including neurologists, strive to achieve two goals in their practice: to “do good” by being a quality practitioner, and helping patients and to “do well” in terms of financial rewards. Unfortunately, as to the second goal, many physicians in private practice do not operate their practices with optimal after-tax efficiency. In fact, we often see doctors leaving tens of thousands of dollars “on the table” each year, which can equate to nearly \$1 million of lost wealth over a career. The good news is that many physicians can likely improve their post-tax bottom line in several ways.

## Time is of the Essence

Over the past three decades, there has truly been no better time than now to focus on post-tax efficiency. This is due to several factors:

1. Proposals from President Trump and the Republican party are on the table to reduce the top individual tax rates as well as corporate tax rates. Taxes that came into being due to the Affordable Care Act may also go away. But, unless these cuts are revenue neutral, they will sunset in 10 years. It will be important to take full advantage of these changes right away, as they may not be around for long.
2. The potential for reduced corporate tax rates and reduced rates on pass-through business income will make corporate structure planning vital.
3. More taxpayers could be subject to the 20 percent capital gains rate as the proposals call for that rate to be effective for married taxpayers with taxable income above \$225,000 (as opposed to the current \$466,950).

## The Common Causes of “Dollars Left on the Table”

While the causes of “dollars left on the table” in a medical practice can range from billing errors to unproductive employees, our expertise and focus is corporate structure, tax reduction and benefit planning. For this article, we will focus on two strategies for recapturing some of the funds left on the table:

1. Using the ideal corporate structure; and
2. Maximizing tax-deductible and non-qualified benefits for the physician-owner(s)

The most important thing you can do is keep an open mind. Changing just a few areas of your practice could recover \$10,000 to \$100,000 of “lost dollars” annually. Let’s explore the two strategies:

### 1. Using the Ideal Corporate Structure

Choosing the form and structure of one’s medical practice is an important decision and one that can have a direct impact on your financial efficiency and the state and federal taxes you will owe every April. Yet, from our experiences in examining over 1,000 medical practices of our clients, most physicians get it wrong. Here are a few ideas to consider when thinking about your present corporate structure:

- A. You likely want to avoid using a general partnership, proprietorship, or “disregarded entity.”** These entities are asset protection nightmares and can be tax traps for physicians. Nonetheless, we have seen very successful doctors operating their practices as such. The good news is that doctors who run their practices as partnerships, proprietorships, or disregarded entities have a tremendous opportunity to find “dollars on the table” through lower taxes, especially through the Medicare tax on income. This can be a \$10,000-30,000 annual recovery.
- B. If you use an S corporation, don’t treat it like a C corporation.** We estimate that 60 to 70 percent of all medical practices are S corporations. Unfortunately, many physicians do not take advantage of their S corporation status and instead use inefficient compensation structures that completely erase the tax benefits of having the S in the first place. If your practice is an S corporation, you should maximize your Medicare tax savings through your compensation system in a reasonable way. This can be a \$10,000 plus annual recovery for practices not properly structured.

Should pass-through income be subject to lower tax rates under new tax laws, this will become even more important as it will lower not only Medicare taxes but also income taxes.

**C. Implement a C corporation.** Once upon a time, C corporations were the most popular entity for U.S. medical practices. Today, fewer than 15 percent of medical practices operate as C corporations. Why? We believe it is because most physicians, bookkeepers and accountants focus on avoiding the corporate and individual “double tax” problem.

While this is vital to the proper use of a C corporation, it is only one of several important considerations a physician must make when choosing the proper entity. If you have not recently examined the potential tax benefits you would receive by converting your practice to a C corporation, we recommend that you do so. A reduced tax rate on C corporations will make this evaluation especially pertinent.

**D. Get the Best of Both Worlds: Use Multiple Entities.**

Very few medical practices use more than one entity for the operation of the practice; If they do, it is simply to own the practice real estate. While this tactic is also wise from an asset-protection perspective, its tax benefits are typically non-existent.

Some practices may benefit from a superior practice structure that includes both an S and a C corporation. This can create both tax reduction and asset protection advantages. If you have not explored the benefits of using both an S and C corporation to get the best of both worlds, now is the time to do so.

## 2. Maximizing Tax-Favored Benefits for the Doctors in the Practice

If you are serious about capturing “dollars left on the table,” tax efficient benefit planning must be a focus. Benefit planning can definitely help you reduce taxes, but that is not enough. Benefits plans that deliver a disproportionate amount of the benefits to employees can be deductible to the practice, but too costly for the practice owners. These plans can be considered inefficient. To create an efficient benefit plan, physicians need to combine qualified retirement plans (QRPs) with non-qualified plans.

Nearly 95 percent of the physicians who have contacted us over the years have some type of QRP in place. These include 401(k)s, profit-sharing plans, money purchase plans, defined benefit plans, 403(b)s, SEP or SIMPLE IRAs, and other variations. This is positive, as contributions to these plans are typically 100 percent tax deductible and the funds in these plans are afforded excellent asset protection. However, there are two problems with this approach:

1) many QRPs are outdated; and 2) QRPs are only one piece of puzzle.

First, most physicians have not examined their QRPs in the last few years. The Pension Protection Act improved the QRP options for many doctors. In other words, many of you may be using an “outdated” plan and forgoing further contributions and deductions allowed under the most recent rule changes. By maximizing your QRP under the new rules, you could increase your deductions for 2017 by tens of thousands of dollars annually, depending on your current plan.

Second, the vast majority of physicians begin and end their retirement planning with QRPs. Most have not analyzed, let alone implemented, any other type of benefit plan. Have you explored non-qualified plans recently? The unfortunate truth for many physicians is that they are unaware of plans that enjoy favorable long-term tax treatment. In fact, if income tax marginal rates come down as the administration has promised (and such rates will come back up because of sunset provisions described above), the next few years may become an ideal time to fund non-qualified plans; perhaps the most advantageous time to fund such plans since the 1980s. If you have not yet analyzed all options for your practice, we highly encourage you to do so.

## Conclusion

Nearly every one reading this article would like to be more tax efficient, especially with anticipated tax changes for 2017 and beyond. We hope these new tax rules motivate you to make tax and efficiency planning a priority, so you too can recapture the “dollars left on the table.” ■

*David B. Mandell, JD, MBA is a former attorney and author of the book For Doctors Only: A Guide to Working Less and Building More. He is a principal of the financial consulting firm OJM Group [www.ojm-group.com](http://www.ojm-group.com), where Carole C. Foos, CPA is a principal and lead tax consultant. They can be reached at 877-656-4362 or [mandell@ojmgroup.com](mailto:mandell@ojmgroup.com).*



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