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CHARTERED ACCOUNTANTS

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Transitions

Beware of the "Superstar" Practice

In your search for the right opportunity, you have come across a listing for a practice in a great location, producing $1.2million. The net cash flow of $500,000 makes you salivate. The price tag of $750,000 does not seem outrageous. Digging deeper, you learn that the dentist produces about $85,000 per month, working 5 days a week, with no associate, and a hygiene income of about $200,000. The salaries of $230,000 are barely 20% of gross. The cash flow is huge, and the overhead is low. Your first instinct is to sign on the dotted line, before some other lucky prospect snaps it up.

Before you get carried away with your own enthusiasm, take a moment and project what the cash flow would be under your ownership. There is no way you can produce $1,000,000 of dentistry on your own, probably more like $600,000. Hiring an associate to generate the additional $400,000, will cost $150,000, with extra staff costs coming in at around $100,000. The annual payments to the bank to service the $750,000 debt at 5% over 10 years are about $100,000. Assuming a perfect patient retention and no increase in expenses, your before tax cash flow has shrunk to a mere $150,000. How exciting does the deal look now!

The dentist who single-handedly produces $1,000,000 is a "superstar". He or she possesses extraordinary technical skills, is totally committed to the practice, and always eager to learn and implement new techniques. Like all superstars, this dentist has the stamina that very few of us possess, and unless you are yourself are truly a superstar, you will not be able to duplicate the income stream.

One of the important steps in your due diligence is to analyze the revenue breakdown by provider, and project the revenues as if you are the owner. The revenue projection will change the overhead expenses as well, notably staff salaries, so make sure to review each expense item. Ultimately, the purchase price should be based on your projected cash flow, and not what the vendor generated.

You may prefer to have a "superstar" as a mentor, and not as the vendor.

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Reduce Your Annual Tax Bite

Your favourite season of the year is nearly upon us and you cannot procrastinate any longer. Yes, it's time to drag out the shoe box from under the bed and start the annual chore of summarizing your tax receipts for your accountant. On the positive side, it is definitely worth your while to be as thorough as possible, especially when you consider that for every $1,000 tax write-off you can dig up, you will save $400.

While enduring the slumping economy, it is even more important to pay attention to tax planning tactics. To assist you in reducing your 2008 tax bill to the absolute legal minimum, I offer the following list of common expenses, some of which are routinely overlooked, for your consideration.

Generally, any expense you incurred related to the practice is deductible. If you are not sure whether a particular expenditure qualifies for the deduction, include it on the list anyway, but be sure to review it with your accountant.

Home office

Home expenses include mortgage interest, landscaping, repairs, property taxes, utilities etc., all prorated to the office space used in the home. You can also use annual depreciation to write off the cost of furnishing your office using either the square footage allocation or the number of rooms (bathrooms and kitchen are excluded), which ever gives you the higher percentage.

Automobile

If you are self-employed, you can deduct the operating costs of your vehicle, as well as the car loan interest or leasing costs. The expenses are prorated based on the practice use percentage. If you are incorporated, you can claim a tax free allowance if it is based on the kilometers driven up to $.52 per kilometer for the first 5000 km and $.46 per kilometer thereafter. The travel from your home to the clinic is nondeductible. If you exclusively work as an associate or locum, and you don't have an office in the clinic, then the travel from home to the practice is considered deductible.

Administration fee to family members

Paying a reasonable administration fee to your spouse or a salary to your children for filing or janitorial services, is a great income splitting strategy . It can save you thousands of tax dollars, and it's easy to implement. The key word here is "reasonable", so make sure that the payments are comparable to the salary you would have paid an unrelated party.

Entertainment

Entertainment expenses can include tickets to an entertainment or sporting event, meals and beverages, as well as the cost of entertaining at home. Make sure you keep a record of the guests. The maximum amount that can be claimed is 50% of the actual cost of food, beverages and entertainment incurred.

Conferences

The cost of attending conferences is deductible, including travel, meals and entertainment. If the practice benefits by having your spouse attend the conference, then all the related costs are deductible as well. Pay attention to where your course is located, as travel costs for attending a course in Costa Rica that is available also in Vancouver, are considered unreasonable.

Dental library and instruments

Especially in your first year of practice, make sure that you report on your tax return the cost or fair market value of your library, and instruments. The cost of instruments is fully deductible. The cost of the library is amortized at 20% per year.

Practice search

This is a deduction that many dentists overlook. You can claim the cost of travel, lodging, and food associated with researching a new position or practice location.

Locum/associate assignments

As a locum or associate, you can deduct all your travel expenses including transportation, hotel accommodation and meals, however, the 50% limit applies to the cost of meals, beverages, and entertainment. Costs incurred for accompanying family members are not deductible.

Clothing

The cost of clothing is not deductible unless it qualifies as a uniform. CRA will not consider your Gucci suit a uniform; however, a shirt with a distinctive clinic logo will qualify.

Interest expenses

Don't forget to deduct interest on qualifying student loans, and interest costs incurred on your loan and credit if the proceeds were used for the practice or to purchase investments.

Capital losses

This strategy is particularly relevant in the current economic climate. With many investors incurring heavy losses in their investment portfolios, you can generate a tax refund by applying unused capital losses to any capital gains reported in the prior three years.

Five Things You Should Do

Here the five most important things to keep in the back of your mind when you are preparing your retirement financial plan.

Number One - Don't lowball living expenses.

If you can barely make ends meet now with an income of $10,000 a month, don't fool yourself that you can live on half that amount once you quit practicing. Budget at least 80% of your current income.

Number Two - Don't count on any income while "phasing out"

Dentists have the wonderful option of a "phased retirement". This means that you don't have to stop cold turkey, like most other professionals. You can work as many days as you like as you transition to a full retirement. There are many choices, such as entering into a cost share arrangement with another dentist, or working part-time as an associate. Any such income must be considered the icing on your retirement cake and must not be included in your retirement budget. There are too many "retired" dentists who end up working more hours than they want to, just to pay for life's basic necessities.

Number Three - Prepare an annual net worth statement.

At least once a year, measure the progress of your investment accumulation efforts by preparing a net worth statement. This crucial planning tool is simply a summary of your investment assets and liabilities, including mortgages, and loans. Do not include your family residence, or any recreational property, if you don't plan on selling it. When you review your balance sheet each year, set a goal of how much you can save over the next year. The net worth statement is the most efficient method in determining whether or not you stayed on track with your savings target and if not, how you can quickly remedy the situation.

Number Four - Always save in the corporation.

Build up your savings in the corporation and only take out funds for personal and living expenses. If you save $50,000 per year in the corporation for the next ten years, your investments will grow to $725,000 (before tax). If you draw the funds from the corporation, and invest personally, then your savings will only grow to $500,000. You will need to deal with the personal taxes when you eventually draw the funds from the corporation, but there are many strategies available to minimize the cost of withdrawal.

Number Five - Consider working more.

For most, the proposition of expanding practice hours is a non-starter. But, before you discard the idea completely, consider this. Working just a few extra hours now can have a huge impact on your future lifestyle. If you decided to work an extra day per week, for example, you could generate an additional $1,000 after-tax. If you invest the $1,000 for 45 weeks per year for 10 years, then you will have accumulated an additional $580,000.

Succeed With Agile Leadership: A Lesson From an Industry Giant

Being a leader is not easy in the best of times. In these difficult economic periods, it a challenge for a practice owner to keep up staff morale, some of whom may be facing the pending layoff of a spouse, or suffering from a decline in their RRSP investments. As a practice owner, you also have to stay upbeat with patients, while making adjustments to the treatment plan to make it more affordable to patients distracted by economic issues. Patricia Nazemetz is a vice president of Xerox Corp. a company that has gone through painful organizational changes while adjusting to the "new economy". To steer an organization through these turbulent times and remain successful, she advocates following these two essential elements: Keep Your Head; and Be Effective. She notes that agility is important to accomplish these goals and be prepared to "whatever it takes and avoid being too dogmatic. Listen, pay attention, read signals fast, and adjust."

Structuring Successful Group Practices

You surely have heard horror stories from your colleagues of group practice breakups. Like a bad marriage, these breakups create financial hardships, make enemies out of friends, and is hard on staff and family.

Dentists tend to trust colleagues of their profession and will enter into a group practice or associate relationship on a handshake and a vague verbal arrangement. Nobody takes the time initially to determine their mutual compatibility, define the goals for the practice and communicate their expectations. Often the written agreement lacks sufficient details to deal with the many possible future events in a relationship.

Over the last 30 years we have assisted many dentists in structuring successful and rewarding relationships. Every relationship is unique and you require a tailor-made agreement to address your specific concerns.

We can help you implement a successful transition structure, which will withstand the test of time. Call or email me for a free consultation at (888) 668-0629 or manfred@purtzki.com.

We look forward to seeing you at the 2009 Pacific Dental Conference on March 5th and 6th, 2009 at the Vancouver Convention and Exhibition Centre.

Visit us at Booth 1827.

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