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Understanding taxes and insurance for independent contractors

Locum tenens physicians **work as independent contractors, not employees.** Because there are many differences between these roles, we encourage you to consult a financial, tax, or insurance professional for individualized help. Read on for a summary of insurance and tax differences you can expect as an independent contractor.

Insurance and benefits

1. Independent contractors cannot generally claim unemployment benefits because this compensation is available for employees who previously worked for an employer who paid unemployment taxes. Physicians may file unemployment claims if they previously worked as an employee, but they should not list the locum tenens staffing agency as a previous employer or report any staffing agency compensation on the unemployment claim.

2. Workers' compensation insurance is government-mandated employee insurance designed to cover health costs if employees experience accidents while working. While independent contractors can enroll in this insurance if they'd like to, it may duplicate other health insurance coverage.

3. Non-employees cannot enroll in typical health, dental, disability, and life insurance programs tax-free as employees generally do. However, independent contractors may be covered under a spouse or partner's employment.

4. While independent contractors aren't eligible for a staffing agency's 401(k) plan, more lucrative retirement plans are available (discussed more below).

Taxes

Below is a summary of the income tax advantages and disadvantages for independent contractors.

Advantages

1. Independent contractors can claim more work-related expenses than typical employees because they don't have itemized deduction limitations on IRS Form 1040 Schedule A. They must report **all** related income and expenses on IRS Form 1040 Schedule C. These expenses can include all associated costs, such as travel, meals, housing, work tools and supplies, and continuing education. Independent contractors cannot claim deductions for personal, living, or family expenses, however.

2. Reasonable, actual out-of-pocket meal costs are eligible deductions for assignments that require overnight stays (away from home). Use the continental United States (CONUS) rates calculator to determine the current rates, which depend on the assignment location. Independent contractors cannot deduct the housing portion of the per diem, only the actual housing costs the agency or client does not reimburse.

3. All transportation costs (from home to the assignment area and daily trips from temporary housing to the work site) the client or staffing agency does not pay or reimburse on an "away-from-home" assignment should be deductible. Independent contractors who drive their own vehicle can use the IRS standard mileage rates to calculate the amount to deduct per mile. They may also deduct the cost of tolls and parking or claim actual expenses, including a pro rata portion of depreciation, gas, maintenance, and insurance.

4. Independent contractors may have more lucrative retirement plans than the typical employee 401(k) plan. They can create a simplified employee pension plan (SEP) or other self-employed retirement plan before December 31 to contribute to the plan(s) before April 15 of the following year. These plans allow independent contractors to contribute up to 25% of their net earnings from self-employment for the tax year. Review the IRS self-employment retirement plans for the current contribution limits.

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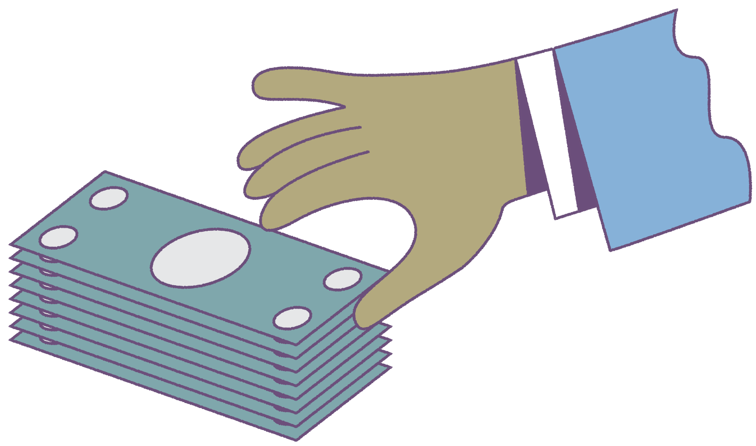
5. As an independent contractor, the physician may deduct premiums they paid for medical, dental, and qualifying long-term insurance coverage. This deduction is entered as an adjusted to your income on Form 1040, which means you benefit whether you itemize your deductions or not.

6. If you set aside a separate room or area in your permanent home for business functions of your locum tenens assignments, you may be able to deduct home office expenses.

7. Forming a professional corporation for your locum tenens business may also yield some business liability and tax advantages, including setting up a defined benefit retirement plan with even more lucrative contribution deductions.

8. CME (Continuing Medical Education) is also deductible.



Disadvantages

1. A locum tenens physician (not incorporated) must pay the federal self-employment tax on IRS Form 1040 Schedule SE (both the employee and employer portion of Social Security and Medicare tax). However, they can claim an income-tax deduction for half of this tax.

2. Federal tax law limits the deduction for actual meal costs or the meal per diem amounts to 50% of that claimed.

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3. A locum tenens physician must generally pay state income taxes in each state where they worked (if the state has a personal income tax). However, independent contractors are often eligible for a nonresident state-tax credit to reduce the home state tax (the state of residence generally taxes all income). This credit should fully or partially eliminate any double state taxes. Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming do not have an income tax.

4. California requires all staffing agencies to withhold 7% of gross compensation paid to nonresident physicians working assignments in California. This withholding should substantially or fully offset the tax liability on the physician's nonresident California income tax return.

5. In limited cases, a locum tenens physician may have a city or county income tax for the tax home and/or the assignment state, a state and/or local sales/gross tax on the gross income earned in the assignment state, or a business or other license (beyond the medical license) requirement.

6. Paying taxes each year becomes more complicated, with filing Schedule C, quarterly estimated tax payments on Form 1040-ES, and potentially one or more state income tax returns with quarterly estimated payments.

The above information has been condensed from various sources generally available to the public that is subject to change and is general in nature for which the propriety may depend on personal facts and circumstances.

Disclaimer: Tax information contained in this document is not intended to be used, and cannot be used, by any person as a basis for avoiding tax penalties that may be imposed by the IRS or any state. We recommend each taxpayer seek advice based on their circumstances from an independent tax advisor.

IRS publications to consider

(Available on the IRS website at irs.gov/businesses/small-businesses-self-employed)

- No. 334: Tax Guide for Small Businesses (For individuals who use Schedule C)
- No. 463: Travel, Entertainment, Gift, and Car Expenses
- No. 505: Tax Withholding and Estimated Tax
- No. 560: Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)
- No. 583: Starting a Business and Keeping Records
- No. 587: Business Use of Your Home