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# WHEN SHOULD DENTISTS INCORPORATE?

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## WHEN SHOULD DENTISTS INCORPORATE?

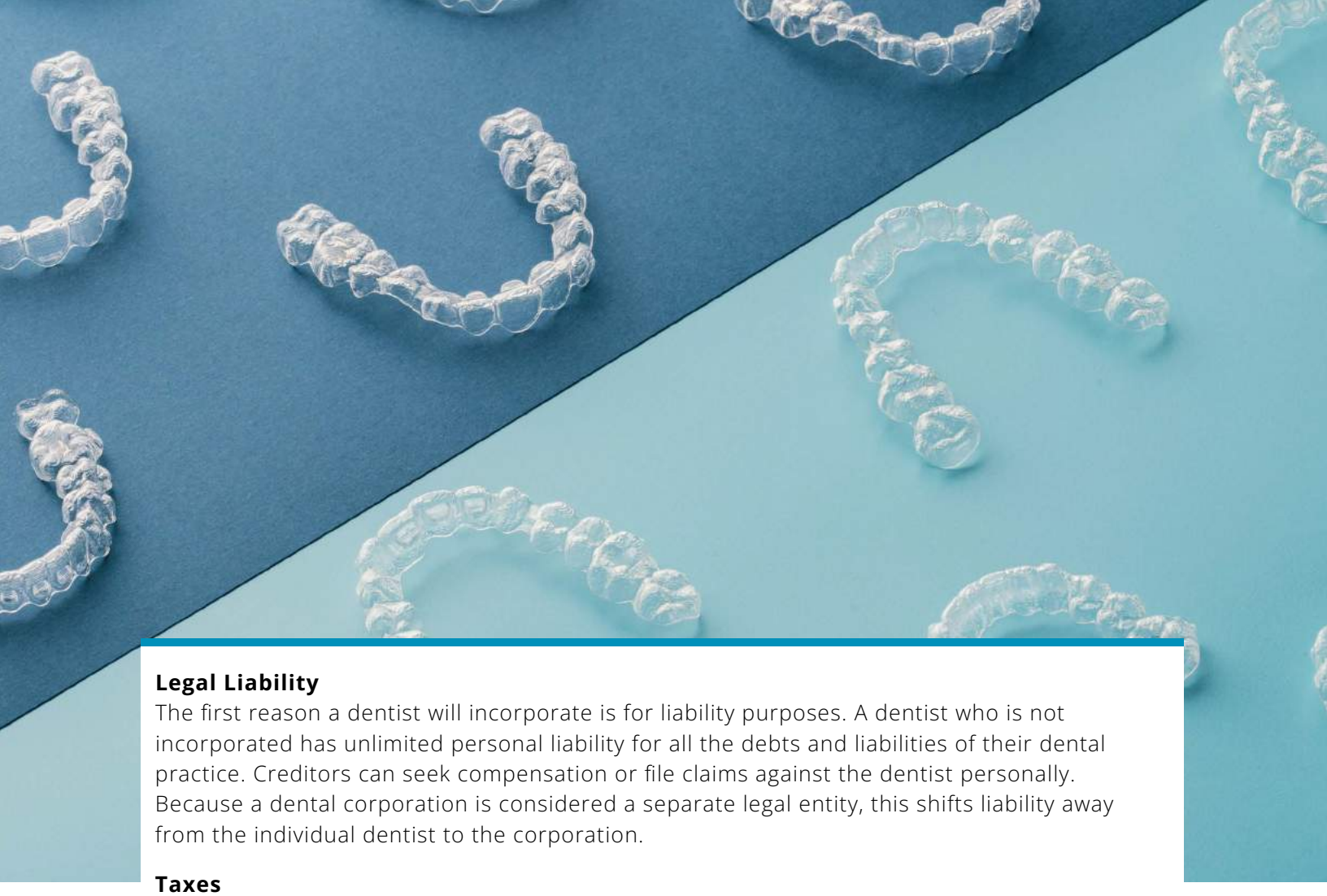
As you move from a student to a practicing dentist, your financial situation will certainly change. You'll face several new financial decisions that you have likely never considered before. A common consideration in the dental community is deciding when to incorporate.

## WHY DO DENTISTS INCORPORATE

Before you understand when to incorporate, you should first recognize the "why." Let's start by looking at what incorporation is and why a dentist might choose to incorporate.

Incorporation is the process of creating a separate legal entity, the corporation. The corporation becomes the owner of the dental practice, and the dentist becomes the shareholder of the corporation. The new corporation will essentially issue shares of which the dentist will have sole ownership.

***So why might one incorporate?***



**Legal Liability**

The first reason a dentist will incorporate is for liability purposes. A dentist who is not incorporated has unlimited personal liability for all the debts and liabilities of their dental practice. Creditors can seek compensation or file claims against the dentist personally. Because a dental corporation is considered a separate legal entity, this shifts liability away from the individual dentist to the corporation.

**Taxes**

The second and most advantageous reason a dentist will incorporate has to do with taxes. In Canada, dental corporations benefit from lower tax rates than individuals and foreign corporations. They have access to the Small Business Deduction (SBD). The SBD allows corporations to pay reduced tax rates on the first $500,000 of active business income each year. In most provinces, this tax rate ranges from 11%-12%. In Ontario, when you factor in the SBD, the tax rate is 12.2%. Every $1 of active business income generated within a dental corporation will only give rise to 12 cents of taxes payable.

## SO WHEN SHOULD A DENTIST INCORPORATE?

The key to recognizing when to incorporate is understanding how much income you need to fund your lifestyle and day-to-day expenses.

It can be extremely advantageous to incorporate if you're earning a significant amount more than you need to live off. This would mean any funds you don't need for lifestyle would be left in the corporation and would benefit from a significantly lower tax rate (12.2% in Ontario). These remaining funds can then be invested for future use.

## EXAMPLE

In the following example, we examine two scenarios. One where the dentist takes all their income personally, investing any excess they don't need for lifestyle. The second is where the corporation only pays the dentist a salary high enough to meet their lifestyle needs, with any excess invested within the corporation. We assume this dentist generates $200,000 of income and only needs $80,000 after-tax to fund their lifestyle.

**No Corporation:**

Because this dentist only needs $80,000 after tax to live, they could make a max RRSP contribution of $29,210, which reduces their taxable income to $170,790. $170,790 generates $54,503 in personal taxes owing, leaving this dentist with an after-tax income of $116,287. After spending $80,000 on lifestyle, this dentist is left with $36,287 to invest.

Including their original RRSP contribution, this dentist was able to invest $65,497. Their total tax bill for the year was $54,503 of personal taxes.

| | |
|---|---|
| Personal income | **$200,000.00** |
| RRSP contribution | **$29,210.00** |
| Taxable income (income less RRSP cont) | **$170,790.00** |
| Personal taxes payable | **$54,503.00** |
| After-tax income | **$116,287.00** |
| Lifestyle expenses | **$80,000.00** |
| Leftover cash to invest | **$36,287.00** |

**With Corporation:**

With a corporation, this $200,000 first gets earned corporately. The dentist then pays out only enough to be able to fund the $80,000 of after-tax lifestyle expenses. In Ontario, that means a salary of $106,000 is required. This salary expense is a deduction to the corporation and lowers its corporate taxable income to $94,000. At a 12.2% tax rate, this gives rise to $11,468 in corporate taxes. After paying these corporate taxes, the dentist is left with $82,532 to invest into a retirement portfolio or back into their clinic.

Personally, the $106,000 salary gave rise to $26,000 of personal taxes leaving the dentist with $80,000 after tax to fund their lifestyle. Overall, through incorporation, this dentist was able to invest an additional $17,035 above and beyond what they could have invested had they not been incorporated.

| | |
|---|---|
| Corporate income | **$200,000.00** |
| Salary | **$106,000.00** |
| Taxable corporate income | **$94,000.00** |
| Corporate taxes payable | **$11,468.00** |
| Left over cash to invest | **$82,532.00** |

| | |
|---|---|
| Personal income | **$106,000.00** |
| Personal taxes payable* | **$26,000.00** |
| After tax income* | **$80,000.00** |
| Lifestyle expenses | **$80,000.00** |
| Leftover cash to invest | **$ -** |

**Tax Savings Compounded**

If we assume this dentist's income will increase over time at a rate that matches inflation (2%) and we assume a conservative annual average rate of return of 4% earned on investments, the additional savings from incorporation when compounded over 20 years results in an added $624,000 to this dentist's net worth. Over 30 years this number is $1.268 million.

## OTHER CONSIDERATIONS:

**Is there an opportunity to split income with family members?**
If you are married and or have children, by being incorporated, there is an opportunity to do what we call "income splitting." This is where we take some of the income earned within the corporation and pay it out to a family member who is in a lower personal tax bracket which provides tax savings on that income. This is done in two ways:

1. Salary – You can pay a spouse or child to perform work for the practice (ex: administrative or marketing support). This amount needs to be considered reasonable by CRA. Reasonable is defined as an amount that would be paid to an unrelated person for the same work.

2. Dividends – You can pay dividends to related shareholders, however, these dividends will be subject to a reasonability test. This means the amount of dividends matches the contribution the family member shareholder has given to the corporation. The language related to what's reasonable is ambiguous and should be reviewed with a tax accountant before implementing this strategy.

The reality is, for all incorporated individuals, splitting income with family members has become a lot more complicated since the tax law changes implemented in 2019. When splitting income, a tax accountant should always be consulted.

**Additional Costs and Complexity**
A corporation is a separate legal entity, which will result in a minor increase in the complexity of one's financial and tax circumstances.

You can also expect additional costs in the form of legal, accounting, and tax filing fees. However, the tax benefits far outweigh the costs for dentists who don't require all their income to fund their lifestyle and can take advantage of corporate tax savings.

## SUMMARY

An individual's unique situation will ultimately determine whether incorporating is the right thing to do. Things like debt payments, lifestyle expenses, level of income, and investment goals will all play a role in making the right financial decision. It's always recommended to engage your accountant and other trusted tax professionals in the conversation as they will bring a specialized and expert understanding of your personal and corporate tax situation.

# READY TO TALK?

Grant White & Brandt Butt are Portfolio Managers and Investment Advisors part of an award-winning team at Endeavour Wealth Management with iA Private Wealth. Their focus is working with incorporated physicians and dentists who have dreams of reaching a point where they are choosing to work, instead of having to.

Their team delivers value through advanced financial planning solutions for incorporated professionals while working closely with their accounting and legal professionals. By doing so, their clients' situations are optimized which can save them hundreds of thousands in taxes each year allowing them to grow their net worth faster with the goal of reaching complete financial independence.

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