Doctors Nova Scotia

Business of Medicine
Support for a Healthy Practice

Accounting, Taxation & Incorporation for Physicians

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Accounting, Taxation & Incorporation for Physicians

- Income tax status
  - Unincorporated vs. incorporated practices
- Overview of financial statements
- Advantages of incorporating
  - Tax savings
  - Income splitting
  - Tax deferral
  - Creditor protection (depending on ownership structure)
- Costs of incorporating
- Conclusion
- Steps to incorporate

Income Tax Status - Unincorporated

Employee – T4 income (not common)

- Employer deducts CPP, EI and income taxes from gross pay
- Employer pays for most expenses
- Income reported on personal tax return
- Income subject to personal income taxes

Self-Employed – T4A income

- No taxes are deducted at source from gross pay
- Physician pays for most expenses
- Physician deducts business expenses against income
- Income reported on personal tax return
- Income subject to personal income taxes

Income Tax Status - Incorporated

Incorporated

- Fee revenue reported by company
- Company pays for business expenses
- Company deducts business expenses against income
- Company pays physician a salary/dividend as compensation
- Income reported on corporate tax return
- Income subject to corporate taxes
- Salary/dividend paid to physician subject to personal taxes

Overview of Financial Statements

- Financial Statement – a written report of the financial condition of a business
  - The 2 most important statements for physicians are:
    - Income Statement and
    - Balance Sheet

Income Statement

- The Income Statement measures your practice revenue and expenses for a given time.
- Revenue is billings earned for the services provided – can be MSI billings, Non-Insured Services, Workers' Comp, and other 3rd Party Billing
- Expenses are costs incurred to run your practice. They can be fixed or variable – examples are staff salaries, rent, supplies, etc.

Income Statement:
Unincorporated or Incorporated

Gross revenue / billings	**$270,000**
Expenses	
Accounting & legal	3,000
Conferences	4,000
Health insurance	3,000
CMPA	2,000
Office	3,000
Professional dues	5,000
Rent	12,000
Telephone	2,000
Staff	36,000
	70,000
Income available for physician	$200,000

Balance Sheet

- The Balance Sheet provides a snapshot at a point in time of a business':
  - Assets (things that you own)
  - Liabilities (debts that you owe), and
  - Owner's equity (funds generated by the practice)

- Asset = Liabilities + Owner's Equity

Balance Sheet Sample

Balance Sheet
For Dr. X
As at Ended Dec 31, 20XX

Current Assets	
Cash	15,000
Accounts Receivable	1,000
Total Current Asset	16,000
Fixed Asset	
Furniture & Office Equipment	10,000
Less Accumulated Depreciation	(5,000)
Total Fixed Asset	5,000
Total Assets	**21,000**
Current Liabilities	
Accounts Payable	500
Total Current Liabilities	500
Long-term Liabilities	
Due to Shareholder - Dr. X	2,500
Total Long-term Liabilities	2,500
Total Liabilities	**3,000**
Owner's Equity	
Common Stock - Dr. X	100
Retained Earnings	17,900
Total Owner's Equity	**18,000**
Total Liabilities and Owner's Equity	**21,000**

Financial Statements

- Financial Statements are needed to complete your tax returns.
- What tax returns do you need to complete?
  - It depends on whether you are:
    - Sole proprietor or
    - Incorporated

Benefits of Incorporating - Nova Scotia

- Tax savings
  - approximately 4%
- Income splitting
  - with spouse and non-minor children
- Tax deferral (biggest benefit)
  - if leave cash to invest inside company
  - 85 cent tax dollars vs. 50 cent tax dollars
  - defer paying personal dividend taxes of 36.2% or less until money is taken out of company
- Creditor protection
  - If holding company and family trust
  - It should be noted that incorporating a practice DOES NOT provide the physician protection against being sued for malpractice.
- Increased discipline

Salary versus Dividends

When you incorporate you can pay yourself with either:

Salary

- Expense of your practice
- Contribute to CPP (both employee and employer)
- Creates ability to contribute to RRSP
- Physician pays personal income taxes

Dividends

- Distribution of after-tax corporate profits
- No contribution to CPP
- No RRSP contribution room created
- Physician pays personal taxes on dividend

Personal Tax Rates - Nova Scotia

Individual Tax Rates – 2013

	Annual Taxable Income (thousands)				
	< $43	$43- $85	$85 - $132	$132 - $150	> $150
Salary / Unincorporated	24%	37%	43%	47%	50%
Dividend	3%	20%	28%	32%	36%

Corporate Tax Rates - Nova Scotia

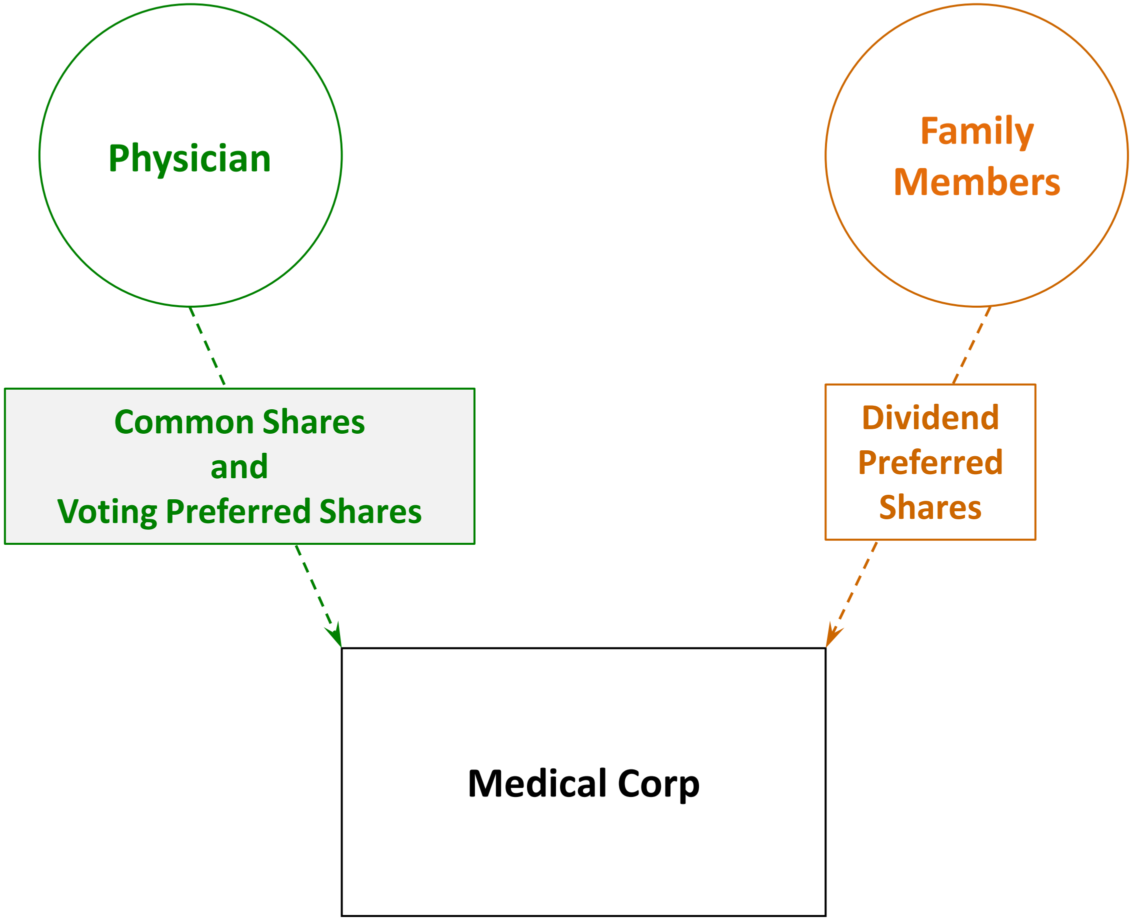
Tax Rates – 2013

Type of Income	Annual Taxable Income (thousands)		
	< $400	$400 - $500	> $500
Active Business	14.5%	27%	31%

Advantages - Tax Savings

(Thousands)	Salary / Unincorporated	Incorporated
Income available for physician	$ 200	$200
Salary / CPP	(200)	-
Net income before taxes	-	200
Corp taxes	-	(30)
Available for dividend	$ -	$170
Personal income	$200	$170
Personal taxes	(78)	(40)
Available to physician	$122	$130

Advantages – Income Splitting



Advantages – Income Splitting – Nova Scotia Tax Savings (Thousands $)

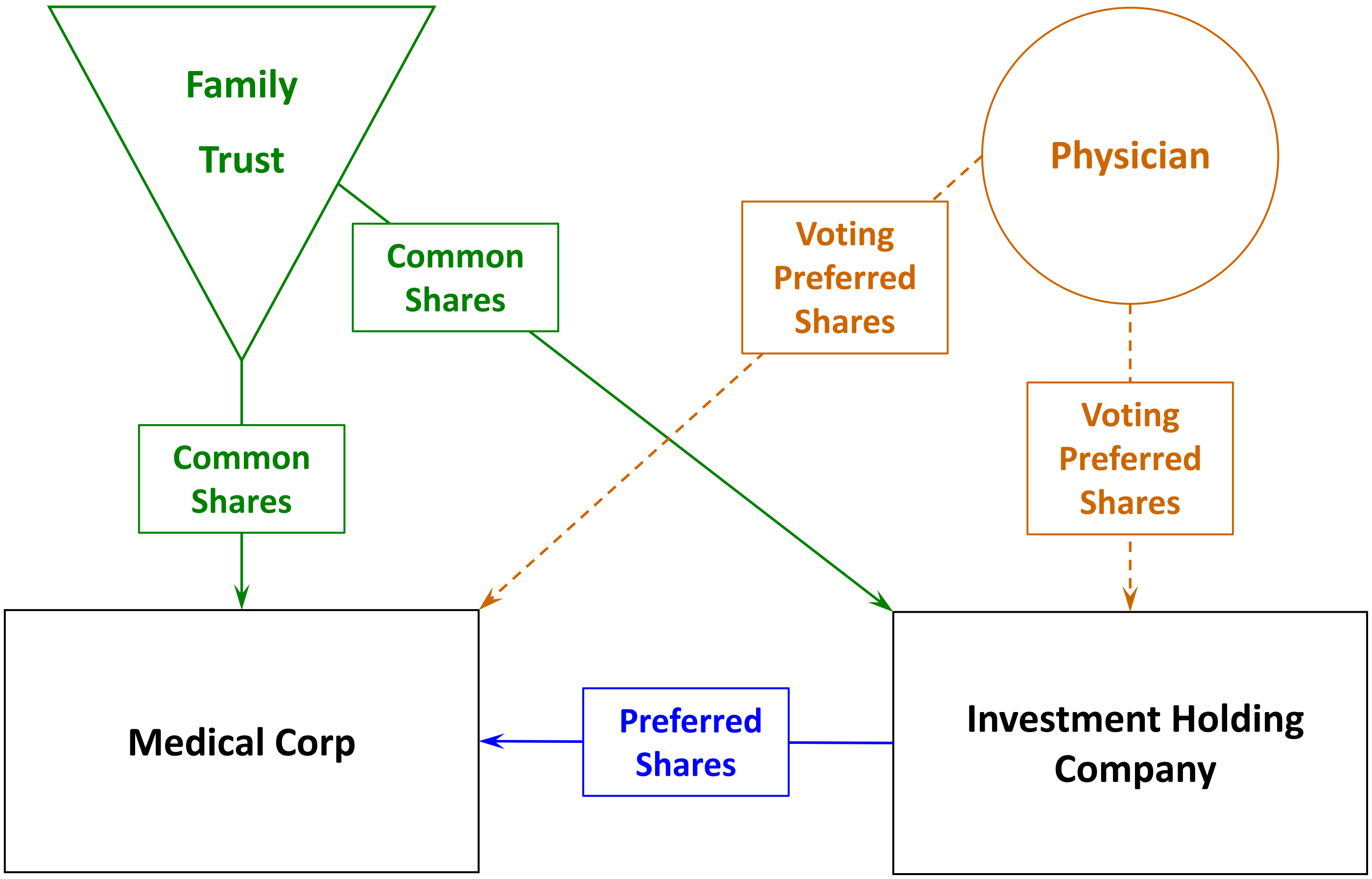
Spouse Net Income	Physician Net Income						
	$100	$150	$200	$250	$300	$350	$400
$nil	11	17	23	28	31	33	35
$25	8	12	18	22	24	26	28
$50	6	9	14	18	20	22	24
$75	5	8	12	15	17	19	21
$100	5	7	11	13	15	17	19
No spouse	5	6	8	10	13	14	16

Assumptions: - all income paid out as a dividend
- no cash retained in company

Advantages - Tax Deferral

(Thousands)	Salary / Unincorporated	Dividend (Cash Distributed)	Dividend (Cash in Corp)
Net income	$ -	$200	$ 200
Corp taxes	-	(30)	(30)
Dividend to physician	-	(170)	(120)
Cash in company	$ -	$ -	$ 50
Personal income	$200	$170	$120
Personal taxes	(78)	(40)	(22)
Cash to physician	$122	$130	$98
Corp and Personal Cash	$122	$130	$148

Advantages – Creditor Protection



Costs of Incorporating

Initial set-up

- legal and accounting approximate costs:
  - Without a family trust - $5k
  - With a family trust - $7k
  - With family trust and holdco - $9k

On-going costs

- Incremental professional fees and other costs
  - approximately $2k per year

Increased complexity

- Having to pay yourself from the corporation
- Additional bank accounts

Conclusion - Is incorporation right for you?

If the benefits:

- Tax savings
  - tax rates, income splitting, and tax deferral
- Credit protection
  - Use of family trust and holding company

Outweigh the costs:

- Initial set up and ongoing fees
- Increased complexity

Then consider incorporation

If considering incorporation, Doctors Nova Scotia recommends that you seek professional advice to determine if incorporation is right for you.

Steps to Incorporate

1. Meet with your lawyer to determine corporation name and shareholders
2. Lawyer submits name for approval with Registry of Joint Stocks and College of Physicians and Surgeons of NS
3. Meet with accountants to discuss any issues (i.e., tax free roll-over of assets). The accountant will work with the lawyer on those issues

Steps to Incorporate Cont.

4. Once the lawyer receives approval of the corporation name, they draft documents and establish share structure.
5. The lawyer then seeks approval from CPSNS for the physician to begin using the company
6. Once approval is granted, the physician meets with the lawyer to review how the company is set up

Steps to Incorporate Cont.

7. The physician is given documents required to open a bank account.
8. Once the bank account is opened, the accountant can help choose a date to begin operating the company

Once you incorporate your medical practice, you will need to file personal and corporate income tax returns each year.

Accounting, Taxation & Incorporation for Physicians

Types of Business Entities

- Sole proprietor
  - A business structure in which an individual and his/her company are considered a single entity for tax and liability purposes.
  - Simplest form of business to run – easy to set up and nominal start up costs
  - Report revenue and business expenses on your personal tax returns
  - Will pay taxes at the highest personal tax rates

Types of Business Entities

- Incorporated Practice
  - A business structure in which an individual and his/her company are considered a separate entity (shareholder & employee) for tax and liability purposes.
  - Higher costs - legal fees to incorporate and annual corporate tax return
  - Physician can take income as salary or dividend
  - Can defer or split income with family members – can be more tax efficient

It should be noted that incorporating a practice DOES NOT provide the physician protection against being sued for malpractice.

Income Tax Scenarios

- The physician has $200,000 net income before taxes:
  - Scenario 1 – physician is a sole proprietor and has to claim all income
  - Scenario 2 – physician is incorporated, takes $100k in salary and dividends (before tax)
  - Scenario 3 – physician is incorporated, takes $100k in salary and defers the remaining amount to future years
  - Scenario 4 – physician is incorporated, takes $100k in salary and split income, by way of dividend, to himself/herself, spouse ($60k income), and 2 adult children ($0 income)

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Income Tax Scenarios

Income Tax Scenarios (2011 rates)	Scenario 1	Scenario 2	Scenario 3	Scenario 4				
Net Income Before Taxes	200,000	200,000	200,000	200,000				200,000
				Physician	Spouse	Adult Child 1	Adult Child 2	Total
Salary	200,000	100,000	100,000	100,000				100,000
Dividend^	0	84,500		21,125	21,125	21,125	21,125	84,500
Personal Income Taxe Rate*	39.37%	31.35%	31.35%	31.35%				
Personal Inc Taxe Rate-Div#		32.07%		28.08%	22.05%	0.00%	0.00%	
Personal Income Tax - Sal	78,737	31,352	31,352	31,352				31,352
Personal Income Tax - Div		27,102		5,932	4,658	-	-	10,590
Corporate Tax		15,500	15,500	15,500				15,500
Total Taxes	78,737	73,954	46,852	52,784	4,658	-	-	57,442
Net Income After Taxes	121,263	126,046	153,148					142,558
Difference vs Scenario 1		4,783	31,885					21,295
Average Tax Rate	39.37%	36.98%	23.43%					28.72%

* Estimate Average Tax incorporates Basic Personal Exemption

^ Net of corporate tax

Incorporates the gross up of dividends and dividend tax credit

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Salary versus Dividends

- When you incorporate you can pay yourself with either salary or dividend
  - Salary is paid at the higher personal tax rates, dividends are more tax efficient due to the dividend tax credit
  - Salary earns RRSP contribution room, dividends are not considered “earned” income, therefore you do not earn RRSP contribution room
  - With salary, you will have to pay both sides of CPP (employee and employer) but you are entitled to the pension benefit at 65 or a reduced pension at 60.

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