Tax Savings For Residents

Q.

Could you do an article on tax savings for residents specifically? I have lots of questions and it would be a great help. For example, I had to buy ~$3000 worth of equipment for residency and did not get reimbursed at all. I wanted to know how best to lower my taxes using this, including potentially getting an education tax credit for the $900 I spent on books. You could also include moving expenses, travel expenses to different sites and so on.

A.

One of the funniest things about doctors and their finances, at least when you step back and take a look at it, is that they think they’re different from everybody else. There are a few minor differences of course, but for the most part, personal finance for doctors is exactly like personal finance for everybody else. What I mean to say is that what is deductible for residents is exactly what is deductible for attendings is exactly what is deductible for everyone else. You don’t need resident-specific information; you just need a basic understanding of the tax code (the subject of the book I keep trying to get around to writing.)
Some good examples of this concept can be taken from your specific questions. You mention that you bought “$3,000 worth of equipment for residency.” Now, I don’t know whether you’re talking about the mountain bike you ride to the hospital, some fancy stethoscope, or a set of books, and the devil for deducting equipment is all in the details.

**Deducting Work Expenses as an Employee**

Residents are first and foremost employees, so the rules that apply to residents are found in the sections of the IRS code that deal with employees. Employees can theoretically deduct their unreimbursed work-related expenses (not that mountain bike), HOWEVER, this is subject to two huge caveats that usually keep residents from actually saving anything on their taxes.

First, you have to itemize your deductions. If you take the standard deduction, like most residents, you’re out of luck. You’re also out of luck for that portion of your itemized expenses that is less than the standard deduction. For example, if your standard deduction is $12,400, and your itemized deductions are $13,000 of which $3,000 is otherwise deductible work expenses, then you’re really not getting much tax savings for having spent that $3K (probably about $150 in tax savings.) Obviously it’s pretty dumb to spend $3K to save $150 unless you were going to spend that $3K anyway.

The second caveat is that unreimbursed work-related expenses (done on Form 2106 and plugged in on line 21 of Schedule A) are subject, along with investment related expenses and tax preparation fees, to a 2% of income floor. That means if your income is $50K, you don’t get to deduct the first $1000 of those deductions. Now that resident mentioned above doesn’t even get to save that $150.

So is it possible to get a deduction for unreimbursed work-
related expenses as a resident? Sure, it’s possible, but not very likely.

Work Expenses as a Business Owner

So, the secret to deducting work related expenses is to avoid being an employee and be a business owner instead. The way for a resident to be a business owner is to moonlight and be paid as an independent contractor (1099 income.) Now, all those business related expenses are all of a sudden completely deductible as a business expense on Schedule C. It doesn’t matter if you itemize or not. It isn’t subject to the 2% floor. It’s just 100% deductible against your business income. That can include all kinds of stuff you might need for your regular employee job too, such as these items:

- CME Costs
- Medical License
- DEA License
- Lab Coats
- Scrubs
- Stethoscope
- Books
- Pager
- Cell Phone
- Computer
- Professional society dues
- Job search expenses for a “job in your current occupation” (I interpret this as your attending job search expenses are deductible, but your residency search expenses are not.)

Commuting Expenses

Commuting rules are the same for everyone. You can’t deduct your commuting expenses but you can deduct work-related travel. The basic gist of this is that if you go to two work
sites during the day, the travel between the two is deductible, but the travel from your home to the first site, and from the second site to home is not. The deduction is either actual expenses or 56.5 cents per mile. Remember, if you’re an employee, it goes on Schedule A and is subject to the 2% floor. If your second job is as a business owner, then you can put it all on Schedule C.

Travel to Temporary Job Site

You can also deduct travel to a temporary job site (think a rotation somewhere away from your home hospital.) However, it can’t be in the same metropolitan area. I missed this one in residency for my two elective rotations (one in another state and one in another country.)

Work-related Education Deductions

Some educational expenses are deductible. However, this area gets pretty gray for residents. It’s easy to meet the first requirement (“the education improves or maintains skills needed in your present work,”) but the second requirement, that it cannot be “needed to meet the minimum education requirements of your present trade” nor “part of a program of study that will qualify you for a new trade” is a little harder for residents to jump over. I would argue that if you are reading a book in residency that it is “needed to meet the minimum education requirements of your present trade” but I think there’s a little room there for an alternate interpretation (i.e. that your present trade is medicine in general rather than a particular specialty.)

So while it’s possible to get a deduction, I don’t know of any education-related tax credit you could take as a resident. Pub 970 lists 4 requirements to get the American Opportunity Credit. Residents don’t even meet the first of these. Qualifying for the Lifetime Learning Credit is a little less rigorous. However, residents still probably aren’t going to
qualify (unless their kid in college.) The reason is that it requires the student to attend “an eligible educational institution” defined as “any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education.” That doesn’t sound like residency or any CME course I know of. Eligible expenses are defined as “student-activity fees and expenses for course-related books, supplies, and equipment are included in qualified education expenses only if the fees and expenses must be paid to the institution for enrollment or attendance.” Again, that’s quite a stretch for a resident to claim this tax credit.

**Moving Expenses**

*Moving expenses* can also be deductible. You have to be relocating for a job, it has to be further than 50 miles away, and you have to stay at that job for a year. The cool thing about this one is that it is an above the line deduction—meaning you can take it even if you use the standard deduction.

**Student Loan Interest**

The first $2500 that you pay in *student loan interest* each year is also an above the line deduction. Most residents and
fellows will be able to take this, but few attendings will due to the income limitation, which phases out between $60-75K for single filers, and $125-155K for married filing jointly. Interestingly, if you are married filing separately (like many residents trying to minimize IBR/PAYE payments, you can’t deduct this at all.

**Retirement Contributions**

Residents are often allowed to participate in a 401(k)/403(b) and can at least contribute to a traditional IRA. This is a big deduction, but I think most residents ought to take a pass on it and contribute to a Roth IRA or Roth 401(k) instead. A side benefit of taking this deduction may be lowering your IBR/PAYE payments and possibly increasing future loan forgiveness.

**Child Care Expenses**

Lots of residents find this one useful. Basically, 20-35% of the first $3K you spend on legitimate child care can be taken as a tax credit (better than a deduction). The limit is 20-35% of $6K if you have two or more kids. For a typical resident with 1 kid, that’s basically $600 back in your pocket.

Although residents don’t really pay all that much in taxes compared to what they will pay later (this year I’ll be paying about 3 times my resident salary in taxes), a little extra money is a lot more valuable for them. Making sure you get all
of the deductions you qualify for sure beats leaving Uncle Sam a tip.

What do you think? What deductions did you take as a resident? Did I miss any big ones?