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WEALTH PLANNING FOR HEALTH-CARE PROFESSIONALS – PART 4: PREPARING FOR RETIREMENT

Whether you are a new graduate, working as an associate, running your own practice or approaching retirement, tax, financial and retirement planning will always play a key part at every stage of your career. As your personal, professional and financial situations continue to evolve, you should ensure that you've done appropriate planning to help you achieve your goals and objectives throughout the different stages of your professional life.

The content in this article is for information purposes only and does not constitute tax or legal advice. It is imperative that you obtain professional advice from qualified tax and legal advisors before acting on any of the information in this article. This will ensure that your own circumstances are properly considered and that action is taken based on the most current legislation.

This four-part series takes you through some of the key planning issues you should consider at various stages of your professional career.

Part 1: The Early Years

Part 2: Starting Out on Your Own

Part 3: The Peak Earning Years

Part 4: Preparing for Retirement

Part 4 of this four-part series discusses the relevant issues you face when you are in the pre-retirement phase of your career.



RBC Wealth Management



If the PC has built up retained earnings, you may be in a position to take out the retained earnings over your retirement years as dividend distributions from the corporation.

RETIREMENT PLANNING

You have spent considerable time building up your practice and have developed a loyal and profitable patient base. As you approach your retirement years, have you decided what to do with your existing practice? How do you plan to exit from your current business? Do you have a sufficient stream of income or assets to fund your retirement? All of these questions will need to be addressed as you are nearing retirement.

The first step to developing your retirement plan is to assess and identify where you are financially and determine what you will need to retire comfortably. From a financial and professional perspective, you will need to determine what your ideal working scenario is and what the timetable would be. You should seek help from a qualified advisor to assist you in this process to ensure that you have considered all aspects of your financial situation.

The next step may be to develop plans to achieve your retirement goal. Depending on your circumstances, your practice transition strategy may differ. Due to the nature of the profession, the patient market and the relative ease in opening a practice, there may not be a market for a physician selling a practice. On the other hand, there is currently a growing market for dentists selling their practices. The market in which your practice should be considered to determine the exit strategies that are available to you.

You will need advice from a variety of sources including your accountant, lawyer, and financial planner to help you coordinate both your plan for transition and the sale of your practice. These professionals can assist you in

determining the after-tax amount you can expect to receive when exiting your business, while taking into account your retirement goals and funds available to create a plan that meets your needs.

LEAVING YOUR BUSINESS

From a business standpoint, a succession plan is a detailed roadmap that identifies your potential successors, and provides direction on how the ownership of your business will be transferred to another party upon your retirement. There is generally no succession plan for physicians as the existing practice is typically wound up on the physician's retirement. For dentists, the transition of the practice is usually done in one of two ways: 1) an internal process whereby the practice is transitioned to an associate already working in the practice or 2) an external process whereby the practice is sold to an external party, usually another professional.

WINDING UP YOUR PRACTICE

If your practice cannot be sold, consider winding up the operations of the practice and liquidating its assets. The professional corporation (PC) need not be wound up once you cease practicing through that corporation. If the PC has built up retained earnings, you may be in a position to take out the retained earnings over your retirement years as dividend distributions from the corporation. Talk to your lawyer about revoking the PC's licence or permit and converting the PC into a regular corporation (i.e., holding company) upon retirement. Also, depending on your province of residence and the type of corporate structure in place, now is the time to consider a reorganization to consolidate or simplify your holdings to minimize costs and administration.

In the health-care industry, because it is generally considered a lower risk industry, obtaining financing from a bank is typically the most affordable and accessible type of financing.

INTERNAL SALE

This process involves transitioning the practice to an associate already working in the practice. In the case of a family practice, the successor may be a younger family member. This type of sale may be easier than dealing with an external purchaser for several reasons. The associate will not only have insight into the existing practice, but is generally familiar with the vendor. This may mean less conflict during the planning process and an increased likelihood that the planned succession will succeed. Less due diligence may also be required by the associate in this scenario. Since the associate is familiar with the existing practice's cash flow and profits, he or she may encounter less difficulty if debt financing is needed for a portion of the purchase price. Finally, as the associate is familiar to the patients, suppliers and staff members, an internal transition sale may minimize disruption and maximize continuity for all parties involved.

Typically, once the associate has practiced with the selling dentist for a certain period of time (a period of two to five years, depending on experience) and has generated a certain amount of business (based on a percentage or actual amount of revenue dollars), the associate would begin to “buy-in” to the practice. The associate continues to buy more of the business as he or she gains more experience

and eventually purchases the whole practice. At that point in time, the vendor will either retire or work as an employee or consultant of the practice. This method of transferring ownership interest of the practice allows for a gradual transition, providing flexibility and reducing some of the uncertainty inherent to the process.

Generally, in a business sale to an internal party, an “earn-out” provision is used whereby the vendor receives a lower price on the initial sale of the business but includes a provision in the sale contract which indicates that future compensation is to be paid by the purchaser to the vendor if certain financial results are met (i.e. the business meets certain revenue or profit targets). Other internal buy-outs are structured to occur over a number of years. This allows for the funds to be gradually transferred to the retiring owner while the new owner is able to gradually assume control and responsibility within the same time frame. This kind of “staged exit” may be particularly desirable when the business represents a large portion of the owner's individual net worth. The vendor may be able to spread the receipts — and their attached taxable capital gains — over a maximum period of five years.

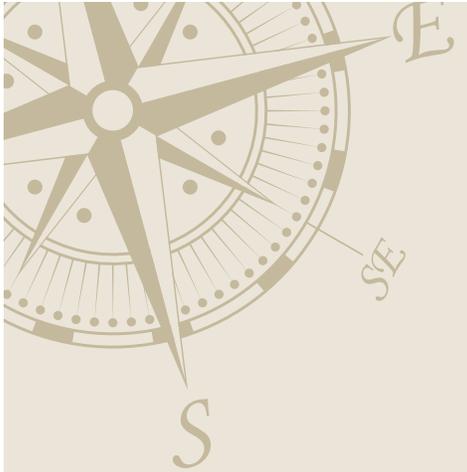
In the health industry, obtaining financing from a bank is typically the most affordable and accessible type

of financing. Due to the prevailing low interest rates and because the dental industry is considered a low-risk industry for financial institutions to invest in, banks generally offer financing on very good terms, such as an interest-only loan for the first year, then a term loan at prime for the next 10 years. Also, because the practice has been in existence and its past cash flow projections are known, the bank can more easily assess the associate's ability to repay the loan and will therefore be likely to help with the financing.

In the Health-care industry, because it is generally considered a lower risk industry, obtaining financing from a bank is typically the most affordable and accessible type of financing. Banks have generally offered very good terms and pricing on financing based upon the assessment of the business plan and an evaluation of the transaction you are contemplating. We encourage you to have early conversations with an RBC health-care specialist who is well positioned to provide you or a potential purchaser of your practice with the advice and financial solutions to meet your changing needs.

EXTERNAL SALE

For dentists looking to maximize the value of their practice, a sale to an external party (i.e., an entity or individual not working in the practice) may be the best option. A typical scenario would be the sale of the



On a share sale, the after-tax cash to the vendor is equivalent to the net cash retained personally by the vendor, after he or she has paid tax on any capital gains.

practice to another professional, group of professionals, or other practice related organizations.

It is often recommended that a business valuator and business broker be hired as part of a team of professionals to manage the succession planning process and the eventual sale of a practice. The business valuator can help determine an appropriate value of the practice. The broker can help find the right buyer and navigate you through the sale process. Planning for this type of transition is normally more difficult because of market uncertainty at the time of the desired transition. Also, an interested buyer may require significant disclosure of patient demographic and financial information as well as have his or her team of advisors perform a certain amount of due diligence. This process may involve the buyer requesting access to sensitive information that you may not necessarily wish to provide. It is recommended that you have a lawyer involved in this process as early as possible to help determine what information can and should be provided to the potential buyer as part of the due diligence process, as well as to assist with negotiating and structuring the sale of the business.. This type of sale generally involves a period of time in which the buyer and the seller work in the practice simultaneously to effect a smoother transition.

SELLING THE PRACTICE

The sale of a practice usually involves the practice owner, the potential buyer, and their team of advisors. However, there are other parties affected as well, such as the patients, staff members and other parties to the business relationship such as creditors and suppliers. If you are planning on selling your practice, it is recommended that

you consult a qualified legal advisor regarding the sale process as early as possible who can advise you with respect to any of the following: any existing partnership or shareholder agreement between you and the other parties; negotiations with the landlord about leasing arrangements; and, the handling of patient lists, existing contracts and business agreements with creditors, suppliers, associates, and patients.

ASSET SALE VS. SHARE SALE

Whether the sale of the practice is structured as an asset sale or share sale will depend on the negotiations between the parties and terms of the contract. For the vendor, the asset sale versus share sale decision will depend on a number of factors, including the ultimate after-tax cash amount to be received personally. On a share sale, the after-tax cash to the vendor is equivalent to the net cash retained personally by the vendor, after he or she has paid tax on any capital gains. The vendor's decision will also depend on whether he or she is able to claim the lifetime capital gains exemption (LCGE) to offset all or a portion of the gain on the sale of his or her shares.

For more information on the LCGE and criteria to qualify for the exemption, please ask your RBC advisor for the article entitled "Capital Gains Exemption on Private Shares".

In order to compare the after-tax amount received by the professional on a share sale versus asset sale, it is necessary to perform the calculations as if the PC will be wound up on an asset sale (even if this is not your intention). This notional winding-up calculation represents a "worst case scenario" as it assumes that all personal tax is paid immediately, when in fact, a deferral of tax is likely

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if you only take capital dividends out of the corporation and draw on the retained earnings in the future (i.e. during your retirement years). The amount that a vendor should be willing to accept under an asset sale should be comparable to the amount that the vendor will net after-tax on the sale of shares.

Determining the amount the purchaser may be willing to pay for the shares is a bit more complex. If the purchaser buys the assets of the PC, then there is full cost basis in the assets (equal to fair market value) to the purchaser. The purchaser will then be able to depreciate the assets from this value. When the purchaser buys the shares, the PC generally retains the lower historical tax values of the assets. Therefore, the purchaser will generally discount the share purchase price by the amount of tax savings in future depreciation that they are foregoing by purchasing the shares instead of assets.

Currently, the top marginal tax rate for capital gains is between 19.5% and 25% depending on the individual vendor's province of residence. Therefore, the value of a claim of \$750,000 LCGE is between \$146,000 and \$188,000. The effective tax rate on the proceeds received by the PC on the sale of goodwill is 50% of the applicable corporate tax rate (where the income is eligible for the small business deduction, the rate is 11% to 19%,

depending on the province; otherwise, the general rate is 25% to 31%). Thus, the outcomes of selling shares or assets are different for each situation due to the varying corporate and personal tax rates among the provinces, the dollar amount involved, and the availability and number of LCGEs which may be utilized where there are multiple shareholders.

FINANCIAL CONSIDERATIONS

There are a number of financial factors to consider as you plan for your retirement. Tax and estate planning should be an on-going process throughout your working life to ensure that your plan continues to reflect your changing needs and meets your current circumstances. It is essential to ensure your plan is still on track to help you achieve your retirement goals. In addition to assessing your sources of retirement income, you will need to review your succession plan periodically to ensure that the projected proceeds from the sale or transfer of your business, or residual cash flow from your corporation (if you end up winding up your practice) will last as long as your retirement does. It can be difficult to replace an income stream in later years, so remember to factor in the effect of inflation and consider strategies that can increase the value of the funds you will receive from the practice transition well before your planned retirement date.

CONSIDER YOUR SOURCES OF RETIREMENT INCOME AND WHEN WILL THEY BE AVAILABLE

It's important to understand your sources of retirement income and how much recurring income will be produced by these sources and by existing income sources. Income sources could include the Canada Pension Plan or Quebec Pension Plan, Registered Retirement Savings Plans, proceeds from the sale of the practice, income from an ongoing interest in the practice, income from a new business venture, or an Individual Pension Plan.

CONSIDER HOW TO MANAGE THESE SOURCES OF RETIREMENT INCOME TO MAXIMIZE THEIR EFFICIENCY

Where will you obtain funds if you have a cash flow shortfall? The general rule is to withdraw funds from non-registered investments before redeeming funds held in tax-sheltered plans. This ensures you continue to defer paying tax on registered investments and preserves the power of tax-free compounding as long as possible. Your RBC advisor can help you decide how to draw on your various sources of retirement income in the most efficient manner to minimize tax, maximize flexibility and make the most of the available tax credits. Your RBC advisor can also help you identify the issues that are relevant for your situation and keep your long-term financial plan on track.



A comprehensive estate plan should contemplate not only the distribution of your assets on your death, but also which individuals or organizations would make decisions on your behalf, from both a personal and financial perspective, if you become incapacitated.

PLAN YOUR RETIREMENT EARLY

Will you need all the proceeds from the sale of the business to fund your retirement? Ensure your succession plan has taken this factor into account. How will you convert the funds received from the sale into an income stream available for you in retirement? If you are transferring the business to family members, perhaps for little or no consideration, this should be taken into consideration in your planning. You will need to ensure that there will be sufficient income either from your business or from other sources to meet your lifestyle needs.

ASK YOUR RBC ADVISOR TO PREPARE A RETIREMENT PROJECTION OR COMPREHENSIVE FINANCIAL PLAN

The million-dollar question that everyone asks is, “Will I have enough income and savings when I retire so I can live comfortably?” As life expectancies get longer, maintaining a comfortable standard of living throughout your retirement may become more challenging. Give yourself peace of mind and speak to your RBC advisor about preparing a retirement projection for you so you can gain a clearer picture of where you stand today and what changes, if any, need to be made in order to reach your retirement income goals.

If you have a higher net worth and your situation is more complex or you are going through a transition period with your practice, then you may want to speak to your RBC advisor about having a comprehensive financial plan prepared. A comprehensive financial plan should address all aspects of your financial affairs, including cash and debt management, tax and investment planning, risk management, and retirement and estate planning.

ESTATE PLANNING

While you are in the process of positioning your business for an eventual sale and planning your exit strategy, you also need to plan to protect yourself in the face of unexpected events. A comprehensive estate plan should contemplate not only the distribution of your assets on your death, but also which individuals or organizations would make decisions on your behalf, from both a personal and financial perspective, if you become incapacitated. Update your Power of Attorney (POA), Will(s), and insurance coverage to ensure that if you or a key member of the practice becomes unexpectedly ill or dies, your personal and professional affairs can be taken care of without undue legal complexities or tax burdens.

- **Planned locum agreement** – A locum agreement is essentially a contract for services where the locum (temporary replacement physician or dentist) steps in to provide professional services to the practice’s patients and maintain the practice’s operations while the professional is away and cannot attend their practice. Having a locum agreement is good practice management as it reduces the uncertainty surrounding the situation where the professional is unable to perform his or her duties and allows the business to continue without interruption. It also allows the professional and the locum to negotiate mutually agreeable terms in advance.
- **Contingency plan** – In the event of a premature death, would you want your practice to continue, close or be transferred on your behalf? If you are a sole practitioner of your own PC, the corporation does not cease to exist. However,

Having an updated Will ensures that in the event of your passing, your property will be distributed to your beneficiaries according to your wishes and the individual or corporation that you wish to act on your behalf to carry out your wishes are able to do so.

since only a registered practitioner can hold voting shares of the PC, and your estate is not considered to be a registered practitioner, your corporation would no longer comply with the regulatory requirement that only registered practitioners may hold voting shares of the PC. Therefore, your legal representative or ultimate beneficiary may choose to wind up the corporation, sell the shares or continue the corporation as a regular corporation that is not a professional corporation. If you are in partnership with other practitioners, you should consider putting in place a partnership agreement that includes an insured, tax-effective buy-out plan to be implemented in the event of the death of one of the practitioners.

- **Update your Will** – A Will represents the most fundamental element in any estate plan and is essential to ensuring your wishes are carried out with minimum expense and delay. Having an updated Will ensures that in the event of your passing, your property will be distributed to your beneficiaries according to your wishes and the individual or corporation that you wish to act on your behalf to carry out your wishes are able to do so.

- **Update your POA** – An enduring or continuing POA is a legal document which may become invaluable in the event you become incapacitated and cannot perform for yourself your normal daily tasks, such as paying bills and managing your investments. This document gives another person(s), referred to as the attorney(s), the power and authority to act on your behalf.

A POA for property is used to allow the attorney(s) to make decisions about financial and property matters. A different legal document may be used in some provinces and territories to allow an attorney to make personal care decisions on behalf of another individual. In some provinces, you may be able to execute one document which will contain your authority for an attorney to act on your behalf in relation to financial and property matters as well as personal care matters.

- **Minimize double tax exposure** – Have you thought about what your beneficiaries will do if you leave them private company shares? You may know that you are generally deemed to have disposed of your capital property, including any private company shares, at

fair market value on your death. However, you may not be aware that there could be a potential for double taxation of your assets. Your estate pays tax on any capital gains realized on the deemed disposition of your shares on your death. If the surviving shareholders decide to wind up the PC, the corporation may be required to pay tax on the sale of the assets, followed by more taxes payable by individual shareholders when the proceeds are distributed to them. You can defer this double taxation by leaving shares to a surviving spouse. On death, the shares will roll over to the surviving spouse at cost. Another way to mitigate the tax impact on death is to have the shares sold by your estate if a buyer can be found. Other advanced tax strategies may be available so you should consult with an expert tax or legal advisor to perform what is typically known as “post-mortem” planning. If you own private company shares, such as shares of your PC or holding company, give some thought to post-mortem planning when developing your estate plan.

Give your family and yourself peace of mind by booking an appointment with a legal advisor who specializes in Will and estate planning to review and update your estate plan.

Please contact us for more information about the topics discussed in this article.

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