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Choose Your Own Adventure: The “Perms and Combs” of Career Investing and Practice Sale Strategies

Remember those “Choose Your Own Adventure” books in elementary school? They involved a character who experiences a different journey and eventual outcome based on the options created by the author and chosen by the reader. Also known as “Secret Path” books, the same one could yield different journeys for their characters, even with some of the same choices made by the reader. Based on the number of choices, there were different permutations and combinations that created a different story. For a young, developing mind, these stories gave a sense that, to some degree, the reader could control the outcome, and that choices have consequences. Sometimes, these consequences could be anticipated, while other times they could not.

Then, in high school, finite math involved the study of permutations and combinations, often abbreviated as “perms and combs.” Permutations are mathematical sequences where the order of the number set matters. Combinations are sequences where order does not affect the outcome. Perms and combs could be thought of as a mathematical model of the choose your own adventure books.

When we look at “real life” from a financial perspective, there are an infinite number of choices with consequences and benefits, and with dynamic, external influencers. Even when we control for external influencers and changes in the economic climate, every dollar earned can have a different legacy based on the strategy. In essence, the perms and combs of a financial strategy are endless, but they matter for the lead characters in your life. For dentists, investment strategies and

practice-sale considerations have an effect on retirement outcomes, and are influenced by the climate of the stock market and practice marketplace.

This article will review six financial options for a dentist’s financial “adventure.” Three are presented from the perspective of career investing, and how different long-range approaches can result in different retirement savings outcomes. The other three are presented from a practice-sale perspective, showing how different strategies of practice-sale considerations can yield different after-tax, take-home profits. By no means are these scenarios exclusive or exhaustive, but they give pause for consideration of how dentists can strategize and choose their own path.

A career of investing

As a dentist, you are an associate or practice owner. As a practice owner, you have both challenges and benefits. Owning a practice requires not only investing in your clinical skills but also investing in your team and the practice to support patient care and meet current standards. The investment in practice ownership can offer a rewarding career, but it requires staying on top of clinical technologies, administrative responsibilities, infection prevention and control protocols, and patient-management considerations. Continued learning and relearning are critical for any clinician to maintain and grow a practice. Being an entrepreneur in dental practice ownership can be demanding, invigorating and satisfying — sometimes all in a single day.

The early years of practice ownership often require focus on practice growth, but some consideration should

also be given to a retirement plan. A dentist retiring at age 65 should expect that she and/or her spouse will have at least another 30 years of life to enjoy, with the majority of that time doing the things they want, when they want. In essence, dentists spend the first third of their lives preparing for a career in dentistry, the next third practicing dentistry, and the final third in retirement. To maximize that final third, it is critically important to plan and prepare for retirement early on in a dental career. There are a number of options to consider in planning for retirement through a career of investing that can yield vastly different outcomes; we will highlight three theoretical options.

The first common, simple and straightforward approach to investing is a T4 salary approach. This can be effective in creating retirement savings but may also require contributions to the Canada Pension Plan (CPP), which can have a negative return on the funds contributed. This scenario of career investing may result in an “RRSP trap,” where the investor is forced to contribute to RRSPs in order to reduce the tax bill during her working years, only to find that tax is deferred to the final third of her life.

A second option could be a blend of T4 salary and T5 dividends for the dentist’s paycheque, where one could minimize the amount of T4 salary to coincide with any government-support programs (child care, tax credit, etc.). This would permit the reduction or elimination in CPP contributions, saving up to \$8,000 per year. In this scenario, creating a portfolio of real-estate properties to generate rental income that is then used to pay down debt and increase wealth could be considered.

A third career-investing strategy could follow the second option presented but use the dentist’s professional corporation or a newly created real-estate holding company to invest in a “Whole Life Par Policy.” This could be designed with immediate access to cash value. Designing such a policy would mean the policy holder would pay the insurance premium on a Monday and on a Tuesday a lending institution would provide the owner with 90 to 100 per cent of the premiums back at a prime rate of interest. These borrowed premiums could be used to reinvest in the practice or in real estate. This option permits attaining life insurance coverage for the client to protect her family at the cost of pennies on the dollar. Insurance companies in Canada reward each Whole Life Par Policy with an annual dividend. Insurers have been paying dividends for more than 150 years, with the current dividend at six per cent. These policies can be designed with immediate access to cash value, which is not common knowledge. As such, we have found many policy holders have policies that, although they were

designed for them, limit access to the cash value for at least 10 to 14 years. A customizable approach is always necessary to achieve the best outcome in the interest of the client.

When it’s time to sell


The first option here considers that dental practices can be sold as shares in a dentistry professional corporation, or sold as an “asset sale.” In the case where a dentist was not incorporated or had already taken advantage of the available lifetime capital gains exemption (LCGE) at the time of sale, an asset sale may be chosen over a share sale. If we choose the path of an unincorporated dentist who is ready to appraise and sell her practice, we know that the seller cannot take advantage of the LCGE as in a share sale. In an asset sale, a seller is taxed on the various aspects of the practice, including the hard assets and the goodwill at the time of sale. For a purchaser, buying a practice as assets rather than shares presents an opportunity to depreciate the purchase according to the cost of capital allowance as set by the Canada Revenue Agency (CRA). What this means is that a buyer can “write off” the goodwill and hard assets of the purchase over decades of ownership through the allowance of depreciation that does not exist in a share purchase. Therefore, at the same valuation, an asset sale has the benefit going to the buyer and the disadvantage to the seller. Because of this, it has been argued that for a seller to end up with the same net result on an asset sale as she would with a share sale, the valuation of the practice would have to be increased by more than 30 per cent (1). Often, this can be justified by an appraiser with the consideration of allowable depreciation for the buyer. The challenge is that buyers often look at practice value as a percentage of gross revenue, and the optics of this in the marketplace can create a tougher sell. Additionally, the increase in valuation has to come from the goodwill, since the hard assets of the practice cannot change in value. In accordance with Canadian tax law, goodwill is depreciable at five per cent of the total value annually, whereas many hard assets can be depreciated at 20 per cent annually. With this in mind, and in our experience, buyers and lenders may be more reluctant in today’s climate to permit an asset sale at an inflated value. With a practice at the same valuation as a share sale, our theoretical seller could end up losing up to 30 per cent of realized profit to taxes when her practice sells as an asset sale.

In imagining a second scenario where the same practice owner had incorporated her practice three years prior to her appraisal and intended sale, the outcome looks very different at the same valuation. When the practice is sold as a share sale with a single dentist as a shareholder

in her own dentistry professional corporation, the first \$883,384 is exempt from taxes due to the LCGE. At a comparable valuation, this creates a clear advantage to the seller. Although the buyer does not have immediate benefit from the purchase of the share sale, they are permitted to sell the practice down the road in the same arrangement.

A third scenario involves incorporation with the addition of a spouse as a shareholder. Imagine our theoretical dentist incorporated and registered her dentistry professional corporation in 2008, when she graduated. She was recently married and has decided to add her spouse as a non-voting shareholder to her dentistry professional corporation for future tax advantages. In light of the current climate and the shut-down period attributable to COVID-19, her practice has a three-month window where she was unable to practice dentistry in the past year. She has had her practice appraised; it reflects a reduced valuation due to the effects of the pandemic on her practice's revenue, the reduced capacity for treatment using aerosolizing procedures, and increased caution in the dental practice marketplace. With the resultant lower practice valuation, she can now add her spouse as a shareholder to the corporation and take advantage of the practice's recovery moving forward. As the LCGE increases with inflation and the practice value increases with growth and inflation, so too does the ability for her spouse to take full advantage of the capital gains upon practice sale. In the year 2038 when this dentist decides to sell her practice and retire, both she and her spouse will be able to take advantage of the LCGE as shareholders, which could shelter half or more of the practice value from taxes, resulting in a significant tax advantage as compared to the other two scenarios of sale reviewed.

A happy ending

As the adage goes, "knowledge is power." A comprehensive, personalized approach taking into account your career and retirement goals should include options and strategies that help you get where you want to go — these are your co-authors on your financial adventure. The scenarios presented in this article are theoretical and not exhaustive, but are intended to emphasize the idea that it is not what you make in your career of earning, investing and later selling your practice, it is what you keep. 

REFERENCE

1. Li R. Selling your practice: The difference between a share sale and an asset sale. *Ontario Dentist*. 2019 November;96(9):36-38.



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