just for dentists

November 2002

Purtzki & Associates

CHARTERED ACCOUNTANTS

Manfred Purtzki, CA

You will notice the change in format of our newsletter and, as Barb Carle-Thiesson and I are no longer practicing together, I have started a new firm—Manfred Purtzki & Associates Ltd. What hasn't changed is our strong belief that we must earn the right to be your respected financial advisor; our commitment to give prompt, personal service you have come to expect; and our passion to provide creative, practical solutions to the many challenges you face in building wealth and managing your practice profitability.

Just over 15 years ago I mailed the first "Just for Dentists" newsletter to dentists practicing on Vancouver Island. Thanks to your encouragement and the strong commitment from our staff, our newsletter circulation now covers all of British Columbia.

Keep your e-mails coming—I look forward to your comments and feedback.

Regards,

Manfred Purtzki

"Purification" critical in a practice sale

Purification is a process to transfer non-dental assets from the dental corporation ("*Dentalco*") to a related company ("*Holdco*), on a tax-free basis. This process is necessary for two reasons: firstly, the purchaser only wishes to acquire the dental assets of the corporation; and, secondly, the shares will not qualify for the $500,000 capital gains exemption if more than 10% of the fair market value of assets in *Dentalco* are not related to dentistry.

In order to keep *Dentalco* a "pure" dental corporation, any practice surplus must be distributed to *Holdco* in the form of a tax-free, inter-corporate dividend. Since dividends can only be paid to a shareholder, *Holdco* must then become a shareholder of *Dentalco*. Not putting this proper corporate structure in place to keep *Dentalco* "pure" can cause a lot of grief, as one dentist learned, recently.

With the sale of his dental corporation in the final stages, Dr. Seller found, to his great shock, that his shares in *Dentalco* did not qualify for the coveted tax-free exemption. Dr. Seller thought he had followed his accountant's advice exactly when he incorporated *Holdco*, a few years prior, to transfer cash surplus from his dental corporation. *Holdco*, however, was not made a shareholder in *Dentalco*, so the transfer of funds was accounted for as an inter-company debt rather than an inter-corporate dividend. The difference is that a receivable owing from a holding company is not considered a dental asset, thus making the shares ineligible for the tax-free exemption.

By not paying careful attention to the purification process, Dr. Seller is now between a rock and a hard place; he can conclude the deal and pay tax, or abort the sale. And, in

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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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order to purify the dental corporation properly, he must continue to practice for at least another two years before contemplating another sale. Not very palatable options, are they?

If you decide to sell the shares in your dental corporation today, will they qualify for the tax-exemption? Be prepared—know the answer before inking the deal with the purchaser in the lawyer's office. Give us a call if you need assistance.

Fox or hedgehog: what are you?

Some people are like foxes—curious about many subjects and passionate about learning anything and everything. They see the world from many perspectives. Others are like hedgehogs—they concentrate on a single idea and see the world from just one perspective. Within the context of personal finances, the fox typically lacks a clear direction, always looking around for the deal of a lifetime. As a result, the fox is prone to putting money into investments with unacceptable risks. The fox is on the prospects' list of every tax shelter promoter.

Hedgehogs, on the other hand, work on a 5, 10 or even 25-year plan. Initially, the plan may be to pay off the mortgage. With great persistence, the hedgehog will channel all available funds toward the repayment of the mortgage. The hedgehog is a saver and assured of financial security during retirement. Being a hedgehog may not be sexy, and they may not be great fun to live with, but when it comes to finances it definitely pays to be a hedgehog.

Compensating staff

How you should pay your staff

Here are some thoughts when structuring your staff compensation.

- ✔ Remember, it is only the average employee who is paid the industry average. The most profitable practices generally pay the highest salaries to their employees.
- ✔ Exceptional employees command exceptional salaries. When you are building a team of exceptional people, be prepared to pay above-average compensation. It is not the size of the paycheque, but the contribution the staff makes to the financial success of your practice. Review compensation with each employee, annually, and adjust the pay accordingly. Often your best employees are the ones paid less than what they are worth. Underpaid employees will leave you or will harbour ill feelings, which has such a demoralizing effect on your practice that they give you no choice but to terminate them.
- ✔ The increase in staff wages must come from a corresponding increase in the profitability of your practice; otherwise, you are simply taking money out of your pocket and giving it to your staff. In the absence of productivity increases, it is a zero-sum game with you as the loser. Therefore, the increase in salary must be based on the individual's performance. This requires setting specific performance criterion against which each employee is evaluated. It also means spending time with those employees who receive no, or less than, the expected raise and working with them to improve their performance.

Deducting your mortgage interest

Trust #2 to make your mortgage interest tax deductible

You can deduct your mortgage interest by converting the mortgage into a share purchase loan with a second trust.

Let's assume that, presently, the shares of Dentalco are worth about $300,000 and are held by a family trust ("*Trust #1*"), with your spouse and children as beneficiaries. Next, you need to create an additional trust ("*Trust #2*"), with the same beneficiaries, but with a different settlor. Here is how the transaction works to transfer the mortgage into a share purchase loan:

1. *Trust #1* sells the shares of Dentalco to *Trust #2* for $300,000. There will be no tax on the transfer because the beneficiaries of *Trust #1* will claim the capital gains exemption.
2. *Trust #2* borrows $300,000 from the bank to pay for the shares. Loan payments will be made from the trust, and interest is deducted from trust income.
3. *Trust #1* pays the share proceeds to the parent beneficiaries of the trust, who then pays off the house mortgage.

Using multiple trusts is a great idea, especially when the existing trust is already a shareholder of Dentalco, but you need to arrange a purchase and sale of shares between family members. Give us a call if you need assistance setting up multiple trusts.

Effective tax planning

Income splitting still tax shelter #1

Dentists in B.C. and Nova Scotia are blessed because these are the only provinces where you can use your dental practice to effectively split income with family members. Dentists in Ontario are now allowed to incorporate their practices; however, they must own all the shares, which severely curtails any income splitting efforts. Here is a real life example to illustrate the beauty of income splitting.

To finance the purchase of his home and renovations, Dr. Blessed implemented the strategy to pay $180,000 from the corporation before December 31, 2002, and $180,000 in January 2003. Allocating the income for tax purposes to his three children, the total distribution of $360,000 resulted in personal tax of $30,000—an effective personal tax of only 8.3%. Had he taken the income personally, Dr. Blessed would have had to pay approximately $120,000 in taxes. The result is a whopping $90,000 in tax savings!

The following illustration shows the savings accumulation for three dentists: a proprietor, an incorporated dentist without income splitting, and one incorporated with income splitting.

		Not Incorporated	Incorporated No Splitting	Incorporated Splitting
Practice income		$ 200,000	$ 200,000	$ 200,000
Income tax		(73,000)	(61,000)	(38,000)
Living expenses		(100,000)	(100,000)	(100,000)
Available to invest		$ 27,000	$ 39,000	$ 62,000
Investment:	**20 years**	**$ 725,000**	**$ 840,000**	**$ 1,340,000**
	30 years	**$ 1,280,000**	**$ 1,480,000**	**$ 2,360,000**

Assumptions: Income splitting with 3 dependents; Rate of return: 3% after tax

Income splitting not only helps to finance the family home, but also provides long-term financial security. Income splitting allows you to invest funds that otherwise would have been paid as taxes.

Q&A sk the Experts

***Q:* I understand that recent changes to the Employment Standards Act reduces overtime pay. What are the new rules?**

A: According to the *Employment Standards Act* the standard workday for employees in British Columbia is 8 hours per day, and the standard workweek is 40 hours. When you exceed these standards, overtime is payable. Commencing October 2002, the *Employment Standards Act* allows employers and employees to enter into an agreement that will vary the standards when overtime is payable. Employers and employees can agree to work up to 12 hours in a day, averaging 40 hours in a week, and averaged over 2, 3, or 4 weeks, without overtime. The rules are that the agreement must be in writing, it must specify over how many weeks the work hours are averaged, and it must also specify the start and expiry dates. Dentists who require their staff to work more than 8 hours on certain days welcome this change to British Columbia's labour laws.

Setting goals

Execution is everything

Execution is the gap between what you want, and what you end up with. In your practice, is implementation your strength? Are the great practice management ideas that you gleaned from your last course collecting dust on your office shelf just because you do not have the time or resources to devote to their realization? The reason many great ideas and strategies never see the light of day is because the dentist has not devoted the time and energy required to build the skill and enthusiasm in the staff that can help implement it. Like a military leader, you can have a great plan, but if you don't have the skilled, well trained and motivated soldiers on the ground, your mission will fail miserably.

Set a goal—for instance, to increase hygiene production from the present 25% to 35% of production for the next year—and put your energy into the execution of the objective. Execution means getting the job done, rather than talking about it.

Just for Dentists Seminars

Attend our seminars on leading-edge accounting, financial and practice management advice for dentists at all stages of their careers. Register before Friday, 8 November 2002, as seating is limited.

Building Wealth

Learn strategic tips to double or triple your net worth in only 10 years. Join the 5% of dentists who can afford to retire with the lifestyle to which they are accustomed. Design your own personal plan to reach financial independence. Learn winning strategies gleaned from our 23 years' experience working with dentists. Topics include:

- Strategies to boost practice profitability.
- Living the deductible life and other tips for big cuts in taxes.
- Winning strategies to guarantee your financial freedom.
- How to reduce financial stress—do you control your finances or do they control you?
- Save thousands of dollars in unnecessary insurance costs.
- Setting up the right retirement plan for you.

Monday, 18 November 2002, 7 pm – 9 pm

The Metropolitan Hotel, Connaught Room
645 Howe Street, Vancouver
$45 per person (incl. coffee, tea and sweets)

Friday, 29 November 2002, 12 noon – 2 pm

Park Place, Boardroom
666 Burrard Street, Vancouver
$45 per person (incl. working lunch)

Successful Practice Transitions

Design your practice transition to meet your own personal needs. Know your options as you prepare to transition your practice. This seminar illustrates the practical steps involved in various successful transition models. Learn to maximize your benefits and minimize your risks. Topics include:

- What is the best transition strategy for you?
- What is your practice really worth?
- Should you hire a broker?
- Identify the right buyer.
- How the right negotiation tactics can save you thousands of dollars.
- How to minimize the "tax bite" for the vendor and maximize tax write offs for the purchaser.
- When should you sell?
- Real estate: selling or leasing?

Friday, 22 November 2002, 12 noon – 2 pm

Park Place, Boardroom
666 Burrard Street, Vancouver
$45 per person (incl. working lunch)

Monday, 25 November 2002, 7 pm – 9 pm

The Metropolitan Hotel, Connaught Room
645 Howe Street, Vancouver
$45 per person (incl. coffee, tea and sweets)

RSVP before Friday, 8 November 2002 to:

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Payment is due upon registration: cash, cheque, Visa and MasterCard accepted.

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