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Tax tips for locum tenens physicians: Reducing your overall tax burden

By David J. Schiller, JD

In this article, David J. Schiller, JD, a tax and estate-planning specialist with Schiller Law Associates and an editorial consultant for sister publication *Medical Economics*, gives you a few general tips for reducing your tax burden.

David J. Schiller (Courtesy of David Schiller)

Although the looming 2011 tax increase for "the rich" (that is, you) seems unfair, many will just take their lumps and shell it out. Others are wondering what they possibly can do to lower their taxes and keep more of their hard-earned money for themselves and their children.

Now is the time to stop wondering and start acting, because recent and anticipated tax law changes provide new opportunities to avoid overpaying taxes. Read on to find out how you can legally protect more of your income, shelter your investments, and secure your future.

You and your children can enjoy lifetime tax-free income. Starting this year, you can convert your existing IRA and a portion of your profit-sharing money into a Roth IRA. The rule precluding conversion by people with higher incomes no longer applies. Although you'll pay tax on pre-tax dollars on conversion, if you convert your IRA in 2010, you can spread the tax burden over 2011 and 2012. Therefore, it makes sense to delay filing your 2010 tax return to determine the 2011 rates, because you can choose whether to report the tax in 2010 or spread the tax burden over the succeeding two years. It is anticipated that legislation will pass later this year that will include higher income tax rates for 2011.

Don't forget that after you convert your IRA, you must wait at least five years and be at least 591/2 years old, disabled, or deceased to ensure that all growth will be tax-free. Roth money is not subject to required minimum distributions during your lifetime.

Although the Roth money is income-tax-free, it is still subject to estate taxes. Wealthy people whose estates may be subject to the death tax will save 45 percent on the cost of conversion by paying tax on conversion into a Roth, because the tax dollars will reduce the size of their estates. If you anticipate that your future tax rates will be higher than they are today, then conversion makes greater sense. Even if your life expectancy is less than 25 years, your children eventually will enjoy income-tax-free treatment as they take your Roth distributions.

A special rule does not allow you to convert your after-tax IRA accounts only. You can get around this rule by transferring some or all of your pre-tax IRAs into a qualified plan and then converting the remaining after-tax IRAs the following year to help reduce the cost of converting. One can continue to make after-tax IRA contributions annually and then immediately convert them to Roth IRA accounts. This is another opportunity to save $5,000 or $6,000 on a tax-free basis each year. The law requires you to go through this two-step process and does not allow you to directly fund a Roth IRA. You can, however, fund $16,500 or more in a Roth 401(k) each year, and this process works similarly.

Does college cost too much? Take the new American Opportunity Credit during 2009 and 2010. This law

expands the Hope Credit and allows a tax credit of $2,500 per year for each of four years of college per child. If you are married and your adjusted gross income (AGI) exceeds $160,000 ($80,000 if single), then your child can take the credit on his or her tax return. Even if your child hasn't earned money, the new credit is 40 percent refundable, which means that the government writes your child a check that can be used toward college expenses. Your child can't claim the credit if you take him or her as a dependent, but you likely can't get any benefit from the personal exemption anyway.

Are you purchasing a new principal residence by April 30 and settling by June 30? In addition to the first-time homeowner credit of $8,000, which was extended and expanded, the new Long-Time Resident Credit allows you to enjoy a $6,500 tax reduction if you change your principal residence after having lived in your old home for at least five of the past eight years. Both spouses must qualify, and the new home must not cost more than $800,000. Since the AGI limits were raised to $225,000 if married and $125,000 if single—with a partial credit if you go above the limit—perhaps your child could purchase a new principal residence? He or she might even let you use it periodically. Related-party sales are excluded, so you can't sell the home to your child.

Are you investing in any new businesses? If you purchase stock in a C corporation with assets of less than $50 million, and if you hold your stock for at least five years, you will not be taxed on 75 percent of the gain if the purchase occurs between Feb. 17, 2009, and Dec. 31, 2010.

Did you buy a car in 2009 after Feb. 17? If so, then you can deduct the sales tax on the first $49,500 of the purchase price, even if you don't itemize your deductions. This rule doesn't apply to car leases and doesn't apply if your AGI exceeds $250,000 if married or $125,000 if single.

Have you made any home improvements recently? Residential energy credits are available, regardless of your AGI, for certain improvements made during the balance of 2010. The credit was increased to 30 percent of the expenses, not to exceed $1,500, if you install new doors, windows, air conditioning, heaters, skylights, water heaters, metal roofs, or insulation.

Do you still own stocks that have losses? If so, then be sure to first sell them and then contribute the money to charity so that you can use—or carry forward—the capital losses, and the losses aren't wasted. Never contribute the actual shares to charity if you have a capital loss on them.

Does charity begin at home? If you "gift" appreciated shares of stock to your children, then the capital gain is taxed to your children on disposition, which makes sense if they are in lower tax brackets. Because adult children often have their dividends and capital gains taxed at $0 if their regular tax brackets are low enough (and presumably lower than your bracket), why not have your gains taxed at a lower rate? A caveat: Don't give away shares to your children if you have capital losses, because they can't use them, and they will be wasted because their basis is the *lesser* of your basis or the fair market value of the stock on the date of transfer. Also, if your children are younger than 25, don't forget to factor in the "kiddie tax."

Act now to take advantage of new legislation and avoid unfair tax increases. Review your portfolio to determine which opportunities apply, and consult with your financial adviser to help you optimize them—for today and for tomorrow.

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