just for dentists™

September 2003

Purtzki & Associates

CHARTERED ACCOUNTANTS

Manfred Purtzki, CA

Do you collect every penny?

The reasons for putting strong financial controls in your billing/collection system are simple enough:

- to ensure that all procedures are billed to the patients and in the correct amounts; and
- to ensure that all billings are collected promptly.

Many dentists do not seem to pay much attention to these internal controls when setting up their front desk systems. A recent practice review showed a glaring absence of effective internal controls in the billings/collection function. In one situation, the front desk person could have easily doubled her salary with a few keystrokes on her computer terminal. There is just too much money flowing through your practice to ignore the internal control system. As you are getting into full swing after the summer holidays, make the review of your accounting system a priority. We can conduct a review of your internal controls that meets your specific needs. We have developed auditing tools tailored to a dental office. Following such a review, we will provide you with recommendations. Let us help you strengthen the financial health of your practice.

Make a 50% return on your money: stash it under a mattress

Your main financial goal is to accumulate money. As a busy dentist with little time or ambition to follow the stock market, you leave the investment decisions to your financial planner. Financial success, in fact the very relationship with your investment counselor, is measured by the returns generated in the market. Many dentists feel that to build a decent retirement nest egg, they need to invest in the volatile stock market, even if the investment risk is outside their comfort zone.

Remember, your retirement income is determined by the amount of savings you put aside from your practice earnings and the income generated from these savings.

Here is a thought. Stop agonizing where to invest your money and start focusing on the capital accumulation side of the retirement equation, instead. Forget about trying to maximize investment returns. As an incorporated dentist with above average income, you can afford to put your savings into such mattress-equivalent vehicles as GICs and Triple A bonds.

Consider the following example. Dr. GIC (incorporated) and Dr. Dow Jones (not incorporated), each earn $170,000 of pre-tax practice income. Annual living expenses are $80,000. Dr. GIC puts his money into ultra-conservative investments at 4%. Dr. Dow Jones invests in a sophisticated portfolio hand-tailored by his investment advisor, promising a long-term return of 8%. After management/broker fees, the net return is 6%. The funds are invested for 20 years and then paid out during retirement over 15 years. What retirement income can they each expect?

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What we do best

- Practice transitions
- Practice valuations
- Practice management advice
- Internal Control Reviews
- Tax minimization
- Personal financial planning
- Estate planning
- Accounting

Do you really need Universal Life?

Is the proliferation of Universal life policies a classic example of a solution searching for a problem?

An increasing number of dentists are being approached by their insurance agents with a proposal to purchase a Universal life contract that promises easy money for their retirement years. The lure of receiving risk-free, tax-free retirement income is hard to resist for even the most conservative investors, and, consequently, they commit themselves to many years of substantial premium payments. The idea behind the tax-free retirement income is that a portion of the premium is invested in a tax-sheltered investment account inside the insurance policy. Rather than withdrawing the policy's cash value, which is subject to tax, the insurance company makes an arrangement where the payments to you are funded from a bank loan, which is secured by the policy. No interest needs to be paid on this loan during your lifetime and, on death, the bank loan plus accumulated interest is paid off from the insurance proceeds.

While the concept is great, the frustration of many policyholders is the slow accumulation of the premium dollars inside the investment account. For many investors the projected cash value of the policy has never materialized. With low investment returns, and the fact that a substantial portion of the premium is used to pay for the death benefit, it is no wonder so many policyholders are looking to get out of the policy. This is easier said than done, considering the stiff surrender charges, usually during the first ten years of the policy.

When you are contemplating a Universal life policy, you have to ask yourself: Do I need (not like to have) permanent life insurance coverage? Like many dentists, you need lots of coverage, but usually not past your dental career. There are a small number of dentists, who do need the long-term coverage, for instance, to pay for capital gains taxes, so that the real estate can be transferred to the children without a fire sale, or to secure long-term funding for a disabled child.

On the other hand, if you have no need for long term insurance, then the Universal life policy as a retirement vehicle is hard to justify.

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Illustration:

	Dr. GIC (incorporated)	Dr. Dow Jones (not incorporated)
Before tax income	$ 170,000	$ 170,000
Living expenses	(80,000)	(80,000)
Personal tax	(15,000)	(60,000)
Corporate tax	(30,000)	–
Available to invest	45,000	30,000
Investments in 20 years	1,200,000	840,000
Annual after-tax income for 15 years	$ 82,000	$ 78,000

Conclusions:

- The tax deferral benefit of using the corporation as a savings vehicle is huge. Like getting a 50% return from CCRA, Dr. GIC can save 50% more, each year, than Dr. Dow Jones.
- With a corporate tax rate of only 18% of the retained practice income, you can basically retire on the accumulated capital. Putting the funds in a GIC type investment is mainly to preserve the capital against inflation.
- Dr. GIC earns more after-tax retirement income than Dr. Dow Jones, even though Dr. GIC pays the additional personal tax when withdrawing the funds from the company.
- No need for you to take investment risks. Only take out corporate funds to pay for living expenses and leave all your cash surplus in the corporation. Contribute to an RRSP on the salary you need to live on. Don't maximize your RRSP contribution if it means drawing a larger salary.

How to make the associate buy-in transition a win-win

The consensus among the top U.S. practice consultants is that 7 out of 8 associate-to-owner transitions fail. From my experience, the same dismal results apply to dental practices in B.C., as well.

How do you create a buy-in transition for your associate that is smooth, fair, and also a win-win for all parties? Being involved in many associate buy-in situations, I have developed the following protocol that could work well in your practice.

1. **Strategy Conference**
   After receiving pertinent information about the practice and the proposed transition, I suggest a strategy conference with both practitioners. The meeting usually covers a two-hour agenda, depending on the complexity of the practice situation. We discuss a step-by-step list of items to consider in structuring the proposed transaction, covering such areas as the purchase of the practice interest, cost-sharing, succession, and other buy/sell arrangements.

2. **Practice Valuation**
   Using the proposed transition as a blueprint, we prepare a practice valuation to determine the purchase price of the practice interest to be acquired by the associate. The valuation is specifically tailored to the situation and reflects the anticipated patient volume for the new owner, as well as the impact of the cost-sharing arrangement on the expected practice earnings of the new dentist. For example, a 50/50 split of hygiene revenues is usually more beneficial to the new dentist than separate hygiene revenues, and this fact should be reflected in the valuation.

3. **Letter of Intent**
   Following the strategy conference, I prepare a letter of intent that sets out the terms of the proposed relationship, including a timeline for the entire transition. It is crucial that the terms of the letter of intent really create a long-term, win-win relationship for both parties.

4. **Follow-Up Meeting**
   Sometimes a follow-up meeting is necessary to resolve outstanding issues. Generally, issues can be resolved through correspondence and/or a telephone conference.

Once the dentists agree to the terms in the letter of intent, the next step is to have legal counsel prepare the pertinent documents.

Financial arrangements

Recognizing that each practice transition is unique, it limits my ability to provide a "one-size-fits-all" blanket fee. I discuss practice transition needs and develop an individual financial arrangement quote. From my experience, once we agree on the scope of the proposed engagement and the estimated hours to complete it, most clients are comfortable with the hourly fee arrangement. Give us a call if you need help.

Should the company own your next car?

Of course you would love to drive a company-owned car. Rather than paying for the car with after-tax dollars personally, it is much cheaper to use corporate dollars instead. The reason why accountants advise their clients to purchase the car in their own name is to avoid the huge personal taxable benefit, or standby charge, that is imposed on a corporate-owned automobile.

This taxable benefit is 24% of the cost of the car, or two thirds of the lease payments. This benefit does not include any payments the company makes for gasoline, repairs and insurance. Before 2003, you could only get a reduction of the standby charge if you used the car 90% or more for practice use—not an easy test to meet in a dental practice, considering the trip between home and the office is deemed personal.

For 2003 the taxable benefit is reduced, if you meet the following two conditions:

- the personal use of the car is less than 1,667 km per month; and
- the automobile is used more than 50% (instead of 90%) for practice purposes.

If you meet these two tests, then the standby charge is reduced. To illustrate, suppose your corporation purchases an automobile for $40,000. The annual standby charge is $9,600, which is 24% of $40,000. During the year you drive 10,000 personal kilometers and 15,000 practice kilometers. The standby charge will only be $3,840, which is 40% of $9,600. As a result of the reduction in the taxable benefit, those of you who use the car more than 50% for practice use should consider having your dental corporation own the automobile. To prove that you are entitled to the reduced taxable benefit, you must keep a complete log of your mileage.

You can't build a strong team without firing somebody

Likely, the most hated job in your practice management life is to fire an employee.

Dentists who procrastinate the termination will end up with deadwood staff, who are a drag on morale and productivity.

If you want to create a championship team, you must adopt a mindset that termination is a positive move for both the practice and the terminated employee. The practice has more room now for a better employee, and the departing employee has the opportunity to be successful somewhere else.

Here are some tips.

- Do not put off the firing of an employee. Be proactive in letting a staff member go. It will quickly restore office morale, boost productivity and, by showing leadership, you'll earn respect from your staff. By shedding poor employees quickly, you broadcast to your staff and to your patients that only topnotch people deserve to have a career with you.
- Terminated employees should leave the premises immediately. Many dentists believe that they are saving the "in lieu of notice" pay by having the dismissed employee continue to work during the notice period. How short sighted! A dismissed employee with nothing to lose is like a loose cannon and can inflict great damage to staff morale and the reputation of the practice.
- Follow the provincial employment standards when paying severance.
- Don't fire an employee for cause, unless the infraction is blatant, i.e., theft. Termination for cause is a two-edged sword. On one hand, you save the severance pay if your case holds up in court. On the other hand, a court-ordered severance obligation may be severe. Laziness or tardiness is not a reason to fire an employee, unless the employee had sufficient warnings.
- Keep the termination to less than three minutes. A termination interview means giving the employee his/her final paycheque, which includes severance and holiday pay, thanking them for their service, and wishing them well for the future — all the while maintaining a friendly composure. Don't get involved in a debate about the reason for dismissal, as you could expose yourself to a wrongful dismissal suit. The courts will increase the award for mental suffering in cases where the employer terminates the employee in an arrogant or insensitive manner.

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