

TAX MATTERS FOR DENTISTS

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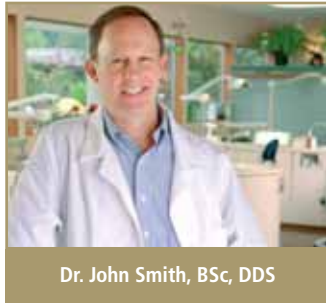
*Mike Lakhani
and his Team of Specialists,
Tax Advisors for the
Dental Community*



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Our Team of Contributors



TAX PLANNING

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

The Cost of Good Advice

What is a cynic? A man who knows the price of everything and the value of nothing. — Oscar Wilde

How many times have you felt this way when a patient questions your invoice as it is handed to them? It is as if they do not appreciate that you've just improved their smile, eliminated their pain, kept their body healthy and restored their confidence? As a dentist, you understand there is tremendous value in providing these benefits to the patient. But all the patient sees is the final price and whether the last 20% is negotiable.

This type of approach is also quite common in our business. We often come across dental practitioners who try to save a few dollars by incorporating on their own, filing their own taxes, negotiating their own mortgages, hiring hygienists on contract, estimating the value of their practice, and so on. Very often, the practitioner is dealing with multiple advisors such as a lawyer, accountant, investment advisor, insurance specialist, etc. The dentist is left to make heads or tails of the advice and integrate it into one cohesive approach. At the end of the day, it's not the price that was paid but the cost of the missed opportunities that really count the most.

We've all heard the expression, you don't know what you don't know. This can manifest itself in many different ways. For example,

consider the situation in which a dentist incorporates himself. There may be \$50,000 of equipment that should be transferred into the company. When done properly, the practitioner can withdraw

At the end of the day, it's not the price that was paid but the cost of the missed opportunities that really count the most.

\$50,000 from the company tax-free. Or for example, adult children can be assigned non-voting shares in a Professional Corporation. Under the right circumstances, each child can receive dividends in excess of \$30,000 per year tax-free. Another example is allocating non-voting

shares to an adult child without a proper shareholder's agreement. If the child has the misfortune to suffer marital breakdown or bankruptcy, a portion of the value of your practice could be lost irrevocably.

In our practice, we prepare a comprehensive financial plan that integrates the cash flow your business generates with your personal lifestyle. We look at ways to accomplish your personal objectives while minimizing the amount of tax payable. Although there is a cost of \$2,500 to prepare a comprehensive analysis, the value of the review is tremendous as it will provide the confidence you need to make decisions about your business and your life.

Let me close with another famous quotation by Oscar Wilde that, I hope, will encourage you to call.

The only thing to do with good advice is pass it on. It is never any use to oneself.

Mike Lakhani, B.Comm., F.C.C.A., C.G.A., CFP, RFP is Vice President, Senior Financial Advisor with Assante Financial Management Ltd. Mike has over 20 years experience as a financial advisor working in the Mississauga area. Mike specializes in tax, estate and investment planning for the dental profession. You can contact him at 905-273-6605 or via email at mlakhani@assante.com

Case Study



Chris Molloy, CFP

Dr. Bailey Uses \$400,000 Corporate Cash to Pay Off Mortgage

Now that dentists in Ontario have been able to incorporate for a few years, many are beginning to see the benefits. One of the positive results of incorporation is that dentists are building-up cash within their companies. In most cases this is good news, unless it comes at the expense of prolonging the repayment of a mortgage or other non-deductible debt.

The Problem

We recently met with Dr Arthur Bailey and his wife Mary (names have been changed). The Bailey's (ages 48 and 47 respectively) have one adult child (19) attending university and one minor child (16). Mary works actively in the practice as the office manager. Dr Bailey had incorporated in 2003 but did not have a hygiene company.

As a result of the ability to leave money in the corporation (unlike a sole proprietor), Dr Bailey had built-up a large amount of cash within his company (\$600,000). The Bailey's had recently upgraded their home and taken on a \$400,000 mortgage. They had enough cash in the company to pay off the new mortgage but were reluctant to do so, fearful of the anticipated tax on the withdrawal. Our objective was to find a way to pay off the mortgage immediately with minimal tax impact.

The Bailey's also owned a rental property that had been purchased just a couple of years ago. The property had increased in value, but they found that they were not too keen on being landlords after all, so they were considering selling the property.

The Bailey's other top priorities were paying for the children's post-secondary education and saving for retirement.

The Opportunity

Using the new shareholder rules, we suggested adding their eldest child (age 19) as a non-voting shareholder.

This would allow for the payment of dividends on a tax-free basis up to \$35,000 per year, since he had no other source of income. Income to the son could be used initially for mortgage repayment, then in subsequent years towards his education costs. We also suggested creating a hygiene company with Mary as the sole shareholder to allow additional flexibility for income splitting.

To address their retirement plans, we suggested creating an Individual Pension Plan (IPP) to include both Arthur and Mary as beneficiaries. There are a number of benefits to IPPs, such as they allow for greater contributions than RRSPs, contributions are paid by the company instead of the individual, the funds are creditor-protected, and there can be additional deposits permitted upon retirement. With incorporation dating back to 2003, additional top-up payments could also be made to catch-up on past service.

The Bailey's could now resume saving within the Professional Corp. and Hygiene Corp. for their retirement.

The Solution

With the new corporate structure in place, a number of steps could be

Client Profile

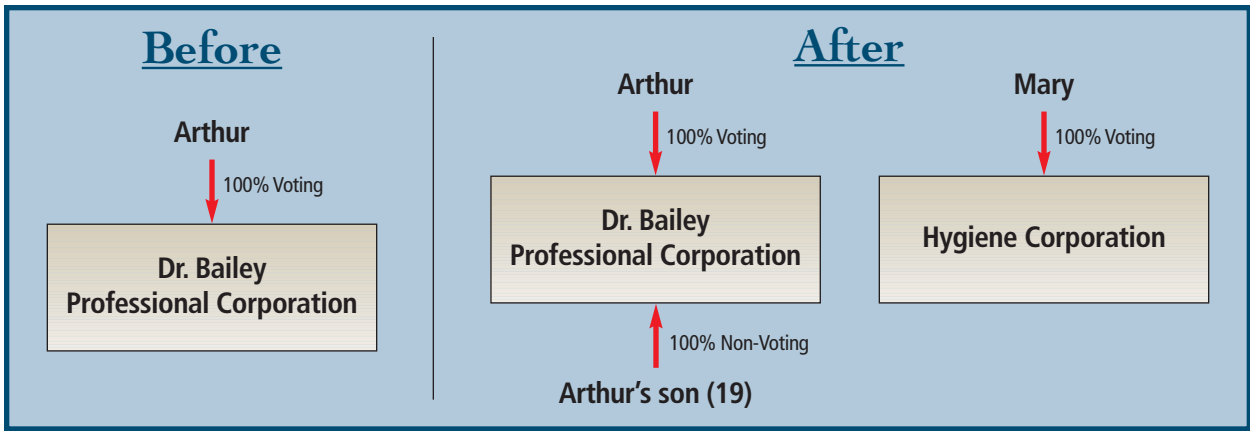
- \$600,000 cash in Professional Corp
- Gross Practice Revenue of \$900,000
- Retained Earnings of \$425,000
- Shareholder Credit of \$25,000 (from transfer-in of leaseholds and equipment)
- All major equipment leases paid-off a couple of years ago allowed significant cash to build-up
- Salary of \$100,000 to Arthur and \$50,000 to Mary
- Mortgage of \$400,000

Assets

Cash in Corp	\$600,000
RRSPs	\$325,000
Non-registered Investments (ACB=\$35,000)	\$55,000
Value of Practice	\$600,000
Home	\$800,000
Rental Property (ACB=\$160,000)	\$200,000
Vehicles	\$50,000
Total Assets	\$2,630,000

Liabilities

Mortgage	\$400,000
Rental Property Mortgage	\$140,000
Car Loans	\$20,000
Total Liabilities	\$560,000
NET WORTH	\$2,070,000



taken to pay off the mortgage immediately. Given the large amount of retained earnings in the company, we decided to spread dividend payments over two years.

- 1) Allocate \$150,000 of dividends to Dr Bailey, resulting in \$105,000 net of tax.
- 2) Allocate \$70,000 of dividends to his son, resulting in \$70,000 net of tax.
- 3) Advance \$135,000 from the Prof. Corp. to the Hygiene Company as loans. Each year, Mary could take a \$67,500 shareholder loan (based on the projected profitability each year); this loan would need to be repaid within 12 months, then paid out again as dividends, resulting in \$100,000 net after tax.
- 4) Withdraw \$25,000 from the Prof. Corp. tax-free against the shareholder account.
- 5) Sell the condo for proceeds of \$50,000 net after tax.
- 6) Sell the non-registered investment portfolio for proceeds of \$50,000 net of tax (this amount to be re-borrowed so the resulting debt becomes tax-deductible).

To finalize their plan, the IPP would be funded with \$75,000 cash in the Professional Corp, and the remaining \$145,000 would be used towards their retirement goal.

The Result

With the mortgage paid off and the IPP started, the Bailey's could focus their free cash flow on additional retirement savings. Based on a 10-year time horizon, the Bailey's would need to have \$4 million in savings to achieve their retirement goal of \$120,000 net after tax, indexed to inflation. With the ability to save within the Professional Corp and Hygiene Corp, they can take advantage of the tax deferral that is available. In addition, they could invest in a new type of investment vehicle, called Corporate Class funds. These new funds do not distribute investment income each year but defer them until the investments are sold, thus reducing the annual tax burden. This is a powerful feature that will help them reach their goals faster.

And under the new structure with Dr Bailey's son as a shareholder, he can continue to pay dividends to his son essentially tax-free while he remains a student. The other child could also be allocated non-voting shares once becoming an adult in a couple of years.

Dr. Bailey and his wife are now mortgage-free, are able to save for their retirement and fund their children's education in the most tax efficient manner possible. The above case not only demonstrates the flexibility a proper corporate structure can add to your affairs, but that solutions have to be tailored to each individual client given their unique circumstances and preferences.

	Gross Amount	Tax	Net Proceeds to Pay Mortgage
Dividends to Dr Bailey 2007	\$75,000	\$22,500	\$52,500
Dividends to Dr Bailey 2008	\$75,000	\$22,500	\$52,500
Dividends to Son 2007	\$35,000	\$0	\$35,000
Dividends to Son 2008	\$35,000	\$0	\$35,000
Advance to Mary 2007	\$67,500	\$17,500	\$50,000
Advance to Mary 2008	\$67,500	\$17,500	\$50,000
Shareholder Credit	\$25,000	\$0	\$25,000
Proceeds from Rental	\$60,000	\$10,000	\$50,000
Proceeds from Investments	\$55,000	\$5,000	\$50,000
	<u>\$495,000</u>	<u>\$95,000</u>	<u>\$400,000</u>

By following the steps above, the mortgage can be paid off immediately. The solution will result in \$95,000 of tax. By contrast, the interest that would have been paid on the mortgage over a 15-year term is two-and-one-half times the immediate tax impact, so this is a substantial savings.

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.



Steve Farronato,
CA, CFP

12 Tax Tips for Dentists

Just like any good hygiene program, regular scheduled visits are crucial to good oral care. Similar to taxes and tax planning, re-visiting the 12 tax tips is important to your financial success.

1. Professional Corporation

Any dentist paying a personal tax rate over 19% (or over \$80,000 of taxable income) should consider incorporation. Pay tax at a 19 cent dollar versus a 46 cent dollar. The new federal budget has increased the \$300,000 payable at 19 cents to \$400,000.

2. Non-Voting Shares

The new legislation in Ontario permits family members to own non-voting shares in the Professional Corporation. Dividends up to \$35,000 can be paid tax free for education or other purposes to children over 18.

3. Hygiene Corporation

Ideal for income splitting with a spouse or a family member. Provides an additional small business deduction of \$400,000 at a low tax rate of 19%.

4. Year End Selection

The establishment of a corporation allows the flexibility to choose a non-calendar year-end with the potential to defer tax on profit through bonuses. Under the right circumstances, it may be possible to generate a one-time tax saving by not drawing income in the first year of the company.

5. Individual Pension Plan (IPP)

An IPP allows for the ability to put more money into retirement savings than RRSPs using contribution with corporation dollars.

6. Private Health Services Plan (PHSP)

A PHSP allows a dentist and the employees to pay for medical expenses through the company, instead of individually. This results in personal tax savings because the expenses are paid with pre-tax dollars. There are many more medical expenses that qualify

under a PHSP and there are no limits on the amount that can be claimed.

7. Estate Plan

There are a tremendous number of opportunities for tax reduction with a carefully drafted estate plan. Many of the benefits include:

- Probate Fees by-passed
- Establishing a Spousal Trust and/or Family Trust for Children – potentially lower taxes with complete discretion over allocation of income to family members
- Transfer ownership of assets to joint names
- Charitable Donation of Investments qualify for 100% tax-free capital gains

8. Interest Deductibility

Swap non-deductible interest on debt (such as a mortgage) with tax-deductible debt using certain strategies.

9. Dividend vs. Salary Mix

The top tax rate on dividends (31%) is lower than the top rate on salary (46%), so it is possible to allocate a combination of dividends and salary to generate personal tax savings. It is not advisable to receive all income as dividends because this will eliminate the ability to contribute to an RRSP or IPP, and the corporation must also pay tax on the profits before distributing the dividend.

10. Non-Deductible Expenses

Non-deductible expenses, such as entertainment, club dues and life insurance premiums, or debt payments, are paid with corporate tax dollars at 19% vs personal higher rates at 46%.

11. Family Members on Payroll

Family members can be paid reasonable salaries for work done in the practice. Care must be taken to pay the same amount of salary as would have been paid to non-family members for the type of work being done.

12. Corporate Owned Life Insurance

Life insurance can be owned and paid by the corporation instead of being done personally. This makes the payment of the premiums much more affordable because they are paid with the lower-taxed corporate dollars instead of higher-taxed personal dollars. In addition, the majority, if not all, of the death benefit is paid tax-free to the remaining shareholder.

Of the 12 tips noted above, the two that are most often overlooked are #2, Non-Voting Shares and, #5, IPPs.

In January, 2006, a few years after incorporation was permitted for dentists, legislation was amended to allow family members to own non-voting shares. The family members include spouse, children (if a minor child must be held in trust) and even parents.

What we have found is that a number of dentists who incorporated initially when the rules did not allow family members, have not gotten around to making the adjustment.

The problem of not making the adjustment is the inability to draw monies out of the corporation tax-free via dividends to individuals with little or no income. The problem can be easily fixed. The process would involve freezing the current value of your existing shares and then allowing family members to subscribe for new shares. Remember, these new shares should be different from your existing shares, as they should contain specific attributes that would allow them to receive discretionary dividends and the opportunity to redeem these shares in the future. As always, speak to your financial advisor before implementing any strategy.

Individual Pension Plan (IPP) is one of the best-kept secrets in retirement planning. With the ability for dentists to incorporate, they now have the ability to establish their own company sponsored IPP. For those doctors that are over the age of 40 and pay themselves a salary of over \$100,000 the benefits of an IPP are extensive. I refer you to an example we provided in a previous Tax Matters for Dentists (Volume 1 #3) (visit our website www.ddstaxes.com for all previous versions).

Dr. Smith, age 50 has a salary of \$100,000 and his spouse, age 46 has a salary of \$60,000. Assuming a retirement age of 65, Dr. Smith and his spouse have the ability to contribute to their RRSP a combined total of \$618,900 over the next 15 years. Due to a number of benefits available in setting up an IPP, Dr. Smith and his wife could contribute a combined \$926,500. With a growth rate of 7.5% (government regulated) the difference is close to \$478,000.

The above two tax tips are only a few ways in which we can help you establish and enhance your financial future. Give us a call at 905-273-6605 for your free one-hour consultation.

Stive Farronato, CA, CFP is a financial planning advisor for Assante Financial Management Ltd. He specializes in providing advanced tax planning strategies for the dental professional. Stive graduated from the University of Toronto in 1989. He received the Chartered Accountant (CA) designation in 1992 and his Certified Financial Planning (CFP) designation in 1998. Prior to joining Assante Financial Management Ltd., Stive worked in public practice from 1989 to 1993 and with the Canada Revenue Agency from 1993 to 1995. In 1995, he joined Mike Lakhani's team. Stive is happily married with two lovely daughters and is an avid golfer.

Tax Matters for Dentists

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The Tax Saver Plan includes:

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- 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
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- Preparation and filing of Corporate Federal/Provincial Returns
- All appropriate tax filings of Personal/Family Tax Returns
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E-mail: mlakhani@assante.com Website: ddstaxes.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

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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. Kordas pays \$180,000 dividends tax-free to children to pay for post-secondary education.
- Case #7: Dr. Zappa pays off \$420,000 mortgage & \$660,000 practice Debt in six years.
- Case #8: Protect your Practice in the event of marital breakdown
- Case #9: Dr. Bailey uses \$400k Corporate cash to pay off mortgage.



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WEALTH MANAGEMENT

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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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