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## Reduce tax on your investments

Accumulating funds for the well-deserved retirement years in this current low-return, high-tax environment is a job for Sisyphus. It seems to be impossible to make much progress, no matter how hard you try. To reduce the tax on your investments, you need to take advantage of Canada's favourite tax shelter: income splitting with children, especially with minors who have no other income.

In order to thwart the efforts of parents wishing to reduce tax by shifting income to their children, CRA enforces income attribution rules where the income earned by minor children is attributed back to the parents for tax purposes, thus mitigating any savings.

Two aspects of these income attribution rules provide enormous tax planning opportunities, however. First, capital gains are excluded from the rules. Second, income is not attributed back if the transferor of the

money reports income on the transferred funds at the CRA-prescribed interest rate. Currently this rate, adjusted quarterly, is at an all time low of 3%. This low rate begs for some serious income splitting with family members. The approximate set-up cost of about \$1,000 is a bargain when you consider the tax benefits.

Here is an example of how income splitting can work.

Dr. Bob sells the family cottage and receives \$600,000 that he plans to invest. He transfers the funds, in two instalments, to a newly created family trust for the benefit of his three children. He invests \$300,000, at zero interest, in equities producing capital gains; and \$300,000 at a 3% interest promissory note to be invested by the trust in fixed income investments. If the equity and fixed income investments earn 10% and 7% respectively, how much does Dr. Bob save from this income splitting manoeuvre?

If Dr. Bob does not take advantage of any income splitting strategies, he would pay a tax of \$15,600 on the gain of \$30,000 and interest income of \$21,000; however, if he utilizes income splitting and the children report the \$30,000 of capital gains and \$21,000 of interest income, Dr. Bob pays tax on the remaining \$9,000 income, resulting in a combined tax payment of only \$4,500. That's a tax saving of \$11,100!

Dr. Bob reduced the tax by a whopping 70% — enough money to pay for a family holiday, or a substantial contribution to an education savings plan for the kids, courtesy of the federal treasury.

Keep the following issues in mind when you set up an income splitting situation with your children.

- Instead of cash, you can transfer your existing portfolio to the trust, although you must report any cap-

See *REDUCE TAX*, page 3

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### What we do best

- |                              |                             |   |
|------------------------------|-----------------------------|---|
| ▶ Practice transitions       | Tax minimization            | ◀ |
| ▶ Practice valuations        | Personal financial planning | ◀ |
| ▶ Practice management advice | Estate planning             | ◀ |
| ▶ Internal control reviews   | Accounting                  | ◀ |

# Share sale vs. asset sale

When a purchaser acquires the shares of your dental corporation, he assumes the assets at the existing book value. He loses the benefit of writing off the assets at the higher current value. To illustrate, if he buys dental equipment with a book value of \$40,000 for the fair market value of \$100,000 in an asset sale, he is able to amortize the \$100,000 at 20% per year. In a share purchase, the purchaser assumes the vendor's tax cost of \$40,000, which means the annual amortization is based on the \$40,000 asset cost, rather than the \$100,000. The purchaser thus loses the tax benefit of \$60,000 in future depreciation. You can count on the issue of share purchase dis-

counts being brought up during negotiations.

The reality is that most practices in B.C. are sold as a share sale. In our experience, the share selling price is most often not discounted. If you are willing to negotiate a discount, then make sure you use the "Tax Shield" calculation to determine the present value of losing the tax benefit from future depreciation claims.

From the illustration below, you see that the discount is low when you consider the purchaser's savings of transfer taxes in a share purchase.

Taking a share discount may be a small price to pay when you consider that the sale proceeds are tax-free.

## Tax Shield Calculation – Illustration

Asset	Purchase Price	Tax Cost	Difference	Factor	Discount
Goodwill	\$ 200,000	\$ 40,000	\$ 160,000	.084	\$ 13,440
Dental Equipment	70,000	20,000	50,000	.1408	7,040
Leaseholds	80,000	10,000	70,000	.1408	9,856
<b>Total</b>	<b>\$350,000</b>	<b>\$ 70,000</b>			<b>\$ 30,336</b>

Less: other taxes

a) PST	Dental equipment	\$ 70,000 x 7.5% =	\$ (5,250)
b) Property transfer tax	Leaseholds	80,000 x 1 % =	(800)
c) GST	Leaseholds	80,000 x 7% =	(5,600)
			\$ (11,650)

**Maximum share discount:**

**\$ 18,686**

Assumptions:

- corporate income tax rate: 17.6%
- rate of return: 5%
- half-year rate of amortization ignored
- applicable to BC practice sales only

## Beyond Bean Counting

from *Dental Economics*, by Hugh F. Doherty, DDS, CFP

"If your accountant isn't saving you money, find one who will. There are basically three varieties of accountants. First, is the 'form filler-outer' type. Second, is the 'form filler-outer' who can offer minimal standard advice. And finally, there's the accountant who actually has working knowledge of the business of den-

tistry. Insist on the latter, because someone who understands your business can make intelligent recommendations and help you save or preserve a significant amount of money. It might be difficult to find this kind of accountant, but your efforts will definitely be rewarded."

## Practice Opportunities

### West Coast Periodontal

Periodontal practice with outstanding patient base. Thriving practice with well-equipped operatories. High gross. Central location. Doctor retiring. This is a great opportunity.

**Fax: (604) 688-2419**

**E-mail: [periodontic\\_practice@yahoo.com](mailto:periodontic_practice@yahoo.com)**

### Victoria, BC

Well-established, efficient family practice with 4 operatories; gross \$830,000; excellent location; great staff; owner retiring.

**Fax: (250) 753-9702**

**E-mail: [dental\\_practice2004@yahoo.com](mailto:dental_practice2004@yahoo.com)**

### Campbell River, BC – Waterfront

Established practice in modern well-equipped 6-operator, 3,000 sq. ft. facility; exceptional net income; low overhead; cost-sharing opportunity; associate buy-in available. Dream location.

**Fax: (250) 753-9702**

**E-mail: [dentalguy2004@yahoo.com](mailto:dentalguy2004@yahoo.com)**

### New Westminster, BC

Well-established family practice in professional building; excellent location; 5 operatories; experienced and very skilled staff; owner retiring; great value.

**Phone: (604) 261-0357**

### North Vancouver, BC

Spacious and well-established practice in professional building. Excellent cash flow. Owner retiring. Great opportunity for growth.

**Phone: (604) 988-8004**

**E-mail: [northvandental@yahoo.com](mailto:northvandental@yahoo.com)**

# 5 Tips to max practice proceeds

Here are five tips to help you maximize proceeds from your practice if you are thinking of selling.

## 1. Never let the office production drop

A prospect gets excited about a practice that shows a solid growth record. On the other hand, if the office billings are starting to decline, many prospective purchasers will not be interested in acquiring the practice or, at best, will offer you a much reduced selling price. Make sure that you keep your office running at top productivity.

## 2. Fine tune your practice management

Prospects are attracted to a practice that is well managed and efficiently run. They know they can just step in and easily replace the retiring dentist, while maintaining the practice cash flow, when the practice has a top-notch staff and all systems are fine tuned.

## 3. Make sure the practice looks good

Conduct an image audit to ensure that the practice has “curb appeal” – e.g., the office should be clean, the carpets in top shape, the furniture up-to-date, but perhaps the waiting area needs a coat of paint. Making a large purchase is an emotional decision, and a nice looking office goes a long way in getting the purchaser to say “yes”.

## 4. Set a realistic price

An inflated asking price will ruin your chances for a quick sale. Once the word is out that your practice is overpriced, you will find it difficult to attract any prospects to visit your practice, even if you drop the asking price.

## 5. Structure the sale to minimize your tax liability

Plan the sale of your practice with your accountant, so that you can obtain the benefit of a tax-free sale by using the coveted capital gains exemption.

ital gains for tax purposes. You are denied the claim of capital losses until such time as the trust disposes of the losing investment.

- By making separate transfers, as in the above example, you limit the amount of income attributed back to you. In the case of a lump sum transfer of \$600,000 to the trust, Dr. Bob would have to report the 3% interest benefit on the whole amount, not just on the portion which produces non-capital income gain.
- An additional benefit of transferring the portfolio to the trust is the fact that you can make your existing house mortgage tax deductible. Suppose you transfer your investments of \$500,000 to the trust in exchange for a promissory note. The trust borrows \$500,000 from the bank to repay the note, and you use the funds to pay off the house mortgage. You now have converted the mortgage into a fully deductible investment loan. The bank loan to the trust may still be secured by a collateral mortgage, but this does not change the tax results.

If you are looking for a way to escape the high taxes on investment income, you can't beat the trust strategy of income splitting. Give us a call if you need assistance.

Minimizing taxes

# Income splitting just got better

With the small business deduction increasing to \$300,000 next year, the opportunities for income splitting have never been better. The table shows the tax savings you can expect, depending on the number of low-income family members and the before-tax corporate income. For instance, for corporate income of \$200,000, the tax savings of shifting the income to three dependents is \$38,800.

Income Splitting – Tax Savings					
Corporate Income	Dependents				
	1	2	3	4	5
\$ 100,000	\$ 17,700	\$ 20,100	\$ 21,900	\$ 23,700	\$ 25,400
150,000	22,400	28,600	30,400	32,200	34,000
200,000	26,300	35,700	38,800	40,600	42,400
250,000	29,800	40,600	47,100	49,000	50,900
300,000	33,100	45,100	53,800	57,500	59,300

Assume 2005 Small Business Deduction of \$300,000.  
 Dependents have no other income.  
 Corporate income after dentist salary of \$100,000 and before corporate tax.

Thinking of buying or selling a practice? Check out our on-line store at [www.justfordentists.com](http://www.justfordentists.com) (click Resource Centre, then Toolbox), featuring everything you need for a successful transition.

## Confidentiality Agreement

Protect your investment before you share your innermost financial secrets with a prospective buyer.

## "Due Diligence" Purchase Investigation

Before you sign on the dotted line, you need to conduct a thorough "due diligence" to ensure that you are actually receiving what you have agreed to purchase.

## Letter of Intent

This vital link between the preliminary meeting and preparation of legal documentation is the 'blueprint' for the lawyers. Success of your transition depends to a large extent on how well you draft the letter of intent.

## Cost-Sharing and Buy-Sell Agreement

A must-read if you are planning a group practice – many such practices fall apart due to a lack of, or an inadequate, cost-sharing and buy-sell agreement.

## Practice Purchase Agreement Review Checklist

An invaluable checklist that covers important issues and helps you avoid costly mistakes.

## Associate Agreement - standard

Options and choices of sample wordings to meet your particular circumstances; the checklist is based on a review of myriads of associate agreements.

## Associate-to-Owner Transition Agreement

A crucial agreement before the associate starts in the practice. Includes info on associateship, purchase, cost-share and buy/sell, and helps you design an agreement tailored to your particular transition.

## Private Health Services Plan

Free guide to help you set up a PHSP to pay medical and dental expenses of employees and dependents as a tax-deductible expense to the incorporated company and a non-taxable benefit to employees.

## Shareholder's Agreement Checklist

Before getting involved in a business venture with others, you need a solid shareholder's agreement to protect your investment. Here are the 'nuts and bolts' of it.

## Premises Lease Negotiation Checklist

Use our comprehensive checklist to help you negotiate the best lease for a successful practice situation.

Although we make every effort to ensure the accuracy of the information provided in this newsletter, we cannot accept any liability for its contents. We urge you to consult a professional advisor before acting on any of our ideas. ©Purtzki & Associates 2004. All rights reserved.

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