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2016 4th Quarter Tax Saving Tips:
What to Do NOW to Save $10,000-$25,000 or More on Your 2016 Taxes

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As we approach the 4th quarter of the year, most of our physician clients now have a fairly good idea of what their taxable income will be for 2016. If you are like these clients, you may be wondering "is there anything I can do NOW to save taxes on April 15th?" The answer is very likely "yes." In fact, the 4th quarter of the year ending and the 1st quarter of the new year are the best times for focusing on tax reduction.

This short article will lay out a few ideas that could save you *tens of thousands of dollars* on your 2016 income tax bill, depending on your facts and circumstances, as well as explaining some capital gains and planning concepts.

Techniques to Reduce 2016 Income Taxes

1. Maximize the Tax Benefits of Your Qualified Retirement Plan (QRP)

Nearly 95 percent of physicians have some type of QRP in place. These include 401(k)s, profit-sharing plans, money purchase plans, defined benefit plans, or even SEP or SIMPLE IRAs, for these purposes.

However, most of these plans are NOT maximized for deductions for the business/practice owner(s). The Pension Protection Act improved the QRP options for practice owners. In other words, many owners may be using an "outdated" plan and forgoing further contributions and deductions permitted under the most recent rule changes. By maximizing your QRP under the new rules, you could increase your deductions significantly for 2016 and reduce your taxes on April 15, 2017.

2. Implement a Non-Qualified Plan

Unfortunately, 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 in the last two years? The unfortunate truth for many physicians is that they are unaware of plans that enjoy favorable short-term and long-term tax treatment. If you have not yet analyzed all options, we highly encourage you to do so. A number of these plans can help you reduce your taxable income for years as part of a tax diversification plan.

3. Consider a Captive Insurance Company (CIC)

CICs are used by many of the Fortune 1000 for a host of strategic reasons. For a medical practice, a CIC can be equally beneficial, especially for the practice owners. Here, you actually create your own properly licensed insurance company to insure all types of risks of the practice – often those that have little coverage today. These can be economic risks (that revenues drop), business risks (that electronic records are destroyed), litigation risks (coverage for defense of harassment claims or wrongful termination), and even coverage for surgery centers and real estate. If created and maintained properly, the CIC can enjoy tremendous income tax benefits that can translate into hundreds of thousands of dollars of tax savings annually.

4. Pre-Pay 2017 Expenses in 2016

As the year winds down, we typically counsel cash basis clients to prepay for some of the following year's expenses in the present year. As long as the economic benefit from the prepayment lasts 12 months or less, this can be done. Since 2017 highest marginal tax rates will likely be the same as those in 2016, this makes sense because of the benefit of the early deduction.

Techniques to Reduce Taxes on Investments

1. Planning for the 3.8 Percent Medicare Surtax

Beginning in 2013, the tax law imposed 3.8 percent surtax on certain passive investment income of individuals, trusts and estates. For individuals, the amount subject to the tax is the lesser of (1) net investment income (NII) or (2) the excess of a taxpayer's modified adjusted gross income (MAGI) over an applicable threshold amount.

Net investment income includes dividends, rents, interest, passive activity income, capital gains, annuities and royalties. Specifically excluded from the definition of net investment income are self-employment income, income from an active trade or business, gain on the sale of an active interest in a partnership or S corporation, IRA or qualified plan distributions and income from charitable remainder trusts. MAGI is generally the amount you report on the last line of page 1, Form 1040 adjusted by the above non-includible items.

The applicable threshold amounts are shown below.

Married taxpayers filing jointly	$250,000
Married taxpayers filing separately	$125,000
All other individual taxpayers	$200,000

A simple example will illustrate how the tax is calculated.

Example: Al and Barb, married taxpayers filing jointly, have $300,000 of salary income and $100,000 of NII. The amount subject to the surtax is the lesser of (1) NII ($100,000) or (2) the excess of their MAGI ($400,000) over the threshold amount ($400,000 -$250,000 = $150,000). Because NII is the smaller amount, it is the base on which the tax is calculated. Thus, the amount subject to the tax is $100,000 and the surtax payable is $3,800 (.038 x $100,000).

Fortunately, there are a number of effective strategies that can be used to reduce MAGI and or NII and reduce the base on which the surtax is paid. These include (1) Roth IRA conversions, (2) tax exempt bonds, (3) tax-deferred annuities, (4) life insurance, (5) oil and gas investments, (6) timing estate and trust distributions, (7) charitable remainder trusts, (8) installment sales and maximizing above-the-line deductions. We would be happy to explain how these strategies might save you large amounts of surtax.

2. Use Charitable Giving for Capital Gains Tax Planning

There are many ways you can make tax beneficial charitable gifts while benefiting your family as well. Charitable Remainder Trusts (CRTs), Charitable Lead Trusts (CLTs), Private Foundations – these can all be used, within the IRS rules, to benefit charitable causes, reduce taxes and retain some benefits for families. If you have considered any of these tools in the past, implementing them in a year of high income might be a good idea.

Conclusion

This article gives you a few ideas for potential tax savings for 2016 income and beyond. The key is to take the time to evaluate which of these concepts, or others not mentioned in this short article, may work for you. In 2016, all physicians need to be as financially efficient as possible.

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