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The **Barton Associates Tax Guide** for Locum Tenens Providers

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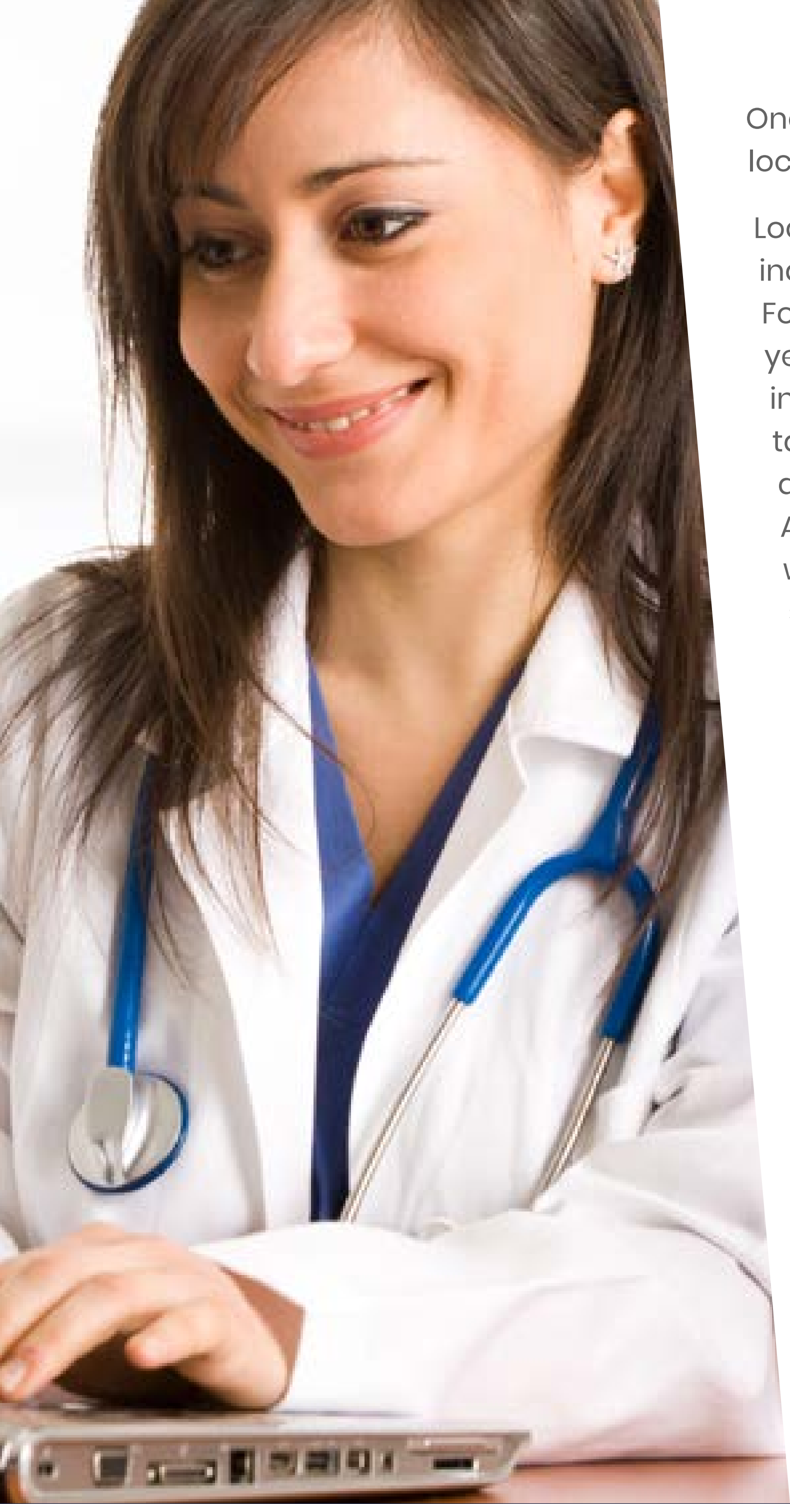

One of the most frequently asked questions I receive from providers interested in locum tenens work concerns the tax implications of being an independent contractor.

Locum tenens healthcare providers are considered independent contractors. An independent contractor's earnings are reported on Form 1099, as opposed to the Form W2 that traditional employees are accustomed to seeing at the end of each year. Unlike with a traditional employee, federal taxes are not withheld from an independent contractor's paycheck. However, some states require withholding of taxes for locum tenens assignments within that state. When state and local taxes are withheld, include that withholding on the state tax return filed for that year. Anyone on an assignment should expect to pay state and local income taxes first to where they are working, and then take a credit for those taxes paid when filing the state and local income taxes for where they live.

There are advantages to being compensated as an independent contractor. For example, independent contractors can deduct certain expenses that traditional employees cannot. However, an independent contractor's tax return can also become a bit more complicated. As an independent contractor, you'll be required to complete the 1040 long form, along with a Schedule C, Schedule SE, and whatever other tax forms and schedules might be required. Locum tenens providers who work in multiple states throughout the year will also need to file separate returns for each state.

Let's take a closer look at what locum tenens providers can do to take advantage of the benefits of being an independent contractor!

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Contents

Section 1: Deductions

One of the biggest advantages of being an independent contractor is there are fewer restrictions on deducting business expenses. This can go a long way toward reducing your taxable income.

Let's say you earn $10,000 as a locum tenens independent contractor, and have $6,000 of unreimbursed professional expenses. In this case, you'll only pay taxes on $4,000 of your net locum tenens income.

To qualify as an allowable deduction, an expense must be both "ordinary" and "necessary" in connection with your profession. For example, purchasing an iPad to use for work qualifies as ordinary and necessary, and therefore, is deductible. Purchasing a leather carrying case from Gucci, however, probably doesn't qualify. Even though you may view your Gucci carrying case as necessary, it most likely doesn't meet the ordinary test.

You are also not allowed to deduct any expenses that are reimbursed by your locum tenens agency or the facility at which you work.

Let's look at some of the professional expenses commonly incurred by locum tenens providers:

Health Insurance

As long as you're not covered under an employer-sponsored health insurance plan, being an independent contractor allows you to write off 100 percent of your health insurance premiums paid during the year. Premiums paid for Medicare also count for this tax break.

However, this only applies if you don't have access to an employee-sponsored plan. For example, if your spouse has access to health insurance through his or her job, or if one of your employers offers you insurance under its plan, but you opt to pay for your own independent plan regardless, your premiums are not deductible.

Travel, Lodging, and Meals

Unreimbursed travel, lodging, and 50 percent of meal costs incurred during a locum job outside the general vicinity of where you live are deductible. However, the job must be for a specific period of less than one year, and you must intend to return to the city in which you were living prior to the assignment. You are not allowed to deduct any expenses that were reimbursed by the locum tenens agency or facility at which you were assigned.

One option for taking advantage of these deductions is to keep track of the eligible expenses incurred during your assignment, either by keeping all your receipts together or by charging everything on one credit card. At the end of the trip, simply tally up what you spent.

A second, easier option is to use per diem rates. Per diem rates are lump sums designed to cover eligible expenses for an entire day. They're an easy way to calculate meals and incidental expenses associated with a locum tenens position without the hassle of saving receipts.

Each year, the federal government assigns one of six per diem rates to every metropolitan area in the continental United States and posts them at gsa.gov. The Department of Defense sets the per diem rates for travel to Alaska, Hawaii, and U.S. territories, and makes them available at defensetravel.dod.mil/site/perdiemCalc.cfm.

Please note that you can only use per diem rates for meals, incidentals, and business entertainment. While the per diem tables do include daily rates for lodging, these rates are set to be used by companies to reimburse their employees. Locums can only deduct actual housing costs incurred that are not reimbursed by the agency or client.

Automobile Expenses

Driving between job sites is deductible. So is driving between your home and a temporary job site, job interviews, and conferences. Commuting between your home and a regular place of business generally isn't tax deductible. If you traveled to a locum tenens job using your own car and were not reimbursed, you can deduct automobile expenses. There are two ways for you to calculate your automobile expenses.

First, you can use the standard mileage rate for each business mile driven, which can be found on the IRS website. The standard mileage rate for business purposes is 53.5 cents per mile driven. You can also include tolls and parking costs associated with any assignments.

The other option is to base your deduction on the percentage of miles your car was driven for business multiplied by the actual costs incurred during the year. Allowable costs include gas, insurance, repairs, parking at home, and your lease payments. If you own your car, you can deduct depreciation.

Unless you drive your car for relatively few miles each year, with most of those miles being allowable business miles, you're generally better off basing your deduction on the standard mileage rate.

Education, Licenses, and Examinations

Costs incurred in connection with improving your skills in your current profession (e.g., continuing medical education) are generally deductible.

It's critical that you keep records of business expenses throughout the year, including receipts. For more information on deductible expenses common to healthcare professionals, as well as a handy spreadsheet to help you track your expenses, check out the "Further Reading" section below.

Further Reading: Per Diem Rates; Common Expenses for Healthcare Professionals

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Section 2: Retirement Accounts

Independent contractors have the option of establishing and contributing money into a pre-tax retirement account based on net locum tenens income. Contributing to a retirement plan is one of the best tax shelters available during one's working years.

When you contribute to a retirement plan, your saved taxes provide you with an immediate return on investment. Let's assume you're in the 28 percent federal tax rate, and you live in a state with a 5 percent rate. Each additional dollar of income you earn is taxed at 33 percent.

In this scenario, you would earn an instant 49.25 percent return on your investment by contributing to a retirement plan. That's because it only costs you $670 in after-tax dollars for every $1,000 that is invested. You've already earned a whopping $330 on the $670 you invested. Yes, you'll owe taxes on the money in your retirement accounts when you take distributions down the road, but you get to keep the compounded growth on the tax savings as long as the money remains invested.

Contributing to a retirement plan is also one of the best ways to build a nest egg to fund your post-working years. Unless you work for a government employer or a business that provides a lucrative pension, it's up to you to make sure you have enough money set aside to fully fund a comfortable retirement. The earlier you start building your nest egg, the better chance you have of reaching your retirement savings goals.

There are many options available, so consult your tax adviser for further guidance.

Further Reading: Why You Should Open a Retirement Plan for Your Practice; Common Retirement Plans for Self-Employed Individuals

Section 3: Health Savings Accounts

Health savings accounts (HSAs) help people not only reduce their health insurance premiums, but also build up money within a tax-advantaged savings account.

Only individuals or families covered under a high-deductible health insurance plan during the year are eligible to contribute to an HSA, and thus take advantage of the following tax breaks:

- Money contributed into an HSA is tax-deductible.
- Money invested within the HSA is your money and grows tax-deferred. Unlike with flexible spending accounts (FSAs), which are offered as part of employee benefit packages and allow you to set aside money to pay for your family's healthcare costs with pre-tax dollars, there is no "use it or lose it" pitfall with HSAs.
- Money can be withdrawn tax-free from your HSA at any time to pay for your family's healthcare expenses.

Any money remaining in your HSA when you reach age 65 is available to subsidize your retirement.

To take advantage of this, you will need to switch to a high-deductible health insurance plan if you are not already using one. If you switch, you will immediately realize a sizeable decrease in your monthly premium that is generally equivalent to the increase in your annual deductible.

Assuming you and your family have a relatively healthy year, you will end up ahead of the game because you get to keep all the money left in your HSA at the end of the year. If you happen to incur substantial healthcare costs, you could possibly deplete your HSA. But once you spend the full amount of your annual deductible, your insurance takes over and protects you against any further financial hardship.

Further Reading: Minimize Your Healthcare Costs and Save Taxes With an HSA; HSAs, Part 2: Bang for Your Buck

Section 4: Estimated Quarterly Taxes

While not having taxes deducted from your paycheck can be a good thing (bigger checks!), it also requires a bit of responsibility on your part.

Independent contractors are generally required to pay estimated taxes on a quarterly basis. This is because the government doesn't want you to write them a big check on April 15. Depending on how much you earn doing locum tenens work, you may be required to send estimated quarterly tax payments to the IRS and the states in which you live and/or work. Independent contractors use the estimated tax method to pay Social Security, Medicare, and income taxes when sufficient taxes aren't otherwise being paid in through withholdings from their or their spouse's salary.

To figure out what you owe, if anything, you will need the following:

- Last year's annual tax return.
- Form 1040-ES, Estimated Tax for Individuals (PDF).

Use last year's return to complete the worksheet in Form 1040-ES and determine your estimated quarterly tax.

If this is your first year as a locum tenens provider, you will need to estimate the amount of income you expect to earn. If you overestimate or underestimate your earnings, simply complete another Form 1040-ES worksheet to recalculate your estimated tax for the next quarter.

If you decide not to pay estimated quarterly taxes or find you didn't pay enough at the end of the year, you will be subject to a penalty when you file your annual tax return. You can figure out the penalty using Federal Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts (PDF).

Further Reading: Estimated Taxes (IRS)

Section 5: Planning

The taxes you'll owe on your locum tenens income are easily manageable if you plan ahead. Here are some tips to keep in mind.

Mind the "40 Percent Rule": To be safe, it's a good idea to set aside 40 percent of what you earn for taxes. Remember, you'll owe federal taxes, state taxes, and self-employment taxes on your earnings.

Submit quarterly estimates: Take the time to calculate what you owe in estimated quarterly payments. This will help prevent the need to write a check to Uncle Sam at the end of the year. It will also eliminate or minimize IRS and state underpayment penalties.

Track your professional expenses: Use the handy spreadsheet below to keep track of your monthly professional expenses so you can easily deduct them from your income at the end of the year.

- Professional Expenses Tracking Sheet (XLS)

Keep good records: When tax time rolls around, you want to make sure you have the paperwork from any significant financial events such as buying or selling real estate, starting or closing a business, or inheriting money. Also be sure to report any earnings from savings accounts or investments.

Take advantage of tax shelters: Retirement accounts and HSAs are great ways to reduce your taxable income and improve your overall financial viability.

Consult a tax professional: The tax code can be confusing and is constantly changing. With that said, you should consult a tax professional or CPA who can advise you based on your unique tax situation.

Disclaimer: The information provided in this guide is meant for informational purposes only and should not be considered tax advice. You should consult a tax professional or certified public accountant (CPA) who can advise you based on your unique tax situation.

About the Authors

Andrew D. Schwartz, CPA, is the founder and managing partner of Schwartz & Schwartz, PC, in Woburn, MA. Since 1993, Schwartz & Schwartz has provided tax, practice management, payroll, and financial planning services to healthcare professionals. Andrew is also the founder of The MDTAXES Network, a national association of CPAs who specialize in the healthcare profession. Andrew graduated from the Wharton School at the University of Pennsylvania. He is a member of the Massachusetts Society of CPAs (MSCPA) and the American Institute of CPAs (AICPA), and he was selected as a multiyear winner of Boston Magazine's "Five-Star Wealth Manager — Best in Client Satisfaction" award.

For more information, please visit SchwartzAccountants.com or call 800.471.0045.

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