Dentist's Tax & Financial Guide

A GUIDE FOR ALL THE STAGES OF YOUR PRACTICE

Ontario Dental Association

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The Ontario Dental Association (ODA) acknowledges the significant contributions of the authors of this resource document.

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PREFACE

Dentistry as a business is becoming more and more complex. Whether you are a new dentist or a seasoned dentist, by taking the opportunity to learn about the world of tax and financial management, you can avoid the pitfalls that result from poor financial management.

Knowing how to start a professional dental career can be daunting. Dental schools provide a good base in the technical aspect of dentistry, but few, if any, give students any instruction in running a business. Being more fiscally responsible by making sound financial business decisions allows you to focus on providing the best care for your patients. The Dentist's Tax and Financial Guide is a must read and good start for any new grad, seasoned practitioner, or retiring dentist who wants to make the most of their expertise. This easy to read guide is packed with clear concepts, easy to follow case studies, and tried and proven tax strategies.

David Chong Yen, David Rosenthal and Frank Passaro pull together all their years of tax, legal and business knowledge and combine it into an indispensable resource. This roadmap to financial success in dentistry is laid out logically and systematically. It should be a required reading for all new grads, a compass for those embarking on purchasing a practice, and a double check for those contemplating selling.

Having lectured to new grads on the business of dentistry for over a decade, I believe this resource provides a lot of practical information that can benefit all ODA dentists in the area of financial management.

Dr. Harry F. Höediono
Past President
Ontario Dental Association

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INTRODUCTION

The Ontario Dental Association (ODA) is pleased to provide its members with this Dentist Tax and Financial Guide.

With dental school behind you, it is important to have a resource to help you understand the world of accounting, tax and financial management. The ODA knows how increasingly complex the dental profession has become. Patient care and clinical abilities are still the top priorities but it is also necessary for you to be financial and business savvy.

The Dentist Tax and Financial Guide is broken down into seven chapters that discuss different aspects of your professional life such as: graduating from dental school, working as an associate, setting up a professional corporation, owning your own practice, managing personal change, expanding your practice, retirement planning and selling your practice. Each chapter gives a summary of what's covered; tax, legal and financial information; quick factoids; questions that reinforce the topics covered; and case studies to illustrate the information discussed.

The main objectives of this handbook are:

1. To give you general financial, tax and legal information to help you succeed in all phases of your practice.
2. To help you navigate the Canadian tax system to find tax savings throughout your career.
3. To assist you develop financial and tax plans to maximize your income and build your practice.

The ODA worked with this multi-dimensional team of professionals to ensure the handbook's effectiveness:

David Chong Yen, Accountant and Tax Specialist
Recognized throughout the dental community as a tax expert, David Chong Yen proposed and wrote the Tax & Financial Handbook to help you cultivate your business acumen.

David Rosenthal, Lawyer
David Rosenthal specializes in healthcare law for dentists. By providing content for this handbook, he helps you navigate the legalities of being a dental professional.

Frank Passaro, Director of Scotiabank's Healthcare Professional Centre in Toronto
With Frank's more than 25 years of experience helping dentists find the right financial solutions and his Personal Financial Planning designation, his contributions will assist you develop a financial plan for the all stages of your practice.

We hope you find the ODA's Financial & Tax Handbook useful and you refer to it often in the years to come.

Note: The information provided is intended to help you understand complex topics; it is not intended to give you advice. Please consult a tax, financial or legal professional for advice on your personal situations.

PREAMBLE

This section focuses on the basic fundamental concepts of the Canadian tax system. It presents both theoretical and practical examples of how tax applies to dentists. It lays the groundwork for future financial and tax planning techniques.

What you will learn in this section:

- Purpose of this book
- How the Canadian tax system works
- Importance of timing in taxes
- How to deal with the Canada Revenue Agency (CRA)

PURPOSE OF THIS GUIDE

Let me tell you a story about a dentist I met a few years ago. I've encountered countless personalities during my career, but he was especially memorable. He walked into my office, shook my hand and got right to the point. His first words were, "I don't want to pay taxes." An awkward silence lingered before I responded. "Doc, if you don't want to pay taxes, I'm afraid you are in the wrong country; in fact you may be on the wrong planet."

It wasn't exactly what he wanted to hear, but quite frankly there are few places in this world where you can get by without paying taxes legally and Canada is certainly not one of them. As the conversation continued, it turned out that he, like many of his peers, was tired and frustrated.

Ten years after graduating from dental school, all he could think about was his debts. His student loan, home mortgage and practice debt were all a permanent part of his life. He was now borrowing just to pay his taxes. Caught up with his never ending battle with taxes and debt, he had lost sight of the big picture and what his goals were.

I shared with him a lesson my mom had taught me when we had our family boating trips. She would say: "You can't control the direction of the wind but you can change the position of the sail." I explained to him that like the wind, taxes may push him off course, but with tax planning adjustments could be made to stay on course.

That's why this handbook is important. It's an introduction to the business and financial issues you may face in your career and helps you to ask the right questions. It's meant to be used as a resource throughout your career to help you make those little adjustments and steer you in the right direction. However, before we start making adjustments, we need to familiarize ourselves with the rules of the game.

HOW THE CANADIAN TAX SYSTEM WORKS

Preparing your tackle box
My fondest memories growing up were fishing with my mom and dad. I had heard stories from local fisherman of catching the big one a 300 pound marlin — and that became my goal from the first time I laid my hands on a fishing rod. My first fishing trip was far different from what I expected. Before the trip, my job was to prepare the tackle box. I had to have enough of the bare necessities (fishing line, bait and hooks) or we couldn't leave the house let alone get on a boat. The same can be said about taxes. Before we get into income splitting, professional corporations and capital gain exemptions, we have to prepare your tax tackle box. Let's start with how taxes are calculated.

The basic tax equation
Taxes at the most basic level are straight forward. There are two variables: (A) your income and (B) the tax rate.

A x B = your taxes

If Canada operated in a flat tax system, it would be this simple. But anyone who's seen the alarming number of pages in a tax return knows that the Canadian tax system is not just two variables. As a starting point however, let's assume it is.

DID YOU KNOW?
Canada's first income tax, known as the Income War Tax Act 1917, was 45 pages in length. The current edition is well over 3,000 pages. (**Source:** http://wartimecanada.ca/sites/default/files/documents/IncomeWarTax.1917.pdf)

Income
Your income is calculated by taking all your earnings from different types of income and reducing it by any tax deductions you may have.

Types of income
Most dentists believe that the money they receive from patients, investments and employment is all the same. A dollar of income should be worth the same regardless of how you receive it. The tax system is a little more discriminatory about the type of income you receive. Certain types of income receive preferential tax treatment, and if planned incorrectly, the dollar you receive could be worth a lot less than what you had expected. Let's look at the primary sources of income:

- **Salaries, business and rental income:** Tax rates on salaries, business and rental income are higher than other types of income. They are considered "earned" income, which allows you to take advantage of some tax tools that are not available on other types of income.
- **Interest income:** This represents income earned on savings accounts, Guaranteed Investment Certificates, bonds and loans. They are taxed in the same manner as salaries, business and rental income, which means taxes are generally higher.
- **Dividends:** Dividends are distributions of after-tax corporate profits to shareholders. Unlike salaries, a corporation does not get a tax deduction from paying dividends, but the shareholder receiving the dividend does get a tax break.
- **Capital gains:** This represents income earned from the sale of capital property such as real estate and investments. Historically, capital gains have received favourable tax treatment. Currently, only 50% of capital gains are taxable. In some cases, up to 100% of capital gains are tax-exempt; this would include gains on the sale of your principal residence and qualifying small business corporation shares including your dentistry professional corporation/ hygiene and/or technical service corporation (PC an/or H/TSC) if certain tests are met.

As we proceed through this book we will discuss in detail the pros and cons of the above types of income. The important thing to understand at this point is that each type of income serves a purpose and depending on your financial goals, planning the right income mix is another tool for reducing your tax burden.

Tax deductions
The second component of determining your income is tax deductions. Tax deductions reduce the total income from all the sources listed above. Examples of tax deduction

are business and rental expenses, contributions to Registered Retirement Savings Plans (RRSP), and child care expenses. We can now expand the basic tax equation to:

(Your income - tax deductions) x tax rate = your taxes

Tax rates

Canada has a progressive tax system meaning those who earn more pay more tax. To achieve this goal, the government alters the tax rates at different income levels through the use of tax brackets. Tax brackets are the ranges of income that are assigned different tax rates (the higher your taxable income, the higher your tax bracket, the higher your tax rate). Below are the 2018 federal and Ontario tax personal income tax brackets.

Taxable income	Salaries/Interest/ business /rental income and other income	Capital gains	Dividends*
$0 - $42,960	20.05%	10.03%	8.00%
$42,961 - 46,605	24.15%	12.08%	12.76%
$46,606 - 75,657	29.65%	14.83%	19.14%
$75,658 - 85,923	31.48%	15.74%	21.26%
$85,924 – 89,131	33.89%	16.95%	24.06%
$89,132 – 93,208	37.91%	18.96%	28.72%
$93,209 – 144,489	43.41%	21.71%	35.10%
$144,490 – 150,000	46.41%	23.21%	38.58%
$150,001 – 205,842	47.97%	23.99%	40.39%
205,843 – 220,000	51.97%	25.99%	45.03%
220,000+	53.53%	26.77%	46.84%

**Represents non-eligible dividends paid from after-tax income subject to the small business deduction.*

CASE STUDY

Dr. Reena Gupta's salary is $100,000. Based on the above chart, she would have taxes payable of:

Bracket	Income	Tax rate	Taxes
$0 - $42,960	$42,960	@20.05% =	$8,613
$42,961 - $46,605	$3,645	@24.15% =	$880
$46,606 - $75,657	$29,052	@29.65%=	$8,614
$75,658 - $85,923	$10,266	@31.48%=	$3,232
$85,924 - $89,131	$3,208	@33.89%=	$1,087
$89,132 - $93,208	$4,077	@37.91%=	$1,546
$93, 209 - $144,489	$6,792	@43.41%=	$2,948
	$100,000		$26,920

Note: This calculation is for illustrative purposes only and does not take into account any tax deductions, credits, Ontario Health Premium, Canada Pension Plan contributions or Employment Insurance premiums.

Reena would have to pay taxes of $26,920 on her salary of $100,000. Her **average tax rate** is 26.92%. This example also serves to illustrate your marginal tax rate. Your marginal tax rate is the rate of tax you have to pay on your next dollar of income. In the above example, if Reena were to earn $100,001, she would pay an additional 43 cents in taxes on that extra $1 of income.

In tax planning, knowing your marginal tax rate is more important than knowing your average tax rate. As my mom used to say, you can't adjust the sail if you don't know the direction of the wind. Let's continue with the above example, except Reena has the opportunity to purchase $10,000 of RRSPs. Using her average tax rate she would calculate her tax savings to be $2,692. However, if she based her decision on her marginal tax rate, she would see that her savings is actually $4,164. This changes her decision making process quite drastically. Remember that your overall goal should be to reduce your average tax rate; but in order to do so you need to make tax decisions based on your marginal tax rate.

TEST YOUR KNOWLEDGE: Your average tax rate is 40%, your salary is currently $250,000, and you receive a bonus of $10,000. How much in taxes are you paying on this bonus?

A) $4,000
B) $5,353
C) $4,953

Answer: B) Since the marginal tax rate on the $10,000 is 53.53%, taxes would be $5,353.

The types of income, tax deductions and tax brackets all work together to form the basic tax equation used to calculate your taxes. Of course, that's not the entire picture; we need to add the concept of tax credits to your tackle box.

Tax credits
There is a lot of confusion about tax credits. Most people assume they are the same as a tax deduction. Both reduce taxes, but the amount of tax savings can be very different. A **tax deduction** reduces your taxable income while a **tax credit** reduces your taxes directly. Confused? Don't worry; you're not the only one. Let's look at an example that may help shed some light on this concept.

Consider what happens when your favourite store has a sale. A common promotion is 20% off the lowest ticketed price. The discount is a direct reduction of the purchase price. A $100 item would cost you $80. You would then pay HST on the reduced price. Your final price would be $90.40 ($80 X 1.13).

Now instead of a 20% discount, let's assume the store's promotion was a $20 gift card when you spend $100 or more. There is no direct discount of your purchase price, the cashier rings up your purchase of $100 plus HST to arrive at a final price of $113. Since you qualified for the promotion, you would receive a $20 gift card effectively bringing down your total price to $93.

How does this relate to taxes? The purchase price is your income, the discount of 20% is a tax deduction, the HST is your tax rate and the gift card is a tax credit. Like this example, tax deductions usually work out to a larger tax savings than tax credits for high income earners. This is because tax deductions provide tax savings at your marginal tax rate whereas tax credits are calculated at fixed rates specified by the tax laws.

Another feature of tax credits is whether or not they are refundable. A **refundable** tax credit means that even if you have no taxes to pay, you can get a refund cheque for any unused credits. A **non-refundable tax credit** means that you can use the credit to bring your taxes to zero, but will not get a refund for any of the unused portion.

TEST YOUR KNOWLEDGE: I bought my first home this year and I am going to claim the $5,000 first-time home buyers' credit. My income is $100,000, what will my taxable income be after I apply this credit?

A) $100,000
B) $95,000

Answer: A) Tax credits are applied as a direct reduction of your taxes not your taxable income. Therefore, your taxable income will still be $100,000.

Building on our basic tax equation we can include tax credits. Your taxes are now calculated using (A) your income (B) your tax rate and (C) tax credits

(A X B) – C = your taxes

You now have the basic building blocks for understanding how taxes are calculated in Canada. The next time you ask your accountant "How much tax will I have to pay?" You'll understand why the answer is usually "in the ball park of…"

DID YOU KNOW?
From 1691 to 1851 taxes in England were based on the number of windows on a house. This led to houses with fewer windows being built. (**Source:** http://www.historyhouse.co.uk/articles/window_tax.html)

TIMING YOUR TAXES

In addition to reducing your taxes, another primary goal of tax planning is to defer your taxes as long as you can. Why pay now when you can pay later? Let's take a look at how timing plays a role in taxes.

Capital vs. current expenses
You may have heard of the term **amortization** or its identical twin **depreciation**. These two terms are used interchangeably quite often by accountants and other financial advisors. These terms exist because not everything you buy is consumed right way. Unlike **current expenses,** which are fully deductible in the year you purchase them, **capital expenses** usually have a much longer useful life. Because of this, the tax rules generally allow you to write-off a portion of the capital expenses each year. For example, instead of claiming a deduction of $1,500 for the loupe you just purchased, you would claim amortization or depreciation expense equal to 20% of the cost each year.

There is also a special tax rule called the “half-year” rule, which means you can claim depreciation on 50% of the purchase price in the year of purchase. Since a capital asset could be purchased at the beginning of the year or the end of the year, it would be cumbersome to keep track of the actual number of days you owned the asset. Instead, the tax laws assume everything was purchased during the middle of the year so you can only deduct 50% of the cost for the first year. Timing your capital purchases can help you increase your tax deductions immediately by pushing expenses into an earlier tax year. For example, purchasing equipment on December 31st provides you a tax deduction equivalent to several months’ depreciation even though you have only owned and used the equipment for 1 day.

TEST YOUR KNOWLEDGE: My income is normally $150,000 but I spent $150,000 on office renovations this year. Will I have to pay any taxes?

A) Yes
B) No

Answer: A) The entire $150,000 of office renovations are considered a capital asset and cannot be claimed as a deduction right away, it will be amortized over several years. As a result there will still be taxable income.

Cash vs. accrual
The phrase “cash is king” doesn’t always apply in the world of taxes. Just like capital and current expenses, even if you’ve paid for it, you don’t always get the full tax benefit right away. This is because your taxable income is calculated on an **accrual basis**, not **cash basis**. Accrual means your income includes patient fees from services that were rendered and expenses that were incurred during the year instead of patient fees that were received and expenses that were paid. Let us assume that your fiscal year is the calendar year. In this case, if a patient pays you on January 5th for services performed before December 31, this amount would be included as income in the previous year, even though you didn’t receive the cash until the following year. The date you performed the service is the day the income was earned. Just like your expenses, you can time your income.

CASE STUDY

Reena has a patient scheduled for a dental implant on December 28 but the patient has a flexible schedule and can also visit on January 3rd. There are no clinical reasons for the procedure to be performed earlier. By waiting a few days, the taxes on this income will be delayed for one full year. Keep in mind that dental insurance plans may have their annual coverage end on December 31. You should discuss the timing of procedures with your patients on a case-by-case basis.

DEALING WITH THE CANADA REVENUE AGENCY (CRA)

A major cause of tax stress is because many people fear the CRA. Understanding how to deal with them is a tax tool few ever consider. Whether it is due to an honest mistake, a misunderstanding or defending your tax position, dealing with the CRA doesn't have to be an intimidating encounter. The key to a stress-free encounter with the CRA is maintaining documentation which supports your tax claims. This means you may want to think twice before turning your tax documents into confetti after you file your return. In fact, you are required to keep all tax records and documents for 6 full years after the year to which these records and documents pertain. For example, if your year end is December 31, 2018, you should keep all your records and documentation related to that year until January 1, 2025.

Going through a CRA review
Most taxpayers assume a letter from the CRA requesting documentation means they are being audited. In fact, the most common type of CRA check is a very simple and routine tax review. A tax review is the first step in CRA's verification process and is less intrusive and less comprehensive than an actual tax audit. The main goal is to match specific claims on your tax return to the appropriate documentation. It is critical to present accurate and truthful responses on a timely manner as the results of a tax review could lead to an audit if the CRA is not satisfied with your reply or documentation.

With the proliferation of electronic filing, the CRA has developed a fairly streamlined process for reviewing tax claims. Once you file your return, the CRA will begin processing your tax return. If there are any items they wish to verify, a letter will be mailed out to you requesting support documents. As scary as it may seem do not panic when you receive a letter from the CRA, it is a routine check. The request could be as simple as faxing or mailing tuition slips, donation receipts or child care receipts. Once the documents are verified, you will likely receive a letter either requesting additional information or confirming that no further adjustments will be made.

Being audited
A tax audit can be stressful. The CRA will look through your books and records to verify if your tax returns are accurate and truthful. While a tax review is typically limited to a few deductions and credits and their corresponding tax receipts and slips, an income tax audit can cover everything from unreported income to checking the validity of all your business expenses claimed. Bank statements, invoices, receipts, deposit books and cancelled cheques are all open to the CRA's scrutiny.

Your best defense against a tax audit is to avoid it completely. Here are ways to minimize the chances of being selected for a tax audit:

1. File your returns on time (see important dates in Appendix A).
2. Pay your taxes on time (see important dates in Appendix A).
3. Ensure the information on your tax filings is accurate and truthful.
4. Report all income including cash income.
5. Avoid tax schemes. For example, donation receipts being issued for amounts higher than you actually donated.
6. Beware of high risk claims. Meals and entertainment, automobile, advertising, donations, home office, interest and subcontract expenses are areas the CRA will likely scrutinize.
7. Be consistent. Drastic changes in your tax filings year-to-year may be a red flag to the CRA.
8. Know the norm for your industry. The CRA collects information every year from other dentists. You don't want your tax return to differ significantly from industry norms.

Even the most prudent taxpayers who follow the above tips may be selected for a tax audit. If that happens to be you, here are some tips:

1. Notify your accountant immediately. He/she may be able to deal directly with the auditor.
2. Find out exactly what year is being audited.
3. Find out what is being audited (i.e. personal, corporate, payroll or a combination).
4. Gather supporting documentation for the items being audited for your accountant to review.
5. Provide all supporting documentation requested by the CRA in an organized and timely manner.
6. Discuss possible questions the CRA may ask you with your accountant. Be prepared to give a response if the CRA contacts you directly.
7. Be respectful to the CRA auditor.
8. Negotiate penalty/interest/taxes and adjustments with the CRA auditor.
9. Be prepared to defend your tax position and know your rights as a taxpayer.
10. File a notice of objection, if required.

Gone fishing

With my tackle box ready, I yelled to my parents to hurry up so we could get on the water. My dad's response, "We aren't going on the water today, we are going to fish by the pond." Disappointed, I asked him why? He said, "You have to get your feet wet before you chase a 300 pound marlin."

Now that you are better equipped with knowledge on how the Canadian tax system works, it is time to put it into practice. We are going to help you catch the big one, but first you have got to learn how to fish. We'll start with what happens once you are outside the classroom.

KEY CONSIDERATIONS

- Utilize this book as a resource to assist you with tax, finance and legal issues.
- The basic equation for taxes is: [(Income - tax deductions) x tax rate] - tax credits = taxes.
- Income can consist of salary/business, interest, dividends and capital gains.
- Tax deductions are allowable expenses, which reduce your taxable income.
- Planning with your marginal tax rate will help you reduce your average tax rate.
- Tax credits are applied to reduce taxes after deductions are applied to your income.
- Timing your taxes can be achieved by deferring income and advancing expenses.
- Don't panic when you get a letter from CRA. Contact your accountant and keep your tax records organized in order to prepare a timely response.

1

GRADUATING FROM DENTAL SCHOOL & WORKING AS AN ASSOCIATE

This chapter focuses on your first steps outside the classroom and towards a career in dentistry. From finding your first associate position to filing your tax returns, this section will help you get the right footing for the early stages of your career.

What you will learn in this chapter:

- Finding the right associate position
- Getting dental experience
- Making and managing money
- Will I pay taxes?
- Filing your tax return
- Tax breaks for new graduates and associates

First time out
At the time, I thought my first fishing trip was a huge disappointment. With the sun beating down on me for hours, I didn't end up catching a single fish. In hindsight, the experience paved the way for achieving much larger goals. There was an expectation gap; I wanted fish and didn't understand the real purpose of the trip. This is a struggle many new graduates have when you are looking for your first associate position. Knowing what to look for in your first associate position will help springboard your career.

FINDING THE RIGHT ASSOCIATE POSITION

There are a myriad of factors to consider when choosing where to associate. Most new dental graduates want a position that fits their lifestyle. This includes being located within close proximity of their friends and family, convenient office hours and office appearance. Often times, this means associating in big metropolitan urban areas where positions are not as readily available or where the position does not offer you an opportunity to fully develop your skills. Finding a balance between your lifestyle and career goals can be a difficult task as they are not always aligned. For new dental graduates, visualizing your future destination can be even harder. Most can only see the student debt in front of them. Fortunately, even if your goal is to become a practice owner, specialist, university professor, dental researcher or you're not sure what you want to do, there are only two primary reasons for working as an associate:

1. **Gaining experience**
2. **Making money**

Experience

Your first priority should be finding a clinic that provides you with mentorship as well as the opportunity to hone your clinical skills. Gaining business and practice management experience and honing your interpersonal and communication skills are also critical. Here's a list of things to consider when applying for an associate position:

- What type of clinical procedures will I be performing?
- What types of services are performed in-house versus referred out?
- Will the principal and/or other associates be providing mentorship?
- Will I get practice management exposure?
- Are there other associates working here?
- Solicit comments from previous associates who worked at the practice.

Narrowing down your options won't be easy, but if you factor those considerations and align them with both your future goals and lifestyle considerations, the path to finding the right associate position will be clearer.

Once you find the right associate position, you may be required to sign an associate agreement. Below is some legal information that you need to know before signing an associate agreement.

Legalities of signing an associate agreement

The associate agreement will probably be the first legal agreement you enter into as a practicing dentist. It's a legal contract that details any arrangements between the dentist who owns the practice (principal) and the associate dentist hired to work at the practice (you). It is important that you review the agreement carefully and consult with your own professional advisors to ensure you fully understand your rights and obligations before signing it.

Relationship

In most cases, as an associate you are considered self-employed. The agreement details the terms in which you agree to provide services to the principal's patients as an independent practitioner.

You can operate as an individual or as a dentistry professional corporation (see chapter 2). As an independent practitioner, you operate your own business. The principal pays you a gross amount and you must remit the required taxes and other remittances from that amount to CRA. As an independent practitioner, you usually pay for license fees, memberships, insurance, continuing education courses, seminars, and other applicable expenses.

The agreement should detail all of the services and facilities you will be given by the practice owner. These can include use of the premises, equipment, dental supplies, staff and services. Staff and services might include the use of receptionists, chairside assistants, dental hygienists, management, administrative, bookkeeping and collection services. If you require specific equipment or staff, this should be detailed in the agreement. The agreement often stipulates that the principal will provide standard equipment and routine dental supplies. It's your responsibility to pay for specialized items.

Remuneration
Associates are typically paid based on a percentage of their collected billings. The current standard rate for general dentistry is 40% of collected billings. If you are a specialty practice associate, you may command a higher percentage. Payments are usually monthly as third party laboratory invoices are typically received on a monthly basis.

Collected billings typically means the gross billings for dental services performed by the associate to the practice's patients for which payment has been received, after deducting laboratory fees. The associate's gross billings can also include the dentist examination fee for dental hygiene services where the examination has been performed by the associate. The vast majority of associate agreements do not include x-ray exam fees where the x-ray is taken by the hygienist and read by the associate.

Review the definition of collected billings to determine if there are other deductions (in addition to deducting laboratory fees) from your gross billings. It's becoming common that credit card processing fees and other patient collection costs are deducted from your gross billings.

If a patient does not pay an account, then it is not included in the calculation of collected billings. If a bad debt is incurred and you were paid, you must repay the amount to the principal.

Professional dental goodwill
The most valuable asset a practice owner has is the professional dental goodwill. This includes patient lists, custody and control of all patient records and files (including patient billing records and treatment plans), patient charts, x-rays and models, and use of any dental practice names. When a dental practice is valued, typically the tangible hard assets comprise about 20% of the total practice value, while the goodwill is valued at approximately 80%. Given such value of goodwill, the practice owner will take appropriate measures to protect his/her asset.

In general, you can expect the following provisions to be contained in the agreement:

- The dental practice's staff is the principal's responsibility.
- The agreement will contain a staff non-solicitation covenant. The time period is typically one or two years after the agreement is terminated.
- A covenant that you will not solicit patients of the practice for a certain time period. The time period is typically one or two years after the agreement is terminated. Even in the case of a verbal associate agreement, the Ontario Dentistry Act specifically states: the associate shall not solicit or cause or permit the solicitation of the principal's patients.
- The agreement will include a non-competition covenant whereby you agree not to compete with the principal within a specified geographic radius for a specific time period time after you stop working at the practice.
- Most importantly, from your perspective, if the arrangement is not working, you must be able to terminate the agreement promptly, typically one to three months prior to written notice.

MAKING AND MANAGING MONEY

Every graduate reacts differently to achieving the major milestone of graduating and beginning life as a dentist. The long awaited opportunity to benefit from both new personal and financial opportunities brings with it important decisions, many with significant long-term financial implications. Some will risk reaching for a desired lifestyle, too early, too fast. Others will choose a more pragmatic approach, recognizing a solid financial plan pays off with greater financial security in the long run. As a new dentist, the goals you set now and the financial plans you set in motion early will help you set a strong foundation for a rewarding career.

So what are the key elements of a good financial plan?
A financial plan is more than a budget. Its objective is to identify the goals that are uniquely important to you and then translate them into a series of actions implemented both in the immediate future and then over your lifetime. A good plan benefits from input from accountants, tax specialists, lawyers,financial planners and business advisors. It should also lay out a step-by-step program towards predictable outcomes.

Step 1 – Establish clear long-term goals.
Step 2 – Set short-term milestones with your long-term goals in mind.
Step 3 – Consider day-to-day cash flow, the debt you're carrying, investments strategies, protection for you and your business, retirement and estate plans and tax minimization strategies.

Managing Debt
Debt is a two-sided coin. The positive side is its ability to help you achieve your goals. As a student you've likely borrowed to fund your education and as you enter your life as a practicing dentist, you may borrow again to open a new practice, buy a home or purchase a car.

The negative side of debt is the reality that poorly managed debt can overwhelm and distract you from achieving your goals. Finding the right balance is different for everyone. Here are some guidelines:

- Make sure new debt you take on aligns with your personal goals as established in your financial plan.
- Avoid impulsive purchases. They may provide short-term pleasure, but long-term pain.
- Patience is often your best friend when seeking to build long-term financial strength.

DID YOU KNOW?
When placed side by side, there are enough credits cards in circulation to cover 3.5 trips around the world. (Source: http://www.supermoney.com/2014/04/credit-card-facts/)

Which debt to pay off first?
Here's a strategy that can help you pay down your debt faster:

Credit card debt: With interest rates up to 20%, your monthly credit card statement should be your first priority. You should always pay the balance in full even if it requires dipping into your personal line of credit. If you consistently run into trouble with credit card interest, you may want to consider cutting up the credit cards and sticking with cash and debit. The convenience, cash back and reward points of using a credit card are not worth a 20% interest charge.

National and Ontario student loans: Government student loans such as Ontario student assistance plan (OSAP) are next on the pecking order. Federal loans charge interest of prime + 2.5% and Ontario loans charge prime + 1%, which is high compared to a student line of credit from a national bank that usually charges prime. While there is a six month grace period after graduation to make payments, only a portion of your student loan is interest free during this period. There is a tax break for interest paid on government student loans but it's usually better to skip the tax break in favour of lower interest.

Student line of credit: Your goal should be to repay the entire student line of credit within three to five years of graduating. Interest is generally charged at prime, which is significantly lower than credit card debt or government student loans. Interest incurred on this debt is not tax deductible so you will still want to pay this balance down quickly. In order to reach this three to five year debt repayment timeline, you will have to budget for your annual expenses.

OTHER FINANCIAL CONSIDERATIONS

Leasing vs. buying a car
After years of being a student, you may be tempted to reward yourself by getting the fanciest car you can, for the lowest monthly cost. Leasing may have a lower monthly cost, but remember you do not own the car. It may be a wiser choice to own a lesser car for the same payment, and once you've made the last instalment, you have a car to show for your investment. Also, talk to your accountant or tax specialist as the decision to buy or lease has tax implications.

Buying a home
For most people, buying a home will be the biggest financial commitment they may take on in their lifetime. For a dental professional, this may not be true. If one of your long-term goals is to own a practice, the costs of acquiring equipment, an office and hiring staff can easily become the biggest financial transaction you will be involved in. When considering buying a home make sure you have a clear understanding of how this affects your ability to direct your financial resources to opening a practice. Here are some things for you to think about:

- Will your day-to-day cash flow be strained by taking on a large mortgage, limiting your ability to invest in your practice in the future?
- Will you find it necessary to move in order to pursue a future opportunity, making rental accommodation a viable alternative? Renters don't have to pay real estate and lawyers' fees when they move, or sell an expensive home when the real estate market may be in the doldrums.
- On the other hand, owning a house may be a great long-term strategy to building equity. It can be used to raise funds if and when you decide to make other investments (practice or personal).

Protect your Credit Rating
Develop the discipline of making payments as agreed, on time and in full. In the case of credit history, past performance is taken to be a reliable predictor of future behavior. Professionals with a good credit history will have better access to more funding when needed, at a lower cost.

Budgeting
Your focus should be on basic expenses and debt repayment. Unfortunately, this means there may not be a lot left over for other expenses. We recommend sitting down and physically budgeting, tracking and quantifying your expenses because if you don't measure it, you can't manage it.

Follow the rule of thirds, even dentists who don't like numbers can budget using this approach. For your first two years, your monthly income can be split into thirds — one third for debt repayment, one third for taxes and the one third for personal expenses. While this won't work for everyone, it's a good starting point.

	Recurring	Non-recurring
Basic expenses	Medical insurance Rent Utilities (heating, electricity, internet, telephone) Transportation (Transit pass, automobile lease/finance payment, gas, insurance, maintenance etc.) Food (groceries) Professional dues and memberships Taxes Child care and education Disability insurance	Medical emergency House hold goods Car repairs (Brakes, winter tires etc.)
Other expenses	Cable television Gym memberships Other monthly subscriptions/ memberships	Travel Clothing Restaurants and entertainment Furniture and electronics Home maintenance and renovations Gifts
Debt repayment	Mortgage payment (if applicable) Student loan payment Credit cards Line of credit	Family/parent loans

Budgeting would not be complete without considering taxes, so let's take a look at what your first tax bill might be.

WILL I PAY TAXES?

Yes. In most cases, you will only have to report up to six months of income on your first personal tax return after you graduate in June. As a result, your tuition credits will likely cover most of the income taxes that you owe during your first tax year. However, the Ontario tuition credit is no longer available for tuition paid after September 2017 so you will end up having to pay provincial taxes on the income. Additionally, Canada Pension Plan (CPP) and the Ontario Health Premium cannot be offset by any tax credits. They must be paid.

As a self-employed individual, you are your own employer and will have to pay both the employer and employee portion of Canada Pension Plan (CPP). The Ontario Health Premium is a special Ontario tax designated for health care that is based on taxable income. Remember to build this into your budget.

Why worry about tax deductions, write-offs, credits and all things tax related?
Tax planning is more than just reducing your taxes for the current year; it's also about putting yourself in the best position to reduce future years' income taxes. For new graduates this means preserving as much tuition credits as you can to reduce next year's taxes. As you will see, tax planning can also get you some money back for those years you didn't think you had to file a tax return.

DID YOU KNOW?
The tax courts allowed a farmer to claim cat and dog food for outdoor pets whose business purpose was to keep wildlife away from blue berries. (**Source:** Zeitz v. The Queen [2002] 4 C.T.C. 2292)

FILING YOUR TAX RETURN

Taxes were probably the last thing on your mind in dental school. For some graduates, this may be the first tax return you have ever filed. Many Canadians believe there is no benefit to filing a tax return if you have no income to report. This assumption could cost you thousands of dollars. Here's why you should file your tax returns even if you have no income, especially during dental school:

Tuition credits: You can carry forward unused tuition credits to the future when you do have income to report. In order to receive a tax break for all the tuition you paid over the years, you need to report the amount of tuition paid in the year it was actually paid. Any Canadian university should issue you a special tax slip known as a T2202A (Tuition, Education, and Textbook Amounts Certificate) that summarizes this information. In most cases, this slip should be available to you by logging into your student account on the University website. If you attended dental school outside of Canada, you will need to provide the school with form T11LA (Tuition, Education, and Textbook Amounts Certificate — University outside Canada) to be completed by the school's administrators. Failing to report these slips in their appropriate year could cost you $30,000 of tax savings assuming you have $200,000 of tuition credits.

Tuition transfers: If your income is too low to pay regular income taxes, you can choose to transfer up to $5,000 of tuition credits to your spouse or parents each year. In this case, your spouse/parents will receive a tax break of approximately $750 in cash. This money could then be gifted back to you to offset your student loan or pay down that pesky credit card bill.

Rent credit: For low income earners such as students, the Ontario government will likely give you a tax break on your rent. This credit is a refundable credit so you get a tax refund even if you paid no taxes during the year. For 2018, the credit will pay you up to a maximum of $1,042. For students living on residence, you will receive $25. For a student paying $1,500 per month for 12 months, you would receive a tax refund of $650 for the rent paid.

Ontario Basic Sales Tax Credit: You can receive up to $301 annually. The full credit is available for a single individual with no kids and income below $23,156 (for 2017).

GST/HST Credit: The GST/HST credit is calculated based on your family's net income and the number of children you have. For a single individual with no income, you will receive $284 per year (for 2018).

If you haven't filed a previous year tax return, it's not too late. You can go back and file these returns. Given what is at stake, it is highly recommended that you do.

Self-employed vs. employee

If you recall our discussion on the different types of income, we said that salaries and business income were taxed at the same rate. Though this is true, there is a significant difference in the tax deductions you can claim between salaried employees and self-employed dentists. Being self-employed is a tax planning tool that is often taken for granted by most dentists.

We have included a list of factors to consider. It's important to review this list as the advertising, meals and entertainment, office, automobile and travel expenses you have paid may not be deductible if the CRA considers you to be an employee. In addition, there may be HST implications for those who are self-employed depending on the fee arrangement they have with the principal dentist.

Factors to Consider		
	Employee	**Self-employed**
Level of control	• Principal determines treatment plan and work. • You rely on the principal's professional judgement. • You must work set office hours. • You do not have flexibility with which patient cases to perform.	• You determine the work to be performed on patients • You work autonomously • You are usually able to choose your own schedule • You can accept or refuse to perform work
Tools and equipment	• The principal provides all tools and equipment.	• You provide your own tools and equipment.
Opportunity for profit	• Remunerations are fixed. • You receive a salary.	• There are no restrictions on the number of patients you see and the work you perform. You control the amount of income earned. • You work at more than one clinic increasing control of your income.
Financial risk	• Principal is responsible for legal, financial liabilities from patient complaints, malpractice, professional misconduct etc.	• You are responsible for legal, financial liabilities from patient complaints, malpractice, professional misconduct etc.

CASE STUDY

Dr. Alan Chen is not sure whether he is an employee or self-employed. Since graduation he has been an associate at three different practices. His fees are 40% of patient collections at two of the locations and 45% at the third. He brings his own dental loupes and hand pieces to each clinic. Alan has committed to work 1-2 days a week at each clinic on the days of his choosing. For scheduling purposes, he must notify the administrative staff of the days he wishes to work at least 2 weeks in advance, but is otherwise free to choice his working hours. All treatment plans and work is 100% up to Alan's professional judgement and discretion. The principal does not hold any influence as to the extent of services performed on patients.

Based on the factors above, he would likely be considered self-employed as the relationship does not appear to be one of employer and employee. Instead Alan has control over his income and full autonomy over the services he provides. Working at three clinics also demonstrates that Alan is not economically dependent on any one clinic.

TEST YOUR KNOWLEDGE: I received a T4 slip from the dental clinic reporting $120,000 of employment income. I have automobile expenses of $3,000 and meals and entertainment expenses of $4,000 related to earning income. My taxable income is:
A) $120,000
B) $117,000
C) $113,000

Answer: A) Since you have received a T4, the income you have received is considered employment income and you will not be able to deduct business expenses.

TAX BREAKS FOR NEW GRADUATES AND ASSOCIATES

Here are some tax breaks that may only be available at this stage in your career. So make sure you take advantage of them.

Tuition
All those years of tuition fees are finally paying off in more ways than you think. Your first big tax break will come in the form of tuition credits. You are entitled to a tax credit on tuition fees paid to a qualifying post-secondary institution inside and outside of Canada. You will get a tax break of approximately fifteen cents for every dollar of tuition you paid. Remember, these are tax credits not deductions, so the tax savings is at a fixed rate and does not change regardless of your income. As a general guideline, taxes on the first 12 months of earnings will be significant lower for most associates. This is where you may make your first financial mistake. With lower taxes to pay on this income, you may be tempted to over indulge. Instead of spending freely, now would be a good time to make a dent into that student debt.

Examination fees
Similar to tuition, fees paid for examinations in order to obtain your DDS entitle you to a tax credit. This would include exams such as the National Dental Board Examination.

Student interest
Student loan interest is a prime example that taxes should not be the only consideration in making financial decisions. Take the following two options: 1) Consolidate your student debt into one line of credit from a national bank or 2) Keep your Canada and Ontario student loan.

From a tax perspective, interest at prime rate plus 2.5% paid on Canada and prime rate plus 1% on Ontario student loans entitles you to a tax credit in the year it was paid or up to the following 5 years. There is no tax break on interest, usually at prime rate, paid on student lines of credit from a national bank. If you only consider taxes when making this decision, option 2 appears to be far more attractive.

However, given current interest rates on student lines of credit compared to Canada and Ontario student loans, you would likely be better off to forego the tax break on the Canada and Ontario student loan in favour of a student line of credit with no tax break. The difference in interest rates would more than likely make up for the lost tax savings.

Foreign tax credits
Many dental students who study abroad end up working and earning income in those countries. Even though this occurs outside of Canada, it still impacts your taxes. Canadian residents are taxed on their worldwide income. Since most dental students are residents of Canada for tax purposes, even when they study abroad, they must report this income on their Canadian tax returns. In general, there is relief for any taxes you paid on the foreign income. Foreign tax credits are usually a dollar-for-dollar credit for the taxes you paid to a foreign country. Let's look at how you would file your income tax return in both countries in a simplified case.

	Foreign tax return	Canadian tax return
Income earned abroad	$50,000	$50,000
Taxes owing	10,000	11,000
Less: taxes paid	(10,000)	0
Less: foreign taxes paid		(10,000)
Balance	0	1,000

If you worked outside of Canada, you should report the income you earned and the taxes paid in that country on your Canadian tax return. Provided that the foreign country has a tax treaty with Canada, the foreign taxes you paid would generally be the same as if you had taxes withheld from your pay cheque. If the foreign country has lower taxes than Canada, then you would owe the difference in Canada as is the case in the above example. For those dental graduates who worked outside of Canada, it is important to keep track of your foreign income earned; foreign taxes paid and file the appropriate foreign income tax returns.

There is one caveat that applies especially to graduates. Graduates have a large amount of tuition credits but not a lot of income in their first year after graduation. There are special "ordering" rules that determine which credits must be claimed first. Unfortunately, tuition credits must be claimed before foreign tax credits. As a result, a person with a large amount of tuition credits is forced to use the tuition credits first to reduce their taxes to NIL. Since there are no more taxes to offset, the foreign tax credits, which are non-refundable and cannot be carried forward, end up being unused. This means you receive no credit for the foreign taxes paid while still having to use tuition credits to offset the foreign income reported on your Canadian tax return. This would be a case of double taxation.

Equipment purchased from dental school
Equipment such as hand pieces and loupes that you continue to use while you associate can be claimed as a deduction in your tax return. This equipment would be part of your capital assets, which is subject to depreciation/amortization. In some cases, this is already included in your tuition fees.

Dental supplies and tools under $500
Supplies and tools you purchase that cost under $500 can be fully deducted in the year they are purchased. They are not required to be amortized over multiple years.

Laptop, computers, tablets and smart phones
Electronics that you use for business purposes also make up part of your business capital assets. Different categories of electronics have different rates of depreciation. For example, laptops or computers are currently depreciated at a rate of 55% per year. Items such as cameras, scanners and printers would be depreciated at a rate of 20% per year. Keep in mind that only the business portion of these capital assets would be deductible for tax purposes.

TEST YOUR KNOWLEDGE: I purchased a laptop this year for $2,900, which I use 40% of the time for business. I will be able to deduct from my income:

A) $1,160
B) $2,900
C) $1,595
D) $319
E) $638

Answer: D) Amortization for the first year of purchase is calculated as $2,900 x 40% business use x 55% depreciation rate x 50% half year rule = $319. Remember the "half year" rule applies in the first year of purchase.

Dental library
The cost of books purchased during dental school forms part of your dental library and is deductible at a rate of 20% yearly. The cost of any books purchased after starting your associateship is fully deductible in the year of purchase.

Meals and entertainment
Fifty percent of meals and entertainment incurred to earn income is tax deductible. This could include food provided to your patients and contacts as part of business advertising. It could also be food and entertainment expenses incurred while away at a convention, seminar or conference.

Professional dues
ODA, Royal College of Dental Surgeons of Ontario (RCDSO) and other professional dues and memberships are 100% tax deductible.

Conventions and Seminars
Up to two conventions in connection with your practice/profession can be deducted per year. There are geographical limitations that could prevent a convention from being deductible. Conventions held outside of a sponsoring organization's ordinary area of activity are not deductible for tax purposes.

Generally speaking, this means conventions outside of Canada and the United States of America would not be deductible. A tax tip is to consider combining your personal vacation with conventions you are scheduled to attend. This would allow you to deduct a portion of your travel costs.

Seminars and courses for maintaining, improving or updating your clinical proficiency and knowledge are tax deductible, as are related travel costs.

Scrubs
Many dentists would like to claim clothing as a business expense. The tax laws allow you to claim clothing as a business expense on one condition — it can only be used in your practice. In most cases, the only article of clothing falling into this category for a dentist would be scrubs.

Cell phone and internet
You can claim the business portion of cell phone and home internet costs as business expenses.

Legal and accounting fees
Annual legal and accounting fees to review your associate agreement or file your tax returns are fully tax deductible. Professional fees incurred in relation to incorporating (except for the first $3,000) and purchasing a practice, are considered capital expenses and would be deducted over several years.

Home office
You can deduct home office expenses if you meet one of the following conditions:

1. The work space is where you mainly do your work (more than 50% of the time).
2. You use the workspace only to earn your employment/business income. You also have to use it on a regular and continuous basis for meeting clients or customers.

Short of having a dental chair inside your home, there is a risk that home office expenses would be disallowed by the CRA. In addition, you can only claim the portion of your home you use for your home office based on square footage. Compare the potential tax savings with the risk of an audit.

Getting help with your books
Keeping your financials in order, record keeping and tracking business activities are probably quite far down on your to do list. Consider paying low income family members to help with these tasks. This is an example of income splitting. You claim a tax deduction for the amount paid and the lower income family member reports the income. As long as you are in a higher tax bracket, the family saves taxes.

To avoid having the CRA disallow the deduction, the amount paid must be reasonable for the services provided. In other words, it has to be comparable to what you would pay a stranger for the same services. In addition, the amount must actually be paid and deposited into the family member's bank account. Proper payroll deductions, where applicable, must be withheld and submitted to CRA.

TEST YOUR KNOWLEDGE: Can I deduct $50,000 of annually salary paid to my spouse if he/she provides little to no service to my business?

A) Yes
B) No

Answer: B) Compensation must be reasonable based on the services provided otherwise it will be disallowed by the CRA. The family member receiving the $50,000 of salary would still be taxed on the salary even if the deduction was disallowed. This is an example of double taxation.

Motor vehicle expenses
The following expenses can be claimed on the business portion of your vehicle:

- Gas/fuel
- Insurance
- Maintenance and repairs
- License/registration
- Loan interest/leasing costs/depreciation (capital cost allowance)
- Parking (only those charges incurred for your practice may be claimed and no proration based on business mileage is necessary)
- CAA and auto club membership
- Toll road charges

The deductible portion of auto expenses is calculated based on the following formula:
(business kilometres /total kilometres) x motor vehicle expenses = deductible auto expenses

Examples of business kilometres include driving to the bank to make deposits; driving between clinics directly if you work at more than one clinic in a day; travelling to lawyers and/or accountants; and driving to pick up supplies or equipment. Travelling from home to the clinic directly and for interviews does not count as business kilometres. To support your claims, you should keep a log book for your business kilometres.

Leasing vs. buying a car
As we discussed earlier in the chapter, the first big purchase most new graduates make is a car. With student debt and other financial obligations restricting your cash flow, you may consider leasing a vehicle. Part of the sales pitch from car dealerships is that your lease payments are tax deductible and as a result leasing is a cheaper option than financing/buying. While this may be true, it is not the whole picture. You will receive a tax deduction regardless of whether you choose to lease or buy your vehicle. The deductions are as follows:

	Lease	Buy	Finance
Tax deductible?	**Yes**	**Yes**	**Yes**
Annual deductible amount	Monthly payments up to a maximum of $904 (including HST) per month	30% per year of vehicle purchase price (depreciation/ capital cost allowance) up to $33,900 including HST.	30% per year of vehicle purchase price (depreciation/ capital cost allowance) up to $33,900 (including HST) plus interest expense paid

As with other capital expenses, only the business portion of the lease payments or depreciation is deductible. Similar to student loan interest, we want to avoid making an exclusively tax-driven decision based on perceived benefits. The real questions that need to be considered are as follows:

- Do you intend to keep the car for 5 years or longer?
- Do you plan to drive more than 24,000 km in a year?

If yes to either, buying/financing your vehicle will most likely leave you in a better position in the long run. If you're going to purchase the car at the end of the lease, you would be better off financing or buying it from the beginning. In addition, there are charges for going over annual kilometre allowances (typically 24,000 km) and there may be excessive wear and tear costs if you choose to return the vehicle. You should consult your accountant and get advice regarding your specific case before you decide to lease or buy your car.

Moving expenses
If you have accepted an associate position away from your home, you may be able to deduct your moving expenses. You are eligible to deduct moving expense if your new residence is at least 40 kilometres closer to your new work place than your old residence. Deductible expenses include the following:

- travel costs including meals and lodging (max. 15 days)
- transportation and storage of your household items
- costs incurred in cancelling an unexpired lease
- cost of selling former residence, including legal, advertising and real estate commission
- legal costs of buying a new residence if you sold a former home as part of the move
- mortgage cancellation costs

Moving expenses are deductible against the income you earn at your new workplace. If you have unused moving expenses, they can be carried forward and claimed in the following year or until they are used up.

TEST YOUR KNOWLEDGE: My apartment lease extends until August 31, 2018. Can I deduct the lease cancellation penalty, which I paid in June 2018 due to early termination?

A) Yes
B) No

Answer: A) Yes, provided you meet the 40 km distance requirement lease cancellation fees to relocate for the purpose of starting a new job qualifies as a valid moving expense.

Donation credit

Donations to a registered charity will entitle you to a donation tax credit. You receive greater tax savings after the first $200 of donations. If you are married or living common law, it is beneficial to combine charitable donations on one spouse's return to exceed the $200 threshold. Donations can also be carried forward up to five years.

Medical expenses

You can claim medical expenses for yourself and your family members. This would include your spouse and any relative (child, grandchild, parents, and grandparents etc.) who are dependent on you for financial support. Similar to donations, you should group all the medical bills for you and your dependents and make the claim on one tax return. Medical expenses are subject to an income test and as a result it is typically more beneficial for the lower income spouse to claim medical expenses for the entire family. For self-employed associates, you may be able to deduct medical premiums from your associate income. The limit for you and your spouse is $1,500 each and $750 for each of your children.

Registered Retirement Savings Plan (RRSP)

At this point in your career, we don't recommend RRSPs for the following reasons:

- **Limited contribution room:** RRSP contribution room is created based on previous year's earned income. Given that you likely haven't reported that much income in the past, you may not be able to contribute much to an RRSP your first year after graduation.
- **Tax benefits are lower:** Since you are only reporting up to six months of income this year, deferring your RRSP deduction for another year with higher income will result in higher tax savings.
- **Cash flow:** With debt repayment and personal expenses a top priority, you likely won't have available funds to invest into an RRSP your first year.

The tax breaks listed here will help you preserve your tuition credits for a little while longer, giving you more tax-free income to pay off any debts and build your savings. For the first year, your tuition credits will be your life jacket helping you avoid drowning in taxes. Unfortunately, they won't last forever. Our next chapter will discuss a new tax savings vehicle known as the professional corporation (PC).

Hitting the open waters
It took several trips to the pond before I finally caught my first fish. Learning to fish was a slow process. My parents stressed that the results would come as long as I kept casting my line and waiting for something to bite. The entire experience was a lesson in patience but I learned what I needed to from the little pond near our house and was ready to hit the open water.

Much like my experience, you will have to work your way up and around different obstacles. Your associateship is your training grounds; it's where you learn how dentistry works outside of textbooks and lecture rooms.

KEY CONSIDERATIONS

- Clinical and practice management experience should be your first priority when looking for an associate position. Money comes second.
- Before signing an associate agreement, ensure you understand what is involved. Some items are negotiable, others are not.
- Pay off debt in the following order: credit card balances, government student loans then student line of credits.
- Your first tax bill after graduation is expected to be lower because of tuition credits.
- Being self-employed opens up tax breaks not available to employees.
- Maximize your tax deductions and credits to preserve your tuition credits for next year's taxes.

2

TAXES, INVESTMENTS & PROFESSIONAL CORPORATIONS

This chapter focuses on the issues you will face as you continue to gain experience as an associate. This includes handling your first big tax bill and where you should be spending your money. It will also present new tax savings techniques including setting up a professional corporation (PC).

What you will learn in this chapter:

- What are tax instalments?
- Where should you park your savings?
- What is a Professional Corporation (PC)?
- When should I set up a PC?
- What are the benefits of a PC?
- What are the caveats of a PC?
- How do I get money out of my PC?

Your first year after graduating from dental school will fly by quickly. It is important to reflect on what you have accomplished and to identify your next goals. As an associate, your focus remains getting experience and preparing for your next steps. There are several new financial considerations you will have to think about such as taxes and savings.

TAX INSTALMENTS

Your wallet may be a little lighter after your first tax bill, but it's definitely a bargain compared to what you will have to pay without your tuition credits. The CRA may begin sending you a notice to pay something called tax instalments, which are prepayments of your current year income taxes. Tax Instalments are typically based on your prior year's income tax bill.

Personal tax instalments are paid quarterly on March 15th, June 15th, September 15th and December 15th. For example, if you owed a tax bill of $10,000 due on April 30th, 2018, you would likely be advised to pay tax instalments of $5,000 on September 15th and December 15th, 2018, assuming this was the first year you were required to pay instalments. In subsequent years, your tax instalments will likely be spread over the four instalment payment dates.

Why must you pay personal tax instalments? Unlike most employees who have taxes withheld from each pay cheque, self-employed individuals, and those with other sources of income, do not typically have any taxes withheld. As a result, depending on your tax bill, the CRA may want its tax payment upfront. Failure to pay tax instalments on time means interest and penalties, so it's important to know the amounts you have to pay and when you have to pay them.

TEST YOUR KNOWLEDGE: I paid tax installments last year of $10,000 and had a refund of $2,000. My income for the upcoming year is expected to be the same as last year. Will I have to pay instalments even though I received a refund?

a) Yes
b) No

Answer: A) Since your income is expected to be the same as prior years, you will likely have a large balance owing, which requires instalments to be paid. Receiving a tax refund does not eliminate the need for tax instalments.

PARK YOUR SAVINGS

The transition from dental student to dental associate brings with it many changes, but one of the most significant is the beginning of a professional career in which you generate income. When you start to earn money, it is a good time to develop a financial strategy that includes budgeting and investment planning.

You're probably familiar with the first element — budgeting. While most people do not like budgets, they help you manage how to distribute your associate income. A budget also helps you find the money that you want to invest or "park." With steady income and the prospect of freedom from student debt, you will have to decide where you want to park your new found savings. The answers to the below questions will help you determine where you should put your money.

1. Have I determined my career path? Am I going to be a career associate? Do I want to be a practice owner? Am I going back to school to become a specialist?
2. What are the biggest expenses that I'm going to make in the next 3 years? Dental practice? Wedding? House? Education?

Think about an investment plan
Investment plans are financial frameworks that consider how you can accumulate money to achieve your personal short- and long-term goals. You and your financial advisor will determine when you will need your funds; how much risk you are comfortable taking to achieve investment growth; and how much money you will need to set aside to achieve your goals.

Tax Friendly Investment Options
There are a number of places you can park your money, but we would like to start discussing the investment and savings vehicles that provide tax advantages.

Registered Retirement Savings Plans (RRSPs) — An RRSP allows you to accumulate various types of investments under the umbrella of a special investment account, up to certain annual investments limits. Think of it as a parking garage in which you can put various types of investments such as Guaranteed Investment Certificates to Mutual Funds and separate them from your regular investments for the purposes of calculating taxes. When you make an investment in an RRSP, you do so with "before tax" dollars. Any investment income or capital gains generated while your money is invested in an RRSP are not taxed until they are withdrawn from the plan. This is different from income or capital gains generated from investments outside of an RRSP, which are taxed immediately in the year in which they are earned.

Three RRSP Advantages

1. You do not have to immediately pay taxes on any income you invest in your RRSP, creating a tax planning opportunity to reduce current taxes.
2. Any earnings generated by the investments in the plan can generate more earnings, rather than being reduced by the payment of taxes annually, as would normally be the case when earning interest and capital gains outside an RRSP. This has the benefit of increasing the effect of compounding returns.
3. You can control when you withdraw your money from an RRSP, you can time a withdrawal to take place during periods in which your income is likely to be lower, thereby making them subject to a lower tax rate. This works well when you contribute to an RRSP in your higher earning years (when your tax rate is higher), and withdraw them in years when you know your income will be lower (and correspondingly your tax rate is lower) such as when you retire.

Why RRSPs Now?

1. **Tax deduction at high personal tax brackets:** Graduating in June means you likely only reported six months of income and did not reach the high income tax brackets. Reporting a full year's income means you may be paying taxes at a marginal tax rate of up to 53.53%. It also means each dollar contributed to an RRSP may reduce your taxes by 53 cents.
2. **Home Buyer's Plan:** If you are looking to buy your first house soon, consider taking advantage of the first time home buyer's plan. This will allow you to boost your down payment while deferring taxes. How does it work? Let's assume you earned $175,000 and contributed $25,000 to a RRSP during the year. This $25,000 contribution could reduce your taxes by up to $12,000. In a year's time, when you buy your house, you could withdraw the $25,000 (maximum allowable) from the RRSP and use it, plus the $12,000 you saved in taxes, as a down payment for a home. The $25,000 is considered a "loan" from your RRSP and hence would have to be repaid over the next 15 years to your RRSP. If any annual repayments are not made, they would be included as income and increase your tax bill for that year.
3. **Life-Long Learning Plan:** Similar to the Home Buyer's Plan above, you can borrow from your RRSP to return to school full-time to become a specialist. The maximum that you can withdraw for the plan is $20,000 with an annual limit of $10,000. Repayments would begin after you graduate.
4. **Saving for your future:** RRSPs were developed as a way for you to save for your future while reducing your taxes now. In addition to the immediate tax reduction, investment income earned within an RRSP grows tax-free until you withdraw the funds. While a tax deferral may not seem like a major benefit now, but over a 25 year period the deferral of taxes on this investment income could significantly improve your retirement nest egg.
5. **Spousal RRSPs:** If you have a spouse, including a common law partner, a Spousal RRSP is a good way for you to split retirement income. By contributing to a Spousal RRSP, you receive a tax deduction while transferring assets to your lower income spouse's RRSP. In this case, you use your RRSP contribution room (see the notice

of assessment you received from the CRA) and you receive the tax deduction. Your spouse will not be taxed until funds are eventually withdrawn. Just a word of warning, if your spouse withdraws the money you contributed to his/her RRSP within 3 calendar years, that amount will be added to your taxable income in the year of the withdrawal.

Who should consider investing in RRSPs? Generally speaking, career associates and those looking to take advantage of the Home Buyer's Plan and/or Life-Long Learning Plan in the next 3 years. If you're considering opening a practice or you have large imminent expenditures such as a car or wedding, consider whether you have enough funds to pay for these upcoming costs as well as contribute to an RRSP. Keep in mind, withdrawals from an RRSP are taxable. This means a portion of your withdrawal may go to the government.

DID YOU KNOW?
If you are short on cash, you can contribute eligible investments into your RRSP instead and still receive a RRSP deduction.

CASE STUDY

Dr. Rosa Hernandez is currently earning $170,000 as an associate. Rosa plans to purchase a practice within the next year and a home with her husband in the next 2 to 3 years. Rosa has about $30,000 in student loans and $60,000 in savings. She wants to know if she should contribute to an RRSP and, if so, how much?

The first step for Rosa is to pay down the student loans of $30,000 with her savings. Although interest is charged at prime, it is not tax deductible. This means, the after-tax cost to pay down the interest is about 7.11% [3.70%/(1-0.4797]. While other investments may offer higher returns, none of them do so with zero risk. As a result, paying off her student debt will give her a 7.11% return risk free on her $30,000.

Rosa's priority is to purchase a practice which will require a down payment. This down payment could vary, but generally it will be at least $25,000. After paying off the student loan, she still has $30,000 in savings. However, if she contributes $25,000 to her RRSP and receive a tax savings of about $12,000, Rosa would be short $8,000 for the down payment of a practice. If enough time permits, she could earn sufficient associate income to fund the short fall before any deposit is due. Alternatively, she could borrow from the line of credit if required. Another option could be to postpone the RRSP contribution until next year as she doesn't plan on purchasing the home for another 2-3 years.

Tax Free Savings Accounts (TFSA) — Another tax-efficient method of growing your savings is through a TFSA. If you are a Canadian citizen and you are over 18 years of age, you can contribute up to $5,500 annually. As of January 1, 2018, you can contribute up to $57,500 into your TFSA if you have never contributed and were 18 in 2009.

A TFSA is similar to an RRSP in that it allows you to accumulate various investments under the umbrella of a special investment account, but different from an RRSP in that these investments are made from "after tax" dollars. A key TFSA feature is that any interest earned in the TFSA is tax free for life, and can be withdrawn at any time. From a tax planning point of view, this creates an opportunity to shelter interest, dividends and capital gains from tax allowing you to grow your investments more rapidly.

While you may not be thinking of retirement just yet, TFSA withdrawals do not impact retirement benefits such as Old Age Security. The downside is that contributions are not tax-deductible and the annual contribution limit is only $5,500 compared to an RRSP which could be up to $26,500 (for 2019).

OTHER PLACES TO PARK YOUR MONEY

- If your risk tolerance is low (you are not comfortable with the idea of losing money), you may want to consider safer investment vehicles such as Savings Accounts and Guaranteed Investment Certificates (GICs). Though safer, you reduce your potential to earn higher interest rates.
- Mutual Funds are another alternative. By reading the fund prospectus you will learn what types of investments the fund manager(s) are allowed to make in order to grow the fund and generate income for investors. These underlying investments determine the amount of risk you will be exposed to and the incremental returns you may be able to achieve.
- Stocks are another option to consider; giving you the opportunity to become a part owner of a wide range of publicly traded companies. As an owner you will have the potential to benefit from both the income the business generates and its value in the market place. Individual stocks are generally considered to have a higher level of risk than Mutual Funds, but each will vary depending on the underlying business itself.

Making a Decision
The choice between these options doesn't have to be mutually exclusive. In fact, you should consider taking advantage of all the different features of each. At this point in your career, the important thing is that you put money aside for your future goals and retirement.

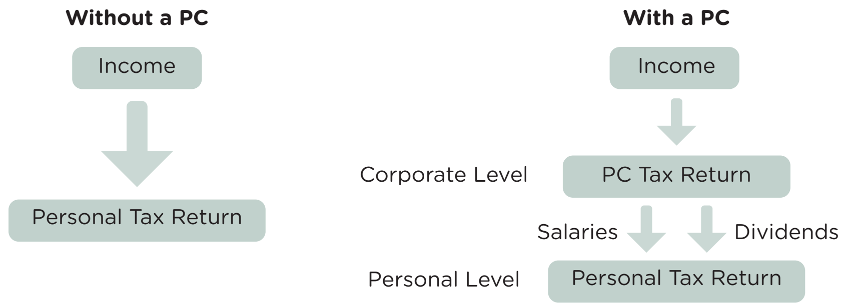
THE PROFESSIONAL CORPORATION (PC)

One of the best ways to increase your savings is to reduce your expenses, so let's start with the biggest one: taxes. Paying 53 cents for every dollar you earn to the CRA will definitely slow down your savings. It's likely that you've exhausted all your tax deductions and tax credits and your tax bill is still very high. At this point you have to change your tax planning strategy by shifting the focus to the tax rate.

You'll remember from chapter 1 that tax rates depend on your income level. How can we change the tax rate if we have already minimized our income? This is where a PC comes in. A PC is a special type of corporation that allows dentists and other professionals to incorporate their businesses. It is a separate tax entity from you that has its own set of tax rules and rates. An enticing feature of a PC is the low tax rate of 13.5% on all active annual taxable income below $500,000. Compared to a personal tax rate of 53.53%, a corporate tax rate of 13.5% is a bargain.

When should you setup a PC?
In general, we recommend you consider setting up a PC when you are earning taxable income of $150,000 or more per year. There are added costs to incorporate and maintain a professional corporation, so you have to make sure the tax savings outweigh the costs.

How a PC works
As a separate tax entity, the PC has to report its own income and file its own tax return. All the income you previously reported on your personal tax return is deposited into the PC's bank account and reported on the PC's tax return. You are a shareholder and, if you wish, an employee of the PC. To get the money out of the PC's bank account, you can either pay yourself dividends as a shareholder or salaries as an employee. There is a third option, which we will address later in this chapter. Below, you will see how income and money flow to you personally with and without a PC.



With a PC, you will pay both corporate and personal tax. You might be thinking how can a PC reduce my taxes if I have to pay two taxes instead of one? Let's look at the benefits of a PC to explain why the sum of two taxes may sometimes be less than one.

BENEFITS OF A PC

Deferring taxes
A tax deferral is a legal way to delay paying taxes. One way to achieve this is by retaining all the income inside your PC instead of declaring dividends or salaries. You would only pay taxes of 13.5% and delay your personal taxes indefinitely until you decide to take the money from your PC. Of course this also means you won't have any money to use personally. This strategy works best when you take out enough money for your personal expenses and leave any excess cash inside the PC. This is why being able to reduce and budget your personal expenses is important. It allows you to use the PC's low tax rate to defer as much as 40.03% (53.53% – 13.5%) of personal taxes by retaining as much profit as possible inside the PC. The PC becomes a super-sized RRSP/savings account where you can save for a practice deposit or to invest. You also get to choose when to withdraw funds controlling the amount of personal taxes you pay each year.

New rules for passive investment income
Rule changes introduced in 2018 could limit your tax deferral and plans to use your PC as a super-sized RRSP. These new rules affect passive investment income such as capital gains, interest, rental and other investment income which is generated from non-active businesses/ non-active assets. In other words, the income you earn without having to lift a finger. These can include income from stocks, GICs, mutual funds, bonds, exchange traded funds and real estate not used for the dental practice.

Starting in 2019, corporations which have more than $50,000 in passive investment income per year may have to pay higher corporate taxes. This is because the small business deduction will be reduced by $5 for every $1 of passive investment income over $50,000. The small business deduction is the amount of income which is eligible to receive the low corporate tax rate of 12.5% (2019). The maximum small business deduction is currently $500,000. This means, the first $500,000 of active business income inside your corporation is taxed at 12.5% (2019). Once the passive investment income inside your corporation exceeds $50,000 in a given year, the $500,000 threshold is reduced. If your corporation has $150,000 or more of passive investment income, all your dental and hygiene income will be taxed at 26.5% instead of 12.5%. Below is a chart of the effect of corporate tax rates at various levels of passive investment income.

Impact of passive income on 2019 corporate tax rates

Passive income	Small business deduction available	What is my corporate tax rate? *
50,000	$500,000	12.5%
75,000	$375,000	12.5% on first $375,000, 26.5% thereafter
100,000	$250,000	12.5% on first $250,000, 26.5% thereafter
125,000	$125,000	12.5% on first $125,000, 26.5% thereafter
150,000 or more	$0	26.5%

**Tax rate on active business income*

CASE STUDY

Dr. Albert Chan has $2,000,000 in investments inside his PC which generate on average a 5% return or about $100,000 in investment income. The dental income from his PC is $400,000 per year. He wants to know what the impact of the new passive investment income would be on his corporate taxes.

	Before rules	After rules	Difference
PC's income	$400,000	$400,000	
Investment income	$100,000	$100,000	
Small business deduction	$500,000	$250,000	$250,000
Tax on active income eligible for SBD	$50,000 (12.5% x 400,000)	$31,250 (12.5% x 250,000)	$18,750
Tax on active income not eligible for SBD	$0	$39,750 (26.5% x 150,000)	$(39,750)
Tax on investment income	$50,170 (50.17% x 100,000)	$50,170 (50.17% x 100,000)	$0
Total corporate taxes	$100,170	$121,170	$21,000

In Dr. Chan's case, because of the passive investment income, he would have to pay $21,000 more in corporate taxes under the new tax rules.

It's important to note that this extra tax the PC pays would result in lower personal taxes when the money is paid out as dividends to the shareholders of his PC. Where the corporation pays the higher corporate tax rate of 26.5%, dividends paid to shareholders are taxed at a lower rate. Where the corporation pays the lower corporate tax rate of 12.5%, the dividends paid to the shareholder are subject to higher personal tax rates. Ultimately the goal of the new rules is to reduce the benefit of deferring your personal taxes by saving and investing inside your corporation. You will eventually get credit for paying the higher corporate taxes upfront, it just requires you to pay out dividends and incur personal taxes. The overall cost of high corporate taxes plus lower personal taxes is about 2% more than low corporate taxes plus higher personal taxes.

Avoiding the higher corporate tax rates

Changing your investment philosophy because of taxes isn't something we recommend. We have always been believers in vetting an investment based on its merits, your personal investment philosophy and risk profile and not solely the tax consequences.

However, given these new rules and the potential increase in corporate taxes, there are some tweaks you could consider:

1. Invest in investments that appreciate in value but don't necessarily pay out dividends and investment income. A large dividend, distribution or interest from an investment could put you over the $50,000 threshold. Investing in stocks that don't pay dividends, interest or distributions but instead appreciate in value gives you more control over the amount of passive investment income you are generating. You only have to include a capital gain in your passive investment income when you choose to sell that investment. With dividend, interest and other distributions, you have no control over when passive income has to be reported.
2. Invest in active assets such as a dental building or another dental practice. These investments are considered "good" investments for tax purposes as they don't contribute to passive investment income. Owning your own dental building not only saves you rent as you are paying yourself, but it protects and enhances your dental practice as it guarantees you have a place to practice dentistry that is free from landlord demands such as demolition and relocation clauses. Any appreciation in real estate is icing on the cake. A nearby dental practice that you can merge with your own also serves as a good investment as it provides synergies. It allows you to increase your income significantly without having to increase your expenses by the same amount. You won't be paying more rent, more office expenses or advertising, these costs generally remain the same. You will also be able to increase your active business income which is taxed at 12.5% instead of your passive investment income which is taxed at 50.17% and keep your low corporate tax rates. When you sell your PC/T/HSC shares, you could use the capital gains exemption to shelter the investment in the nearby practice from taxes compared to triggering personal taxes by transferring corporate investments to your personal account prior to the sale of your PC/T/HSC.
3. Invest in an Individual Pension Plan (IPP). You can use excess cash inside your PC to invest in your pension plan through an IPP. The PC makes a tax deductible contribution to your IPP which then grows tax-free inside the IPP until you withdraw from it. In essence an IPP is a supersized RRSP. The drawbacks are there are tax deductible fees to setup and maintain an IPP and an IPP is not as flexible in terms of contributing and withdrawing funds/money when compared to an RRSP.
4. Invest in certain types of insurance such as universal and/or whole life insurance. These types of investments get around the passive investment income rules as the investment grows tax-free inside the policy. The downside is that management fees are built into the premiums and having a permanent insurance policy such as universal or whole life could affect your corporation's ability to qualify for the lifetime capital gain exemption. Speak to your advisors prior to purchasing such a policy.

Income splitting
While tax deferrals allow you to spread your taxes over a longer period of time, income splitting allows you to spread your taxes over several people such as family members. Imagine trying to carry a heavy piece of furniture by yourself, an easier solution would be to have one or more people help you carry the load. This is the idea behind income splitting.

Canada's progressive tax system and income brackets means a single person who earns $150,000 will pay $16,000 (see figure below) more in taxes than two people who earn $75,000 each. A PC allows you to income split by distributing the income earned inside the PC to lower income family members who are employees or shareholders, minimizing your family's taxes. Paying two taxes in this case is better than paying one.

	Without income splitting	With income splitting		
		Dentist	Spouse	Total
Self-employment income	$150,000	$75,000	$75,000	$150,000
Personal taxes (excluding CPP)	(46,000)	(15,000)	(15,000)	(30,000)
Cash in your pockets	$104,000	$60,000	$60,000	$120,000

Figures presented are rounded to nearest $1,000

There are caveats you should be aware of when income splitting. If you are paying salaries to a family member, the amount paid must be reasonable for the actual work performed otherwise the CRA could disallow the expense. This would result in double taxation. Not only would the PC not get to deduct the salary payment, the family member receiving the salary would still have to report the income.

As of 2018, dividends are also now subject to a reasonableness test. Family members who are deemed to receive unreasonable dividends (i.e. failing the reasonableness test) would face a personal tax bill at the highest tax rate of 46.84% on ineligible dividends. See table below for difference in 2018 taxes due to the new rules assuming the family member has no other income:

Unreasonable dividend received (ineligible)	Personal Taxes		
	Before tax rules	**After tax rules**	**Difference**
50,000	$3,550	$23,420	$19,870
75,000	$8,720	$35,130	$26,410
100,000	$17,067	$46,840	$29,773
125,000	$25,867	$58,550	$32,683
150,000	$35,877	$70,260	$34,383
175,000	$46,124	$81,970	$35,846
200,000	$57,456	$93,680	$36,224

So how does one avoid paying these high tax rates on dividends? Your first priority should be to avoid the reasonableness test completely and there are only two ways to do so.

1. The family member (18 years of age and older) works at least 20 hours per week throughout the year for the practice or any of the 5 previous years or
2. The dentist is 65 years of age or older and the family member receiving the dividend is the spouse/partner

The most common way to avoid the reasonableness test is to ensure that your family members are working at least 20 hours per week for the clinic. They don't need to physically be in the clinic for 20 hours, but you need to be able to prove that their contributions to the clinic amount to at least 20 hours per week of labour. Some examples of tasks that could be done outside the clinic:

1. Bookkeeping, budgeting, ordering supplies, paying bills, depositing cheques and cash and reconciling patient payments received with actual deposits in the bank
2. Monitoring accounts receivables and following up with collection of accounts past due
3. Updating the practice website, social media and maintaining a dental blog/articles for the practice
4. Meeting and corresponding with suppliers (dental reps, accountants, lawyers, insurance brokers, labs, etc.)
5. Maintaining an online chat window with patients where for a few hours a day the family member can have live chats directly with patients inquiring about the clinic
6. Reviewing resumes for new hires and preparing staff performance evaluations
7. Attending practice management courses

If the family member doesn't work in 2018 but has worked 20 hours per week in any of the previous 5 years, that would also avoid the reasonableness test. Gathering supporting documentation of the work and hours your family member's put into the business will be critical. Examples of documentation include:

- Timesheets and calendar showing hours worked, appointments and meetings
- Emails, written correspondence between family member and staff, suppliers, patients etc.

For those dentists who are 65 and older, you can avoid the reasonableness test as long as the dividends are paid to your spouse. This exception does not apply where you pay dividends to your adult children even if you are older 65 years old.

Failing to reach one of the above 2 criteria means dividends paid would be subject to a reasonableness test. The reasonableness test is applied differently depending on the family member's age.

Family member age	Factors considered in determining if a dividend is reasonable
Under 18	None, all dividends taxed at highest tax rate
18-24	Capital contribution
25+	Labour contributed Capital contributed Risk assumed

In general, those under 18 years old should not receive any dividends from your PC. Those who are 18-24 years old can receive dividends but only based on monies contributed to the corporation. These dividends will also be restricted to one of the following:

1. **Safe Harbour Capital Return:** The dividend is restricted to CRA's prescribed interest rate (currently 2%). For example, if a shareholder received $100,000 in 2017 and contributes it back to the PC, they would be allowed a dividend of$2,000 for 2018 from the PC.
2. **Reasonable return on arm's length capital:** Arm's length capital is money that was contributed to the corporation by the 18-24 year old shareholder that was not obtained from related parties or related business. For example, your 18-24 year old child could not contribute money they received as dividends from the PC back to the PC, they could contribute money they earned from a summer job or other employment. If your 18-24 year old child had a summer job and contributed $25,000 to the corporation, they would be allowed to receive a "reasonable return" on this money. Given that many dental practices can get loans and line of credits from the bank at prime rate (currently 3.95%), that could be a starting point in determining what a "reasonable return" may be.

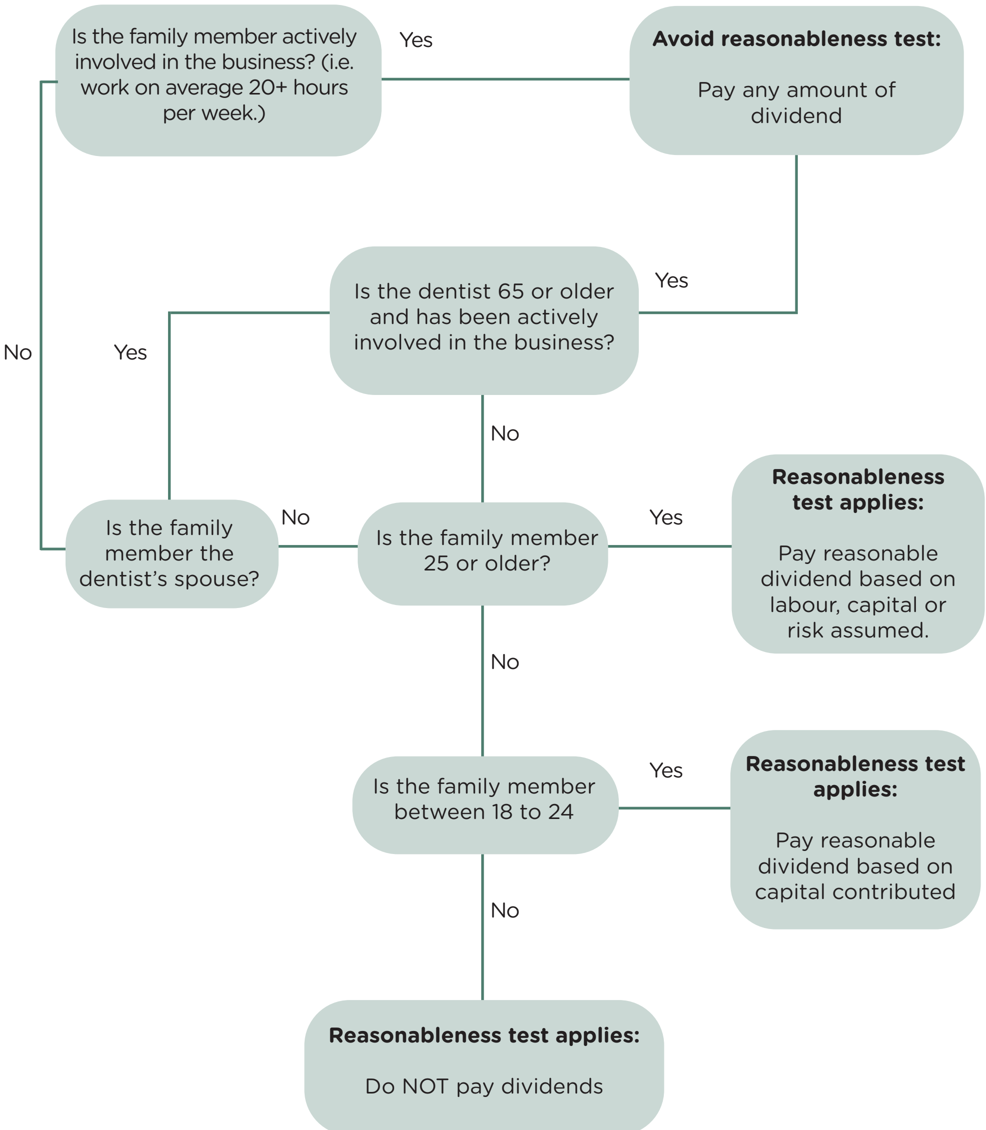
For 18-24 year old shareholders, the amount of dividend you could pay would not be significant enough for the family to save significant taxes. As a result, it is likely not advisable to pay dividends to anyone in this age group unless they work 20 hours+ per week for the practice.

For family member shareholders over 25, the restrictions are reduced and these family members could receive dividends based on the monies they contribute and/or the labour they provide. Generally speaking, the CRA views a reasonable remuneration for labour as what you would pay a stranger to do the same task. For example, if a family member who is a shareholder works 10 hours per week on average for the clinic, and you determine a stranger would be paid $20 per hour, you could pay this family member $200 per week or roughly $10,000 per year in dividends. This wouldn't provide significant tax savings for the family compared to being able to pay them $100,000 or more in dividends previously. Having this family member work an extra 10 hours per week to get their total to 20 hours would allow them to avoid the reasonableness test and then you could pay them dividends at your discretion.

An illustration below is provided which summarizes the dividend options available. As a general rule, if you don't meet one of the two criteria to completely avoid the reasonableness test, it likely does not make sense to pay dividends and you should consider paying salaries instead.

The final caveat with regards to income splitting is that family members age 65 and older receiving old age security (OAS) or guaranteed income supplement (GIS) may have their benefits clawed back if their income is too high. Contact your accountant before income splitting with anyone who receives OAS or GIS.

HOW SHOULD YOU PAY FAMILY MEMBERS?



Practical tip: Where reasonableness test applies, consider paying a salary to the family member instead of a dividend.

DID YOU KNOW?
CPP contribution rates were first set at 1.8% of gross income per year in 1966, today's CPP contribution rates are 4.95%. (Source: http://www.historymuseum.ca/cmc/exhibitions/hist/pensions/cpp-a52-wcr_e.shtml)

Capital gains exemption (CGE)
The other benefit of a PC is being eligible to claim the CGE. The CGE is a lifetime $848,252 (inflation adjusted) exemption from tax on capital gains on certain shares and farm property available to every Canadian resident. If your PC shares qualify, you could sell them and pay virtually no tax on the first $848,252 of capital gains. At this point in your career, this isn't a prominent benefit as without a practice your PC shares are likely not extremely valuable. However, this benefit should be considered when you setup a PC as it could lead to significant costs in the future if overlooked.

Setting up a PC
Setting up a PC isn't as simple as notifying your accountant or lawyer that you would like one. There are several items you should consider. The first being, who should be a shareholder? Currently, the RCDSO allows the following individuals to be shareholders of a PC:

- Dentist
- Spouse of the dentist (including common-law and same- sex)
- Children of the dentist (in trust if under 18 years of age)
- Parents of dentist

Who's excluded from this list? Siblings, uncles, aunts, cousins, friends and parents in-law cannot be shareholders of your PC, but this doesn't mean they can't be part of the tax savings. In addition to the RCDSO restrictions, from a tax perspective, the shareholders should all be Canadian residents. This means parents living in another country would likely not make good shareholders of your PC. Once you have decided who the shareholders will be, you have to decide what type of shareholder they will be. There are two choices: dividend and equity.

Dividend vs. equity shares
When you start your PC, you are planting your tree in the hope that it grows in the future and also bears fruit during that time. Equity shares are the trunk and branches of the tree. Equity shares grow when the value of your PC shares grow. The fruit that grows on the tree would be the dividends. Once you shake the tree and the fruit falls off, the dividends can be given to anyone who owns dividend or equity shares. The tree itself remains the property of the equity shareholders. In other words, dividend shareholders do not participate in the future growth of the PC shares, while equity shareholders do. The difference between the two is critical when it comes time to sell the PC shares. Only the equity shareholders receive money from the sale. This is also important when we consider the CGE.

Provided the shares qualify, each equity shareholder can use their CGE to shield themselves from taxes when they are sold. By having more than one equity shareholder, you can multiply your CGE. Each CGE can save up to $227,000 in taxes. For example, if you and your spouse are both 50% equity share-holders, you could sell your PC shares for up to $1.7 million dollars and pay virtually no taxes. That could be a savings of about $454,000 in taxes.

As an associate, the CGE is likely not a major concern; however, to minimize your costs and avoid having to restructure your PC later on, it is ideal to decide who will be the shareholders of your PC, what type of shares and what percentage of your PC they will own at the beginning.

TEST YOUR KNOWLEDGE: My spouse and I own 40/60% of the equity shares in my PC's. Along with my mom and dad, who are dividend shareholders. Each of us has $848,252 of CGE. How much can I sell my PC shares for before I have to pay taxes?

A) $848,252
B) $1,696,504
C) $1,413,753
D) $3,393,008

Answer: C) Only you and your spouse can use your CGE since you are the only equity shareholders. Since the allocation is 40/60%, a sales price of $1,413,753 would result in proceeds of $848,252 (1,413,753 X 60%) and $565,501 (1,413,753 X 40%) being allocated to you and your spouse respectively. As both are under the $848,252 threshold, the CGE would shield you from taxes (ignoring minimum taxes) provided your PC shares qualified. An allocation of 50/50 would allow you give you a total combined CGE of $1.696 million.

LEGALITIES OF SETTING UP A PC

As an associate you can be an individual dentist or a PC. As discussed there may be many potential tax benefits in using a PC as the associate so it is worthwhile contacting your tax advisors to determine whether to use a PC as the associate.

One of your first steps should be to review your associate agreement to confirm it permits you to use a PC as an associate. Typically agreements allow associates to use a PC providing prior notice is given to the principal and the PC obligations are guaranteed under the associate agreement. If your associate agreement does not permit the use of a PC, then you will need to speak with the principal dentist to obtain the principal's consent.

The laws permit specified family members of a dentist to be non-voting shareholders of the dentist's PC. A "family member" means a dentist's spouse, child or parent. A "spouse" is defined as someone to whom the dentist is married or with whom the dentist is living in a conjugal relationship outside marriage.

Creating the proper share structure for your PC with non-voting shares is a critical step and your tax and legal advisors will assist you in that process. Consider the attributes the PC non-voting shares might have:

- Do the shares participate in the profits only (non-equity shares) and/or in the PC's growth (equity shares)?
- What priority do the shares have against other classes of PC shares for dividends or distribution when winding up or selling the PC shares?
- Do the shares have a fixed value?
- Are there redemption or retraction rights?
- How many different classes of non-voting shares should be issued?

Non-voting shares of your PC may be issued to your family members. Ontario laws currently permit such shares to be issued to the dentist's spouse, parents and children. Income splitting with dividends to such family members requires careful tax planning. There are very specific tax laws and restrictions on dividend payments. Factors include:

- Does the family member actively work in the business;
- What age is the dentist;
- What age is the family member;
- What meaningful contribution (such as labour, capital or risk assumption) the family member has made to the business.

These and other considerations will determine what dividend amount can be paid to that family member on a tax efficient basis. In certain cases there may be no restriction but in other cases the dividend amount must be reasonable based on specific criteria. In certain situations it may be that no dividend whatsoever should be paid to that family member. Before you proceed, it is critical you review such matters in detail with your accountant and/or other tax advisors.

Minor children (under age 18) cannot own shares in their own names. The laws require that shares for your minor child must be issued to a trustee on the child's behalf. The tax laws discourage issuing any dividends whatsoever to shares held for minors, since doing so will attract tax at the maximum personal income tax rates. Accordingly, the trustee should not be paid any dividends at all, and, when the child reaches 18, the shares will need to be transferred into the child's name.

If family members receive equity shares or dividend shares that are not redeemable by the PC, it is essential to have a shareholders agreement. A shareholders agreement is a private contract between the shareholders. Your dental practice is your livelihood and it is critical that you, the dentist, and not your family members, have absolute control over the practice at all times.

You might be surprised to learn that non-voting shares of a PC (or any corporation) have voting rights under the Business Corporations Act (Ontario) in certain cases. Furthermore, in some circumstances shareholders of a class are entitled to vote separately as a class, whether or not that class of shares carry the right to vote. Imagine the scenario where you do not have a shareholders agreement and you need to reorganize your PC share structure, but a rebellious family member will not agree. This can be dealt with in the shareholders agreement by family members giving a voting trust or power of attorney in favour of the dentist relating specifically to the PC shares.

Consider other stressful events such as death of a family member or divorce or separation from your spouse. The shareholders agreement should specify what happens to the family member's shares. For example, the shares might be redeemed by the PC or purchased by the dentist. The shareholders agreement should deal with how those shares are going to be valued and the terms of payment.

You must remain in control of the PC regardless of changing circumstances. A properly drafted shareholders agreement will ensure this. The ideal time to complete the shareholders agreement is at the beginning of the process when the shares are being issued to family members.

The rules permitting family members to own non-voting shares of your PC present significant tax planning opportunities and potentially substantial tax savings for you and your family. However, the laws are complex. Proceed carefully with the benefit of proper and expert professional advice.

Caveats of a PC

If a PC can save and defer taxes, why doesn't everyone do it? The simple answer is not everyone can. We mentioned previously that determining whether you are an independent contractor or an employee was an important tax planning consideration. It becomes even more critical when you wish to setup a PC. Employees do not receive the same tax benefits as self-employed individuals when they incorporate. An employee who incorporates will be classified as a Personal Service Business (PSB) and faces the following tax consequences:

- Severely restricted tax deductions, limited primarily to salaries paid to you.
- Corporate tax rate of 44.5% instead of 13.5%.

In summary, you would be worse off incorporating as an employee. To help you avoid this issue, review our list of employee versus independent contractor factors and consult an accountant before proceeding with incorporating.

How to get money out of your PC

As was alluded to earlier in this chapter, there are three ways to get money out of your PC. We'll focus on salaries and dividends first. The primary difference between the two is that salaries are an expense to the PC while dividends are not. As a result, salaries reduce the PC's profit and corporate taxes. Dividends on the other hand are paid out of after-tax profit from the PC. The PC doesn't get a tax break for issuing dividends but the individual receiving the dividend does.

CASE STUDY

Let's see what happens when Rosa takes out salaries and dividends.

	No PC	Dividends	Salaries
Corporate Level			
PC's profit	$ -	$150,000	$150,000
Less: Rosa's Salary	-		(147,406)
Less: CPP employer	-		(2,594)
PC's taxable income	-	150,000	-
Corporate taxes (13.5%)	-	(20,250)	-
Cash available to distribute	-	129,750	-
Cash dividends	-	(129,750)	-
Cash inside PC	-	-	
Personal Level			
Business income	150,000		
Dividend income		129,750	
Salary income			147,406
Total personal income Personal taxes	150,000	129,750	147,406
Taxes on salary/business income	45,450		45,270
Taxes on dividends		27,698	
CPP employee portion	(2,594)		(2,594)
CPP employer portion	(2,594)		
Cash in Rosa's pockets	$99,362	$102,052	$99,542
Total corporate and personal taxes (excluding CPP)	$45,450	$47,948	$45,270

The example illustrates several important points. First, because all the PC's income was paid out to a Rosa, the benefits of tax deferrals and income splitting were negated and there was virtually no tax savings by incorporating. Second, the difference between dividends and salaries is very small. Salaries produce higher personal taxes, but lower corporate taxes and vice versa for dividends. Excluding CPP, the difference is not significant. So how does Rosa decide between salaries and dividends? She will have to look beyond calculations and numbers.

TEST YOUR KNOWLEDGE: My PC had $100,000 of active income before I paid out dividends of $70,000 and salaries of $30,000 what will my PC's tax bill be?

A) $13,500
B) $9,450
C) $4,050

Answer: B) The corporate tax rate is 13.5% on active business income under $500,000 inside a PC. The PC's taxable income is $70,000 since salaries are deductible while dividends are not. Therefore, taxes are $9,450 ($70,000 X 13.5%).

Benefits of salaries

- **Income deferral:** Corporate taxes can be delayed an entire year by declaring a bonus. The PC gets a tax deduction immediately, while the bonus including payroll deductions do not have to be paid until 179 days later. Since your corporate taxes are lower, this also means your corporate tax instalments for the following year are lower.
- **RRSPs:** RRSP contribution room is created when you have earned income which includes salaries but not interest, dividends or capital gains. For 2018, you will need a salary of about $148,000 to maximize next year's RRSP contribution room.
- **Canada Pension Plan (CPP):** CPP contributions are calculated based on pensionable earnings which include salaries but not interest, dividends or capital gains. You are eligible to contribute to CPP and receive CPP benefits in the future if you receive a salary. For 2018, the maximum CPP contribution is reached when your salary is $55,900.
- **$10,000 employee death benefit:** Your PC can pay and receive a tax deduction of up to $10,000 as a death benefit upon your death. Your designated family member can receive the $10,000 tax free; but you have to be an employee which means you must receive a salary.
- **Child care expenses:** Generally, deductions for child care expenses can only be claimed if you have earned income and you are the lower income spouse.
- **Disability insurance:** Your insurance policy may only replace employment income (i.e. salaries). Consult with your insurance advisor to determine if both salaries and dividends are covered in the event you need to make a claim.

Caveats of salaries

- You have to remit payroll deductions, which means paying your taxes sooner.
- Salaries paid to family members must be reasonable.
- Employer Health Tax (EHT) is currently required when annual payroll (including the dentist's salary, payments to casual labour but not independent contractors) exceeds $450,000 in a calendar year.

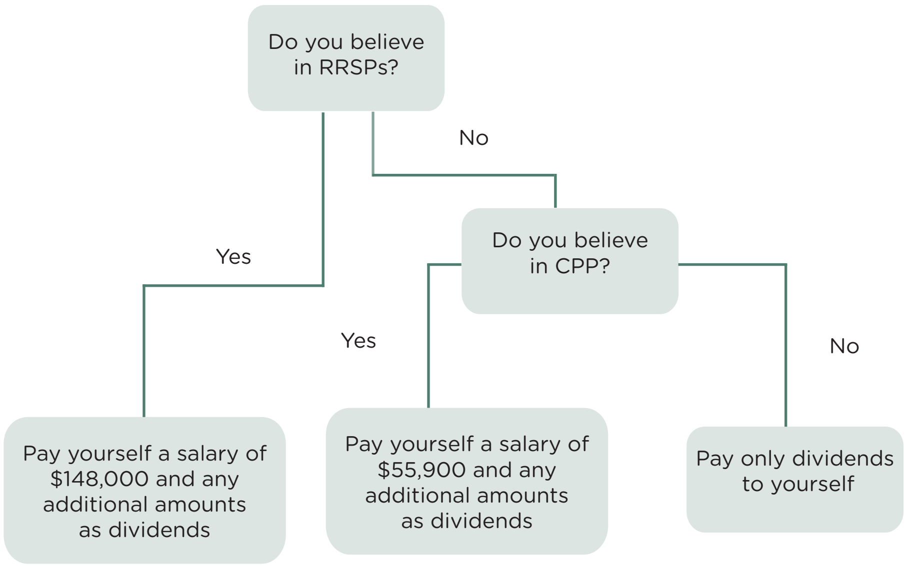
Benefits of dividends

- **Simple:** No payroll deductions; write a cheque to the shareholder for the dividend.
- **No EHT:** Dividends are not subject to EHT.

Caveats of dividends

- No RRSP room is created with dividends.
- Not eligible to contribute to CPP.
- No $10,000 tax-free benefit to loved ones upon death.
- No child care expenses may be claimed.
- You may be required to pay quarterly personal tax instalments.
- Dividends paid to family members may be subject to a reasonableness test (refer to previous chart on how should you pay family members)

HOW SHOULD YOU PAY YOURSELF? (DENTIST)



Reassessing Salaries versus Dividends

Prior to the new rules introduced in 2018, dividends held a significant advantage for income splitting with family members. You could pay at your discretion, any amount of dividends to shareholders of your corporation, whereas salaries were always subject to a reasonableness test. With the introduction of a reasonableness test on dividends, unless you can avoid the test completely, it makes sense to consider paying family members a salary. The reason? The penalty for unreasonable dividends is higher than the penalty for unreasonable salaries.

CASE STUDY:

Dr. Sara Ali wants to pay her 19 year old son, $50,000 to cover tuition and living costs. Her son has worked occasionally at the clinic during the year but not 20 hours per week. What should she do?

Taxes assuming salary/dividends are reasonable.

	Salary	Dividend
PC's income	$400,000	$400,000
Salary to family member	$(50,000)	$(0)
CPP employer	$(2,302)	
Net income	$347,698	$400,000
Corporate taxes (13.5%)	$(46,939)	$(54,000)
Dividend to family member		$(50,000)
Cash in PC	$300,759	$296,000
Personal income	$50,000	$50,000
Taxes	$(8,165)	$(3,550)
CPP employee	$(2,302)	
Cash in pocket	$39,533	$46,450

If the CRA deems the salary and/or dividend of $50,000 to be unreasonable, the following (in addition to penalty and/or interest) would occur:

Taxes assuming salary/dividends are not reasonable.

	Salary	Dividend
PC's income	$400,000	$400,000
Salary to family member	$(50,000)	$(0)
CPP employer	$(2,302)	
Net income	$347,698	$400,000
Corporate taxes (13.5%)	$(46,939)	$(54,000)
Corporate tax on disallowed salary	$(6,750)	
Dividend to family member		$(50,000)
Cash in PC	$294,009	$296,000
Personal income	$50,000	$50,000
Taxes	$(8,165)	$(23,420)
CPP employee	$(2,302)	
Cash in pockets	$39,533	$26,580

Unreasonable Salary
The PC would be disallowed the salary expense of $50,000 and have to pay additional corporate taxes of $6,750 (13.5% X $50,000), this leaves the PC with $294,009 ($300,759 – $6,750). Her son would still have to report the $50,000 of income and pay the taxes leaving him with $39,533. This is known as double taxation as the PC would have to pay corporate taxes on his salary, and the son would still have to pay personal taxes. Where the PC's income is greater than $500,000, the penalty would be 26.5% of the unreasonable salary instead of 13.5%. In the above example the additional corporate taxes if the corporation's income was above $500,000 would be $13,250 (26.5% x $50,000)

Unreasonable Dividend
Instead of $3,550 in personal taxes Dr. Ali's son would have to pay the highest tax rate on the dividends which is currently 46.84% resulting in a personal tax bill of $23,420 (46.84%X $50,000) leaving him with $26,580 in his pockets.

In this example, the penalty for unreasonable salaries was a $6,750 tax bill to the PC whereas the penalty for unreasonable dividends was a $23,420 tax bill that has to be paid from personal dollars. It's clear to see that where one cannot escape the reasonableness test on dividends, it's safer and more practical to pay a salary.

TEST YOUR KNOWLEDGE: An advantage of dividends over salaries is:

A) Not having to contribute to an RRSP.
B) Tax savings since personal tax rate on dividends is lower than salaries.
C) Tax savings through income splitting with low income family members who are shareholders and actively involved in the business
D) I can defer my taxes every year by paying dividends and not paying any withholdings.

Answer: C) Dividends are fully discretionary if family members work at least 20 hours per week for the practice. Where you cannot support a 20 hour per week workload, consider paying salaries to family members instead. Other answers are incorrect because: A) RRSP are elective, you can choose to not contribute to an RRSP even if you are paid salaries; B) Overall tax savings may vary once you take into account both personal and corporate taxes; D) You do not have to remit withholdings on dividend payments, however you may be required to pay personal tax instalments, which will limit your tax deferral.

Shareholder loans
There is a third way to get money out of a PC. Instead of salaries and dividends, the PC could loan you money. This is often the time when dentists run into a lot of problems. The PC's bank account is not the same as your personal bank account. Money inside the PC's bank account should not be used for personal purchases. The only permanent way to get money out of the PC for personal use is through salaries or dividends. With that mind, the income tax laws do allow you to borrow from the PC under certain circumstances.

You can borrow from the PC as long as the loan is repaid within one year of the PC's taxation year in which it was taken out. If the loan is not repaid after one year, the total loan is included in your income for the year it was taken out.

CASE STUDY

Rosa borrowed $100,000 on July 31, 2018. Her PC has a July 31 year end. If this loan has not been repaid by July 31, 2019, the entire $100,000 must be included as income in Rosa's 2018 personal tax return. When she repays the loan, she will be allowed a personal tax deduction for the amount repaid in the year of prepayment.

Even if the loan is repaid within the year, the tax laws require her to include in her income the interest benefit she received for taking out an interest-free loan from the PC. This interest benefit is calculated at CRA's prescribed interest rates (currently 2% as at July 31, 2018). For example, if Rosa repaid the $100,000 on July 31, 2019, she would not have to include the $100,000 as income for 2018. However, she would have to include $833 (2% X 100,000 X 5/12 months) of interest benefit on her 2018 personal tax return and $1,167 (2% X 100,000 X 7/12 months) on her 2019 personal tax returns assuming the prescribed interest rate stays the same.

Tax laws also allow you to take out an employee loan from the PC to purchase a car, owner-occupied home or shares in the corporation. This offer should be available to all employees and therefore you will need to be careful and exercise risk management. The benefit of your employee loan may end up costing you more if other employees take you up on this offer.

Chasing big fishes
Stepping into my parent's boat for the first time is still one of my favourite memories. It didn't matter that the boat was small, it offered endless opportunities. I was chasing "big fishes" now and I was ready. If you want to be a practice owner, a dental practice is the biggest fish you will ever catch.

KEY CONSIDERATIONS

- Tax installments are a prepayment of estimated taxes for the upcoming year.
- Three places to park your money: RRSPs, TFSA and non-registered investments.
- Consider setting up a PC when your income is $150,000 or more.
- Dividend shares allow you to income split annually. Equity shares allow you to split income when you sell your practice and multiply the CGE.
- Salaries and dividends result in similar overall taxes. The decision between the two depends on RRSP, CPP and other non-tax factors.
- You can take a loan from the PC, but be prepared to pay it back or face adverse tax consequences.
- New tax rules can limit the benefit of income splitting with family members who are not actively involved in the practice.
- Passive investment income inside your corporation could result in higher corporate tax rates.

3

OWNING YOUR OWN PRACTICE

This chapter focuses highlighting opportunities to help you purchase or open your first dental practice. It identifies all the tax, legal and financial considerations you need to be aware of prior to becoming a practice owner.

What you will learn in this chapter:

- How to maximize your chances of buying a practice?
- What you should look for in a dental practice?
- What you should consider before opening a practice?

Our boat was the smallest vessel in the water. From a distance, many people would mistake us for an inflatable raft if not for one unique feature – our boat had nine fishing rods hanging off the side. We were the only boat with more fishing rods than people on board. My parents would say: "To maximize your chances of catching fish, you have to have as many fishing rods in the water as possible."

HOW TO MAXIMIZE YOUR CHANCES OF BUYING A PRACTICE?

The market for dental practices has been extremely competitive in recent years in many areas of Ontario. In order to maximize your chances of buying a dental practice, you will need to have more than one fishing rod in the water. Here are five things you should consider:

1. **Brokers:** Sign up online with all the dental brokers. They have access to practice listings and open houses.
2. **Dental representatives:** Speak with dental representatives from the various equipment manufacturers. They regularly visit dental offices and may be able to connect you with a dentist looking to sell their practice.
3. **Professional development courses:** Attend professional development courses that are aimed at retirement and selling practices. The audience will consist primarily of dentists looking to sell their practice. Introducing yourself as a potential purchaser may lead to the biggest catch of your life.

4. **Professionals in the dental industry:** Get to know accountants, lawyers and bankers whose primary client base are dentists. They are actively involved in the purchase and sale process and may have leads to practices that are up for sale or will be in the near future.
5. **Internet research and snail mail:** Combine modern technology with traditional marketing methods. Using information available online, identify practices in your desired area that may be up for sale. These could be dentists who have been practicing for 30 years or more (i.e. graduated from dental school in 1988 or earlier). Consider writing and mailing them a letter introducing yourself as someone who would continue their legacy if the opportunity ever arose.

WHAT YOU SHOULD LOOK FOR IN A DENTAL PRACTICE?

The above methods may help you locate a practice, but as with fishing you may not want to keep every fish you catch. Identifying the right practice for you is critical. No practice will meet all the criteria on your checklist; however, there are a few minimum requirements.

Patients: The most important factor when purchasing a practice is active patients. We define an active patient as a patient that has visited the clinic for dental services in the past 12 months and who exhibits a record of regularly visiting the clinic. In additional to the number of active patients, the age and demographics of these patients should also be considered when evaluating a practice.

A dental practice with more active patients will typically command a higher price. Before you eliminate practices based solely on patient charts, you should know that sometimes, less is more. You have to align the practice size with your goals. Consider whether you are able to physically treat a large patient base and if you want to hire an associate in the event that you are not able to. Some dentists are comfortable having 3000 patients, while others are more than satisfied with 1600. We consider a full practice to have approximately 1,600 active patients. Keep in mind that even if the results of a chart count are promising, there is always the risk of patient attrition. We typically see about 10% of the patient base leaving the practice.

When it comes to age and demographics, diversity is important. Many dentists look for practices with young to middle age patients because they are or will become parents who will bring their children to the clinic. Older patients also play a role as they may be able to afford more comprehensive dental treatment plans compared to young families. In many cases, practices are sold with a patient base similar in age to the vendor. An ideal practice will have a balanced patient base.

Premise Lease: 2,000 patient charts won't mean much if you don't have a place to work. Not only will you have to secure an office location, you will need to secure it for several years. If you are renting an office, you will want a lease term including renewals of at least 10 years. While it may not seem like a critical component, do not overlook the tenant and landlord relationship. Failing to secure a lease extension could prevent you from securing financing. Other considerations include whether there is a relocation and/or demolition clause. A **relocation** clause means the landlord could, with minimal notice, force you to relocate your practice, disrupting your business and your patients. A **demolition** clause allows the landlord to demolish the building where your practice is situated with short notice. This often occurs if the landlord is selling the property to a developer or wishes to repurpose the property. The presence of either of these two clauses increases your risk significantly and you should proceed cautiously before making a purchase.

Building purchase: Sometimes the landlord and the dentist selling the practice are the same person. Owning the clinic where your dental practice is located is an investment strategy for many dentists. As a buyer, this represents an opportunity for you to purchase the building in addition to the practice.

Even if you are not ready financially or you are not prepared to take on the burden of owning and operating a commercial building, you could still secure your practice's location by negotiating **a building purchase option**. This would give you the ability to purchase the building within the first few years after purchasing the practice.

Another clause you may want to include is a **first right of refusal**. A first right of refusal gives you the first opportunity to purchase the building when the landlord is ready to sell. Both clauses put you first in line to purchase the building, but the timing is different. A building purchase option puts you in the driver's seat as you can force the building owner to sell prior to the option's expiration date. A first right of refusal is dependent on the vendor wanting to sell.

Location: When you buy a practice, your location choices are limited to what is available in the market. You won't get to choose specific details such as what street you are on, which neighbourhood you are in or where you are located inside a building. You do have a choice in what city you will practice. To narrow down these choices, consider whether you want to work in a major urban centre, a remote rural town or somewhere in between. You can research potential cities and towns by dividing the population by the total number of dentists in that area.

Remember, a full practice requires 1600 patients per dentist. A city or town with a ratio less than that means there is more competition. You will find many major urban centres have a ratio of 800 patients per dentist. Similar to finding an associate position, you will have to balance lifestyle factors and career goals. The difference is that buying a practice is a significant commitment, one that you cannot just walk away from. Taking the time to do your research, assessing your own goals and discussing them with your family will help you make a decision. A starting point would be using the resources of the Ontario Dental Association. They have demographic information, which will help you during this process.

Untapped potential versus sustainable cash flow: Sometimes numbers don't tell the whole truth. Many advisors will analyze historical financial performance looking for predictors of future performance. The problem with historical performance is that it doesn't take into account the most important change when a practice is purchased: you.

DID YOU KNOW?
A 99 year-lease is considered the longest possible term for a lease of real property used in common business practice. (**Resource:** http://en.wikipedia.org/wiki/99-year_lease)

CASE STUDY

Dr. William Ramouski has found a practice with a large patient base, but poor financial performance. William assumes the practice will continue to produce the same poor results year after year and dismissed the practice without considering the untapped potential. The practice's large patient base and low patient fees may be a sign that many services are being referred out. As William has years of experience handling oral surgery and implants that were previously referred out, he could have increased the patient fees from the existing patient base simply by performing the services in-house.

Your clinical judgement, knowledge, experience and confidence will allow you to determine whether those services are appropriate to perform in-house. This could convert an under-performing practice into a vibrant clinic.

The reverse scenario may also exist. A practice with 1,000 patients and billings of $1.2 million may appear to be a good opportunity. The issue to address is whether you can sustain the high level of billings per patient. Consider that the average annual billing per patient is $670 versus $1,200 in this case. Determining the reason for the high billing, which could range from services such as implants or orthodontics, will help you determine if this is truly a good opportunity. With this knowledge, you can assess whether you have the clinical skill set and desire to continue providing these services.

Other issues: There are several other issues you and your advisors should discuss. These include whether a practice is an assignment or non-assignment clinic. A telltale sign of a clinic with poor collections is a high accounts receivable balance and/or a large amount of write-offs and bad debts. The number of patients with insurance coverage and number of patients receiving social assistance will also affect the future performance of the clinic.

TEST YOUR KNOWLEDGE: Which of the following has the most appeal to a buyer if the price was identical?

A) Practice with new equipment, large patient base and a 3 year lease and no renewal options
B) Practice with older equipment, large patient base and a 10 year lease and a 5 year renewal option
C) Practice with new equipment, small patient base and a 20 year lease

Answer: B) The two most important criteria are patients to care for and a place to work. A 3 year lease means you may not be able to secure financing and the practice may have to be moved when the lease ends. Most of the value of a practice is driven by the patients and as a result, a long lease with new equipment cannot replace a large patient base.

Locating the right practice is one hurdle. A bigger challenge is determining what you should pay for it. In some markets for dental practices, high prices, bidding wars and short supply means you will often pay a premium for a practice. So how do you determine what price to offer? Work with advisors that have specific knowledge and extensive experience in working with dentists to secure a practice. It's also important to set a ceiling for what you are comfortable paying for each practices you evaluate. Ultimately the price you pay will be your decision but having the right team in place to advise and provide feedback will help expedite the process.

LEGALITIES OF PURCHASING A PRACTICE

Premises Lease: If the vendor's practice is located in rented premises, the premises lease is transferred and assigned to you on closing. Almost all premises lease require the landlord's consent.

As a condition to granting consent, landlords typically require the dentist's personal guarantee of the tenant lease obligations if the purchaser (which will be the new tenant) is a corporation. The landlord may agree to limit the dentist's personal guarantee to a specific date, such as two years from the closing date. After the specific time period the guarantee would not apply.

Since you are taking over the vendor's existing lease, you will be subject to all existing tenant obligations in the lease. Therefore you must review the vendor's premises lease carefully to determine:

- That the term of lease is at least 10 years, including renewal options. Your bank financing the purchase of practice typically require at least 10 years. Ideally there will be several five year renewal options so the purchaser has assurance it will remain in the premises for many years.

- That, for renewal options, both parties should agree to a fair market rental rate or failing this agreement by arbitration. The lease should contain a dispute resolution mechanism to ensure you and landlord will be able to agree on the rent for the renewal terms. Whether 'danger' clauses exist in the lease, which are very unfavourable and problematic for you the purchaser, including: (1) **relocation** gives the landlord right to relocate the practice within the building or plaza; (2) **demolition** gives the landlord the right to terminate the lease early if the building is to be demolished or substantially renovated; and (3) **termination** gives landlord right to terminate the lease when the vendor sells the practice and requests landlord consent to transfer lease. If these 'danger' clauses are in the lease, your conditions to purchasing the practice could include the landlord's agreement to delete these sections from the lease. If the landlord refuses, then you can terminate the purchase agreement and transaction.

Due Diligence: Due diligence is critical when purchasing a practice. This requires a detailed examination of all aspects of the vendor's practice. The starting point of due diligence is the practice appraisal. Typically the vendor will have the practice appraised by a licensed valuator. The appraisal details the equipment, furnishings, leasehold improvements, inventory, supplies and the goodwill. It will contain financial information including billings, the number of active recall patients, staff information, premises lease, and many other items. The vendor will provide the appraisal to you for review. You need to consider the following questions: Is the appraisal current? Did an experienced valuator of dental practices prepare the appraisal? Does that valuator have a reputation for valuing conservatively or aggressively?

If a vendor hires a valuator to prepare an appraisal, then that appraisal was prepared solely for the vendor's benefit. This is an important fact that you may overlook. The valuator's responsibility and legal liability is to the vendor, not you. You must review the appraisal with caution, keeping in mind that it was prepared for the vendor and was based primarily on information given to the valuator by the vendor. Even though the valuator may know the appraisal is being prepared in anticipation of a practice sale, the appraiser has no direct obligation to you.

Therefore, you cannot rely on the appraisal and must make your own due diligence investigation of the dental practice. As part of this process, it is imperative that you complete a detailed patient chart audit to determine the number and quality of the active patient charts and lists.

The legally binding document between vendor and purchaser is the purchase and sale agreement. This agreement should contain the condition that you (and your professional advisors) may conduct the due diligence examination of the practice, including an audit of the patient charts and fees, review of the financial information and to confirm the dental equipment, computer hardware and software and other assets function correctly. It is essential you complete a thorough due diligence review early in the process of purchasing a practice. If the results of the due diligence investigation are not satisfactory to you prior to expiry time of the condition, then you can terminate the purchase agreement and transaction.

Associate agreement with vendor: To facilitate the transition of patients and practice goodwill to the purchaser, the vendor may associate at the practice after closing. Typically a vendor is paid 45 per cent (not 40 per cent) of his collected billings. You, as principal, enter into an associate agreement with the vendor, as associate, on closing of the purchase.

Chapter 1 discusses associate agreements and outlines a number of issues to consider when becoming an associate and signing an associate agreement. Those very same issues apply here except from the opposite perspective. In the purchase of practice scenario, you are now the principal and the vendor is the associate dentist.

There is one important difference. When purchasing a practice, the purchaser pays a substantial amount of money to the vendor. Therefore, as part of the purchase and sale transaction, it is reasonable for the vendor's agreement not to compete to be a substantially greater time period and a greater geographic radius than is typical in the normal associate/principal arrangement.

In a purchase scenario, the time period for the vendor non-competition agreement is usually five years and the geographic radius five kilometres in a densely urban area or 10 to 25 kilometres in a rural setting.

TAX CONSIDERATIONS

Buying assets versus shares: In most cases, when you buy a dental practice, you are buying either the assets of the practice or the shares of the PC (which owns the dental practice). Assets usually give you, the buyer, more tax breaks and limit your exposure to current and potential future liabilities left by the vendor. When you purchase shares, you receive not only all of the assets, but also all the liabilities of the PC on closing. The seller may also be able to reduce their taxes with the use of the CGE. Generally, sellers want to sell shares, while buyers want to buy assets.

CASE STUDY

What if William purchased the identical practice as assets and shares? In an asset deal, the total purchase price is allocated among the assets. In a share deal, the entire purchase price is allocated to the shares.

Assets		**Shares**	
Dental supplies	$10,000	Shares	$500,000
Equipment	25,000		
Software	10,000		
Hardware	15,000		
Leaseholds	50,000		
Goodwill	390,000		
Total	**$500,000**	**Total**	**$500,000**

In an asset deal, William could claim the following depreciation in the first year:

	Write off %	**Tax Deduction** (including half-year rule)
Dental supplies	100%	$10,000
Equipment	20% x 50%	$2,500
Software	100% x 50%	$5,000
Hardware	55% x 50	$4,125
Leaseholds	10% X 50%	$2,500
Goodwill	5% x 50%	$9,750
		$ 33,875

A tax deduction of $33,875 is worth about $4,500 (13.5% X $33,875) in the first year. Once all the assets have been depreciated, the total tax deductions could be worth up to $60,000 in tax savings. In a share deal, the shares themselves are not depreciable for tax purposes. William will get to claim some depreciation expense if the vendor's PC has any capital assets that have not already been fully depreciated for tax purposes. With older practices that have not been updated in recent years, the depreciation available to claim is very small. As a result, an asset deal could be up to $60,000 cheaper for William compared to a share deal.

DID YOU KNOW?
The concept of depreciation was introduced to encourage private investment into railroads. The initial costs of the railroad were recorded as assets and written off over several years instead of being recorded as operating expenses. This helped to avoid discouraging private investors with large initial losses. (Source: http://economix.blogs.nytimes.com/2013/09/10/depreciations-place-in-tax-policy/?_r=1)

HST Implications: In most situations, HST does not apply to dentists since they provide an HST exempt service. In an asset deal, you could be subject to paying HST at 13% on certain assets (i.e. leaseholds), which may not be recoverable. In a share deal, there are no HST implications. This is one of the few tax breaks you receive when purchasing shares.

TEST YOUR KNOWLEDGE: The fair market value of the leasehold improvements is $100,000 and the tax cost to the vendor's PC is $0. If my PC purchases assets what are the potential tax savings over time with a corporate tax rate of 13.5%?
A) $13,500
B) $2,255
C) $14,690

Answer: B) The PC will have to pay HST of $13,000 (i.e. $100,000 x 13%) on leasehold improvements. With the additional HST paid, which is eligible to be depreciated, potential corporate tax savings is $15,255 (i.e. $113,000 x 13.5%). Hence, net tax savings is $15,255 less $13,000, which is $2,255.

Ownership Structure: Prior to purchasing a dental practice, you should also consider the type of ownership structure you wish to have. In general, you really have two broad categories: you can own a clinic by yourself or in conjunction with another dentist. Below is a summary of various ownership structures:

Single dentist practice		**Multi-dentist practice**	
Sole Proprietor	**PC**	**Partnership**	**Cost sharing**
Pros:	**Pros:**	**Pros:**	**Pros:**
Easiest and least costly to setup	Income splitting available through salaries or dividends to lower income family members if they are actively involved with the clinic	Can own a practice with another dentist to spread financial and business risk	Can share a clinic with another dentist to spread financial and business risk

Annual maintenance costs would be lower	Tax deferral opportunities		Income splitting available through salaries or dividends to lower income family members if they are actively involved with the clinic
	Low corporate tax rate of 13.5%		Tax deferral opportunities
			Low corporate tax rate of 13.5%
Cons:	**Cons:**	**Cons:**	**Cons:**
No tax deferrals available	Setup costs and annual maintenance fees	Setup costs to create a partnership agreement	Setup costs to create a cost sharing arrangement
Income splitting limited to paying reasonable salaries to family members	Administrative work involved to maintain a PC	Risk of disputes among partners	Risk of disputes among cost sharing participants
		No tax deferrals available	Administrative work involved to ensure cost sharing arrangement is upheld
		Income splitting limited to paying reasonable salaries to family members	
		Higher annual cost as additional tax filings may be required	

Who should be the purchaser? Regardless of whether the purchaser will be a solo or group venture, you have two possible options to buy the practice. You can purchase it personally or your PC can purchase it. Let's look at some of the key differences.

Buying a practice personally: If you purchase shares or assets of a practice personally, the price you pay becomes the "cost base" of the shares/assets. This is similar to when you buy shares in a public company on the stock market. Upon sale of the shares/assets in the future, only the difference between the new sales price and your cost base would be considered a capital gain. For example, if you bought shares for $500,000 today and sold them for $750,000 in 10 years, you would report a capital gain of $250,000 in the year of sale. In this case, you could use the CGE in addition to the original cost to shield you from taxes.

The downside with purchasing shares/assets of the practice personally is the loan used to pay for the shares/assets is also borrowed by you personally. While the interest is deductible on your personal tax return, all principal repayments, which are not tax-deductible, must be made from personal funds. Why does this matter? A bank loan is more expensive than you may think. Let's imagine you lived on one end of a toll bridge called the “personal bridge” and your bank branch was at the other end. In order to get to the bank, you would have to drive across the bridge and pay a toll of up to 50 cents for every $1 of loan you wish to repay. To repay a $1 million loan, you would need up to $2 million; $1 million for the actual loan and up to $1 million for taxes to get the money in your hands personally. In other words, every loan repayment you make will trigger personal taxes.

Buying a practice using a PC: If a PC is the purchaser of the shares/assets, then the loan is borrowed in the PC’s name and not yours. This means that you don’t need personal funds to repay the loan; it can be paid directly out of the PC’s after-tax income. Let’s reconsider the above example, and assume that nearby there was another toll bridge called the “PC bridge.” This bridge charges only 13.5 cents for every dollar you bring across. To pay the same $1 million loan at the branch located across the bridge would cost the PC $1,156,069; $1 million for the actual loan and $156,069 for tolls. Repaying the same $1 million dollar loan would cost you $816,568 less using a PC ($2 million less $1,156,069).

The downside of using a PC is that the RCDSO does not allow one PC to own another. As a result, when the buyer’s PC buys the seller’s PC, the two PC’s must immediately **amalgamate** after closing. Amalgamation is the process of combining the two corporations into one. When this occurs, the cost the PC paid to purchase the shares of the practice is deemed to be virtually NIL. This means, if you paid $1 million for the shares and you subsequently sell them for $1 million you would report a capital gain of $1 million even though you originally paid $1 million for them. You could still use your CGE to shield yourself from some of the taxes, but unlike when you bought the shares personally, the cost you paid to buy the dental practice is not considered when you sell. In general, we still recommend the PC be the purchaser of the dental practice. If you plan carefully and multiply the CGE by using other family members you can effectively minimize the impact of having your purchase price/cost being reduced to NIL. The alternative of having to repay the practice loan with “expensive” after-tax personal funds will keep you in debt for a long time and cost you significant amounts in taxes each year.

TEST YOUR KNOWLEDGE: If my marginal tax rate is 53.53%, how much money will I be required to earn to pay back $200,000 of personal bank loans in one payment?

A) $200,000
B) $373,622
C) $430,385

Answer: C) To repay $200,000, you will need $430,385 (200,000/(1-.5353)). Of the $430,385 of income, $230,385 (430,385 X .5353) would represent taxes and the remaining 200,000 would be the actual payment of the loan.

OPENING A DENTAL PRACTICE

After being priced out of the market or not finding the right clinic, opening a new practice becomes an attractive option. Opening a dental practice means being able to build the practice of your dreams. You choose the location, the equipment, the office’s appearance and the employees. The downside is on the day you open, you may have zero patients booked and it will likely take a while to generate any cash flow. This makes opening a practice a significantly riskier venture. Before proceeding with this route, you have to be honest with yourself and assess your abilities to attract new patients. Word of mouth referrals will be slow since you are starting with zero patients. Cash flow will be critical and you may have to continue associating just to support your personal expenses as well as any short falls in the practice. There are many other considerations when opening a clinic. Let’s see what’s in store for you if you open a practice.

LEGALITIES OF OPENING A PRACTICE

Premises Lease: When opening a practice, the premises lease is a critical legal document. Leases set out the tenant and landlord rights and obligations relating to premises and they can be 20 to 50 pages or even longer. It is important to retain a real estate lawyer or other leasing advisors who specializes in advising dentists for commercial lease tenancies.

In the case of new plaza or building, which is not yet built, you and the landlord typically first enter into a letter of intent outlining the general business terms, including rent amounts, for the lease. The letter of intent will contain target dates for landlord build out of the building and premises and the timing when you must complete the tenant improvements and when you need to move into the premises. Since construction of the building is often delayed for many reasons, the landlord has the legal right to extend the date it must deliver the premises to the tenant.

Ideally, a schedule to the letter of intent will be in the form of actual premises lease, which enables you to review the lease with your professional advisors before signing the letter of intent. If changes are required to the draft lease, they should be negotiated and finalized early in the process.

The legal issues related to premise leases when purchasing a practice are the same when opening a new practice and signing a new lease. You require a long-term lease including renewal options with a formula to determine rent on the renewal terms. The lease should not contain those ‘danger’ clauses, which are very unfavourable and problematic for you, the tenant.

If the landlord does not require the dentist’s personal guarantee of the tenant lease obligations or agrees to limit such personal guarantee for a limited time period, then you can be a separate holding corporation. This may limit the dentist’s potential personal legal liability relating to the premise. The lease would list the holding corporation as tenant and expressly permit the tenant to sublease the premises to the dentist or the dentist’s professional corporation for the purpose of carrying on the dental practice.

Incorporating after opening a practice: Current Ontario laws restrict ownership of a dental practice. Specifically, only a dentist or a PC can own the professional dental goodwill of a dental practice. That goodwill includes custody and control of all patient records and files (including patient billing records and treatment plans), patient charts, x-rays and models, patient lists, and use of any dental practice names.

Given that restriction, when opening a practice the most common structure is a PC. The PC owns the new practice and is the tenant on the lease. The PC borrows the required funds from a bank to set up and build out the new practice location, including the tenant leasehold improvements and to purchase the dental equipment and supplies. The PC, as owner of the practice, also hires all the staff.

When opening a practice it is typical to incorporate a PC to own the practice. The various legal issues to set up a PC outlined in chapter 2 apply here, except from the perspective of the PC owning the practice instead of being an associate PC.

When the PC owns the practice, it may be appropriate to issue ‘equity’ shares to family members.

Equity shares increase in proportionate value as the residual equity value of the practice increases. By issuing family members ‘equity’ shares, family members can benefit in any capital gain when the PC equity shares are eventually sold to another dentist. The purchaser dentist buys the practice by purchasing all the PC equity shares from the vendor dentist and his or her family members. All equity shareholders share in the net sale proceeds in proportion to their shareholdings, regardless whether the equity shares are voting (owned by the dentist only) or non-voting (owned by the dentist's family members). Remember, a shareholders agreement is essential if you issue equity shares to your family members.

Cost of opening
The initial costs of opening a clinic will depend on the size of the practice, number of operatories and the equipment. Renovations can cost about $200-$220 per square foot. Add in dental equipment, computer software, hardware, furniture, office equipment and signage and many new clinics can range in costs from $500,000 to $750,000. You will have to balance cost effectiveness and expandability. A larger space means more renovation costs and higher rent, but could be priceless when your practice grows. Consider roughing in and not equipping some operatories to reduce renovation costs while allowing room for future expansion.

Location
Location can mean a lot of things. It's not just the city, neighbourhood or street the practice is on. It is also the type of building, where it is positioned inside the building and what's nearby. When you open a practice, there are less geographical restrictions. You could locate anywhere there is a space to put a dental practice. Consider the following factors when you evaluate a potential location:

Factors to consider	Specific examples
Geographical location	Major city, rural town or suburbs
Neighbourhood	Demographics (Age, ethnicity, household income) Housing (low density homes, high rise condos/ apartments, new housing development)
Building type	Standalone house/building, heritage building, outdoor plaza, medical building, shopping mall or condo, nearby tenants (other dentists, medical doctors, major retailers or small local businesses)
Visibility & foot traffic	Type of street (side street or major intersections) Positioning (signage/practice facing street or hidden) Signage (sandwich, pylon, bulkhead, A-frame)

Specialized equipment
Prior to opening a practice you may have associated in a clinic with all the latest technology. You may have been accustomed to using a 3D cone beam, Cerec or E4D. When opening a practice, your number one concern should be cash flow. This may mean acquiring specialized equipment at a later date based on patient needs and when cash flow allows.

Premise Lease
The lease agreement for your dental practice has tax implications. The length of your initial lease period plus the first renewal is important in determining the period that you can depreciate any leasehold improvements. **Leasehold improvements** are the major renovations made to improve the premises of a rented unit or building. The tax laws allow you to depreciate any leasehold improvement costs over the greater of:

- the initial lease period plus the first renewal option, or
- 5 years

In order to write off the leasehold improvements as soon as possible, you should negotiate with the landlord to have your first two lease periods total 5 years. For example, a 20 year lease with an initial period of 2 years and first renewal of 3 years plus three 5 year renewals would be more tax efficient than a lease with four 5 year terms.

CASE STUDY

Dr. Susan Cho invests $100,000 in leasehold improvements. A tax efficient lease agreement with an initial period of 2 years and renewal of 3 years would result in a $10,000 (100,000 X 1/5 X 50%) deduction the first year due to the half year rule. If the lease was structured as 5 + 5 (i.e. first term with 5 years and a renewal term of another 5 years), then Susan's PC could only deduct $5,000 in the first year.

Do you need a PC to open a dental practice?
Similar to purchasing a practice, you can either open your practice personally or with a PC. The same pros and cons of purchasing a practice with a PC would apply. The difference with opening is timing. Since your practice may generate a loss at the beginning, a PC may not be beneficial as your personal tax rate will be low. To avoid additional costs, you can consider delaying setting up a PC until your income warrants. If you are associating outside of the practice while starting up the clinic, a PC may be beneficial as you could improve your cash flow by deferring or reducing any associate income inside the PC.

Financing considerations when buying your own practice
Whether you are applying for a business loan to purchase an existing practice or planning to open a new one, your lender will focus on some key factors when considering your credit application. By understanding what these factors are, you can be better prepared to make a well supported request; increasing the likelihood that you will get the credit approval you (and the lender) want. In addition to the specifics of what you plan to buy (the building, leasehold improvements, equipment etc.) a lender will consider the five Cs of credit: character, capacity, capital, collateral and conditions. Let's have a quick look at these, considering how you can best prepare to present your request with these in mind.

Capacity: Capacity is both the amount and predictability of future cash flow. Your lender will look for cash flow projections as part of your business plan. This will help them understand the practice's capacity to meet both existing and future obligations. An understanding of how your personal budget will work is also important as your practice will need to generate enough cash flow to ensure you can rely on a salary sufficient for your needs. This step is an important part of preparing for a conversation with your lender.

Capital: Typically most purchases require that the borrower make a down payment. Many of us have experienced this when buying a car or a house. For the dental practitioner, a lender will likely consider you a lower risk given your future earning potential and may not require you to invest your own capital. It may make sense for you to invest in the practice to reduce the interest expense you will incur. It's good to have a conversation with your accountant before applying for credit to consider how much to borrow, the costs and tax implications of your various choices.

Character: The single largest factor that demonstrates your financial "character" is your credit history. Your track record of meeting payment terms of credit obligations in the past will give your lender a good indication of how you will deal with future debt. A lender will ask for permission to obtain a credit report. It's a good idea to get a copy of your credit bureau in advance so you can be ready to answer any questions. If there are negative factors on your personal credit history, be prepared to explain them, ideally with documentation that shows any agreements not reflected on the credit report or ultimate resolution of the obligation. You can get a copy of your credit history by requesting one from Equifax or Trans Union, the two main credit reporting agencies in Canada.

Collateral: Collateral represents an alternative source of repayment for the lender in the event you (or your business) cannot meet your obligations. Typically the assets of the practice and a personal guarantee will form the collateral package, which supports lending to a dental office.

Conditions: It will be important for your lender to understand the conditions in which your practice will operate. This includes the local economic environment, competition, location of your business, your client base, availability of staff and access to the various suppliers you will need to rely on. Your business plan will include commentary that gives a lender a good picture of how your specific business will prosper given the unique set of conditions in your chosen location.

Creating a business plan

A business plan sets out a description of your practice, your plans for its success and a financial roadmap showing how you will generate profits. A lender will review the business plan to determine what financing is required to achieve your objectives, and will recommend how to best structure loans and leases. You need to consider important elements of your business plan like how much revenue you will generate from the patients and premises, equipment and systems costs, and how you will pay for them. Your business plan will document these assumptions and create a projected balance sheet (a statement of the assets you will own, and the liabilities you owe); an income statement (a statement of the revenue you plan to earn and the expenses you will need to pay); and the profit you expect to generate (the difference between your revenue and your expenses). You will work with your accountant to create a reliable business plan as it forms an important tool to both apply for credit and manage your practice over time.

For an existing practice, your business plan may draw heavily from financial information provided by the previous owner, or from an appraisal done to gain an understanding of value of current operation. Depending on the terms of the agreement you reach in your purchase and sale agreement, the existing owner may be actively involved in the practice through a period of ownership transition, which would be described in your business plan. Your lender will look for copies of previous financial statements, appraisal reports and purchase and sale agreements as supporting documentation to accompany the business plan.

For a new practice, you'll be asked to detail what is being purchased, to provide quotes or contracts with detailed costs and payment terms as well as details of who is undertaking any improvements with their credentials and capability to complete the terms of their engagement.

By being prepared to provide your lender with the information they need to understand your situation and your plans to capitalize on the opportunity you have in front of you, you significantly improve the likelihood of getting the right financing, structured in the best way to support the future success of your dental practice.

Navigating the changing wind ahead

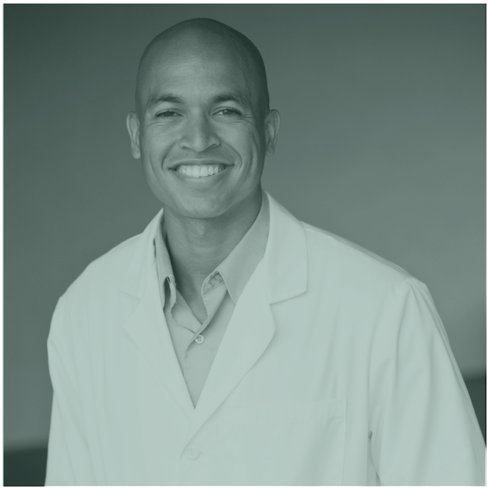
Reaching your destination to become a practice owner is a major milestone. As with any goal that is reached, you have to set new ones. Owning a practice doesn't guarantee success and the transition to a practice owner may be the toughest test in your professional career. In addition to the stress of opening your own practice, you are most likely experiencing personal changes at the same time. In the next chapter, we'll look at some possible personal changes and how you can manage them financially.

KEY CONSIDERATIONS

- In a seller's market, it is difficult to stand out as a potential purchaser. You need to explore different leads to find a practice.
- Patients and premises are the most important things to consider when you evaluate a practice.
- The fees per patient may tell you if a practice has is under performing but has potential versus one that may be unsustainable.
- In general, buyers want to purchase assets and sellers want to sell shares.
- Buying a practice with a PC means your loan can be repaid with "cheaper" after-tax income.
- Opening a dental practice may be cheaper, but will also be a riskier venture.

4

MANAGING PERSONAL CHANGES



This chapter focuses on managing financial and tax considerations during times of personal change.

What you will learn in this chapter:

- Financial considerations when getting married
- Financial considerations when having children
- Financial consequences of divorce
- Financial considerations when you or your loved one has a disability
- Financial considerations of death

DID YOU KNOW?
Taxes come into play with marriage, children, divorce, disability and death.

FINANCIAL CONSIDERATIONS WHEN GETTING MARRIED

Finances and taxes are likely the last thing on your mind when you are getting married but you need to discuss these topics before tying the knot.

Banking: Going to the bank and paying bills will be different once you get married. A common arrangement is to have a joint bank account in which both you and your spouse deposit a fixed amount periodically for monthly expenses, while retaining personal accounts. The individual accounts serve two purposes. First, it helps distinguish each spouse's income in the eyes of the tax department. This is important if your lower income spouse is receiving dividends from the PC. Second, the personal accounts can be used by each spouse for individual purchases without affecting the cash available for joint expenses such as mortgage payments. This system generally works well when both partners have the same income. However, consider what happens when your incomes are significantly different.

CASE STUDY

Dr. Joan Howard earns $200,000 after-tax while her husband, John, earns $60,000 after-tax. They both deposit $5,000 per month into a joint account to pay the mortgage and monthly household expenses. Joan is left with $140,000 for personal spending and investing while John has none. The discrepancy between their take-home pay leaves the lower income spouse with little for his or her personal expenses after paying into the joint bank account. This may create resentment and strain on the relationship.

Discussing your finances with your spouse regularly, including your respective debts, income and spending habits, will help alleviate the financial stress of marriage and help align both of your expectations. In many cases, the main decision to make is: "who should pay what bills"?

Paying the bills: We discussed previously some methods of income splitting including paying your lower income spouse a salary or dividend from your PC. Another simple way to income split is by having the right person pay the bills. Taking a lesson from Canada's progressive tax system, the higher your income, the more bills you should pay.

CASE STUDY

Let's continue with Joan's situation. Her annual savings of $140,000 is put into investments each year earning a return of about 5%. After 20 years, she has $2.8 million in investments earning investment income of about $140,000 per year. She is ready to sell her practice that she expects to get another $1 million (after-tax). Her total retirement assets are $3.8 million generating income of $190,000 each year. John has no savings or retirement assets and pays no taxes because he has no investment income.

The problem with this picture is that Joan has to continue paying taxes at a high rate since her retirement assets are significantly more than John's. If Joan had paid all the personal bills and if most of John's after-tax disposable income was used for investment purposes, then John could have had $55,000 of savings per year and $1.2 million in retirement assets while Joan would have the $2.6 million. The overall family taxes during retirement would be lower as the investment income would be taxed in two people's hands instead of one. Each year, investment income of $2,750 (5% X $55,000) earned on the assets that were shifted to John would be taxed in his hands at a lower personal tax rate.

In summary, not only should you equalize your income during your working years, you should also consider equalizing your assets with your spouse.

TEST YOUR KNOWLEDGE: Your 19 year old child is attending university and has no other income other than dividends from your professional corporation. Who should pay for tuition?

A) You, a dentist with a salary of $140,000.
B) Your lower-income spouse who receives $60,000 in dividends.
C) You 19 year old who receives $40,000 in dividends.

Answer: A) Since you have the highest income, you should pay for your child's education. This will allow your children to invest the dividends and earn investment income at lower tax-rates. The same spending principles with your spouse can be applied to your children as well.

Taxes: Getting married does provide some tax breaks that are not otherwise available to individuals. Here's a list of some of these tax breaks:

- **Donations** paid by you and your spouse can be claimed on a single tax return. There is a bigger tax break after the first $200 of donations. By grouping your donation receipts with your spouse on a single tax return you can maximize your donation tax credits.
- **Medical expenses** can also be combined on a single tax return. For high income earners such as dentists, you normally need over $2,000 in medical expenses for the year in order to qualify for a tax break. If you have a lower income spouse, the threshold may be lower depending on his or her net income. By combining your medical expenses together on the lower income spouse's return, you may qualify for tax breaks that would not have otherwise been available.
- You can contribute to a Spousal RRSP once you are married. By transferring retirement assets to your lower income spouse, you get a tax deduction. We discuss the benefits of Spousal RRSPs in detail in chapter 2.
- Another way to equalize your assets with a lower income spouse is to lend money to the lower income spouse. This money can be used to earn investment income, which will be taxed at a lower tax rate. In this scenario, the lender/higher income spouse must charge and collect interest from your spouse by January 30 of the following calendar year. Interest on the loan is charged at the CRA's prescribed interest rate (2% for the quarter April 1 to July 31, 2018). This rate varies from time to time.

DID YOU KNOW?
In 2012 Canadian's donated $8.3 billion. (Source: Stats Canada)

Buying your first home: If you are thinking about purchasing a home with your spouse, there are a few tax considerations for you to think about. The **first time home buyers credit** entitles you to a $5,000 tax credit, which is worth $750 in tax savings. To qualify, you and your spouse must not have owned a home in the past 4 years. Either one of you may claim or share the credit, but the total claim cannot exceed $5,000. This applies when you jointly purchase a home, even if the other person is not your spouse (i.e. friend or siblings etc.).

First time home buyers may also be eligible for a refund of up to $2,000 for the land transfer tax. If you and your spouse purchase a home together, the maximum is $2,000 combined. If either one of you owned another property during the marriage, neither one of you would be eligible for the refund. If you purchase the property jointly with someone else and that person had previously owned another property, then you are only entitled to a maximum refund equal to $2,000 times your percentage of ownership.

The **home buyers plan** allows you to borrow up to $25,000 from your RRSP to purchase a home. Refer to our discussion in chapter 2, for more details.

FINANCIAL CONSIDERATIONS WHEN HAVING CHILDREN

As with marriage, a growing family means more changes to your finances and taxes. Fortunately, there are some benefits and tax breaks available to alleviate the financial cost of raising children.

Canada Child Benefit (CCB): This is a tax-free monthly payment for families with children under 18 years of age. The CCB pays up to $541.33 per month each child under 6 and up to $456.75 per month for each child aged 6 to 17. The CCB is based on the family's net income and generally most dentist's and do not qualify.

Child care expenses: Child care expenses include payments for babysitting, day care, boarding school, and summer camps. They do not include the tuition or education portion of private school, although some private schools do allocate a portion of the school fees as child care expenses for younger children. Additionally, claims for boarding school and overnight camps are limited to a maximum of $175 per week for children under 7, $100 for children age 7 to 16, and $250 for children with a disability. In most circumstances, the lower income spouse claims the child care expenses. If the lower income spouse is in school (full- or part-time) or is physically/mentally incapable of taking care of the children, then the higher income spouse can make the claim.

As mentioned in chapter 2, child care expenses can only be claimed against earned income (i.e. salaries or business income). Investment income such as interest and dividends would not count. This means a couple with a stay at home parent, who has no salary, would not be able to claim child care expenses.

An income splitting opportunity exists if you pay a relative or a child over 18 years old to babysit your young children. The income would be reported on their income tax returns while you or your spouse receives the deduction. The maximum amount of child care expenses you can claim per child are as follows:

Age	Annual Deduction Limit
0 – 6	$8,000
7 – 16	$5,000
0 – 16 (with disability)	$11,000
Over 16 (with disability)	$5,000

TEST YOUR KNOWLEDGE: My spouse and I have two children who are 5 and 11 years old. In 2018, we paid child care expense of $10,000 for our 5 year old and $2,000 for our 11 year old. None of the expenses are for boarding school or overnight camps. Assuming that we have sufficient earned income, what is the maximum child care expense that we can claim?

A)$10,000
B) $12,000
C) $13,000

Answer: B) Since your children are 5 and 11, you or your spouse (whoever has the lower income) is entitled to an annual limit of $13,000 (i.e. $8,000 + $5,000). There are no restrictions as to which child the expenses are paid for.

Adoption expenses: Adoption expenses including court, legal and administrative expenses, reasonable travel and living costs for the child and adoptive parents, and fees paid to an adoption agency may be claimed in your tax return. This credit can be claimed in the year the adoption becomes permanent, and all expenses incurred during the adoption period are eligible. The maximum amount you can claim is $15,905 for 2018.

Registered Education Savings Plan (RESP): With education costs rising, a tax efficient way of saving for your children's education is through an RESP. RESPs allow you to contribute up to $50,000 towards the cost of your child's post-secondary education. The contribution grows tax-free until withdrawal when it is taxed in the student's hands (i.e. at low tax rates). In addition, RESPs receive a 20% matching grant from the government up to $500 per year with a $7,200 lifetime limit per child. In other words, if you put in $2,500 annually towards your child's RESP, the government will give you a $500 risk-free return.

FINANCIAL CONSEQUENCES OF DIVORCE

Not all marriages have a happy ending. Divorces are difficult and even though you have other more pressing matters to deal with, you should not forget about taxes as they can have a significant impact. Let's look at some often overlooked tax consequences of getting a divorce.

Support payments: There are two types of support payments you can make: spousal and/or child support. Both result in money out of your pocket; however, only one may be tax deductible.

Spousal support payments may arise after a divorce. Fortunately, these payments can be tax deductible if they are structured appropriately. The tax laws provide a tax deduction if the spousal payments are made under a court order or written agreement and if the payments are made periodically. A lump sum settlement would not be deductible.

If you contribute to an RRSP, you should note that the spousal support payments reduce the income used to calculate your RRSP contribution room. In other words, you may not be able to contribute as much to your RRSP as you did before the divorce.

Child support payments are payments made to your former spouse to pay for children's living expenses. These payments are not tax deductible. The laws consider it the responsibility of parents to financially support their children therefore there are no tax breaks.

Child care expenses: Many divorces involve joint custody arrangements. You can claim child care expenses on your tax return for the time your child lives with you. If both you and your ex claim child care expenses, ensure that the total claim is not more than your entitlement.

DISABLEMENT FINANCIAL CONSIDERATIONS

In the event that you or your loved one has a disability, there are some financial and tax tools available.

- **Disability tax credit:** The disability tax credit is available if you or any of your family members have a severe and prolonged (generally 12 months or longer) mental or physical impairment. The disability must significantly restrict your ability to perform more than one basic task. In order to qualify for the credit, a special certificate must be completed and certified by a physician.
- **Medical expenses:** Many of the costs that you or your family incur as a result of

the impairment can be claimed as medical expenses, including various medical devices, some or all of the tuition fees paid for schools that provide specialized equipment, facilities or personnel if certified by a medical practitioner. You can also claim anything you pay for attendant care for yourself or your family. This care can take place in your own home, a nursing home, and another place that provides this service.

- **Canada Caregiver Credit:** This non-refundable credit is available where the taxpayer supports a spouse or dependent with a physical or mental impairment. This credit replaced the caregiver credit, infirm dependent credit and family caregiver credit. The main changes include the requirement that the dependent being supported must be have a physical or mental impairment and that the dependent no longer has to live with you. Dentists who live with their elderly parents or grandparents (65+) and who do not have a physical or mental impairment can no longer claim this credit.

DID YOU KNOW?
Wigs and air conditioners are on CRA's list of eligible medical expenses.
(Resource: https://www.canada.ca/content/dam/cra-arc/formspubs/pub/rc4065/rc4065-17e.pdf

Registered disability savings plan (RDSP): If you have loved ones with a disability, an RDSP allows you to provide long-term care in a tax efficient manner. A trust is set up for a disabled beneficiary and contributions up to the beneficiary's lifetime limit of $200,000 can be made by anyone until the year the beneficiary turns 59. These contributions are not tax deductible, but investment income can grow tax-free until withdrawal.

In addition to contributions made by you, the federal government provides Canada Disability Savings Grants. The government will match contributions dollar for dollar up to $1,000 annually, regardless of household income. Lower income households are eligible for up to $3 for every $1 contributed (depending on income) up to $3,500 annually ($70,000 lifetime maximum per beneficiary). Once beneficiaries turn 18, they are considered to be independent of their parents and therefore their income for this purpose is calculated independent of their parents' income, no matter how high. Disabled persons are eligible for the savings grant until they turn 49.

Withdrawals from an RDSP will be allocated between contributions, investment income, and savings grants, with the beneficiary taxable on investment income earned and any savings grants received, but not on contributions. RDSPs are subject to a 10-year repayment rule; if any funds are withdrawn from the RDSP in the first ten years, if the beneficiary loses eligibility (i.e. is no longer disabled), or if the beneficiary passes away, all grants in the previous ten years must be repaid. There may also be tax consequences depending on your specific situation.

FINANCIAL CONSIDERATIONS OF DEATH

Planning for death is not something most people want to do but it's good to prepared. Your goal is to maximize the amount available to be distributed to your loved ones or charity. Many people know that death and taxes are inevitable but few people know that death can trigger more taxes.

Upon your death, you are deemed to have disposed or sold all your assets including investments, RRSPs, home, cottage, and PC shares, at the fair market value at the time of death. For example, if you have shares in a public company that you paid $10,000 for 10 years ago and were worth on death $25,000, you would have to report a capital gain of $15,000 even though you didn't sell the actual shares. An individual who passes away holding a large amount of assets will likely have a large final tax bill. Here are some ways to minimize taxes on death:

Transfer assets to your spouse: Your spouse is the only person who can defer taxes on your death. By transferring appreciated assets to your surviving spouse via your will, the capital gains and associated taxes can be deferred until your spouse either sells the assets or passes away. Before leaving all the inheritance to your spouse to avoid taxes, ensure you discuss this with all individuals you wish to be beneficiaries of your estate. A possible strategy is to leave some cash to your children or other loved ones while leaving non-cash assets to your spouse.

Ensure your PC shares qualify for the CGE: Unlike other assets, the voting shares of your PC can only be owned by another dentist. Unless your spouse is a dentist, this will force a sale of your PC shares and may trigger taxes. Many dentists overlook this issue since the CGE will shield them from a large portion of the taxes. In order to claim the CGE, you have to qualify. With the uncertainty of timing with death, ensuring your PC shares qualify at all times is something you should take into consideration. In chapter 6, we will discuss how you can remain eligible for the CGE.

Double wills: Taxes are not the only thing you have to pay on death. The government charges a special fee known as a probate fee in order distribute the assets in your estate. Probate fees are 1.5% on assets in your estate in excess of $50,000. To maximize the distributions to your beneficiaries, you should have double wills, one for your PC or other private company shares and one for all your other assets. If your PC or other private company shares are worth $1 million, a second will can save you about $15,000.

RRSPs: Naming your surviving spouse as beneficiary of your RRSP will defer taxes upon your death. When your surviving spouse dies, the balance of the RRSP will be taxed.

TEST YOUR KNOWLEDGE: On death, a dentist left his spouse a cottage that he originally bought for $250,000. This property was worth $350,000 at the time of his death. Two years later, his spouse sells the cottage for $300,000. If the property was not designated as a principal residence, what is the taxable income that should be reported by the dentist and his spouse on the disposition of the property?

A) Dentist – 0; spouse - $50,000
B) Dentist – 0; spouse - $25,000
C) Dentist - $100,000; spouse – loss of $50,000

Answer: B) The dentist can transfer the property at cost to his spouse via his will. As a result, he would not have to report any income on death. Since the cottage was subsequently sold for $300,000, the spouse will realize a capital gain of $50,000 (i.e. $300,000 - $250,000) of which 50% is taxable.

Types of tax returns: On death, all of your income from January 1 to the date of death is to be reported on the final return. To help alleviate some of the tax burden, there are three optional returns that your estate and accountant can file:

1. Rights or things: This return would include amounts that are owed to you and not yet paid at the time of death. These amounts include salary, vacation pay, OAS benefits, and dividends declared prior to the date of death.

2. Partner or proprietor: If you were operating your dental practice as a partnership or sole proprietorship and your business had an off-calendar year-end, you can opt to file a separate return for income earned from the last year-end to the date of death.

3. Income from a testamentary trust (will trust): If you received income from a testamentary trust and the trust has an off-calendar year-end, you can file a separate return for income received from the end of the trust’s fiscal year to the date of death.

On each of these returns, your estate can claim personal tax credits, such as the basic personal amount, age amount, child tax credit etc., in full; hence, it would save your estate some taxes to file the optional returns, if applicable.

Importance of writing a will

Many people do not like to discuss the topic of wills as it requires them to face their own mortality. Nevertheless, wills are critical legal documents and very important for tax, estate and family planning. It is recommended that you review your wills at least every 5 years to ensure your wills reflect your changing life circumstances. If you die and do not have a will, the Ontario Succession Law Reform Act dictates how your estate is distributed. Your spouse is entitled to the first $200,000 of the estate. If your estate is larger than $200,000, your spouse will be entitled to one-half of the excess. If you only have one child, she/he will receive the other half of the excess. If you have more than one child, your spouse receives one-third of the excess and the balance is distributed equally to your children.

If you do not have a surviving spouse or children, your estate is distributed to your next-of-kin in a prescribed order, based on blood relationships. This may not be what you would wish, so it is important to have at least a basic will.

Typically, a will leaves the estate to your spouse. If your spouse predeceases you then the proceeds go to your children. If you have minor children (less than 18 years old), your will should state who you wish to be the guardian of your children and their property until they become of legal age. You should speak with this person before adding them as your guardian in your will to confirm they accept the responsibility. A will also identifies the estate trustee, the person who administers and distributes the estate. Typically the estate trustee is your spouse.

To have a valid will you must sign it in the presence of two witnesses, present at the same time, and they must sign in your presence. The witnesses, or the spouse of a witness, should not be a beneficiary under the will. If they are then the bequest to that witness, or to his or her spouse, is void.

If you have a will, it will be revoked by a subsequent marriage except where the will specifically declares that it is made in contemplation of marriage. Furthermore, in the event of divorce, the appointment of your spouse as an executor is revoked as is a bequest to your spouse of a beneficial interest in property. After a divorce your will is treated as if your former spouse had predeceased you.

When a person dies their will is, in most cases, filed at the Ontario Superior Court of Justice as part of the 'probate' process. There is an estate administration tax, which is calculated on the total value of the deceased's estate wherever situated. That tax is 1.5% of the assets you are required to declare to the government. If your estate is $3,000,000, the tax will be slightly less than $45,000.

However, not all assets are required to be included in the list of assets attracting estate administration tax. With only one will, most of your assets will have to be included in the government filing and you will pay the fees on the total of that amount. But, if you have two wills, one can deal exclusively with assets that must be probated and you will pay the tax on this amount only.

The other will (often called a secondary will) can deal exclusively with assets where probate is not required. Shares of a dentistry PC fall into this category. In the example above of a $3,000,000 estate, if the shares of your dentistry professional corporation are worth $2,000,000, then they can be dealt with in the secondary will. By doing so, the shares are excluded from the probate process and there is no estate administration tax on these assets. In this example your estate will save $30,000 in estate administration tax. Having a secondary will for your dentistry professional corporation can result in substantial tax savings.

This discussion of wills is quite brief and not detailed. Please seek the advice and guidance of a knowledgeable accountant and lawyer when you are ready to draft your will.

Pushing the boundaries
Understanding all the tools and options available to put you and your family in the best position to succeed is an important step. If you are able to handle the changes in your personal life then your next move is to take your career and practice to the next step.

KEY CONSIDERATIONS

- Equalize your retirement assets by having the higher income spouse pay for expenses while the lower income spouse invests.
- Take advantage of tax breaks for children to invest in their education and care.
- Structuring your divorce appropriately can save you significant amounts in taxes.
- Ensure you file the appropriate tax forms to benefit from the disability tax credit.
- Death can trigger taxes for your estate. Ensure your will is structured to maximize the amount of assets for your loved ones.

5

EXPANDING YOUR DENTAL PRACTICE

This chapter will focus on growing your practice as you reach the prime of your career. It includes financial and tax advice based on exploring both internal and external methods of growth.

What you will learn:
- How to grow your practice organically
- How to grow through acquisition
- What to consider before buying your dental building
- What to consider before buying another dental practice
- Tax issues at the peak of your career
- When you should setup a Hygiene/Technical Service Corporation

Looking out at the larger fishing boats on the water, I always wished my parents would get a new boat. I wanted to go faster and farther. But my mom would say: "You have to make the most out of what you have first."

ORGANIC GROWTH

Investing in your staff
Growing internally starts with your employees. Most business owners consider employees to be an expense. However, if you want to expand and achieve bigger goals, you are going to need help. This starts with realizing that employees may be your practice's most underutilized asset.

Your employees interact with your patients almost as often as you do. Questions that patients are afraid to ask you will often be answered by your assistants, hygienists and receptionists. A dental practice's goodwill is driven by relationships with patients. This includes the relationship your patients have with your staff. Ensuring your staff are trained, motivated and satisfied means your patients will be well taken care of.

Each business owner has their own methods and incentive programs to motivate staff. These could include bonuses, gift cards, time off or other wage based programs. Here are a couple of tax efficient methods to reward staff.

Staff meals: Reward your staff with a team meal to build relationships that go beyond employer and employee. While most meals and entertainment are only 50% tax deductible, you can deduct 100% of the cost of up to six staff meals per year. All staff members don't have to attend, but they must all be invited in order to qualify.

Non-cash staff gifts: Every employee (excluding family members) can receive non-cash gifts worth up to $500 (HST included) each year. They could also receive a non-cash long service/anniversary award with a value up to $500 (HST included) for 5 years of service. How does this differ from a $500 bonus? Both a bonus and non-cash gifts are tax deductible for the dentist, but a bonus is taxable in your employee's hands while a gift/award is not. A good time to do this may be right after a holiday party. Take your staff out shopping and allow them to choose exactly what they want. You get a tax deduction for the cost of the gift and don't have to remit payroll taxes such as CPP and EI. Your staff gets a tax break and a gift that they will appreciate.

Investing in your practice

Dental equipment can be expensive, but as your practice and patient base grows, investing in the right equipment could pay dividends.

Digital charting: The move to paperless charts is growing. The convenience and time savings for both you and your staff is likely worth more than the cost of converting. The ability to track, sort, search and safeguard your patients' clinical records is a simple feature, which is almost impossible with manual charts. Most of the major practice management software available either includes integrated imaging software or is compatible with the existing digital-imaging equipment at your practice. It may also facilitate the ability for you to work from home by updating and reviewing patient charts remotely. While it is not a deal breaker, a digital practice is an attractive feature for future potential buyers of your practice.

Digital radiography: A picture says a thousand words. A digital picture says those words much faster. Consider a digital panoramic radiograph as an alternative to traditional film x-rays. The time savings and convenience of storing images directly into their charts will pay dividends for you, your staff and your patients. The ability to instantly view those images and share them with patients to educate them on what is going on in their mouths while they are still sitting in the chair is priceless. Giving them a picture to take home can also help with increasing treatment acceptance.

Specialized equipment: It's easy to get carried away with dental equipment. Some dentists want to be able to provide their patients with the latest technologies. Some equipment should only be considered when it fits the needs of the practice. For example, CAD/CAM technology such as the CEREC or E4D is best suited for practices that frequently perform crown and inlays. You will need to perform more than 10 units per month to recover the cost of the machine over a 5 year period. Before purchasing a CEREC or E4D, there are several items your accountant can help you with. These include differences in payment methods such as leasing, financing, addressing HST implications, and reviewing the purchase contract to maximize tax savings. Refer to our section on hygiene/technical service corporations (HSC/TSC) later in this chapter on how to generate tax savings when a Cerec or E4D is involved.

Whether you make small changes to boost employee productivity or acquire new equipment, there is always room for improvement. If you still have the desire to expand and have gotten the most out of your existing practice, then you should look externally for new opportunities.

GROWTH THROUGH ACQUISITION

To break through a plateau, you are going to have to look at different avenues for expansion. This doesn't mean you have to purchase the next available dental practice you see; in fact, your next purchase may be closer to home than you think.

Buying your dental building
Purchasing the building where your dental practice is located is a good place to start when you are looking to expand. It allows you to substitute rent for a mortgage, which builds equity. It increases the value of your practice by removing uncertainty with regards to the premises lease. If you have a demolition or relocation clause in your lease, this is especially important as it will likely affect the value of your practice. In addition, there's no need to approach the landlord to assign the lease when selling the practice, because you are the landlord. Finally, it becomes part of your retirement assets that can be used to generate cash flow until you are ready to sell the building.

The building itself doesn't necessarily have to be the same building you are renting. In some cases, that may not even be an option if the landlord isn't willing to sell. Purchasing a building nearby and relocating your practice is a potential solution. Before any relocation, you need to consider what could potentially happen to the vacant space. An empty dental office could be filled with a competitor.

Who should purchase the dental building?
As with a dental practice, there are many ways to buy a building — you or your family members, your PC or a holding company (Holdco).

Dentist /Family member	PC	Holdco
Pros:	**Pros:**	**Pros:**
Part of your personal retirement assets. It can be retained even when your PC shares are sold.	Repay the building mortgage using cheap after-tax corporate dollars from dental profits.	Part of your personal retirement assets. It can be retained even when your PC shares are sold.
No HST on closing if you register for HST.	Don't need to pay HST since rent does not need be paid.	No HST on closing if you register for HST.
	Family members could be shareholders of the PC — permitting income splitting.	Property would be protected from creditors in the event of a lawsuit against your dental practice.
		Family members could be shareholders of the Holdco permitting income splitting.
		If structured appropriately, building mortgage can be repaid using cheap after-tax corporate dollars.

Cons:	Cons:	Cons:
Rental income earned is taxed in your hands at high personal tax rates.	Purchase price of building would be subject to HST based on portion of the building used by the PC. Upon sale, the HST paid may be partially or fully recovered.	Additional setup costs and annual maintenance costs with another corporation.
Repay building mortgage using expensive after-tax personal dollars.	Building is included as part of the sale of your PC shares. Separating the building from the PC would involve fees and could trigger taxes.	Holdco's corporate tax rate could be as high as 50.17%.
HST on rent charged to the PC would not be recoverable.		HST on rent charged to the PC would not be recoverable.
In the event of a lawsuit against you, the building may be seized as part of your personal property.	In the event of a lawsuit against the PC, the building may be seized. There would be no protection from creditors.	Holdco shares would likely not qualify for the lifetime capital gains exemption.

TEST YOUR KNOWLEDGE: My holdco owns the dental building and charges my PC $3,000 per month in rent. After property taxes, mortgage interest and depreciation, my holdco has no taxable income. How much taxes will my holdco pay each year?
A) $0
B) $5,580
C) $4,680

Answer: C) While the holdco does not have to pay any corporate income taxes. It does have to remit HST of 13%. Therefore taxes to be paid will be $4,680 (13% X $3,000 X 12). These taxes are to be paid by the PC on top of the monthly rent and collected and remitted by the holdco to the CRA.

Buying another practice
Purchasing another practice is a decision that requires a lot of thought and consideration from you and your family. The time and effort to own and operate another practice will be significant. Running a single practice is difficult as it is; having two or more could mean a lot of personal sacrifices from you and your loved ones. With that in mind, your next practice doesn't need to be open 7 days a week nor have 3,000 patients. There are plenty professionally and financially more rewarding options.

Taking advantage of synergies
You probably won't hear this from an accountant, but sometimes 1 + 1 = 3. By purchasing a practice nearby and merging it with your own, you can take advantage of synergies to produce results greater than the sum of the parts.

You may be able to increase the number of patients without increasing the costs proportionately. Expenses such as rent, administrative salaries, advertising and office expenses are relatively fixed. They won't increase significantly with the addition of new patients.

Not everything with this purchase will work out perfectly. Patients having to travel long distances to the clinic may be resistant to the transition. If you are purchasing shares, you may be required to assume the premises lease. This means either operating two clinics or leaving one clinic vacant while paying rent until the next renewal period. Having your lawyer and accountant review the lease is critical; some landlords do not allow you to leave a unit vacant, even if you continue to pay rent. If you do vacate the premises, this leaves an opportunity for another dentist to fill the space increasing competition. If you are a general practitioner, consider having a "friendly" tenant including a medical doctor or dental specialist take over the space. There are also potential termination and severance concerns if you are not transitioning the staff to your clinic.

Buying a standalone practice
Another option for expansion is to purchase a standalone practice. Refer to chapter 3 to review what to look for when buying a dental practice. The key differences from your first and second practice tend to be from an operational standpoint. Some decisions you will have to make are:

- Should I hire an associate to run the new clinic?
- Should I split my time between both clinics?
- Should I operate the new clinic while an associate operates my existing clinic?
- Should I sell my existing clinic and work at the new clinic?

Aside from selling your existing clinic, the options are generally flexible and there does not have to be a permanent solution. In fact, you could do a bit of trial and error for each option to determine what works best with your lifestyle.

CASE STUDY

Dr. May Rahim's owns a practice with 800 patients and her appointment book is only 60% full each week. While she enjoys spending time with her children, she wishes she could reduce the idle time at her practice. She has come across two practices. One is about 1.5 km away with 700 patients and the other practice is 9 km away with 1,500 patients but is more than double the price. She's unsure which practice to pursue.

Both practices have their merits and there is no right or wrong answer. Given the close proximity and lower purchase price, if she were to merge this practice with her own it could result in the same amount of money in her pockets as purchasing the larger practice. Although the closer practice has half the patients, it also has a fraction of the operational costs.

The farther practice may provide higher patient fees and a higher price when it comes time to sell. It also costs more money upfront and would likely require May to sacrifice some personal time with her family. A third option is to sell her existing practice and operate out of the larger new practice. Then she would have enough patients to keep her appointment book full while still being able to have quality time with her family.

Consider the following financial results

	Existing practice	Practice 1	Practice 2	Existing + Practice 2	Existing + Practice 1 Merged
Income	$540,000	$460,000	$1,000,000	$1,540,000	$1,000,000
Dental supplies (6%)	32,400	27,600	60,000	92,400	60,000
Lab fees (8%)	43,200	36,800	80,000	123,200	80,000
Variable costs	75,600	64,400	140,000	215,600	140,000
Fixed Overhead costs (50%)	270,000	230,000	500,000	770,000	270,000
Income	$194,400	$165,600	$360,000	$554,400	$590,000

Assuming you won't have to incur any of the rent, salaries, maintenance and office expenses of the new clinic, this is an example of where taking advantage of cost savings synergies results in 1+1 =3.

Analyzing the dollars and cents is important, but taking into account your personal goals and letting your advisors know them will guide you to the best decision for you and your family.

Tax issues with your second practice
A second practice does make your tax structure more complicated and brings with it additional tax concerns. We are here to guide you through those issues. We'll start with who should own the practice?

Who should own the practice?
Many of the same ownership options exist as with your first practice. You can own the second practice personally, in a partnership or through a PC. Refer to chapter 3 to review the pros and cons of each. In many cases with a second practice, the main decision will be whether you want to setup a new PC or use your existing PC to purchase the practice. The primary benefit of having two PCs is you can sell the PC shares of one practice while retaining the other. The downside is it will likely cost you more in annual accounting, legal and banking fees to operate a second practice.

With a single PC, you can still sell one practice while retaining the other. However, the first sale will likely have to be an asset sale. This means, you cannot use your CGE and the sale may result in significant taxes for the first practice sold. You can still use the CGE when you sell shares of the second practice at a later date. Alternatively, the assets of the practice up for sale could be spun-off to a separate PC if you want to sell shares. As this is a complex transaction, it will be costly and more likely to be scrutinized by the CRA.

Aside from having to file another corporate tax return, a second PC doesn`t have any effect on your annual taxes. Whether you have one PC or two for both practices, the combined taxes will be the same. This is due to a special rule known as association.

Association is when the tax laws view two or more corporations as being owned by a common shareholder or group of shareholders. Two association scenarios include:

- **Common ownership:** You own shares in both companies.
- **Joint ownership:** You and your wife both own shares in both companies.

Other scenarios can trigger association but the above are the most common. In the case of two PCs, the RCDSO requires the dentist to own the voting shares of the PC. This means, the two PCs will be considered associated.

All associated corporations must share the 13.5% corporate tax rate on the first $500,000 of dental profit each year. All income above this is taxed at the higher corporate tax rate of 26.5%. Regardless of whether you have one PC or two, if your combined profit exceeds $500,000, you will be paying the high corporate tax rate.

While this may seem discouraging, don't let taxes prevent you from reaching new goals and expanding your dental practice. There are ways to get around these issues.

TEST YOUR KNOWLEDGE: My dental building is in a holding corporation solely owned by my spouse. I am the sole shareholder of my PC. The holding corporation had taxable income of $10,000. What will be the corporate tax bill for my holding corporation?
A) 1,550
B) 5,017
C) 2,650

Answer: B) Since the holding corporation and the PC are not associated for tax purposes, the corporate tax rate on passive income (i.e. rental income from non-associated entities and investment income) is 50.17%. In order to reduce the corporate tax rate to 13.5%, you would have to add either your spouse as a shareholder of your PC, or add yourself as a shareholder of the holding corporation. This is an example of where being associated may be preferred.

TAX ISSUES AT THE PEAK OF YOUR CAREER

As your bottom line grows, so do your taxes. The increase in your corporate taxes when your income exceeds $500,000 may seem like a shock initially. We'll look at a temporary solution as well as a more permanent option to get around this issue.

Declaring a bonus to yourself
A common rule of thumb used by accountants was to declare a bonus to bring the PC's taxable income to $500,000 or less. The PC pays a low tax rate of 13.5% on the first $500,000 of income and 26.5% on income higher than $500,000. Unfortunately, the decision to bonus or not is no straight forward. So what's changed?

Ironically, the corporate tax rates haven't changed at all. Instead the personal tax rate on dividends has changed. Similar to the different types of income, there's also more than one type of dividend. Until now, our discussion has been about non-eligible dividends. These are corporate funds that have been taxed at the low corporate tax rates of 13.5% (i.e. active business profit under $500,000). The other type of dividends is eligible dividends. These are corporate funds that have been taxed at high corporate tax rates (i.e. profit above $500,000). The primary difference between the two is that because the corporation paid higher corporate taxes on income above $500,000, the individual gets a bigger tax break on personal taxes on eligible dividends received.

Below are the 2018 marginal personal tax rates on eligible and non-eligible dividends.

Taxable income	Eligible Canadian dividends	Non-eligible Canadian dividends
$0 - $42,960	0%	8%
$42,961-46,605	0%	12.76%
$46,606-75,657	6.39%	19.14%
$75,658-85,923	8.92%	21.26%
$85,924 – 89,131	12.24%	24.06%
$89,132 – 93,208	17.79%	28.72%
$93,209 – 144,489	25.38%	35.10%
$144,490 – 150,000	29.52%	38.58%
$150,001 – 205,842	31.67%	40.39%
$205,843 – 220,000	37.19%	45.03%
$220,000+	39.34%	46.84%

Declaring a bonus is very specific to individual circumstances. One must take into account EHT, whether they would prefer to invest the money inside the corporate and defer the taxes.

DID YOU KNOW?
Over 3,000 trees are cut just so Canadian's can prepare their taxes the old fashioned way.
(Source: http://globalnews.ca/news/515419/8-interesting-tax-facts/)

CASE STUDY

Dr. Neel Gupta's PC has a net income of $600,000 after paying himself a salary of $150,000. He is the sole shareholder. His corporate taxes are nearly due so he has to decide whether he should declare a bonus.

		Bonus	No Bonus
PC's income before bonus		$600,000	$600,000
Less: Bonus		(100,000)	0
PC's taxable income		$500,000	$600,000
Corporate taxes @ 13.5%		($67,500)	($67,500)
Corporate taxes @ 26.5%		0	(26,500)
Cash available for:			
	Non-eligible dividends	$432,500	$434,000
	Eligible dividends ($100,000 x 0.72)	$0	$72,000
		$422,500	$506,000
Less			
	Non-eligible dividends		($1,500)
	Eligible dividends		(72,000)
	Cash in PC	$422,500	$432,500
Personal taxes			
	Bonus	$100,000	
	Non-eligible dividends		$1,500
	Eligible dividends		72,000
	Personal taxes	50,355	25,855
	Cash in hand	49,645	47,645

In Neel's case, declaring a bonus gives him about $2,000 more in his pocket. This isn't the entire picture as there are several other things to consider. First, if his total payroll is over $450,000 before the bonus then he will have to pay EHT at a rate of 1.95%. Since Neel has already paid himself a salary of $150,000, if his staff's wages are $300,000 or more, the PC will have to pay EHT of $1,950 on the bonus. This eliminates the small benefit of declaring a bonus.

Second, if Neel does not need the money personally (i.e. the $150,000 salary is sufficient), then instead of declaring a dividend of $73,500 to himself, he could leave the money inside the PC. In this situation, he would be paying an extra $26,500 in corporate taxes but could defer the personal taxes indefinitely until it is taken out of the PC.

Third, there is the issue of timing. Without a bonus, next year's corporate tax installments will be higher and the corporate tax balance will be due two months after year-end instead of three. With a bonus, your corporate taxes will be reduced immediately, but you will have to pay payroll remittances within 179 days of the bonus being declared. This decision becomes even more complicated if there are other shareholders with whom he could split income with.

While it is not as clear cut as it used to be, in the right circumstances, declaring a bonus is still a tax tool you could use to reduce your corporate taxes quickly. Alternatively, a more permanent solution is to consider a HSC/TSC.

HYGIENE/TECHNICAL SERVICE CORPORATION (HSC/TSC)

An **HSC/TSC** operates the hygiene and/or technical service component of your practice including a lab (Cerec/E4D). Services performed by the practice's hygienists and technical services related to orthodontics would be billed under the HSC/TSC. Let's look at some of the benefits of a HSC/TSC.

No restrictions on who can be a shareholder: In chapter 2 we said that only certain family members could be shareholders of your PC. Those individuals who are excluded from holding PC shares (in-laws, siblings, aunts and uncles, cousins and friends) can now share in the tax savings as long as they are Canadian residents. Shareholders of an HSC/TSC are not restricted to just individuals either. Corporations can own the HSC/TSC.

Super-size your savings
Both a PC and HSC/TSC allow you to save cash for investments. A HSC/TSC offers a significant advantage. Inside a PC, personal taxes on investments and cash can be delayed indefinitely until withdrawal. But what happens when you are forced to withdraw the funds?

CASE STUDY

After a 25 year career earning $500,000 of income inside his PC each year, Dr. Neel Gupta's PC has accumulated millions of dollars in cash and investments. When Neel decides to sell his PC shares, he will likely have to withdraw the funds personally. This can trigger a very large tax bill.

If Neel had setup a HSC/TSC he could divert 50% of the PC`s income into the HSC/TSC. By having a management or holding corporation as one of the shareholders of the HSC/TSC, Neel could declare an intercompany dividend to the management or holding corporation on a tax free basis. Neel and his family would retain the management or holding company, which now holds the cash and investments, while still being able to sell the PC and HSC/TSC. The cash and investments could be withdrawn during retirement at lower tax rates compared to a lump sum dividend payment prior to the sale of his PC shares.

Corporate tax rate of 13.5% on up to $1 million of taxable income: Unlike a PC, a dentist does not have to be the shareholder of a HSC/TSC. This makes it possible to avoid the association issues of a PC. The dentist could own shares in the PC while his or her family owns the shares in the HSC/TSC. Since there is no common or joint ownership, each PC and HSC/TSC can earn $500,000 each and only pay 13.5% in corporate taxes. Ensuring that proper documentation is kept and administratively separating the two businesses is important as the tax authorities have discretionary powers to rule that the two corporations are associated.

TEST YOUR KNOWLEDGE: My spouse is the sole shareholder of an HSC/TSC, and also owns a class of special dividends in my PC while I own 100% of the equity shares. The combined profit for the PC and HSC/TSC was $800,000. What will be the combined corporate taxes?

A) 124,000
B) 147,000
C) 212,000

Answer: B) Since the HSC/TSC and the PC are associated for tax purposes, only the first $500,000 is taxed at 13.5%. The remaining $300,000 is taxed at 26.5%. In total, the combined taxes would be $147,000.

Catch and release
As time went by, I noticed a few changes with my parents. They still loved getting out on the water with the family, but catching fish wasn't really a focus for them anymore. On the rare occasions they reeled in a good catch, they would simply release it back into the water.

As you move slowly past the prime of your career, it is important to start preparing and looking forward to life beyond dentistry. It starts with preparing for the sale of your practice.

KEY CONSIDERATIONS

- Growth can be achieved internally by investing in your employees and equipment.
- Growth can be achieved externally by purchasing your dental building or another practice.
- Consider your work/life balance, family obligations and financial goals when evaluating the next practice you wish to buy.
- A bonus is a temporary fix to a large corporate tax bill but may not be suitable in every situation.
- An HSC/TSC may reduce your corporate tax bill.

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SELLING YOUR PRACTICE

This section helps you prepare for the sale of your practice. Doing this well in advance will help you with the transition. Failing to plan in advance could cost you not only hundreds of thousands of dollars but also your peace of mind.

What will you learn in this chapter?
- How to find the right buyer.
- How to prepare for the sale of your practice.
- What to sell: assets or shares.
- How to claim the Lifetime Capital Gains Exemption (CGE).
- What to consider when selling your building.

Handing over the reins of your legacy is never easy. The relationships you fostered with your patients, staff and community will be hard to relinquish. Regardless of the price, it will take time to fully accept letting go of decades of hard work, care and dedication. Preparing for the sale of your practice well in advance will help ease the transition.

When should I start preparing for the sale of my practice?

The sooner you start preparing the better. In many cases, you should notify your advisors at least two years, preferably three or more before you actually sell. This is the biggest investment of your life, you can’t just wake up tomorrow and decide to sell it. Not only could you lose hundreds of thousands of dollars, but you also want to take the time to ensure your practice lands into the right hands.

FINDING THE RIGHT BUYER

Money is not always the most important factor. Many dentists want to ensure their patients and staff are well taken care of. This means finding someone who fits in with the culture of the practice and shares similar philosophies. It may take some time but here are some ideas to help you start your search.

- **Current associate:** Has he or she expressed an interest in acquiring the practice? Your working relationship with the associate will provide you with insight as to his or her compatibility with staff and patients. Handing the practice over to someone you know may help smooth the transition process.
- **Professional advisors:** Let your professional advisors know early you want to sell. They are there to guide you through every step of the way with financial, tax and legal planning. They can also help introduce you with potential buyers within their own networks.
- **Brokers:** Many potential buyers search through broker listings regularly. For a fee, brokers may be able to cast a wider net by exposing the practice to more potential buyers. You will still have to decide which candidate is suitable.
- **Study clubs and associations:** If you're an active member of a study club or dental association, you will likely be able to network with other like-minded dentists.

Regardless of how you find a buyer for your practice taking the right steps to prepare to sell your practice will increase the chances of a seamless transition. This includes preparing yourself financially as well as mentally for life after dentistry.

PREPARING FOR THE SALE OF YOUR PRACTICE

Mental preparation
Many dentists work their entire life to reach this point and have not thought about what they want to do after they have sold their practice. The biggest obstacle in transitioning to the next stage of your life is not planning for what you are going to do after dentistry. Here are some considerations:

Associating at the clinic — Just because you have sold your clinic doesn't mean you have to stop practicing dentistry. What better way to ease your transition into retirement than to continue interacting with the patient and staff you have known for years. Associating on a reduced schedule means you have more personal time on your hands to pursue other goals while still practicing the profession you love.

Volunteering — Many non-profit organizations could use your experience and knowledge of treating and caring for patients. You may not have had time when you were a practice owner, but with reduced clinical commitments, now may be the time to get involved.

CASE STUDY

You may even think of offering dental care outside of Canada. Dr. Moira Brown and her daughter, who was attending dental school, provided dental care to under the privileged in a third world country. The experience allowed Moira to bond with her daughter and to help people at the same time.

Giving back to the dental community — Even if you are not physically providing dental services, you can still give back to your colleagues by joining study clubs and being an active member of various dental association. You can share your knowledge and experience to help other dentists serve patients.

Pursuing another career — Your age doesn't disqualify you from pursuing another career. Teaching, consulting, sales, finance, research or e-commerce are among the many possible fields you could explore. You will find that many of the skills you honed while being a dentist can be transferred to other professions.

CASE STUDY

10 years prior to retirement Dr. Max Elliot contemplated a different career path after dentistry. He was outgoing, had financial savvy and interpersonal skills. After considering his options, he took on the challenge of becoming a certified financial planner and has been serving dentists for years.

Financial preparation
It is hard to put a price on your legacy. There are many factors both tangible and intangible that affect the value of a practice. Sometimes, these things are out of your control but here are some things you can do:

1. **Get an appraisal** — Oftentimes, what you think your practice is worth may not be the same as what others think. An appraisal provides a good starting point for negotiations.
2. **Review your lease** — Buyers are hesitant to take on a premises lease with a shorter term as it makes obtaining a loan from the bank more difficult. Hence, your premises lease agreement should allow you to operate your practice for at least 7 years (including any renewal options) and should not contain any clauses that could significantly reduce the value of your practice, such as a demolition and/or relocation clause. If necessary, consider negotiating with your landlord to add additional renewal terms and to remove these detrimental clauses in exchange for paying a higher rent and/or other concessions.
3. **Purge your patient charts** — Your charts should be organized and up-to-date, with inactive patient charts separated from those of active patients. You and your advisors can only evaluate the practice's value if you know how many active patients are at the practice.

In planning for the sale of your practice, one of the most important issues to consider is taxes. Let's explore the various options and their tax implications.

WHAT TO SELL: ASSETS VERSUS SHARES

As with buying, the decision of assets versus shares comes into play again. As a seller, you would normally prefer to sell shares in order to claim the CGE. To do so, you first need to have a PC. As we will discuss later in this chapter, even if you don't have a PC, it is still possible to arrange your affairs to claim the CGE. It will just take a little extra time as well as some tax and legal advice.

Selling assets — If your PC owns the practice's assets, the entire sale price will go to the PC's bank account and pass through two levels of taxation. The PC will first have to pay corporate taxes on any taxable income realized on the sale of assets. The shareholders will then pay personal taxes on receipt of the remaining funds.

When your PC sells assets, there are two possible tax outcomes that could occur. The income can either be 50% taxable or it may be 100% taxable.

50% taxable
Capital gains are only 50% taxable and arise when you sell an asset for more than you originally paid. For example, if your PC sells a dental building for $350,000 and paid $250,000 originally, it would report a capital gain of $100,000 of which 50% ($50,000) is taxable.

When selling your practice, capital gains can arise from two sources: 1) Sale of the physical capital assets (i.e. dental equipment, leaseholds, furniture) and 2) Sale of intangible assets (i.e. goodwill)

Goodwill is the total sales prices less the physical assets of the practice. It consists of the patient charts, employees and the reputation of the clinic. These are items that are valuable but cannot be physically touched. For example, when a chef at a restaurant takes ingredients that cost $10 but sells you a meal for $25. The $15 difference is the goodwill that a buyer is willing to pay for the meal.

Gains from both the sale of capital assets and goodwill are only 50% taxable and are considered investment income which means they are subject to a 50.17% corporate tax rate. Effectively, capital gains face a corporate tax rate of about 25% (50.17% X 50%). As we will discuss later, some of this tax is refundable when the money is ultimately paid out to the shareholders.

100% taxable
Not all income from the sale of your practice will be 50% taxable. There is a type of income known as **recapture** that is 100% taxable. Recapture arises because of the depreciation expense you claimed in the past. Remember that depreciation is an estimate of the decline in value of your capital assets for tax purposes. However, sometimes estimates are wrong. When you sell an asset, only then will you determine its true value in the market place. When the selling price is higher than the estimated value on your tax records, the difference up to the original cost will be included in the PC's income as recapture.

For example, you claimed $50,000 of depreciation on the dental building you purchased for $250,000. This means its estimated value for tax purposes is $200,000 and you received $50,000 in tax write-offs over the years. Now if you sold the building for $350,000, that means the building hasn't really depreciated, in fact it has appreciated. As a result, you have to reverse (i.e. recapture) the $50,000 tax deductions you have been claiming by including it as income. Since the depreciation you claimed previously was 100% deductible, the recapture is 100% taxable. The remaining $100,000 over the original cost of $250,000 is still a capital gain and only 50% taxable.

Conversely, if you sell a depreciable asset for a lower price than its estimated tax value; you can claim the deduction to write down the value to its sales price. This is known as a **terminal loss**.

It's important to understand the tax implications of different types of income on the sale of assets. The allocation of the sales price to the various assets could impact your taxes significantly. In some circumstances you may have some discretion for the price allocation among the assets.

CASE STUDY

Dr. Jacob Smith is selling his practice's assets and is faced with two offers:

	Offer #1	Offer #2	Tax value	Original cost
Furniture	10,000	20,000	5,000	30,000
Equipment	50,000	80,000	20,000	100,000
Leaseholds	20,000	50,000	10,000	100,000
Computer software	5,000	10,000	0	10,000
Computer hardware	5,000	10,000	0	20,000
Goodwill	600,000	530,000	0	0
Total	700,000	700,000		

Recapture	**Offer #1**	**Offer #2**
Furniture	5,000	15,000
Equipment	30,000	60,000
Leaseholds	10,000	40,000
Computer software	5,000	10,000
Computer hardware	15,000	10,000
Total recapture income	$65,000	$135,000
Sale of goodwill	600,000	530,000
Taxable portion @50%	300,000	265,000
Total income	365,000	400,000
Corp taxes @ 13.5%	8,775	18,225
Corp taxes @ 50.17%	150,510	132,950
Total Corp taxes	159,285	151,175

Even though both offers were for the same price, the amount left in your pocket could be very different. Ensuring taxes are taken into account will help you evaluate the true merits of each offer.

What happens now that the PC has paid its taxes and has all this money sitting in its bank account? To get the money into your personal hands, the PC can pay dividends to the shareholders. Personal taxes are normally due on this dividend income, however there is an exception. A special type of dividend known as a capital dividend can be paid out to shareholders tax-free. Only 50% of capital gains and goodwill is subject to taxes; the other 50% is tallied in a special account called the capital dividend account, to be distributed tax-free to shareholders. If you receive $1 million for the sale of goodwill, $500,000 will be subject to corporate taxes, the remaining $500,000 will not be subject to taxes and can be paid out to shareholders tax-free.

The other 50% of the capital gain that doesn't go in the capital dividend account is taxed at a rate of 50.17%. However, once this money is paid out to shareholders as a dividend, the corporation will be able to recover some of the 50.17% in corporate taxes paid and effectively reduce the corporate taxes from 50.17% to 19.5% on capital gains. In other words, the high 50.17% corporate tax rate is a prepayment of tax, most of which will be refunded to the corporation once the money is paid out to shareholders and taxed in their personal hands. On $100,000 capital gain, you would pay upfront corporate taxes of $25,085 and once enough dividend are issued to shareholders, the corporation can recover taxes of up to $15,335 out of the $25,085 paid.

TEST YOUR KNOWLEDGE: Your PC originally purchased dental equipment for $300,000 and computer hardware for $50,000. Over the years, the computer hardware was fully depreciated while the remaining tax value of the dental equipment is $75,000. If the sale price for the dental equipment is $60,000 and computer hardware is $25,000, what are the tax implications of the sale for the PC?

A) Active business income of $25,000 and capital loss of $265,000.
B) Active business income of $10,000 and no capital gains or losses.
C) Active business income of $85,000 and no capital gains or losses.

Answer: B) On sale, the PC will realize recapture of $25,000 on the sale of computer hardware and a terminal loss of $15,000 on dental equipment. Hence, the net active business income to be reported would be $10,000. Since both dental equipment and computer hardware are depreciable assets, the PC cannot claim any capital losses.

There's not too many good reasons to sell assets versus shares as income splitting rules and the high corporate tax rate of 50.17% significantly reduce any tax savings and tax deferral from the sale of assets. There are some specific situations where an asset may make sense but generally speaking most practice owners will prefer to sell shares.

Selling Shares — If shares are being sold, all of the equity shareholders will receive their share of the sales price directly into their own bank accounts. They will have to report the capital gains on their personal income tax returns. In many cases, the cost of your shares will be virtually nil. This means the entire sales price less any selling costs and any outstanding loans will be a capital gain to you and other equity shareholders of the PC.

There is tax relief available in the form of the CGE. The first $848,252 (2018) of capital gains of qualifying shares is exempt from taxes. This translates into tax savings of up to $227,000. If family members are also equity shareholders of the PC, then there is the potential to multiply the capital gains exemption, saving up to $227,000 in taxes per family member.

Unlike the sale of assets in which you have discretion to defer personal taxes, you would have to pay personal taxes arising from the sale of shares upfront. In some cases, you can defer a portion of the taxes on the sale over a maximum period of 5 years using a tax tool known as a capital gain reserve. However, the selling price would have to be paid to you in instalments over time. As you can imagine, most sellers want payment on closing and are not willing to take on that risk.

CASE STUDY

Dr. Amelia Lavelle decided to sell her practice, which she started from scratch 15 years ago, to focus on a career as a professor. She operated the practice as a PC and is the sole equity shareholder. She purchased the original 100 common shares of her PC for $1 per share. Her parents own dividend shares only. She recently had an appraisal done and she obtained the cost and tax values of each asset from her accountant:

Asset	Market Value	Cost	Tax Value
Equipment	$80,000	$500,000	$50,000
Hardware	20,000	50,000	0
Goodwill	1,000,000	0	0
Total	**$1,100,000**	**$550,000**	**$325,000**

Amelia's associate expressed interest in purchasing her practice and is willing to accept $1.1 million for shares or assets. Amelia expects her PC to have taxable income before the sale of at least $500,000 and she will be in the top personal tax bracket. She has the full CGE available to her. Let's see how much the selling price would be if she were to sell assets versus shares.

	Assets	Shares (With CGE)
Corporate level:		
Recapture on equipment	$30,000	
Recapture on hardware	20,000	
Taxable capital gain on goodwill	500,000	
Total taxable income on sale	**$550,000**	
Corporate taxes @26.5%	$13,250	
Corporate taxes @50.17%	250,833	
	$264,083	
Total funds available for distribution		
Proceeds on sale	$1,100,000	
Less: corporate taxes	(264,083)	
Add: refundable corp. taxes	153,333	
Net funds available	**$989,250**	

Breakdown of net funds available		
Capital dividends	$500,000	
Eligible dividends	36,000	
Non-eligible dividends	453,250	
Total	**$989,250**	
Personal level:		
Proceeds/distribution	$989,250	$1,100,000
Less: taxes on sale/distribution	(226,465)	(67,380)
Net cash	**$762,785**	**$1,032,620**

With the CGE, it becomes obvious why vendors prefer to sell shares. In Amelia's case, she would have $269,835 more in her hands if she were to sell shares.

As with all tax matters, the specific choice you choose will depend on your specific circumstances. Perhaps you have a HSC/TSC to sell as well or you have two practices. In general, sellers prefer to sell shares as they pay less tax due to the CGE. Of course, the CGE has to be available to you first.

CLAIMING THE LIFETIME CAPITAL GAINS EXEMPTION (CGE)

The CGE is the single biggest tax break available to dentists. Many dentists set up PC/HSC/TSCs solely to utilize the CGE available to them and their family. However, claiming the CGE is not guaranteed and requires some planning on your part.

When it comes to claiming the CGE, the first question you should ask is: "how much can I claim?" All Canadian residents are entitled to a lifetime CGE of up to $848,252(for 2018 and indexed to inflation). You should also be aware that there are factors that can significantly reduce this amount.

Past claims: If you have claimed any CGE previously then you would only be entitled to the remaining balance. For example, if you sold a previous PC for $500,000, you would have a CGE of $348,252 remaining.

Past investment losses: Bad investments in the past could come back to haunt you by reducing your CGE. All of your investments losses (net of any income or gains) over the years, including rental losses, interest and other investment expenses are accumulated in a special balance known as **cumulative net investment losses (CNIL)**. Since you already received a tax break for the investment losses, you won't be able to receive a tax-free capital gain until you have sufficient gains to offset the CNIL balance. As a result, the amount of CGE available is reduced by the CNIL balance.

So what can you do if you have a large CNIL balance? You can eliminate the balance by taking out a dividend from your PC. Depending on the CNIL balance, you may need a few years in order to eliminate your CNIL with dividends while minimizing personal taxes. This is why it is critical that you plan for the sale of your practice well in advance, you may need to time to ensure the CGE is available to you.

You are not out of the woods yet even if you have the full CGE intact. Just because you qualify for the exemption doesn't mean your PC will. The second question that you should ask is: "do my shares qualify for the CGE?" This is another example of where tax planning well in advance becomes crucial. It could take well over two years to ensure that the shares meet all of the following conditions:

1. Have you or someone related to you owned the shares throughout 24 months before the sale?
2. Was at least 50% of the fair market value of the corporation's assets used in active business throughout 24 months preceding the sale?
3. Was at least 90% of the fair market value of the corporation's assets used in active business at the time of the sale?

The first condition is commonly referred to as the holding period test. In most cases, this means you have to own the shares of your PC for a minimum of 2 years. This deters buyers from flipping practices frequently by removing the ability to claim the CGE. There is an exception for sole proprietors and partnerships for this test. If you were not previously operating your practice as a PC, you may be able to claim the CGE by transferring your practice assets to a PC immediately prior to the sale. Provided your total ownership of the practice (sole proprietor + PC) is 24 months or more, the PC shares should qualify.

TEST YOUR KNOWLEDGE: My newly incorporated PC purchased the shares of a vendor's PC on July 31, 2010. At the time, I owned all of the equity shares of my PC. On June 30, 2016, my mom purchased 50% of my equity shares. If all the PC assets are used for active business, how long will we have to wait until our shares qualify for CGE?

A) All the shares qualify for CGE now.
B) Your shares qualify for CGE now and your mom's will qualify on July 1, 2018.
C) Both of your shares will qualify on July 1, 2018.

Answer: A) You have held your shares since 2010, so they would have met the 24 month holding period condition. Since you are related to your mom, the holding period test considers the time when you held the shares before the sale to her. As a result, her shares would also meet the condition.

The second and third tests are to ensure that the PC is an active small business. The purpose of the CGE is to provide a tax break for small business owners. It is not to give a tax break to corporations that hold and invest assets without any real business activity. As a result, the tests look at the ratio of active and inactive assets in comparison to the value of the assets in total.

For a dental practice, assets used in the normal course of dentistry (i.e. for purposes of generating patient fees) would be considered **active assets**. They would include cash used day-to-day to sustain the business (i.e. working capital), accounts receivables, supplies, dental equipment, computer equipment etc. Conversely, **inactive assets** are assets that are used to generate passive income (i.e. investment income). Examples would include excess cash not used as part of the working capital of the business, investments including universal life insurance policies and real estate investment property (other than the dental building under certain circumstances). If your PC has a large amount of inactive assets then the shares would not qualify for the CGE.

These conditions can be a major hurdle for dentists. Over time, as the practice thrives, the PC can accumulate large amounts of cash and investments. You can reduce these inactive assets by distributing annual earnings as salaries or dividends to yourself or your family. If you have been taking only small amounts of salary or dividends from the PC, you may have to take out large amounts of salaries or dividends over a short period of time. This would trigger a large personal tax bill just to ensure your PC shares qualify for the CGE. A better approach would be to smooth your income over several years and utilize all the shareholders available to remove inactive assets from your PC regularly to ensure the shares always qualify.

TEST YOUR KNOWLEDGE: You are planning to sell the shares of your PC. You've held the shares since incorporation 5 years ago, and you're certain that the PC's active assets during this time were at least 50% of the value of the practice. However, the PC has recently accumulated some cash, so you're afraid that the shares may not qualify for CGE. Based on the following information, how much cash do you need to take out in order for the shares to qualify for CGE?

	Market Value
Cash	$150,000
Equipment	$220,000
Goodwill	$500,000
Liabilities (regular working capital of business	$10,000
Net	**$860,000**

A) $64,000
B) $60,000
C) $70,000

Answer: B) Idle cash in the PC is $140,000 (i.e. $150,000 - $10,000). The value of the active assets is $720,000 for equipment and goodwill, which must represent at least 90% of the total value of the assets. The maximum amount of idle cash that can be kept in the corporation would be $80,000 ($720,000/90%x10%). Hence, you must take out at least $60,000.

Purification
Not all is lost if your PC does not qualify due to inactive assets. There is a special tax manoeuvre that you can use to remove these assets from the PC without triggering personal taxes immediately. This manoeuvre is known as **purification**. Purification allows you to transfer inactive assets from the PC to a holding corporation on a tax-deferred basis. Your PC would be purified of the inactive assets allowing it to meet the requirements of the CGE tests. The holding corporation becomes the owner of the inactive assets and you would be subject to personal taxes only if you take money out of the holding corporation.

There are some caveats regarding the purification process that you should be aware of:
- You may trigger HST and/or corporate taxes for some assets.
- There may be a limit on the amount of assets that can be transferred without any further tax implications.
- This process cannot be done in contemplation of a sale.

As the process is very complex, it's imperative that you discuss with your professional advisors as to the costs and benefits involved.

CLAIMING YOUR CGE WITHOUT SELLING YOUR PRACTICE

While purification is a reactive manoeuvre to the CGE test, there is a preventative measure you can take. **Crystallization** allows you to claim the CGE without selling your practice. It's also a complex procedure, but once completed, your CGE will be secured. The manoeuvre involves triggering a capital gain, which is reported on your personal tax return by creating a "notional sale." The sale would involve exchanging your existing common shares for a set of shares with a fixed value equivalent to the fair value of the shares at the time of exchange. To offset the capital gain on your personal tax return, you would claim the CGE. When you sell the shares in the future, you will only pay taxes on the difference between the selling price and the new cost.

CASE STUDY

Dr. Ken Hayashi is the sole shareholder of his PC. When he initially set up the PC, his common shares were worth nothing. His PC had since acquired a practice and over time the value of his shares increased to $800,000. He wants to crystallise the value of the shares since they qualify for CGE now. In doing so, he would be exchanging his common shares for another class of special shares from the PC. As part of the exchange, he can bump up the cost of the special shares by electing the selling price of his common shares to be $800,000. He would report a capital gain of $800,000 and claim CGE of the same amount. In a few years when Ken sells the shares for $1.2million, he would have a capital gain of $400,000 instead of the full $1.2 million since his special shares now have a cost base of $800,000.

Claiming the CGE before the sale of your practice is advantageous for several reasons:

- You are securing your CGE now in the event that the tax break is eliminated in the future.
- You would not have to worry about your PC's accumulation of inactive assets in the future that would otherwise impact your ability to claim CGE.
- You expect to incur significant investment expenses that may reduce your CGE.
- Your estate is protected in the event of an unexpected death; since there is a deemed sale of the shares at the time of death. Your estate may or may not be in a position to claim the CGE if death occurs unexpectedly.

Consult with your financial advisors about the pros and cons of this maneuver before proceeding.

ALTERNATIVE MINIMUM TAX (AMT)

Up until now, we have been describing the CGE as a tax break that allows you to receive up to $848,252 of capital gains tax-free. This is true; however, the CGE does not protect you against a special tax called alternative minimum tax (AMT).

The intention of AMT is to ensure that taxpayers who are able to take advantage of tax saving tools such as CGE, resource property and flow-through shares are paying their fair share of taxes.

When you prepare your personal tax return, there is a behind the scenes calculation that is taking place in parallel. This calculation assumes that you are not claiming the CGE but instead taxes are calculated using a lower fixed tax rate. If your actual taxes for the year are more than the amount derived from this alternate method, then AMT would not apply. If the calculated AMT is higher than your actual tax balance owing, then the AMT becomes your taxes for the year.

The difference between AMT and regular taxes is that AMT is a prepayment of taxes and is recoverable over the next seven years. You won't get a refund cheque from the government; instead, the AMT that you paid would be used to reduce your taxes during the next 7 years. For dentists or other equity shareholders, this could be a concern if you do not expect to have much income after the sale of the practice. Where AMT applies, planning is especially important to ensure that you and your family recover as much of the AMT as possible. Some possible sources of income after retirement you could use to recover the AMT include: associate income, investment income and RRSP withdrawals. The only time that AMT does not apply is if the sale of your shares was triggered by death.

SELLING YOUR DENTAL BUILDING

If you own the dental building where you practice, you must decide whether it will be included in the sale of your dental practice. This decision will depend in part on who owns the building. If your PC owns the building, then it will have to be included as part of the sale unless you transfer it out to another company or yourself individually. This is a complicated and potentially expensive manoeuvre. If you or another corporation owns the building, then you can either hold on to the building or include it with the sale.

The decision to hold or sell your building is one specific to your retirement plans. Many dentists hold on to their buildings in order to generate steady cash flow into their retirement years. Knowing the new tenant (i.e. purchaser of your practice) and having worked in the dental industry for decades gives you invaluable information and insight. This experience reduces the investment risk of holding onto the building. You may also want to sell the building to use the proceeds to pursue personal goals or other forms of investments.

If the building is owned by a holding corporation, the decision to sell asset or shares comes up again. Under specific circumstances, the holding corporation's shares may qualify for the CGE. As you recall, there are two tests to determine if shares qualify for the CGE involving inactive and active assets. The building is considered an active asset if the holding corporation is associated with the PC and the PC is the only tenant. The building becomes an inactive asset when the PC is sold to another dentist who will become the new tenant. In other words, in order to qualify for the CGE, the holding corporation's shares must be sold as part of a packaged deal along with the PC shares. This would be beneficial if you or your family members do not expect to use up all of your CGE on the sale of PC shares. However, long-term tax planning is required to ensure that the holding corporation's shares qualify for CGE.

END OF THE LINE

My parents had stopped casting their line for quite a while, but they had always brought their fishing rods on our family trips. It wasn't until they handed each of my siblings and I one of their rods did I realize that this was the end of the line. They still loved fishing but they were already looking forward to life after it.

KEY CONSIDERATIONS

- Plan at least 2-3 years in advance of selling your practice and consult with your advisors.
- Understand and use the resources available in your search for the right buyer.
- Consider getting an appraisal, reviewing your lease and purging the patient charts.
- The sale of assets includes two levels of tax: corporate and personal.
- You may be able to defer and split personal taxes.
- The sale of shares is advantageous since you can claim CGE to offset some of the capital gains; however, AMT may apply.
- There are strict conditions for shares to qualify for CGE.
- Purification is a possible solution to get around CGE issues related to the accumulation of inactive assets.
- You can claim CGE without selling your practice through the crystallisation manoeuvre.
- You may be able to claim CGE on the sale of dental building under certain circumstances even if it is held by a holding corporation. Your dental building must be sold along with the practice in order to qualify.

7

PLANNING FOR RETIREMENT

This section is the final chapter of the book and will look at ways to make sure your retirement assets last at least as long as you do.

What you will learn in this chapter:

- What should you consider when setting retirement goals?
- What are some potential sources of retirement income?
- RRSP alternatives?
- Tax breaks for the retired dentist

It is time to reap the rewards of your hard work. If you carefully planned and saved during your career, you should have accumulated enough assets to fund your retirement. Before you get carried away, you need to be aware of some financial and tax matters. My mom used to say: “the best part of being in the basement is you can’t fall any further.”

At this point in your career, you are no longer in the basement, which means you have something to lose. If you want your retirement assets to last at least as long as you live; you can’t relax your financial discipline now. You still have some goal setting to do.

SET RETIREMENT GOALS

Everyone's idea of retirement is different. Whether you plan to travel the world or spend more time with the family here at home, you still need a plan to build that retirement nest. Here are important questions to consider when planning for retirement:

1. When do you plan to retire?

Timing has significant financial implications. Even without considering other factors, the amount of money you need for retirement would be vastly different if you were to retire at 55 compared to 65. If you have been working for the past 40 years but have no savings, early retirement may not be an option.

DID YOU KNOW?
According to Stats Canada, the average retirement age for a Canadian is 62.

2. How long do you expect to live?

You may not want to think about death but life expectancy is something that you should not overlook as part of retirement planning. It provides a timeframe that you and your professional advisors can work with. Your medical history, health and lifestyle affect how long you have to live. There are a number of life expectancy calculators online that can give you some projections.

3. How much do you need to retire?

The amount of money you will in retirement will depend on your lifestyle and spending habits. Factors to consider would include:

- **Dependents:** Many retirees are part of the "sandwich" generation. They support both their children and parents. The number of dependents you have to support will greatly impact the amount of money you need in retirement. Helping your children buy their first home while supporting your elderly parents may cause a strain on your finances in retirement.
- **Estimated cost of living:** When you first graduated dental school, filling up your gas tank probably cost you less than half of what it does today. Living costs rise over time due to inflation. Factoring this into your retirement plan will help you avoid any short falls due to rising costs.
- **Investment returns:** While living costs rise, investments also generally rise in value. Consider whether your investment return expectations are in line with your investment portfolio. Your risk profile will determine the mix of investments you hold. If steady returns and asset preservation is your goal then high risk investments may not be suitable for you. Many retirees assume a 5% growth; however, with inflation real growth will be less and investment returns fluctuate year-to-year.
- **Personal spending habits and lifestyle:** Your lifestyle and spending habits will have a big influence on how long your retirement assets last. Forecasting your future annual costs can be difficult. The amount you spend during the early years of retirement fluctuates significantly as you establish a routine. Many retirees spend a disproportionate amount in the first year or two of retirement as they travel the world, renovate their home or pursue various hobbies. Don't be alarmed as this is a natural reaction to retirement. Just make sure to budget for this initial increase in costs before your annual spending levels off.
- **Contingencies:** With any plan, you should have a contingency. This means setting aside some funds for a medical emergency, illness or because your investment returns did not pan out as you had expected.

Your retirement plan is a work in progress. Have a plan with realistic goals, is flexible and has contingencies built in to ensure you are prepared for good times and bad.

SOURCES OF RETIREMENT INCOME

Now that you have set your goals, let's take a look at your sources of income in retirement.

Old Age Security (OAS) benefits
OAS is a taxable monthly payment available to Canadian residents over 65 years of age. To qualify, you have to live in Canada for at least 10 years (after turning 18). If you plan on leaving Canada, you may still qualify if you have lived here for 20 years. Beginning

2023, the age for which you will be eligible to receive OAS will be increased from 65 to 67. This will affect all eligible Canadians born after March 30, 1958.

The amount of your monthly payments will depend on the following factors:

Number of years you lived in Canada. To qualify for the full monthly payment of $596.67 per month (for the first quarter of 2018), you have to have lived in Canada for 40 years (after turning 18). You can receive partial OAS payments if you have lived in Canada for less than 40 years.

Income threshold. OAS is subject to an income test. If your annual taxable income exceeds the threshold ($75,910 for 2018), then your benefits will start to be clawed back. For every dollar in excess of the threshold, your old age security will be clawed back by 15% and will be totally eliminated once your income exceeds $123,302.

Deferring benefits. You don't have to receive your OAS benefits once you turn 65. You can defer these benefits for 60 months (i.e. until you turn 70). As an incentive to defer collecting OAS, the benefits increase by 0.6% for every month you defer. For example, if you are entitled to receive the maximum amount of $596.67 per month at 65, and you decide to defer the benefits for another 60 months, your monthly entitlement increases to $811.47($596.67 + ($596.67 x 0.6% x 60)). You may consider this option if you have income (i.e. RRSP withdrawals) that would result in your OAS being clawed back. The additional 60 months will give you more time to withdraw from your RRSP while your OAS benefits are preserved.

DID YOU KNOW?
The first form of an old age public pension was introduced in 1927. $20 per month was paid out if you had little to no income and were over the age of 70. According to StatsCanada, the life expectancy at the time was about 60.

Canada Pension Plan (CPP) benefits
If you have been making CPP contributions during your working years, you will be entitled to receive CPP benefits when you retire. The amount that you receive will depend on your contributions up to retirement. The maximum CPP benefit is $1,134 per month (for 2018).

Normally, CPP benefit payments begin when you turn 65 years old. You can opt to take the benefits as soon as you turn 60 or to defer them until as late as 70. Much like the OAS benefits, when you decide to receive the benefits will impact the amount that you are entitled to. The benefits will be reduced by 0.6% for every month that you take out CPP early and increase by 0.7% for every month that you delay.

TEST YOUR KNOWLEDGE: You have lived in Canada all your life. At 65 you will receive the maximum OAS of $600 per month your expected CPP benefits will be $900 per month. You plan to defer both until 70. What are your expected monthly payments as a result of the deferral?

A) $816.00 for OAS and $1,278.00 for CPP
B) $600.00 for OAS and $900 for CPP
C) $759.50 for OAS and $1,213.20 for CPP

Answer: A) You would be deferring OAS and CPP for 5 years . The increased OAS monthly benefit would be $816 (600 + $600 x 0.6% x 60). The increased CPP monthly benefit would be $1,278 (900 + $900 x 0.7% x 60).

Registered Retirement Savings Plan (RRSP) & Registered Retirement Income Fund (RRIF)

If you have been taking advantage of RRSPs throughout your career now is the time to plan for your withdrawal strategy. RRSP withdrawals are taxable since you received a tax deduction when you contributed. A $1 million RRSP may actually only be worth $500,000 to you once the taxes are paid. The other portion belongs to the government. Let's look at some RRSP withdrawal strategies:

Withdraw early and often

If you are under 65 years of age and don't want any of your government benefits clawed back, you can maximize your withdrawal before you become eligible for any government benefits. Once you start receiving OAS benefits, you run the risk of losing the payments once you exceed the income thresholds. This works best if you are an early retiree with little to no income and have accumulated a large amount of RRSPs. You may even benefit if you start withdrawing as early as your fifties.

Defer to the very end

If you don't need your RRSP, your income is still high and you want to avoid taxes for as long as possible, you can defer withdrawal from an RRSP until age 71. Once you turn 71, your RRSP is converted into a Registered Retirement Income Fund (RRIF). A RRIF is similar to an RRSP in that all investment income is tax sheltered and you are only taxed on withdrawal. The main difference is that you must withdraw a minimum amount of income from your RRIF each year. This will be dependent on the value of your RRIF, your age and life expectancy. You can always withdraw more than the minimum amount.

If you have a younger spouse, you can use their age instead of your own to reduce the amount of minimum withdrawals. In other words, the minimum withdrawal will be based on the life expectancy of a younger person. This strategy is not for everyone, and can be quite costly if you have a large amount of RRSPs. Imagine trying to withdraw $1.5 million dollars between age 71 and 90. Without factoring in annual investment returns, the minimum annual withdrawal would be close to $80,000. With CPP and other investment income, you will likely never see any OAS payments and you will be paying taxes at rates similar or higher than when you were working.

Match your RRSP withdrawals with your expenses

Few retirees spend exactly the same amount each year. Expenses fluctuate every year even during retirement. You may decide to travel one year, buy a car or choose to spend very little. Barring illness, many retirees spend proportionately more in the first few years of retirement than the latter half. Taking out sufficient RRSPs to fund these expenses will be a more effective way of using your RRSPs than waiting until mandatory withdrawal from a RRIF at 71. You may pay more taxes by fluctuating your withdrawals year-to-year but at least the money will be used when you need it the most.

Smooth your withdrawals

If you like consistency then having the same amount withdrawn year-to-year may serve you best. Upon retirement, you will need to estimate your life expectancy and then divide your total RRSP value by the number of years you expect to live. This number will become the amount you withdraw each year. In theory, consistent withdrawals should produce the lowest overall taxes. However, if your annual withdrawals are fairly large, you may end up forfeiting some government benefits such as OAS.

RRSP ALTERNATIVES: INCOME ON PERSONAL INVESTMENTS

Personal investments generally consist of investments held outside a RRSP. They can include real estate, TFSA, investments in shares/bonds and insurance policies. The tax treatment will vary depending on the type of investment.

TFSA
As the name implies, the benefit of TFSA are that any gains and withdrawals are tax-free. Another benefit is that TFSAs do not affect your government benefits such as OAS.

Real Estate
If you held onto the dental building or have other real-estate investments, you will have to report the annual rental income. The actual sale of the property may trigger a large capital gain, so you should plan well in advance of the sale. Timing the sale will be particularly important.

CASE STUDY

Dr. Eva Saks is 64 years old and owns a dental building that she's looking to sell. The gain on the building will be approximately $150,000. Her only income for the year is her annual withdrawal from her RRSP of about $70,000. She has the choice of having a closing date in December or January of next year.

By selling her building in December, Eva will have to pay taxes on $145,000 of income (70,000 RRSP withdrawal + 75,000 capital gain). As she is 64, she will still be eligible to receive her full OAS benefits when she turns 65 as her next year's income is only expected to be $70,000. If Eva defers the sale until January of the following year, she can defer her RRSP withdrawal and pay taxes on $75,000 of income. She would use the money from the sale of the building to fund her personal spending instead of withdrawing from her RRSPs. Some of her OAS benefits will be clawed back when she turns 65; however, the tax savings of deferring the sale of her building to the next year will more than compensate her. Eva could also delay OAS benefits for 1 year until she turns 66. There would be no claw back when she turns 65 and her OAS benefits would grow.

Non-registered investments
While you don't receive a deduction for investments outside an RRSP, there are advantages to having non-registered investments. Your principal investment is not taxed on withdrawal for personal use, which makes them more flexible in retirement. In addition, unlike a RRSP, you still receive preferential tax treatment for dividend income and capital gains. Withdrawals from an RRSP are 100% taxable even if the income is a capital gain. Speak to your financial advisor about the appropriate mix of growth oriented investments and fixed income investments held inside your registered (RRSP) and non-registered investments accounts.

Insurance
If you are concerned with unexpected illness or death, you may want to consider the insurance products available. In general, there are two types: term and permanent.

Term insurance covers you for the period of the policy. At the end of the term, if you are still alive, no payments will be made to your beneficiaries. The premiums for term insurance are usually lower than permanent insurance.

Permanent insurance policies usually have two components: the insurance portion and a savings/investment portion. The savings/investment component is the part of the premium that is invested by the insurance company and earns income. As the savings/investment component grows, this becomes the cash value of your policy. The insurance component is the portion of premiums used to pay out the face value of your policy if you were to pass away.

The primary feature of a permanent insurance policy is that you can borrow against the cash value of the policy. You will have to pay non-deductible interest on the loan, but you can access the cash inside the policy without death. The other benefit is that upon death, the insurance payout would be used to repay the loan.

Even in retirement, you will still have various forms of income to report and taxes to pay. Taxes come in many forms, having government benefits reduced or clawed back is a form of tax often overlooked. Let's look at some other retirement strategies available to dentists.

RETIREMENT PLANS FOR INCORPORATED DENTISTS

Many dentists who have been in the top 1% of income earners for decades need a super-sized retirement plan. RRSPs and TFSAs are great tools for Canadians but they have a severe limitation for dentists — low annual contribution room. There are several retirement plans available for incorporated dentists as alternatives or supplements to RRSP and TFSAs. Note that these plans need to be setup well in advance of retirement.

Income splitting through a holding/management company
Income splitting doesn't have to end now that you are retired. Consider the use of a holding corporation to hold significant assets such as real estate or investments to pay out dividends to family members that are shareholders, and split the investment income and the taxes. Restrictions on income splitting may apply so care must be taken.

Individual Pension Plan (IPP)
An IPP allows your PC to make tax deductible contributions directly into your retirement. Periodically your PC will be required to make contributions to this plan based on factors such as your salary and years of service. These contributions grow tax-free inside the plan and are then paid out to you during retirement. Since an IPP is a defined pension plan (payout is based on the growth of your investments), if your investments do poorly, your PC can "top-up" by making additional tax-deductible contributions to rebuild the assets so that the expected pay out during retirement remains the same. The downside is an IPP has associated costs. An actuary will need to determine the required contribution and perform a valuation every three years. There are also upfront fees and annual maintenance fees.

Personal Pension Plan (PPP)
This plan is similar to an IPP but has some administrative differences and provides more flexibility. A PPP allows you to switch between defined benefit and defined contribution (guaranteed payout based on a formula) plans.

Retirement Compensation Arrangement (RCA)
This is an arrangement where the PC, as the employer, makes contributions to a third party (the custodian). The custodian would hold the funds in trust to be paid to you on retirement as a form of retirement compensation. Similar to IPP and PPP contributions, the PC can deduct these contributions in the year that they were made and you would not be taxed on these amounts until withdrawal. The difference between a pension plan and an RCA is in the way it is administered. While 100% of the contributions toward an IPP or PPP go directly to the plan, RCA contributions are split with 50% going to the custodian and 50% to the CRA as refundable tax to be held in a non-interest bearing account. The refundable tax is paid out to you when the benefits are paid out. In general, RCA's are suitable for you if you plan to retire in a foreign country that has a tax treaty with Canada. The amount withdrawn maybe taxed more favourably where you live in retirement.

Depending on your age and your retirement plans, one of these may be more suitable for you than the other. All of these plans are essentially super-sized retirement plans, but they are complex and heavily regulated. Additionally, these plans are subject to possibly high set up costs and annual administration fees. You should consult with your professional advisors to determine the right plan for you and the associated costs and benefits to implement these plans.

TAX BREAKS FOR THE RETIRED DENTIST

Saving taxes is not just for those still working. Even in retirement there are tax breaks available.

Age amount
You are entitled to a Federal tax credit of $7,333 (for 2018) if you are 65 or older. This credit is reduced if your taxable income is above $36,976 and completely eliminated if your taxable income is above $85,863 . There is a corresponding Ontario credit of up to $5,055 for if your taxable income is below $71,335.

Pension income splitting
You can split up to 50% of certain pension income with your spouse for purposes of computing your personal taxes. This is an income splitting tool that is especially beneficial if your spouse has much lower retirement income. Eligible pension incomes that are eligible for the split include payments from a RRIF, and annuity payments from an RRSP or pension plan. OAS and CPP benefits and discretionary RRSP withdrawals are not eligible.

Pension income amount
You are entitled to a Federal pension credit of up to $2,000 and Ontario pension credit of up to $1,432 if you receive qualified pension income. This credit is also available to your spouse regardless of his or her age providing if he/she receives qualified pension income as a result of pension income splitting.

TEST YOUR KNOWLEDGE: You and your spouse are currently at the same tax bracket. You have RRIF income that you can split with your spouse, but since you both have the same level of income, there is no benefit to do the pension split.
A) True
B) False

Answer: B) Even if you are in the same tax bracket, pension income splitting could further reduce taxes as it allows your spouse to claim a pension credit that he or she may not otherwise be entitled.

KEY CONSIDERATIONS

- Life expectancy, your retirement assets and spending habits play a huge role in determining if you are ready to retire. Consult a financial planner or investment advisor to determine when you can retire.
- Even in retirement, there will be income to report and taxes to pay.
- Be prepared to share a portion of your RRSPs with the government. Having an RRSP withdrawal strategy will help you keep most of it with you.
- RRSPs are not the only tax-deductible investment vehicle. There are other much larger vehicles, but they do come with a cost.
- Tax breaks are available even when you are retired.

PARTING THOUGHTS

Success is never guaranteed. There are still days when I come back from fishing empty handed. Regardless of the outcome, taking the steps to plan and prepare has always puts me in a position to succeed.

Regardless of where you are in your career, you may still cringe at the thought of taxes, finances and legal issues. Most dentists just want to practice dentistry. You don't have to be an expert on these issues but taking the time to understand them will go a long way. This book is a start.

APPENDICES

APPENDIX A: IMPORTANT DATES

DATE	TAX FILING/DEADLINE
Personal	
February 28/29 (2 months after December 31)	T4, T4A, and T5 filing due date
February 29/March 1 (60 days after December 31)	RRSP contribution deadline (for previous year)
March 15	First personal tax instalment due date
	Employer Health Annual Tax filing and payment due date (except those subject to monthly remittance)
April 30	T1 personal tax return filing (except for self-employed) and payment (including self-employed) due date
June 15	T1 personal tax return filing (for self-employed and spouse) due date
	Second personal tax instalment due date
September 15	Third personal tax instalment due date
December 15	Fourth personal tax instalment due date
December 31	Year-end for most self-employed taxpayers
	RESP contribution deadline
Trust (other than testamentary)	
March 30/31 (90 days after December 31)	T3 trust tax return filing and payment due date
Corporate	
Two or three months after year-end	Tax payment due date
Six months after year-end	T2 corporate tax return filing due date
February 28/29 (2 months after December 31)	T4, T4A, and T5 filing due date

APPENDIX B: WHAT WILL MY 2018 TAX BILL LOOK LIKE?

PERSONAL TAX TABLE			
Self-Employed Taxable Income (excluding CPP)	**Estimated Taxes (Including Ontario Health Premium but excluding CPP)**	**Average Tax Rate**	**Marginal Tax Rate**
$50,000	$7,512	15.02%	29.65%
$75,000	$15,031	20.04%	31.48%
$100,000	$23,657	23.66%	43.41%
$125,000	$34,510	27.61%	43.41%
$150,000	$45,449	30.30%	47.97%
$175,000	$57,401	32.80%	47.97%
$200,000	$69,394	34.70%	47.97%
$250,000	$95,619	38.25%	53.53%
$300,000	$122,384	40.79%	53.53%
$350,000	$149,149	42.61%	53.53%
$400,000	$175,914	43.98%	53.53%
$450,000	$202,678	45.04%	53.53%
$500,000	$229,443	45.89%	53.53%