TAXMATTERS FOR DENTISTS

Volume 3, Number 1

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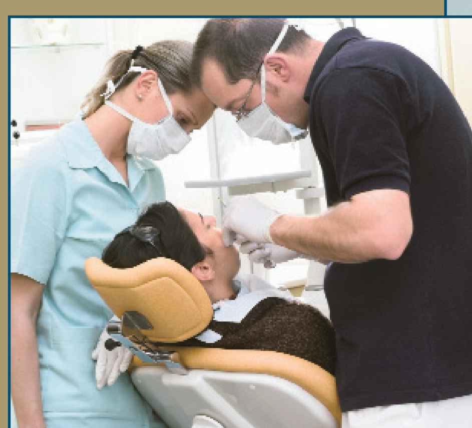

Mike Lakhani and his Team of Specialists. Tax Advisors for the Dental Community

Assante WEALTH MANAGEMENT

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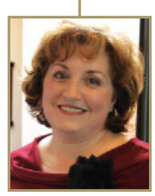

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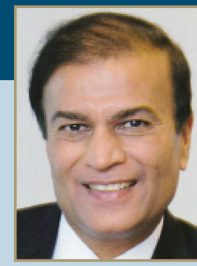
Editorial



Mike Lakhani, B.Comm., F.C.C.A., C.G.A., CFP, R.F.P.

Do You Have A Written Financial Plan?

Do you have a written plan that addresses the key financial issues of your Dental practice and if so, is that plan co-ordinated with your personal financial plan?

I have been working closely with Dentists for many years and I have rarely encountered a client who has a plan that dovetails their practice's critical financial issues with their personal financial situation and goals. The default strategy is usually an assumption that the dental practice generates sufficient cash flow to cover the Dentist's personal and family short and long term goals. This is short sighted. A properly written plan will diagnose the Dental practice's cash flow and the Dentist's personal situation and implement effective strategies to ensure that the financial fundamentals of the practice work to meet the personal goals. Not co-ordinating the two is similar to suggesting a treatment without the required diagnosis.

There are three main areas to address in a written financial plan which are common to both the practice and personal situation. These three areas have a number of subsets, some of which are outlined below.

TAXES:

Taxes are by far the largest expense that drains cash flow out and deposits it directly to Ottawa. Salaries or draws in excess of $120,887 are taxed at 46.4 % compared to a tax rate of 19% for practices that enjoy the benefits of incorporation.

Analyzing what is required for personal use and major items such as mortgage payments, car payments, insurance premiums, children's educational costs etc. reveals a number of effective strategies that can be implemented.

For example, within the practice, Individual Pension Plans (IPPs) and paying personal expenses such as club dues and life insurance premiums through the Corporation rather than personally, results in a lower tax rate. A traditional accountant often is not involved with personal issues and with the nuances of structuring outstanding mortgages and other lifestyle issues, and could miss a number of key strategies that serve to lower taxes.

CASH FLOW:

- It is amazing to observe how prosperous Dentists can make equipment leasing companies even though incorporation has been available for several years. Leasing equipment certainly made more sense when incorporation was not available and a higher tax write off was needed to reduce taxes. By incorporating your practice and financing your equipment with loans at the Corporate rate, the cash flow can be increased significantly. Another significant strategy that improves cash flow is to alter the principal repayment terms of debt incurred to purchase or expand the practice.
- Another key strategy is eliminating non-deductible personal debt by re-directing cash that otherwise would have been applied to tax-deductible practice loans. Banks are generally not involved or interested in the personal side of the Dentist's cash flow and as a result key opportunities are often missed.
- The new income splitting legislation allows non-voting

> *Net worth is the most important factor that a written plan should benchmark and analyze because it is the improvement of this number over time that measures true financial progress.*

shareholders to pay dividends to children over 18 that can be used to repay personal loans, mortgages or education costs. By considering both the practice and personal cash flow situations, a number of improvements can often be realized.

NET WORTH:

- Net Worth is the most important factor that a written plan should benchmark and analyze because it is the improvement of this number over time that measures true financial progress. The main subsets of Net Worth include the value of the Dental Practice, principle residence, investments, other real estate holdings and main debts such as a mortgage, practice debt etc.
- Other areas that have to be considered when trying to protect one's Net Worth are estate planning, diversified investment strategies and income replacement insurance.

Having a written financial plan is the first step in integrating your practice and personal strategies to successfully achieve the desired results. This is where the services of my team of specialists makes the difference. We have years of experience specializing in Dental practices and we can prepare a written plan that co-ordinates your practice with your personal situation. We also commit to helping you implement all of the recommended strategies. The cost of a written plan by our group of specialists is $2,500 which is tax deductible and we guarantee that the savings you will enjoy will exceed this cost.

For a FREE one hour consultation to learn how you can get on the road to financial security and success please contact Rose at my office at 905-273-6605 or rrago@assante.com.

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UPCOMING EVENTS

- April 12, 07 — *SADA Evening Presentation*
- April 26-28, 07 — *Ontario Dental Association Meeting*
- June 22, 07 — *SADA/Assante Golf Tournament*
- September 27-28, 07 — *International Dental Congress*

Darren Miles

The Benefits of a Professional Practice Valuation

When developing a financial plan with your advisor, the determination of your net worth is an essential part of the long term planning process. In order to determine an accurate picture of your retirement resources, a valuation of your practice, executed by a qualified professional, should be performed at an early stage in your career and updated every year. Utilizing our experience in the financial sector, we have developed a formalized valuation process using the methodologies set out by the Canadian Institute of Chartered Business Valuators. In the following paragraphs we shall explain the methodologies utilized, and touch on some of the areas having the greatest impact on the practice valuation.

When looking at placing a value on your practice, the most important aspect is its cash flow generation. The valuation of a dental practice is similar to the valuation of any service-based company. Goodwill represents the greatest portion of value within such a company, due to the lack of significant tangible assets. Goodwill is not based on revenue levels so much as it is based on the resultant earnings and qualitative aspects of those earnings, such as consistency and sustainability, driven by the strength of the underlying patient relationships coupled with a recurring revenue stream and a keen eye on expense levels. The following four methodologies are utilized by our firm to derive a Comprehensive Valuation Report:

1. The Capitalization of Discretionary Cash Flow technique - analyzes historical cash flows.
2. The Discounted Cash Flow technique - allows for future projections to be discounted to present values .
3. The Market Comparative. This approach compares our subject practice to a database of practice sales executed over the past five years. We do not place great weight on this method as it is difficult, if not impossible, to find practices with identical attributes. In addition, due to the private nature of these sales, there are limited amounts of publicly available data.
4. Debt Retirement Analysis – Details the time to retire a loan at a prescribed interest rate given the cash flows of the acquired practice.

Through the utilization of the four different methodologies listed above, we can be very certain as to the accuracy of our value conclusion.

When executing the income based approaches, in order to get an accurate picture of a practice's cash flow, the financial statements of the practice need to be normalized, with discretionary items removed (e.g. that lease for the Porsche). When determining the value of a practice, a capitalization rate is determined to convert the cash flow to a value conclusion. The capitalization rate represents the risk associated with achieving future cash flow levels or replicating past cash flows. The determination of the capitalization rate is a very complex and involved process that takes into consideration everything from general economic conditions, to specific earnings stability, to patient base and service mix, just to name a few. Capitalization rates can vary substantially from one practice to another as well as over time, due to the different risk levels associated with different practices. The valuation of one practice is never the same as another, due to the fact that many variables exist with respect to the transferability of the cash flow in addition to the uniqueness associated with the practice. Below are ten of the many areas we investigate in deriving our capitalization rate:

1. Risk free rate of return (yield on a 10 year government bond)
2. Service mix and degree of specialization
3. Earnings growth and stability
4. Assignment vs. non-assignment
5. Degree of legal business structure (proper agreements in place, documentation etc)
6. Patient base
7. Continuity of business
8. Number and tenure of employees
9. Per patient billings
10. Geographic location and demographics

By developing our valuations from accepted methodologies set out by the Canadian Institute of Chartered Business Valuators, we have found our reports to be very credible and reliable in the eyes of the financial consultants with whom a dental practitioner deals in the course of his or her career.

Darren Miles is President and Founder of Fair Market Value Inc., a business valuation firm which focuses on the technical aspects of mergers, acquisitions and divestitures of professional practices.

Areas of focus include valuation, purchase and sale, incorporation, taxation, associate recruitment and negotiations. You may contact Darren at 416-238-2229 or by email at darren@fmvi.ca.

Case Study

Chris Molloy, CFP

Young Dr. Zappa Pays off $420,000 Mortgage and $660,000 Practice Debt in Six years

Dr. Frank Zappa is a young dentist who has been in practice for four years. He bought into an existing partnership, replacing one member of a two-dentist practice. As is typical in these situations, he financed the purchase and there is still $300,000 of debt remaining. He set up a Professional Corporation (with himself as sole shareholder) and shares the revenue and expenses of the existing Hygiene Corporation equally with his partner.

THE PROBLEM

Dr. Zappa is married with two young children. His wife, Angela, works actively in the practice and is on payroll. The Zappa's also own a home worth $750,000 and have a mortgage of $420,000. Dr. Zappa intends to open a second practice independently from his existing practice. This new location will cost $360,000 to set up and will also be fully financed. Dr. Zappa's primary concern is finding the most effective way to pay off his personal and business debts.

THE OPPORTUNITY

The typical problem we see time and time again with these situations is that the financing arrangements emphasize paying the tax-deductible practice debt faster than the non-deductible mortgage debt. The objective in this case is to reverse this situation to pay the debt in a more tax efficient fashion.

THE SOLUTION

The existing practice loan was initially set up for principal and interest payments of $5,000 per month. This presents an opportunity to renegotiate with the bank to allow up to 2 years of interest-only payments improving cash flow by $30,000 per year. The new practice loan should also be negotiated under a 2-year interest-only payment schedule. By doing so, more cash flow can go towards the non-deductible mortgage debt.

The Zappa's lifestyle expenses are $128,000 per year. This includes the cost of mortgage payments, child care and RRSP savings. The strategy here is to allocate enough salary so that the personal expenses can be covered, then any additional profits can be paid as dividends and directed to the mortgage.

The table on the next page shows the revenue and expenses expectations from the current practice and the new practice, as well as the salary / dividend allocations.

In two years from now, there will still be some debt remaining on the mortgage. Normally, the practice loans would revert back to principal and interest payments after the 2-year period has expired, resulting in a cash flow squeeze. However it this situation, Dr. Zappa should set up a secured line of credit on his home and transfer the remaining practice debt to it. The funds advanced to the company would immediately pay off the practice debt, allowing him to maintain interest-only payments. This debt is tax-deductible, and the free cash flow can continue to be paid towards paying off the mortgage over the next 12-month period.

THE RESULT

Once the mortgage is paid off in 3 years, Dr. Zappa can then start paying off the practice debt over the next 3 years after that. In six years Frank and Angela Zappa will be debt-free.

Thereafter, the Zappa's can focus their attention on saving for retirement. Based on their maximum RRSP contributions and the surplus cash flow in the practice, they could save over $5 million dollars over the next 20 years, which could provide them with an income of $200,000 per year net after taxes for the rest of their lives.

Chris Molloy, CFP, is a Financial Planning Advisor with Assante Financial Management Ltd. Chris has over 10 years experience as a financial advisor working in the Mississauga area. Chris specializes in tax, estate and investment planning for the dental profession. You can contact him at 905-273-6605 or via email at cmolloy@assante.com.

CASH FLOW PROJECTIONS	2007 - 2009			2010 - 2012		
	Professional Revenue	Hygiene	New Practice	Professional Revenue	Hygiene	New Practice
Revenue	$700,000	$300,000	$350,000	$700,000	$300,000	$450,000
Operating Expenses (excl. salary to Dr Zappa, Mrs. Zappa)	($500,000)	($200,000)	($200,000)	($500,000)	($200,000)	($278,000)
Interest Expense on Business Loan	($18,000)	$0	($21,600)	($18,000)	$0	($21,600)
Salary Dr. Zappa	($60,000)	($40,000)	$0	($60,000)	($40,000)	$0
Mrs. Zappa	$0	$0	($60,000)	$0	$0	($60,000)
Net Income before tax	$122,000	$60,000	$68,400	$122,000	$60,000	$90,400
Less: Corp. tax (@ 19%)	($23,000)	($11,500)	($13,000)	($23,000)	($11,500)	($17,900)
Available for Dividends/Debt Repay	$99,000	$48,500	$55,400	$99,000	$48,500	$72,500
Total Dividends		**$202,900**			**$220,000**	
Personal Tax on Dividends (@ 31%)		($62,900)			n/a	
Available for Principal Repayment		**$140,000**			**$220,000**	
Outstanding Debt		$420,000			$660,000	
Years to Pay Off		3			3	

Tax Matters for Dentists

Keep More of What You Earn

A Special Offer from **Mike Lakhani** B.Comm., F.C.C.A., C.G.A., CFP, R.F.P. and his team of specialists to

Initial One Hour (free):
Introductory Consultation for Spectrum subscribers at no charge

Tax Saver Plan:
The Tax Saver Plan includes:
- income tax analysis both Corporate and Personal
- Analysis of Incorporation benefits, if applicable
- Comprehensive Personal Financial Plan
- Debt and financing arrangements

Fee: $2,500 (Tax Deductible, deposit of $1,250 and balance on delivery of the Tax Saver Plan)

Complete Annual Tax Implementation Plan:
The Complete Annual Tax Implementation Plan includes:
- Bookkeeping and related matters
- Preparation of Corporate Financial Statements
- Preparation and filing of Corporate Federal/Provincial Returns
- All appropriate tax filings of Personal/Family Tax Returns
- Preparation and filing of Personal/Family Tax Returns
- Assistance in implementation of Personal Financial Plan

Annual Fee: $5,000 (Tax Deductible, $2,500 will be credited to the first year Fee if Tax Saver Plan above used)

Spectrum Readers **Save Time and Taxes!**

Call Mike's Office

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E-mail: mlakhani@assante.com

Tax Saver Plan and Complete Annual Tax Implementation Plan are provided through ITCC Tax & Accounting Inc.

Our New Web Site for Dentists

www.ddstaxes.ca

Keep More of What You Earn!

Frustrated About Paying Too Much of Your Hard Earned Money in Taxes?

Look No Further... You Could Benefit From the Cases Below!

- **Case #1: Dr. Laura Simpson realized tax benefits in excess of $300,000 with Incorporation.**
- **Case #2: Dr. Stinton managed to pay off a $290,000 mortgage.**
- **Case #3: Dr. Ron Smith was further ahead by $134,000 selling shares of the practice vs. assets and goodwill.**
- **Case #4: Dr. Mary Kappa gained access to $222,000 tax-free by transferring her husband's commercial property to her Professional Corporation.**
- **Case #5: Dr. Reynolds financed a second practice for $475,000 without his bank's help.**
- **Case #6: Dr. Zappa pays off $420,000 mortgage & $660,000 practice Debt in six years.**

The above real savings were uncovered as a part of our comprehensive "Tax Saver" plan process with our clients!

Keep More of What You Earn!

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As a dentist, you now have a new resource for finding relevant and powerful tax saving ideas at www.ddstaxes.ca . The web site is full of valuable information. You'll find important tax planning ideas, past issues of "Tax Matters" and a list of Upcoming Events. If you have specific tax-related questions, you can choose the Ask an Expert tab. It also includes Testimonials of other dentists who have been very satisfied with services of the Lakhani team.

Learn more about the:

- **free one hour consultation**
- **initial "Tax Saver" plan for a set of personalized recommendations**
- **"Complete Annual Tax Implementation" plan for ongoing accounting, tax and personal financial coaching to ensure you keep more of what you earn.**

Come see how Mike Lakhani, Senior Financial Advisor with Assante Financial Management Ltd. and his team of professionals seamlessly integrate the work of your Accountant, Lawyer, Broker, Banker and Insurance Advisor, while protecting and enhancing your personal wealth. Visit www.ddstaxes.ca for more information.

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