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## How to pay tax on only ONE-HALF of your practice income

Dr. Bob receives an annual base salary of \$60,000 from *Profco*, his professional corporation. He also needs another \$100,000 to pay for income taxes, RRSPs and living expenses.

He doesn't care whether the additional funds are paid in the form of salary or dividend. So the decision is left to Dr. Bob's accountant.

Dr. Bob knows that a \$100,000 salary would leave him with \$56,000 of after-tax income, while the equivalent dividend amount would generate \$57,000.

Unknown to him, a third option exists to take money out of his corporation—the capital gains strategy.

Reporting cash draws as capital gains means that Dr. Bob would only have to pay tax on one-half of the income, which will boost his after-tax income to \$65,000—\$8,000 more than the dividend option.

Choosing whether to receive salary, dividend, or capital gains income depends upon the amounts withdrawn from the company. The following table illustrates after-tax income at different levels of cash distribution. You can see that the capital gains option works best for annual cash draws over \$80,000.

Cash Distribution	After-Tax Income of:		
	Salary	Dividends	Capital Gains
\$ 20,000	\$ 17,100	\$ 16,400	\$ 16,300
40,000	31,600	32,200	30,800
60,000	45,000	46,000	45,200
80,000	57,000	58,200	59,500
100,000	68,600	69,800	73,300
120,000	79,400	81,000	87,000
140,000	90,300	92,100	100,700

*Assumptions: 1) 18% corporate tax rate; 2) recipient has no other personal income.*

How can you convert your practice income into capital gains? To implement this strategy, you require two main ingredients:

- ◆ A separate holding company (call it *Holdco*).
- ◆ The ability of your existing corporation to pay stock dividends. This simply means that the dividend is paid in the form of shares that are redeemable, rather than as cash.

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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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## Six Easy Steps to Reduce Tax

1. *Profco* issues 1,000 stock dividend shares to Dr. Bob. These shares will have a redemption value of \$100 per share, for a total redemption value of \$100,000.
2. Dr. Bob sells his stock dividend shares to a family member for \$100,000, in exchange for a promissory note. The sale triggers a capital gain, one-half of which must be reported by Dr. Bob on his personal income tax return.
3. The family member sells the stock dividend shares to *Holdco* for \$100,000. In exchange, *Holdco* will issue a promissory note payable to the family member.
4. *Profco* redeems the 1,000 shares held by *Holdco* for \$100,000. The redemption is tax-free.
5. *Holdco* uses the proceeds to pay off the promissory note owed to the family member.
6. The family member pays off the promissory note owed to Dr. Bob.

The result of this transaction? Dr. Bob now has \$100,000—only half of this is subject to income tax!

The capital gains strategy also allows you to split income with minor children, since capital gains—unlike dividends—are not subject to the income-splitting tax.

When the government dropped the capital gains inclusion rate from two-thirds to one-half last fall, it unwittingly gave dentists an opportunity to convert practice income into more favorably taxed capital gains. □

*Doing math saves money* \_\_\_\_\_

## Do your math before cutting hours

Thinking about cutting back your practice from four to three days a week?

Here's a valuable piece of advice—do your math before you hire a locum/associate for that extra day.

The one-day-a-week associate may seem like the perfect solution: your practice stays open for patients, plus the income generated by the locum looks after overhead costs. However, many dentists who cut back their practice hours were surprised to discover a huge drop in their net incomes.

Consider the following scenario:

	Practice Days	
	4 days	3 days (with locum/associate)
<b>Gross revenue</b>		
Owner	(1) \$500,000	(2) \$375,000
Associate	nil	(3) 63,000
<b>Total revenue</b>	\$500,000	\$438,000
Operating expenses	(300,000)	(300,000)
Associate fees at 35%	nil	(22,000)
<b>Cash flow before tax</b>	\$200,000	\$116,000
(1) 180 days		
(2) 135 days		
(3) 45 days @ \$1,400/day		

Reduce your working hours by 25 percent, and your net cash flow can drop almost in half! Most dentists can't afford to take a pay cut of \$7,000 per month, as shown in the chart, unless they have enough cash stashed away to meet their cash flow needs.

**Reduce your working hours by  
25% and your net cash flow can  
drop almost in half!**

So how do you minimize the financial fall-out if you want to cut your practice from four days a week to three?

- Shift low profit work to your associate. This allows you to earn almost as much in three days as you earned in four.
- Hire an associate with similar productivity as you.

Remember: before cutting your practice hours back, calculate the financial impact. Otherwise, you may be destined to learn some cruel lessons in cost accounting. □

# A prescription for the retirement blues

Just like Buckley's "It tastes awful, but it works" cough syrup, you need a prescription to counteract financial anxiety caused by a lack of retirement savings.

This financial anxiety mainly afflicts dentists who turn 50 and fear that, as retirees, they won't have the funds to continue the lifestyle to which they have become accustomed.

The fear of ending up in the poorhouse has been fueled by the drastic decline in most stock portfolios over the last year.

Before you send your family members out to find part-time jobs, consider the simple solution of working an extra day.

Call it your "saving for retirement" day.

You can save a whopping \$700,000 in 10 years just by working another 40 days a year! Here's how:

<b>Revenue:</b>	
40 days @ \$2,500/day	\$ 100,000
<b>Additional expenses:</b>	
Salaries (25%)	\$ 25,000
Supplies (8%)	8,000
Total expenses:	\$ 33,000
Income before tax	67,000
Corporate income tax	(12,000)
<b>Annual savings</b>	<b>\$ 55,000</b>
<b>Invested @ 5% after-tax for 10 years</b>	<b>\$ 700,000</b>

It's critical that the extra income generated each month is put into an investment portfolio, preferably by automatic transfers. This way, your extra cash won't get "absorbed without a trace" into your household budget.

The prospect of working even more may not be palatable for those dentists who want to reduce their practice hours, but where else can you accumulate such savings? When you can use the low corporate tax rate, the opportunity to build a nest egg is awesome.

So, the prescription to work harder is a lot like Buckley's cough syrup; however, you won't likely find a better cure for the retirement blues. □

## Thinking About Practice Transition?

When you start thinking about bringing another dentist into your practice, it is important to have a solid transition plan in place. The transition plan not only helps you to spell out your financial and retirement goals, but also provides you with a road map for the new dentist joining your practice. When contemplating your transition, which of the following issues are important to you?

- |  | YES                      | NO                       |
|--|--------------------------|--------------------------|
| • Determine the value of my practice.  | <input type="checkbox"/> | <input type="checkbox"/> |
| • Obtain a professional diagnosis of my situation to create a solid transition plan. | <input type="checkbox"/> | <input type="checkbox"/> |
| • Sell my practice and retire.   | <input type="checkbox"/> | <input type="checkbox"/> |
| • Sell my practice and remain as an associate.                                       | <input type="checkbox"/> | <input type="checkbox"/> |
| • Sell a practice interest to an established dentist.                                | <input type="checkbox"/> | <input type="checkbox"/> |
| • Bring in an associate in preparation for retirement.                               | <input type="checkbox"/> | <input type="checkbox"/> |
| • Bring in an associate to cost-share.   | <input type="checkbox"/> | <input type="checkbox"/> |
| • Retain an associate without equity participation.                                  | <input type="checkbox"/> | <input type="checkbox"/> |
| • Start my own practice.   | <input type="checkbox"/> | <input type="checkbox"/> |
| • Buy out my cost-sharing partner.   | <input type="checkbox"/> | <input type="checkbox"/> |
| • Review and/or restructure my present cost-sharing arrangement.                     | <input type="checkbox"/> | <input type="checkbox"/> |
| • Dissolve my cost-sharing arrangement.  | <input type="checkbox"/> | <input type="checkbox"/> |
| • Start, sell or close a satellite office.   | <input type="checkbox"/> | <input type="checkbox"/> |
| • Find a qualified advisor to discuss my needs.                                      | <input type="checkbox"/> | <input type="checkbox"/> |

For over 20 years we have helped dentists make the most of their practice transitions. Whether you are planning to start a practice or contemplating retirement, we can help in your strategic planning to ensure your long-term success.

## Practice Opportunity

### Tsawwassen, B.C.

Experienced associate with the opportunity to purchase a well-established holistic oriented family practice of 30 years, located in sunny Tsawwassen, B.C.

Our spacious facility with eight operatories and an active patient base of 3,200 has great growth potential and a wonderful staff.

Interested?

Phone 604 943-2291 or fax your resume to 604 943-0716.

# The allure of a rural practice

Can't function without your morning latte from Starbucks? If the answer is "no" then you're not a likely candidate to set up a professional dental career in rural B.C.

Too bad, because there are plenty of great benefits to working and living in a small community, such as:

✓ A busy practice—no need to worry about holes in your appointment calendar, as rural practices are usually busier than city practices.

✓ Lower practice overhead—rental costs are cheaper in smaller communities and, usually, you can afford to own the practice real estate.

✓ Less stress in your life—no lengthy commutes in bumper-to-bumper traffic. You can work in a relaxed atmosphere. Where else can you barter the cost of a dental visit with a live catch of dugeness crabs?

✓ Housing and living costs are a fraction of what it costs to live in the big city.

✓ Recreation is at your doorstep, and it's usually more affordable.

With many rural dentists crying for successors, you can own your own practice and pay a little more than half of what you might pay for a practice in Vancouver. What a great opportunity for a young dentist who is ready to settle down and start a family! □

# There's more to retirement than money

How much money do you need for retirement? How can you squirrel away more money into your retirement plan? How can you maximize the proceeds from the sale of your practice? Are you getting the best returns on your investments?

If you're asking yourself these questions, you're not alone. According to the American Association of Retired Persons, the biggest concern people have before retirement is whether or not they will have enough money to live a good life after retirement.

One Internet guru, who goes under the name of 'Rogue Man' noted that: "Once retired, most people found money wasn't as important as life's existential questions,

such as living a meaningful life without a job, relationships, sense of purpose, fear of death and what might lie beyond death's door. As much as most Canadians fantasize about living a life of leisure, most are singularly ill equipped to do so. They have lived lives driven by work and family demands. They have no leisure skills. Retirement—a life of leisure—is utterly alien to their sense of self."

The moral of the story? Stop spending so much time worrying about money you may, or may not, need in your retirement years. Instead, exert your energy looking for ways to enhance your quality of life. □

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