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TaxMatters For Dentists™

Complete Tax & Financial Solutions

"The Connected Dentist™"

- CRM2: What Investors Need to Know
- Selling a Dental Practice: Part I
- Cross Border Tax Planning for the High Net-Worth Individual

CRM2: What Investors Need to Know

At a dinner party or out on the links, it's quite common to discuss investment returns with friends and associates. More often than not, the conversation leans towards bragging about the 'winners' and staying quiet about the 'losers'. But how does an investor know the actual performance of their portfolio net of costs once all the trading activity has been considered?

Important changes to Canada's investment industry were ushered in last year, offering more transparency to Canadian investors with regard to portfolio performance and investment fees. CRM2—aka Client Relationship Model, Phase 2—is now in full effect.

The industry changes introduced two new annual reports:

- *Investment Performance Report* details the rates-of-return earned by your investments.
- *Charges and Compensation Report* details the costs paid to your brokerage or financial institution.

Will CRM2 change the conversation? More likely, it will introduce increased clarity and assurance now that investors can get a better grasp on the performance and costs associated with their investment portfolios.

Standardized performance reporting will provide investors with a better understanding of personalized rates-of-return, especially if this information is not currently reported in any fashion. Investors can assess their results in a fair manner so comparisons can be made to the markets, benchmarks or other portfolios.

The compensation report will provide details about the money received by the brokerage or financial institution over the previous year to provide services to the investor. It does not necessarily indicate how much is paid to the actual advisor or advising team. Each firm determines this amount differently, based on its business

model and split in responsibilities between the firm and the advisor.

Contrary to what many may think, there are always costs to investing, even for do-it-yourselfers. The most common fees include the Management Expense Ratios (MERs) on ETFs and mutual funds, commissions paid for stock/bond trades, or the bid/ask spread on trading securities in a brokerage account.

Many investment advisors, including ourselves, embraced increased transparency years ago using a fee-based model of compensation, meaning the costs of providing financial advice stays separate from investment fees. This new reporting will increase transparency and make it easier for investors to assess the value they receive from their advisors.

Working with an investment advisor should ensure confidence and peace of mind regarding the decisions that are going to grow your wealth as well as protect your nest egg. Our clients have come to appreciate that we consider the entire financial picture within financial planning, not just the investment portfolio. Our goal is

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always focused on managing cash flow, minimizing taxes and growing your Net Worth to help you achieve your personal long-term objectives.

Oscar Wilde, the well-known novelist and playwright, famously quipped about one "who knows the price of everything and the value of nothing." We concur: the values cannot be hidden where your finances are concerned and we're pleased with the introduction of this new enhanced reporting. Not only does it level the playing field across Canada's investment industry, it makes it easier for you, *The Connected Dentist*™, to evaluate the service and value you receive from us, your trusted financial advisors. ■

ALSO IN THIS EDITION

of *Tax Matters for Dentists*, one of our veteran advisors, Chris Molloy, explains how to set the environment when preparing a practice for sale. Our guest contributor, David Altro, discusses cross border tax planning opportunities for high net worth clients who own vacation properties in the United States.

TMFD provides dentists and dental specialists with complete tax and financial solutions from graduation through retirement. To book your no obligation appointment to discuss your goals or obtain a second opinion, please contact us directly at info@tmfd.ca or (844) 311-8633.

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Selling a Dental Practice: PART I

You might be ready for retirement and a long anticipated journey of new pursuits, or in mid-career and looking to sell one of your multiple practices. Either way, the sale of a practice represents the zenith of years of effort, skill and patient relationships. This is the first of a two-part series focused on preparing a dental practice for sale.

The moment you begin to consider a practice sale is the moment you begin to realize the benefits of preparation. Well-laid groundwork can almost guarantee peace of mind, the highest value for your sale and a smooth transition experience for your patients and staff. The alternative is rife with pitfalls that can have negative domino effects on the ultimate sale, from missed opportunities for proper tax planning to a poor experience for all.

PLANNING IN ADVANCE

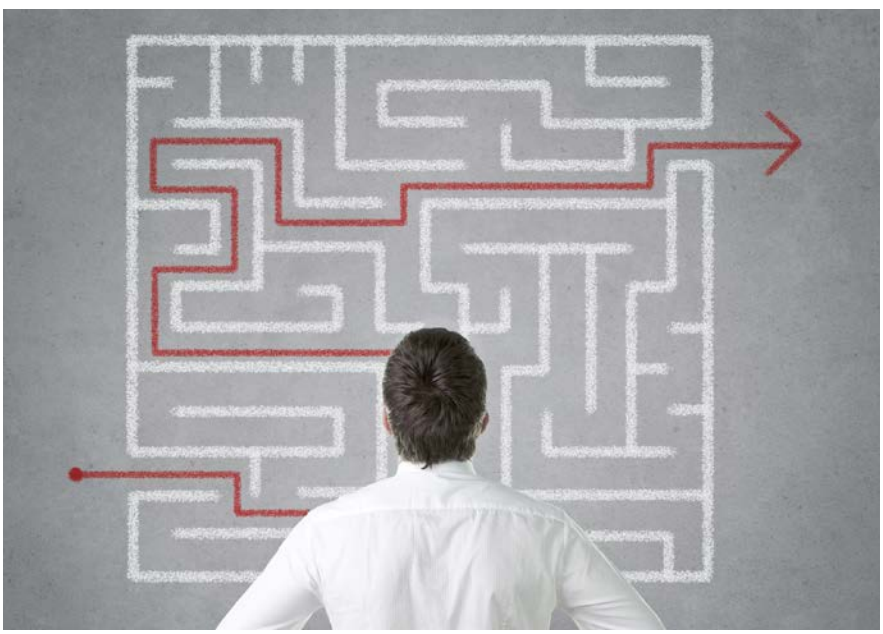
Proper planning should start as early as three to five years prior to practice sale. A common starting point is to obtain a valuation of your practice. Not only will this give an indication of the current value, but it can identify areas which need improvement. Consider that at the time of sale, a typical buyer will be looking at the most recent three year history of revenue and expenses. It makes sense to implement new processes well in advance so that future profits reflect these improvements. Every $1 increase in profit could translate into an additional $6 increase in practice value (based on common metrics in the marketplace today).

PRACTICE MANAGEMENT

Hiring a practice management consultant at this stage can be a wise investment. Dale Tucci, of TMFD Tucci Management Practice Consultants, has a history of helping dentists identify revenue opportunities within a practice. According to Dale, "One of the cornerstones of practice revenue is a strong hygiene program." Dale and her team focus on uncovering dormant hygiene revenue, which can be addressed by allocating hygiene hours to when demand is greatest. In addition, Dale's team works productively with staff to assess hygiene care intervals, so that patient recall frequency stays current and does not slip over time leading to lost revenue. A general dental practice with 40% hygiene production is at an optimal level, which translates into a better practice value.

PREMISES LEASE

Within the three to five year window prior to sale, it's also important to turn your attention to the premises lease. The lease is arguably the most important legal document for any practice since the goodwill value is so closely tied to the location. There are a number of items to review referring to the ability to assign a new tenant, termination, relocation and non-competition clauses to name just a few. It's crucial that the terms for renewal extend at least ten years; banks are



willing to lend for up to ten years but not beyond the final lease renewal, so it's important to plan ahead as each term renewal comes up for negotiation.

TAX PLANNING

Tax planning also requires substantial timelines of preparation to achieve the lowest tax payable.

Ideally, you will want to sell shares to reap the tax benefits; it's in your favour to set up a Professional Corporation and transfer the business into the company. The Lifetime Capital Gains Exemption (LCGE) allows the capital gains to be received tax-free upon the sale of shares in a private company, such as a dental practice, subject to certain limits. For 2016, the LCGE is $824,177 and tax savings could be as much as $220,500 for Ontario residents (2017 rates not available at time of writing). Since this exemption is available per shareholder, the structure of the company is so important prior to a sale. Consider adding your spouse and other immediate family members as growth shareholders as soon as possible so that others can utilize their personal LCGE and potentially "multiply" the benefit of tax-free proceeds.

As an example, let's say a dentist purchased shares of another practice years ago and amalgamated the old company into the new Professional Corporation. The existing practice sells for $1.1 million. The Capital Gains is now determined between the sale price and Adjusted Cost Base (ACB) of the Professional Corporation. Let's also assume the ACB is nominal ($1), which reflects the value at the time his company was established. The taxable gain would be $275,823 (the difference between $1.1 million and the first $824,177). However, if both spouses had been growth shareholders from inception, each spouse would qualify for the LCGE and no tax would have been payable.

Well-laid groundwork can almost guarantee peace of mind, the highest value for your sale and a smooth transition experience for your patients and staff.

There are rules to heed in order to qualify for the LCGE, so it's wise to review your corporate structure well in advance and ensure the company is "purified" of passive assets such as cash and investments. Two years prior to sale, no more than 50% of company assets can represent passive assets, and no more than 10% at the time of sale.

A simple way to "purify" is to withdraw all cash and investments from the company prior to sale. However, according to Stive Farronato, CPA, CA with TFMD, "this is rarely a good solution since the withdrawals are fully taxable. The immediate tax impact could far exceed the savings." Due to RCDSO rules, only a dentist is permitted to own controlling shares of a Professional Corporation. This limits the tax planning opportunities available to dentists. Stive works proactively with clients to assess and advise on solutions to minimize the tax impact upon sale.

WORK WITH TRUSTED ADVISORS

The advice here may seem daunting at first blush, but remember, you don't navigate practice sales waters alone. At TMFD, we work closely with dentists preparing for sale to ensure a positive and productive outcome. Please contact us for a complimentary initial assessment.

In our next article, we will explore other elements of preparing a practice for sale, such as managing practice management software, staff contracts and things to do upon closing.

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Cross Border Tax Planning for the High Net-Worth Individual[1]

If you are a Canadian high net worth individual with a U.S. property, will your estate upon your death be subject to U.S. estate tax? U.S. estate tax applies where a Canadian passes away with real estate worth over $60,000 USD with a worldwide estate value over $5,490,000 USD as of January 1, 2017. Please note that the tax rate is 40% on the U.S. property less a pro rata credit.

There are many different ways that you might hold title to your U.S. property, which we presume is a personal use, recreational house or condo in the Sun Belt.

Instead of wasting your time now reading through reams of pages describing all the possibilities and explaining the pitfalls of each structure, let's zoom in on a special type of trust: the Cross Border Irrevocable Trust (CBIT). We have developed the CBIT over time, fine tuned and recommend it often. If drafted correctly, the CBIT may eliminate the entire U.S. estate tax liability.

The CBIT won't be for everyone. Nothing is perfect and every situation and family dynamic is different and needs to be analyzed carefully.

The Parties to the CBIT

In the CBIT, there are two important parties: the trustee and the beneficiary (or beneficiaries). We like this trust for clients who have children and want to leave their estate to the next generation. For those clients, their children would be the beneficiaries. The CBIT is an irrevocable trust, so you should be comfortable with your choice of beneficiaries although the trust does provide for limited flexibility.

The trustee can be a spouse and/or an independent person (not a beneficiary). The independent person need not be a corporate trustee. Why pay money to an institutional trustee when this is a personal use property with no rental income? If there is an independent trustee who dies or becomes incapacitated, the CBIT has a replacement mechanism.

Once the CBIT is prepared, reviewed, signed, sealed and delivered in accordance with U.S. tax and trust law, while complying with the applicable Canadian laws, it is ready to be the buyer of your property. Make sure you get the right advice from a cross border attorney on how to appropriately fund the CBIT and how and from where the money should be transferred to the U.S. title and escrow company to pay for the purchase.

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[1] This article has appeared, in part, in David A. Altro's book *Owning U.S. Property the Canadian Way, Third Edition.*

After The Dust Settles... What Happens?

You and your family can now enjoy the use of the property. If you pass away, there won't be any U.S. estate tax payable by your estate or that of your spouse upon their subsequent death. Additionally, it won't matter whether the worldwide exemption amount goes up or down now or in the future.

Your children are protected in the trust from their personal creditors, if any, and should your son or daughter unfortunately experience divorce, the ex-spouse can't access the property inside the CBIT because it won't be considered a marital asset.

If you decide to buy a second U.S. property, it can go right into the CBIT.

If you decide to sell and there is a profit, the capital gains tax will be at the minimum Internal Revenue Service (IRS) tax rate of 15% on the net profit (19.6% if gains are over $400,000). Canadian capital gains tax will also be due, but the tax paid by the CBIT to the IRS will be preserved and applied as a foreign credit against the tax payable to the Canada Revenue Agency (CRA). No double taxation!

If you and your spouse decide to sell, are both living, and aren't purchasing another U.S. property, the money from the proceeds of the sale goes into the trust. The money should get wire transferred into the bank account for the CBIT back in Canada. After that, you can either leave the money in the CBIT or take it out.

If purchasing and in need of a mortgage from a U.S. bank, it's important to have your cross border attorney confirm with your U.S. mortgage lender that it understands that title will be in the CBIT and that the lender will provide a mortgage on property owned by a trust. American banks have some lending restrictions. I suppose it's as a result of their overly lenient prior lending practices that resulted, in part, in the U.S. banking disaster.

What If I Already Own the Property?

Things become somewhat more complicated if you already purchased a property in your personal name and discover that you have a U.S. estate tax problem. There are additional steps to go through to submit your property into the CBIT. There is no question it needs to be very carefully structured. Many of our clients come to us after they have already purchased, as they may not have been aware of the issues at that time. It is important to determine whether the property has appreciated in value. We do not want to trigger a capital gain tax upon the transfer to the CBIT. With proper structuring, there are strategies that help to both alleviate the U.S. estate tax hit upon death and to avoid the requirement to probate the estate in the county where located upon your passing.

DAVID A. ALTRO B.A., LL.L., J.D., D.D.N., F. Pl., TEP, Florida Lawyer & Canadian Legal Advisor, is the managing partner of Altro Levy LLP, which he founded in 1988 with offices in Toronto, Montreal, Calgary, Vancouver, Florida, Arizona and California. David is the author of the books *Owning U.S. Property the Canadian Way, Third Edition* and *Americans Living in Canada – Smile, The IRS is Watching You.* Mr. Altro has been practicing law for over 30 years in Canada and the US, and his practice focuses on cross border tax, estate planning and real estate for high net worth individuals. He has written articles for numerous legal and industry publications.