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Purtzki & Associates

CHARTERED ACCOUNTANTS

NEWSLETTER November 2008

Manfred Purtzki, CA

Prospering In The Recession

Despite the pervading atmosphere of doom and gloom, the opportunity for wealth creation has never been better. Here is some food for thought.

1. Stay positive. Don't jump on the recession bandwagon. Maintain your cool and do not get sucked into a negative mindset. The majority of my non-dental clients are spending sleepless nights fretting over declining sales, and credit-squeezing bankers. Celebrate the fact that your job is recession-proof and that you don't need to worry about meeting the next payroll, or making the mortgage payment.
2. Utilize your best patient communication skills. Some of your patients may be in pain from financial, not tooth, decay. Be gentle with them! Try tactics like phasing in a treatment (and payment) plan over a longer period of time.
3. Get in touch with dormant patients. Contact the patients you have not seen in awhile, and invite them back to the practice. Make sure you welcome them back with open arms and remain upbeat.
4. Review practice expenses. When the economy heads south, your suppliers appear to be especially motivated to cut special deals. Take advantage of it. Whether it is dental or office supplies, or equipment, take the time to shop for the best deal around. When it comes to your lease renewal, you can drive a harder bargain with the landlord, who is now preoccupied with just keeping the premises occupied.
5. Focus on your personal finance. There is nothing quite like a big hit in your investment portfolio to make you sit up and pay more attention to your personal finances. Reviewing your financial affairs and setting new priorities will require some tough decision-making. For once, put your financial needs first. Maybe it is time to put the kids back into a good public school, instead of continuing to pay exorbitant private school fees. Break it gently to your daughter that she needs to supplement the cost of her dental education by taking out student loans, instead of relying solely on parental support.
6. Clean up your balance sheet. A lot of dentists buy assets that add little to long-term retirement savings strategy. Are you still getting as much use and pleasure from your recreational assets such as the ski condo, the Mexican beach apartment or yacht, or have they become just a drag on your cash flow? Unload these personal luxury items, and put your money to more productive use.

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What we do best

- Practice transitions
- Practice valuations
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- Tax minimization
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- Bookkeeping
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Maximizing Wealth for Dentists

The "Salary or Dividend" Quandry

Some financial planners suggest that you should pay yourself dividends only to reduce the tax burden and increase your after-tax cash. Here is a comparison of what happens when a corporation pays only a dividend or, the most common scenario, when the dentist and spouse draw a mix of salary and dividends.

Example 1 – Dividends only

Dr. X has a dental corporation generating $200,000 before taxes. He is married to Mrs. X who works exclusively for his company. Dr. and Mrs. X require $120,000 of personal cash to live on for a year. They take their full compensation out of the company as dividends; enough to achieve their annual $120,000 personal cash requirement. The remaining corporate income is left in the company as savings, and taxed at the corporate rate. The following table shows the result of this action.

Example 2 – Salary/Dividend Mix:

Consider the following, where Dr. X now receives a salary of $60,000 and Mrs. X a salary of $36,000. In addition, they each receive dividends from the company in the amount of $23,000 and $47,000, respectively. This allocation of dividends will allow them to achieve their annual $120,000 personal cash requirement, as the following table shows.

My advice? The tax is the same, so stick with the salary/dividend combo. Don't drop the CPP and RRSP contributions as they make great forced saving vehicles. For many retired dentists, the RRSP pension plan, with its tremendous tax shelter benefits, is the cornerstone of their retirement finances.

Dividends Only

	Inc.	Dr. X	Mrs. X
Corporate income	200,000	-	-
Corporate taxes	(31,000)	-	-
Dividends	(126,000)	63,000	63,000
Personal taxes	-	(4,000)	(4,000)
Personal cash	-	59,000	59,000
Corporate savings	43,000	-	-

Total taxes	39,000	19.50%
Total savings	43,000	21.50%
Personal cash	118,000	59.00%

Salary / Dividends

	Inc.	Dr. X.	Mrs. X
Corporate income-before salaries	200,000	-	-
Salaries	(96,000)	60,000	36,000
CPP premiums	-	(4,099)	(3,218)
RRSP contributions	-	(10,800)	(6,480)
Corporate income-after salaries	104,000	-	-
Corporate taxes	(16,120)	-	-
Dividends	(70,000)	23,000	47,000
Personal taxes	-	(12,259)	(10,726)
Personal cash	-	55,842	62,576
Corporate savings	17,880	-	-

Total taxes	39,105	19.55%
Total CPP premiums	7,317	3.66%
Total savings (incl. RRSP)	35,160	17.58%
Personal cash	118,418	59.21%

CRA interest rates – 4th Quarter 2008

(www.cra.gc.ca)

7% (taxpayers pay CRA – non-deductible)

5% (CRA pays taxpayers – taxable)

3% (the rate on taxable benefits and low-interest loans)

Gross: $1,400,000/Value: $0?

As you will see from my story below, one of the crucial steps in buying a practice is to prepare a pro-forma cash flow projection. This projection must takes into account all relevant assumptions, such as the difference in dentist production, the cost of staff changes, the pending cost of moving the practice to a different location etc.

You have to ask yourself: "What is the practice worth to me?". Calculate by how much the projected income as an owner exceeds your current associate income. It's the excess earnings you receive as an owner of the practice, that determines the price of the practice.

Here is a cautionary tale. An Associate Dentist, Dr. Newbie and an established Principal Dentist, Dr. Known worked together happily for two years. After two years, they agreed that Known would receive $700,000 from Newbie for the practice based on a professional valuation. Known agreed to stay on for six months to help Newbie with the transition.

When Newbie prepared an after-sale cash flow projection, or pro-forma, he realized with horror that he would only be able to replace Known, who produced about $65,000 per month, with an associate with average production of $35,000, which is the monthly revenue he was currently producing. With three young children and a demanding wife, Newbie knew he could not work longer hours or increase production above his current level and remain happily married. Comparing the "before sale" with the projected "after sale" income, he realized that his income would drop from $440,000 to $52,000, on which he could hardly support his family to the style they had become accustomed. Even if Known had gifted him the practice, Newbie's annual before-tax income would only be $145,000, less than his present associate income. Sadly, for Newbie, the practice had no value.

Here is how Newbie's calculations looked:

	Before Sale*	**After Sale**
Gross billings:		
Principal - Dr. Known ($65,000/m)	$780,000	—
Principal - Dr. Newbie ($35,000/m)	—	420,000
Associates	420,000	420,000
Hygiene	200,000	200,000
	$1,400,000	**$1,040,000**
Expenses:		
Dental supplies – 8% of gross	$112,000	$83,000
Lab fees – 10% of gross	140,000	104,000
Overhead	540,000	540,000
Associates fees – 40%	168,000	168,000
	$960,000	**$895,000**
Income before dentist compensation, income taxes and debt servicing	$ 400,000	$145,000
Debt servicing - $700,000 @ 6% over 10 years	-	(93,000)
Income before dentist compensation and income taxes	**$ 440,000**	**$ 52,000**

**Based on an actual situation.*

Quote of the Month

Beyond Bean Counting

"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 dentistry. 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."

- Hugh F. Doherty, DDS, CFP
Dental Economics

Wanted

MANAGER

PRACTICE TRANSITIONS AND BROKERAGE

For 30 years, Purtzki & Associates have proudly offered the highest level of accounting, management and practice transition services to our clients.

We now need to meet a growing demand for our expertise in transition planning, valuations, practice sales, associateships, group practice arrangement, and the like. Consequently, we have set up a separate business unit to offer comprehensive appraisal, brokerage and transition consulting services to the dental profession in Western Canada. To assist us in realizing this tremendous potential, we are seeking a dentist or qualified individual with a background in dentistry and practice management.

If you are as excited about this opportunity as much as we are, please contact Manfred Purtzki at Manfred@purtzki.com or phone

(888) 668-0629

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7. Control your spending. A scenario that unhappily is becoming more and more typical is the dentist, close to planned retirement, who is devastated because his $2 million portfolio has shrunk to a mere $1.5. The world has come to an end, since he cannot imagine how he can live on such a paltry sum for the rest of his life. Like so many of his colleagues, he has career fatigue, and postponing retirement is not an option. Of course, he cannot make ends meet, unless he reigns in his spending. Renting villas in Tuscany, Mediterranean cruises, and fancy cars are really not the necessities of life. Perform surgery on your household budget, and make some serious life-saving cuts.

8. Increase your line of credit. You may want to arrange for a maximum home line of credit (LOC) now, before real estate values slide further, and before banks tighten your credit even more. There is no cost in having an LOC, and the interest is usually low, around prime, (currently at 4%). You can use the LOC to snap up deals in the stock market, or refinance more expensive practice debt.

9. Focus on savings, not rate of return. The vast majority of Canadian families have no money left in their budget to save for retirement. As a result, the financial planning industry is geared toward helping clients maximizing investment returns to make their nest egg grow. Of course, with the greater the return comes the increased risk of losing. As top earners, dentists need to focus more on their ability to save their income, rather than getting the highest return in the market. Why take chances, if you don't need to? In addition, using the corporation is an awesome saving tool. Basically, as an incorporated dentist, you can invest your savings at a safe 4%, and generate the same amount as the non-incorporated person investing at 8%.

RETURN REQUESTED

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