Taxation and Reasonableness of Alternative Forms of Physician Compensation

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Presented by:
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Emily prepares and reviews tax returns for corporations, partnerships, trusts, individuals, and tax-exempt entities. Her primary area of expertise is compliance and reporting for tax-exempt organizations, with a focus on hospitals and hospital systems. She also has gained a wealth of experience developing the income tax provision and internal controls of a multi-national, publicly traded company.

She earned a Bachelor of Arts in Psychology from the University of Georgia, a Master of Science in Criminology and Criminal Justice (MSCJ) from Florida State University and a Master of Accountancy from the University of Tennessee. Emily is a Certified Public Accountant licensed in the state of Florida and is a member of the Florida Society of Certified Public Accountants.

Objectives

- Understand the tax impact of physician remuneration other than wages
- Explain the difference between a sign-on bonus, forgivable loan, and retention bonus and identify the proper income tax treatment for each
- Apply federal income tax rules to student loan repayments, tuition, housing allowances, parking, and more
- Describe the difference between an independent contractor and employee and how the tax liability of each differs
- Consider how alternative types of remuneration and benefits affect total physician compensation and fair market value

Physician Recruiting

- Sign on bonus
  - Paid all at once, subject to taxation
- Forgivable loan
  - This is a cash payment made to an employee with the expectation that the employee provide a specified term of service to the employer.
  - To be considered a bona fide loan, there must be a stated interest rate
  - The loan is forgiven ratably over the term of service.
  - The forgiven portion is included in the employee's W-2 wages at the time of forgiveness and is subject to taxation.
- Retention bonus
  - Paid all at once, subject to taxation

Moving Expenses

- Prior to 2018, qualified moving expenses were excludable from the employee's income
- From 2018 to 2025, moving expenses are no longer excludable
  - Exception for certain military taxpayers
- Hospitals that pay moving expenses for physicians must consider reasonable compensation
  - Stark law
  - State law
  - IRS reasonable compensation

Polling Question #1

Employed Physicians

These items are considered business expenses of the hospital and are, thus, excludable from the physician employee's income:

- Continuing medical education
- Malpractice insurance
- Dues
- Licenses
- Scrubs/Uniforms
- Onsite meals for the convenience of the employer

Other Employee Benefits

- Lodging
  - Housing allowance – This must be on the employer’s premises, for the convenience of the employer, and a condition of employment to be excluded from wages.
  - Visiting nurses or other medical providers – Temporary housing for an individual that is away from his or her tax home is excludable from his or her wages.
- Travel
  - Overnight, away from home
  - Business purpose versus personal enjoyment
  - Mileage, hotel, meals
  - Physicians often travel for CME and there is no limit to the dollar amount that can be excluded from wages, presuming the above items are true

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Other Employee Benefits (continued)

- Tuition
  - The employer may reimburse, and the employee may exclude from taxable wages, qualified tuition up to the annual limit ($5,250) – but only if the the employer has an educational assistance program that does not discriminate in favor of highly compensated employees.
  - However, tuition for an educational program that allows the employee to meet the minimum educational requriements of his or her current job is not excludable.
- Student Loan Repayment
  - Whether the employer pays the employee who then uses the funds to pay his or her student loan payment or the employer pays the loan provider directly, <u>the payment is always taxable to the employee</u>.

Polling #2

Other Employee Benefits (continued)

- Parking
  - The Tax Cuts and Jobs Act of 2017 (TCJA) changed the rules for employer-provided parking.
  - For tax-exempt hospitals the **<u>cost</u>** of employer-provided parking is required to be added to unrelated business income (UBI).
  - The tax-exempt hospital is not required, however, to include the cost of employer-provided parking that is reported as income to the employee and taxable via his or her W-2.
  - Alternatively, the tax-exempt hospital could charge the employees for the use of the parking space.
  - Similar rules apply to for-profit employers, except that the cost is not deductible, rather than being reported as UBI.

Employee Perks

- Gift cards
  - No matter how small or large, **gift cards are always taxable to the employee**
- Logoed items
  - De minimis items with the employer's company logo are not included in the employee's taxable income
- Disaster Assistance
  - Financial assistance for employee resulting from a nationally declared disaster is not includable in the employee's taxable income.
- Awards
  - Noncash length of service and safety awards are not includable in the employee's taxable income.
  - Cash awards for any reason are taxable to the employee.

Supplemental Wages

- The most common type of supplemental wages paid to physicians is a bonus.
  - Supplemental wages are always taxable to the employee
  - The employer may chose one of two methods for income tax withholding on the taxable wages
    - Method 1: Aggregate supplemental wages with regular wages and use the standard income tax withholding tables to withhold on the total amount
    - Method 2: Report the supplemental wages separately and withhold at a flat rate of 21%
  - Employers may not apply 0% federal withholding based on the employee's request – unless the employee was completely exempt from all income tax in the previous tax year

Polling Question #3

Employee versus Independent Contractor

- Three-pronged test
  - **Behavioral Control** – If the business has a right to control how the worker does the task for which the worker was hired, then the worker is an employee of the business. This does not preclude a physician from exercising professional judgment when providing care.
  - **Financial Control** – If the business has a financial investment in providing supplies, tools, facilities, etc., then the worker is likely an employee.
  - **Type of Relationship** – If the working relationship is essentially permanent in duration and the business provides employee-type benefits, such as health insurance, vacation pay, etc., then the worker is likely an employee.
- Tax implications
  - Employers are required to pay a portion of the payroll taxes on behalf of employees.
  - Business are not required to pay any payroll taxes on behalf of independent contractors.
  - Independent contractors may deduct certain business expenses against their business income.

Overpaid Wages

- Payroll errors do occur – duplicate payments
  - The employer may (subject to state law) recoup duplicate wages by deducting payment from future paychecks **within the same calendar year**
  - The employer may request that the employee repay the duplicate wages directly to the employer. This results in the employer filing amended payroll tax returns. The duplicate wages are not reported on the employee's current W-2.
  - If the employee must repay the wages in a subsequent calendar year, then the employee may take a deduction (subject to certain limits) on his or her individual tax return in the subsequent calendar year. The current year W-2 will reflect the duplicate payment and the employee will be subject to tax in the current year.

Conclusion

- It is common for hospitals and physicians to get creative when negotiating a compensation package. Though each side has a common aim – for the physician to accept employment with the hospital – it is important that the following items do not get lost in the negotiation process:
  - Total compensation must be reasonable
  - Contract language cannot override tax law and deem items as non-taxable that are subject to tax
  - Some perks or benefits are taxable to the employee – this should be understood on the front end so there are no surprises at tax time

Questions?

Thank You!

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