just for dentists

December 2001

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Wealth prescription for 2002

Here are some tips for your upcoming New Year's resolution to help you become serious about saving in order to preserve your precious cash flow.

1. Focus on debt

Muster all of your available cash to pay off your debts. Resist easy credit and the low interest loans that the banks are offering you — their preferred customer. How you manage your debts may determine whether you are going to be rich or simply middle class. If you are still struggling with debt repayment prior to your retirement, you will likely end up with little more than an RRSP and your home. Especially for late career dentists, debts carry with them a tremendous opportunity cost, since they are using practice dollars to repay debt instead of putting them in a savings plan.

2. Pay yourself 10% of your production

The wisdom of paying yourself first is as old as the hills, but very few are paying attention. If you are still working at the peak of your career, write yourself a cheque equal to 10% of your monthly production and put it into an investment portfolio. If you happen to be short one month, don't skip the payment. Instead, take it out of your line of credit. Never dip into your savings to pay personal bills.

3. Stick to fixed monthly cash draws

Prepare a 2002 forecast of your monthly expenditures for personal and living expenses. Like any employee on a fixed income, you will take no more from the practice than the budgeted amount. Too many people have a bad habit of

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Court makes mortgage tax deductible

Writing off your mortgage interest has become even easier with a recent Supreme Court of Canada ruling, thanks to Mr. Singleton, a Vancouver lawyer who tenaciously fought the tax department until the highest court in the land finally sanctioned his interest-deduction strategy.

His personal victory opens the door for the rest of us to implement a similar strategy of moving funds in a circle to convert a personal loan to a tax-deductible loan, so that we can write off our mortgage interest.

Here are three scenarios that illustrate how the interest-deduction strategy works.

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What we do best

- Help you plan and successfully execute your practice transition.
- Structure associateships and practice purchases.
- Prepare practice valuations and marketing prospectuses.
- Organize successful group practice arrangements.
- Provide you with leading-edge tax, financial and estate planning advice.

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writing cheques if there is cash in the practice bank account, or room in the line of credit. The habit of uncontrolled spending is a recipe for poverty.

4. Make big cuts in your tax bill

Dentists in other provinces would crawl over broken glass to get the tax breaks that dentists enjoy in BC. Are you taking full advantage of the tax savings and income-splitting benefits that a dental corporation provides? In 2002, make your tax planning a top priority. Often, the tax savings alone are sufficient to create a sizable retirement nest egg.

5. Embark on serious financial planning

Have you ever wondered why colleagues with a similar income are financially better off than you? The difference is financial planning, in particular, being pro-active in implementing a financial plan. Procrastination, a curse that afflicts many, keeps the best financial plans on the shelf collecting dust. Make 2002 your implementation year!

Federal Budget Day

10 December 2001

For information on the budget and how it will affect you, check out our website at

www.pct.ca

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▪ The "equity-strip" strategy

Suppose you have $200,000 invested in your dental corporation ("*Dentalco*"), either as shares or a shareholder's loan, and you also have a $200,000 house mortgage. *Dentalco* can borrow $200,000 to repay your equity. You can use the proceeds to pay off your mortgage. You take out a new mortgage for $200,000 and inject the money back into *Dentalco*. The interest on your mortgage is now tax deductible.

▪ The "share-sale" strategy

In this scenario you sell the shares of your company to family members for $200,000, but only if the gain on the sale of the shares is protected by the capital gains exemption. Your family members borrow $200,000 from the bank to pay for the shares. You use the sale proceeds to pay off your mortgage. The interest on the share purchase loan is tax deductible.

▪ The "sale-and-buy-back" strategy

This strategy is very easy to implement. You own investments worth $200,000, and you have a $200,000 mortgage. You sell the investments and use the funds to retire the mortgage. Next you take out a $200,000 bank loan to buy back the investments.

The key to making these tax deduction strategies work for you is to establish a crystal-clear trail between the borrowed funds and the use of the funds, so that you avoid future problems with the tax department. For instance, the proceeds from the sale of the investments must be used to discharge the old mortgage. You can then take out a new mortgage to buy back the investments. There are no shortcuts! Don't be tempted to allow the bank to simply change the loan records without actually establishing a new loan.

A non-tax-deductible debt costs you many thousands of dollars that could be better used in your practice or saved for your retirement. Instead of wasting your precious financial resources, convert them to fully deductible business or investment loans. With the Supreme Court deciding in favor of the taxpayer, it has never been easier to find a mortgage deduction strategy that is right for you.

Give us a call to find out what interest deduction strategy will best suit your circumstances.

Planning a Transition: how to get off to the right start

Transition planning is not just for those 60-year old dentists looking to sell their practices and retire to the golf course. Transitions can occur at all stages in a dental career: as a dental graduate searching for the right associate position with ownership potential; as a mid-career dentist looking to merge practices with a compatible colleague to reduce clinic overhead; as a dentist who wishes to pursue a specialty in his practice and who is looking for a young dentist to provide general dentistry to his patients; as a dentist in search of better education for his children and who is planning to move his family to a new community.

No matter what practice transition you are contemplating, your transition has to be well planned in order to ensure its successful outcome.

Before you embark seriously on any transition, you have to analyze three important factors: yourself, your family, and your practice.

▪ Analyze Yourself

Spend time to determine what you really want out of life, and how a practice transition can help you achieve it. A practice transition is usually designed to reach your long-term objectives. A transition has a huge impact on your life and daily routines, so be specific about the goals of a contemplated transition, i.e., retirement in five years. When you plan the transition, consider the financial implications and prepare financial forecasts.

▪ Analyze your Family

Determine the effect the proposed transition will have on your family. Maybe your spouse does not share your dream of retirement in five years. On the other hand, if the purchase of a new practice places heavy demands on your time and energy, how will these demands affect the free time available for your spouse and children?

▪ Analyze your Practice

Do you need to make changes to your practice in light of your contemplated transition?

Is there sufficient space to accommodate your goal of bringing a new dentist into your practice? Are you able to increase your production and fine-tune your operation so as to increase practice value and make the practice more appealing to prospective purchasers?

Preparing yourself, your family, and your practice for a transition is a challenging task because you need to make sure that you get it right the first time. Consider putting an experienced coach on your team of advisors to assist you in the transition planning process.

At Purtzki Carle-Thiesson we have the experience, reputation and integrity to be your coach and to make sure that your transition is successfully implemented. We're here if you want to give us a call to find out how we can help you realize your dreams.

Q&A Ask the Experts

Q: *Why should I keep putting money into my holding company, when it costs more in income taxes and attracts extra accounting and legal fees?*

A: You are correct: the corporate tax on investment income is higher than the personal tax rate. While personal tax rates are down to 45.7% after the July 30, 2001 BC mini-budget, the investment income in your holding company ("*Holdco*") is still taxed at 52%. On $10,000 of interest income, *Holdco* pays tax of $5,200 – that is $630 more than you would pay on personal investment income.

It does not make sense to transfer your personal investments into a corporation to shelter taxes; however, most holding companies used by dentists are funded by the cash flow generated by their practices because, as you are already aware, it is important to ensure that *Dentalco* does not accumulate significant investment assets. This strategy will ensure that a subsequent sale of the *Dentalco* shares can occur tax-free. *Holdco* will invest capital, which has been taxed at only 18% in the dental corporation. For every $100 of practice income, you have $82 left to invest, compared to $55 if you were to invest the funds personally. The bottom line is that the dental/holding company combination gives you an awesome ability to accumulate capital. The additional tax on the investment income is a small price to pay for this strategy.

Here is a great strategy to reduce the corporate tax on your invest-

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Don't miss the deadline for tax-loss selling

Before the year-end deadline, consider taking the trash out of your investment portfolio and turning those unrealized losses into sizable tax refunds. What's the point of hanging on to the dogs indefinitely, unless you see some real long-term potential. If the stock you bought for $100 hits a low of $20, that's a drop of 80%. For the stock to recover fully, it has to increase by 500%!

There has never been a better time for tax-loss selling, especially when you can carry this year's loss back to any of the three preceding years. A capital loss of $ 1,000 triggered in 2001 converts into a tax deduction of $500. If you don't have any capital gains to apply the loss against this year, the loss can be carried forward indefinitely and utilized at any time in the future. If you had a capital gain in 1999 when the inclusion rate was 75%, you could have carried back $750 (which is 3/4 of $1,000), thereby generating a $250 greater deduction than if you carried the loss forward.

Remember, the deadline for realizing stock losses is December 21, 2001

If you wish to trigger the tax loss by selling the stock and then buying it back, you have to wait at least 30 days to repurchase the stock, or the loss will be considered a non-deductible "superficial" loss.

If you wish to transfer a capital loss to your spouse, you must sell the investment to your spouse and elect to have the sale occur at fair market value. Provided the stock is not sold for 30 days, the capital loss belongs to your spouse.

Remember, the deadline for realizing stock losses is December 21, 2001.

Q & A

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ment income. Consider taking a salary/bonus from your holding company instead of from your dental corporation. A $10,000 salary from your dental corporation results in a tax saving of $1,760. The same $10,000 salary from your holding company increases this saving to $5,210. You have almost doubled the benefit to $3,450!

Does the tax department allow the holding company to pay you a salary or bonus, since you are actually employed by the dental corporation? CCRA has stated that where there is a holding company between you and your dental corporation in which you are an employee, the bonus payment made by the holding company to the dentist is deductible against investment income.

Ask the Experts will be a regular feature in *Just for Dentists*. E-mail your questions to: QandA@pct.ca.

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