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Selling your practice?

Payment for restrictive covenant could be tax exempt

According to a Federal Court of Appeal decision, a payment received in respect of a non-competition agreement is not subject to tax. The tax-exempt status of these payments under such agreements was established in 1997 in the case of *Fortino v. Canada*. The court case has implications, particularly for those dentists who are contemplating selling their dental assets. If you negotiate with the purchaser that a portion of the purchase price be allocated to the restrictive covenant, then in fact the proceeds would be tax exempt. Before you plan to allocate a large portion to the restrictive covenant, however, you need to have the purchaser agree to the allocation. Keep in mind the tax symmetry: when the payment is not taxable to you, the purchaser will not be able to deduct the payment or write it off as goodwill amortization. Interestingly, while everything else attracts income tax, payments under a non-competition agreement are non-taxable. While the court decision stands for now, don't be surprised if in the future the tax department changes the laws.

Earn an extra \$7,200 per employee per year

Did you know that the average dental practice loses an estimated \$7,200 a year per employee due to waste, fraud, and poor internal controls?

Your CA-prepared financial statements don't include an audit of your practice and, in most cases, no one is carefully reviewing your accounting procedures including whether an internal control system is in place and functioning properly to protect the assets of your practice.

You would not think of purchasing a home without a home inspection. Likewise, shouldn't you insist on a review of internal controls and operational efficiency before you purchase a dental practice?

If you need to be reassured about the efficiency and strength of your practice management systems, you should inquire about our Dental Practice Operations Review.

Our review consists of a systematic analysis of your procedures and poli-

cies to identify the operational strengths and weaknesses of your practice. The analytical tools we developed are specifically tailored to the requirements of a dental office. The main areas of review typically include billings, accounts receivables, cash receipts, disbursements, purchasing of supplies, and payroll. The program is designed to address your specific circumstances. We will present you with a report of the practice review, including money-saving tips for increased efficiency, and help you implement the recommendations.

The Operations Review reflects our comprehensive training as accountants and auditors, and our 23 years of experience with dental practices.

When it comes to the financial health of your practice, an ounce of prevention is worth a pound of cure.

Contact us and find out more about our Dental Practice Operations Review.

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When price becomes the only issue

You are in the process of selling your practice but are running into heavy resistance when the topic turns to the purchase price. Your asking price, supported by a valuation report, seems more than reasonable. Still, the ‘price’ issue—a seemingly insurmountable hurdle—turns into a gorilla sitting between you and the prospect.

How do you move the issue of price to the backburner, so that you can move forward to successfully complete the transition?

The pros in the business—which includes those dentists who have a knack for selling a number of practices on their terms during their dental careers—understand that the prospect will only commit to a purchase if the value of the practice, as perceived by the prospect, exceeds the purchase price. These dentists use the negotiations as a means to increase the perceived value of their practice. They put themselves in the shoes of the prospect and find out what the key issues are: Is the purchaser looking for a trial associate-ship? A mentoring opportunity? A job for the spouse? Help with the financing of the practice purchase?

Solving these key issues to the prospect’s satisfaction will increase the perceived value of your practice and remove price as the central issue. As long as the price is fair, it will only become a deal-breaker if you fail to raise the perceived value of your practice above the asking price. Rather than browbeating the prospect into accepting the deal on your terms, with a “my way or the highway” attitude, learn to under-

stand where the prospect is coming from and devise your negotiation strategies accordingly.

Remember the advice of famous sales trainer Zig Zigler: “You can have everything in life you want, as

long as you help enough other people get what they want.”

Respond to the prospect’s needs, and price will no longer be the obstacle in finalizing the deal.

How to turn a Good practice into a Great practice

One of the best business books I read in the last year is called *Good to Great*, by Jim Collins. The book provides strategies for a company to make the leap from being a good company to being a great one.

You probably know many good dental practices that are not necessarily great practices. A dental practice can achieve impressive, often short-term financial success on the strength and personality of the dentist. These practices seem to succeed in spite of themselves. In other words, instead of their practice being great, it is really the owner-dentist who is great. Their practices often lack sound strategies for marketing, management and developing people.

Collins observes that good-to-great leaders are “modest, quiet, reserved, even shy, a paradoxical blend of personal humility and professional will. They rely on inspired standards, not charisma, to motivate. In a great dental practice, the dentist builds a strong team.”

Get the right people

According to Collins, “Good-to-great firms did not *first* figure out where to drive the bus and then get

people to take it there. Instead, they *first* got the right people on the bus (and the wrong people *off* the bus) and *then* figured out where to drive it. People either stay on the bus for a long time or they get off in a hurry.”

A common mistake in dental practices is lowering standards for whom to hire and whom to keep. When it comes to how much dentists will expect from staff, they often accept mediocre performance.

Pursue the hedgehog concept

Hedgehogs, when under attack, roll themselves up into little balls and become spheres of sharp spikes, always surviving against the enemies. Collins states, “Hedgehogs simplify a complex world. They reduce all challenges to simple ideas. Hedgehogs see what is essential and ignore the rest.”

The lesson here is that you should focus on what you do best, be passionate about it, and pursue your dreams and goals with disciplined action, strong standards, and with integrity.

Thieves you trust

When his accountant called during the preparation of the financial statements to ask whether he was taking more time off from the practice or choosing to see fewer patients, Dr. Don Lewis, an oral surgeon in Cleveland, Ohio was stunned. He had been doing just the opposite: seeing a record number of patients, and his free time was at an all-time low. Don's accountant presented him with the incredible news that despite his best efforts, he was making less money any way he could measure it. It was the day that Don, for the first time, took a serious look at his financial records.

“Almost half of all dentists have been or are being embezzled”

— Mindy Salzman

Ten years earlier he had hired an office manager. She was a doctor's dream—or so he thought. The office manager handled everything pertaining to the business side of his practice. She did the billings, handled the banking, dealt with insurers, and worked with collection agencies. She worked tirelessly. When Don finished his financial audit, he realized that his office manager had embezzled a documented \$80,000, which he figured was just the tip of the iceberg. There was no restitution for his financial loss, as all the money had disappeared, and the insurer's liability was limited to only \$10,000.

To help other dentists avoid such a devastating experience, he published a book entitled *Employee*

Embezzlement and Fraud in the Dental Office, in which he outlines the preventative measures the dental practice can take against fraud, including the establishment of sound accounting policies and internal controls.

In a study by KPMG, three main factors were identified to determine whether a person will likely commit fraud.

1. Situational pressures

An employee may be under pressure because of personal problems, job frustration, or huge debts.

2. Opportunity

An employee's opportunity to commit fraud will increase as his or her responsibility increases, or when effective internal controls are absent.

3. Personal integrity

This is probably the most important factor: a person intent on committing fraud will succeed even in a well-managed practice; conversely, a person with strong moral values and integrity will never commit fraud, even when faced with the opportunity to do so.

There are an unlimited number of embezzlement schemes. Here are two of the more common ones:

Skimming

Here, the cash received from the patient is simply skimmed and taken by the employee. This can be done by not making any record of the transaction. The cash is received but not recorded.

Lapping

Consider this scenario. Patient A makes a payment of \$100. The employee steals the money and does not record it. The embezzler then takes \$100 from Patient B's

\$200 payment and credits Patient A's account for \$100. Now Patient B's account is off by the \$100 taken by the employee. This scheme can go on for many years, especially when an employee has control over many financial aspects of the practice.

According to Dr. Lewis, there are a number of ways to protect your practice.

- Set a good example as the employer. Your employees observe what you do, and they will imitate both your good habits and bad habits. An employer who frequently dips into the petty cash drawer for personal use sets a bad example of acceptable business behavior.
- Establish proper accounting policies.
- Make sure you are knowledgeable about the financial aspects of your practice. Your indifference to the financial health of your practice may be the invitation for an employee to take advantage of you.
- Put in place appropriate internal controls and a good accounting system.
- Whenever possible, there should be a separation of duties.
- Make sure you study up-to-date financial statements.
- Ensure that your employees take regular vacations.

According to Dr. Lewis, if you suspect you are a victim, don't jump to any hasty conclusions. What first may appear to be a clear-cut case of fraud or embezzlement may be nothing more than poor internal controls, creating a situation with a perfectly valid explanation.

Pay yourself capital gains

Dr. Al Dente took out \$200,000 from his dental corporation for living expenses and home renovations. Whether Dr. Al took the funds in the form of a salary or dividend does not matter; the tax is about the same. Reporting the \$200,000 as a dividend, Dr. Al will end up with after-tax income of \$151,000. On the other hand, declaring the \$200,000 as capital gains, the after-tax cash is boosted by \$19,000—to \$170,000. The capital gains strategy works best in the following scenarios.

1. You take substantial cash draws (\$100,000+) from the company, and you don't have the ability to split income with family members in the low tax bracket.
2. You can use the capital gains strategy to split income with minor children, most commonly through a family trust. While income splitting through dividends is *verboten* and subject to the punitive, so-called "kiddie" tax, capital gains allocations to minor children are not subject to any restrictions. For most dentists, using capital gains as an

income splitting mechanism for their minor kids should generate tax savings of about \$10,000 annually for each child. The tax savings are huge, and the extra cash comes in handy in paying off the home mortgage or funding the children's private school.

3. If you have lost money in the stock market, you can apply these capital losses against the capital gains generated from your practice. Suppose Dr. Al reports \$200,000 of his draws as capital gains and utilizes \$80,000 of his capital losses carried forward from the prior year. The extra tax savings are \$15,000. Since many dentists have suffered stock market losses, the capital gains method of drawing funds from your practice helps to utilize these capital losses.

Putting such a strategy in place involves some complexity, in particular the establishment of a holding company. Utilizing the capital gains method means, in effect, paying tax on only one-half of your practice income.

Avoid the taxable benefit of travel points

Many dentists finance their family vacations with Aeroplan points. To boost the accumulation of points, all kinds of practice expenses including lab and dental supplies are paid for by the points-generating credit cards. To minimize the possible assessment of a taxable benefit by CCRA, you should do the following:

- the card should be in your personal name, rather than the company name;
- if your dental corporation is paying off the credit card purchases directly, make sure you write a personal cheque to the company to reimburse the annual card fee.

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