7 Tax Deductions Doctors Miss Out On

[Editor’s Note 1/15/2018: The long-awaited White Coat Investor Online Course is live and is available for purchase [here](). The course is entitled: [Fire Your Financial Advisor](). No more wading through dozens of books at the library, scrolling through hundreds of blog posts on dozens of blogs, *or checking in daily with online forums trying to gain a financial education the way the hobbyists do. This course will take you from feeling anxious and having no plan to having a written financial plan you can follow the rest of your investing career as a professional and a retiree. This course is the material that should have been taught to you in college, medical school, or residency, but never was.]*

It’s tax season again. I have found tax literacy among doctors to be particularly low, so much so that many doctors get sucked into questionable investments and “tax shelters” to save minimal amounts on taxes. I have an entire series coming up on understanding the basics of the tax code, but I thought I’d do a little piece before April 15th about tax deductions. Let’s take a look at ways you can reduce your tax bill.

1. Tax-deferred Retirement Plans

This is the biggest tax deduction I see doctors routinely missing out on. I'd guess less than 1/4 of doctors actually max out all the retirement account options available to them. Some because they simply don't save enough money (a related, but separate issue), but many simply don't realize just how much money they can squirrel away into these things with huge tax benefits.

Every dollar put into a tax-deferred retirement account isn't taxed this year. If you're in the highest tax bracket, and have hefty state and local income taxes, you could have a marginal tax rate approaching 50%. That means for every $2 you put in a retirement account, you save $1 on your tax bill. That's pretty darn good.

If you're a contractor (paid on 1099s) you should be able to contribute 20% of your income to a SEP-IRA, up to a maximum of $50K, with an additional "catch-up" contribution of $5500 if you're over 50. If you don't make $250K, you can contribute even more than 20% to a Solo 401K, so you might want to use that instead of a SEP.

If you're an employee (paid on W-2s) you may be limited to as little as $17,000 into a 401K, but many 401Ks will match you or at least allow you to self-match up to the $50K limit. If yours doesn't I suggest you talk to your employer.

A defined benefit plan can allow you to shelter additional money from taxes, sometimes as much as another $30K, $50K, or even more.

2. The Backdoor Roth IRA

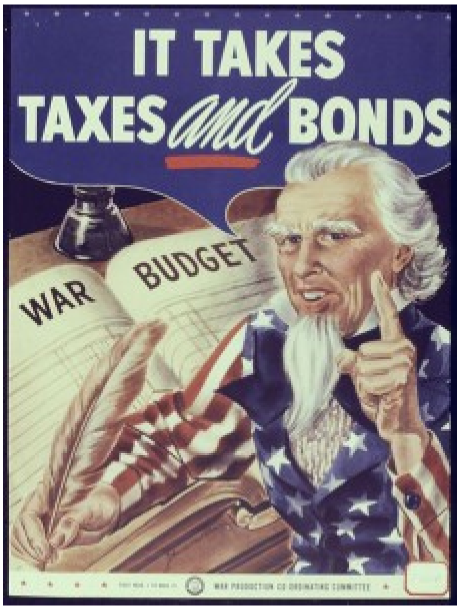
This one doesn't give you a tax break this year, but it does allow you to shelter retirement investments from any future taxes. It is a far better option than many insurance-related tax shelters salesmen often push on you. You can put up to $5K into a non-deductible IRA for you and $5K for your spouse. Then you can instantly convert them to an IRA. There is one catch, you can't have any other SEP-IRA or traditional IRA due to the pro-rata rule, but there are ways around this for most, such as rolling those IRAs into your 401K. [Update: for a step by step tutorial on the Back Door Roth IRA read "The Back Door Roth IRA Tutorial".]

3. Health Care

Health insurance is expensive, no doubt. But at least you can pay for it with pre-tax money. Your health insurance premiums are a deductible business expense, as are the contributions to a health savings account (AKA a stealth IRA) that you can use for co-pays and deductibles. A high-deductible health plan combined with an HSA isn't the right move for everyone, but for the healthy, you can save a lot of money on premiums and on your taxes.

4. Business Expenses

Many self-employed doctors miss out on all kinds of tax deductions just because they don't realize what is deductible and what isn't. If you are a sole proprietor, partner, or a contractor, it would behoove you to keep careful records of your business expenses. Travel, meals, accommodations, office equipment and supplies, medical equipment, CME expenses, licensing fees, communication expenses, board exam fees…the list goes on and on and on. The main benefit of being an owner, rather than an employee, is that you can get all these sweet deductions. That's off-set by the requirement to pay the employer portion of your payroll taxes, but at least those are deductible too.



Employees generally miss out on these great deductions. Unreimbursed work expenses are subject to a 2% floor, which for most doctors is more than they spent. There are two ways around this. First, you can get your employer to pay for them. He gets to pay them pre-tax, just like you would if you were self-employed. Many employees have a CME fund for instance. My employer picks up my ACEP dues and similar fees. The second method, is to become an owner. Just because 95% of your income comes from your main job, where you are an employee, doesn't mean you can't get a moonlighting job on the side and get all the deductions a contractor would have. If the moonlighting job requires a medical license, DEA license, CME etc, then you can deduct your business expenses from that income. This one works great for military docs.

Your business doesn't even have to be medicine related. The income from this blog last year wasn't taxed at all since I deducted office supplies, internet-related fees, and phone-related fees from it. This type of entrepreneurial path has changed the lives of many doctors allowing them to not only claim tax deductions but even more importantly, helping them reap the benefits of earning passive income. Every little bit helps.

5. Mortgage Interest

Many doctors find themselves with hefty loans, including consumer loans, car loans, credit cards, student loans, home equity loans, investing loans, and mortgages. While I generally advocate avoiding most of these loans, and paying down those you take out as quickly as possible, the IRS makes carrying mortgage interest tax-friendly. If you're going to have the loans, you might as well convert them into loans that have a low rate and are tax deductible. Let's say you have $100K in student loans, for instance, at 6.8%. You also own a house worth $600K with a 5% mortgage for $300K on it. Refinancing the mortgage into a 4% $400K loan and paying off the student loans would lower the interest rate on the mortgage, lower the interest rate on the student loans, and make the student loan interest deductible. You can do the same thing with credit cards, car loans etc. It's not good to use your house as an ATM, but it also isn't smart to pay too much in interest, especially when tax-deductible interest is an option.

6. Charity

Doctors tend to be charitable folk. If they don't give money, they often give time. Any donations to a qualified charity are tax-deductible just like mortgage interest (assuming you have enough total deductions to justify itemizing them) or donating large items such as an old boat. You can use Turbotax's It's deductible to figure the value of things you give to goodwill. You can also count the miles used to drive to and from your charity of choice and any other expenses associated with donating your time (although you can't deduct a value for your time itself.)

7. Tax-Loss Harvesting

Investors hate losing money. But in a taxable account, Uncle Sam will share your pain. You can even get a break on your taxes without having to "sell low" by doing tax-loss harvesting. You sell a losing investment, and buy one that is highly correlated to the one you sold. For example, you might sell the Vanguard Total Stock Market Index Fund and buy the Vanguard 500 Index Fund. These two funds generally move in lockstep, but they are different investments. You can deduct up to $3000 a year of investment losses against your ordinary income.