Making the Most of a Mature Dental Practice

You are a successful dentist with a mature practice.

Student loans and other personal debts have been paid off. Your cottage is paid for; you are settled in your home and have completed any major renovations. In other words, you have paid for all the "big stuff."

You are now generating significant cash flow from your practice and have other decisions to make such as: What to do with the surplus cash? How much to save? How much to spend? What's the best way to turn surplus cash flow into wealth?

If these are your issues and choices, here are some ideas worth considering.

NEW SURTAX ENHANCES TAX SAVINGS OF PROFESSIONAL CORPORATIONS

The federal government introduced legislation to incease the tax rate for high income earning individuals. For example, the top marginal rate for individuals with taxable income in excess of $220,000 is now 53.5%. This, compared to the 15.0% corporate tax rate on the first $500,000 of net business income earned through a professional corporation, makes incorporating a practice even more compelling. The big win is the tax deferral of 38.5% (53.5% - 15.0%) if you can leave the funds in the company rather than take the after-tax amount out as dividends. The typical strategy would be to pay a salary from the company sufficient to reduce income below the $500,000 threshold.

SPLIT INCOME WITH FAMILY MEMBERS

Income splitting is transferring income from a high tax rate to a low tax rate family member; thereby, reducing the total family tax bill. Here are three effective income splitting strategies:

1. PAYING SALARIES

Children attending school will likely have little or no taxes to pay on income from summer or part time jobs. Family members can receive compensation for legitimate work performed on behalf of the practice.

2. PRESCRIBED RATE LOANS

You cannot simply give capital to family members and have the investment income taxed in their hands. However, you can loan capital to them either directly or indirectly through a trust (required for minor children) secured by a promissory note bearing CRA's prescribed rate (currently 1%) and have the excess amount taxed in their hands. For example, let's say you loan $1 million to three family members who otherwise have no income. The amount is invested and earns 6%, annually. The borrowers must pay you 1% interest, or a total of $10,000, within 30 days of each calendar year. The net return of 5% or $50,000 is then taxed in the hands of the lower taxed family members.

3. REORGANIZE SHARES TO INCLUDE ADULT CHILDREN AS SHAREHOLDERS

Dentists with mature practices often have adult children they are supporting financially. Children can receive dividends on non-voting shares of professional corporations as a tax-effective way to pay for family expenses. Many dentists incorporated their practices several years ago but excluded minor children as shareholders as they would otherwise be subject to an unpleasant "kiddie tax" on dividends. Once children reach age 18 there is no kiddie tax, and paying dividends to dependent children can be a very effective way of paying for education or other costs. Another benefit of adding family members as shareholders is that, upon a sale of the professional corporation, the capital gain on future growth can potentially be sheltered by each shareholder's $824,176 capital gains exemption on qualifying small business shares.

ACCUMULATE WEALTH WITH CASH FLOW

You are in your peak earning years, also your peak saving years. Your best chance of building wealth is to save your free cash flow. Unfortunately, many would-be savers just can't help themselves from big ticket spending on 'things', which may satisfy in the short term, but do nothing to build wealth for the future. To become more disciplined in both spending and saving, we suggest:

1. PAY YOURSELF FIRST

A forced savings program has worked well for some of our dentist clients whereby a fixed amount each month (e.g., $10,000) is deposited into investment accounts. We recommend, first, topping up your RRSPs and TFSAs for you and your spouse and then building your non-registered assets. It's not fancy, but if the money isn't burning a hole in your pocket you are less likely to spend it. Investing savings each month effectively averages into securities rather than trying to time the market, which never works.

2. CREATE AN OBLIGATION TO PAY

If you have difficulty saving money, consider taking on debt for investment to be paid over a fixed period. The amount should be determined by working backwards from an affordable monthly payment of interest and principal. At maturity, the debt will have been totally repaid, your principal will have been saved (and if invested prudently, hopefully will have grown from the original amount) and you will have received tax deductions for the interest payments made each year. Two cautionary points of note, however: (1) do not play the spread game, which is paying interest only and trying to earn a return in excess of your interest costs, and (2) do invest the loan proceeds conservatively to build wealth rather than risk capital losses.

DEVELOP A ROAD MAP AS YOUR GUIDE

Typically, your top financial priority is to accumulate sufficient capital to be in a position to retire by a particular age. The plan should start with detailed projections to test the reasonableness of that plan based on certain assumptions regarding investment returns, inflation, personal spending and savings. Generally, we find that most clients have realistic retirement goals and do not need to take on significant investment risk to attain them. Others may need to make adjustments to their spending or push back their planned retirement. Either way, you need an objective assessment of where you stand. We call this our ***Retirement Crash Test™***.

IMPLEMENT AN INVESTMENT PROGRAM AND STICK WITH IT

You are an expert in your profession of dentistry. You may like to dabble in stocks, but you know it's a part-time hobby and not a full-time profession. Given the large amount of cash flow and assets involved from a mature practice, many dentists come to realize their approach to investment management is almost as important as their approach to dental practice management. We recommend finding an advisor you trust to develop an investment plan that meets your needs, and has a philosophy and process that generates proven results. Your road map should dictate the amount of investment risk and allocation between yield and growth investments. Investments should be spread across multiple asset categories (e.g., corporate and high-yield bonds, income-producing real estate, mortgages, Canadian and global equities). The concentration in each category will change periodically as market conditions dictate, but the overall strategy should not. You cannot accurately time the market, so don't try. Instead, develop an investment program at the outset that is appropriate for you based on your needs and tolerance for risk. Then just stick with it over the long term.

Dentists, together with lawyers and accountants, are among a fortunate group of high income earners with an opportunity to build substantial wealth simply by saving professional income and investing it wisely. It's like hitting singles rather than swinging for the fences. Some say there is no magic to it; we say yes, there is. It's the magic of compounding. Save as early as you can and as much as you can and you will be amazed at how attainable that retirement goal actually is.

ABOUT NEWPORT PRIVATE WEALTH

Newport Private Wealth is among Canada's largest independent wealth management firms for high-net-worth individuals.

The firm offers professional investment management and full-service wealth management delivered through a team of multi-disciplined investment professionals averaging 25 years of experience. Based in Toronto, Newport Private Wealth is privately owned and managed by its professionals who, to ensure alignment of interests, have their own money invested alongside clients.

Newport Private Wealth's investment approach is purpose built for individuals who want to earn steady income to fund their lifestyle now or in the future, grow their wealth ahead of inflation and protect their capital from significant or permanent loss.

To achieve these objectives, Newport Private Wealth offers its clients the best of both worlds: the preferred access of an institutional investor with the personal service of a boutique.

Using its size and capabilities, Newport Private Wealth sources hard-to-access private investments, such as real estate, infrastructure, etc. to complement traditional stock and bond asset classes, so client portfolios are less dependent on the ups and downs of the stock market. For specialized expertise in these asset classes, it retains independent money managers – many of whom are unavailable to individual investors.

At the same time, the firm's style of personalized service, low turnover and high levels of client satisfaction* evoke a boutique experience for the families it serves.

Newport Private Wealth's services are best suited to individuals with a minimum of $1 million to invest. Individuals with less than $1 million can access Newport Private Wealth's investment management capabilities through its division, Lonsdale Portfolios.

We take a different perspective.
Yours.

Newport Private Wealth
469 King Street West, 4th Floor
Toronto, Ontario Canada M5V 1K4
Main: 416.867.7555
Toll-free: 1.866.534.5402
www.newportprivatewealth.ca

* 97% client satisfaction rating as measured in a 2013 third-party survey conducted by Advisor Impact.