Module 4:

Personal And Professional Accounting And Taxation

MD PHYSICIAN SERVICES
CMA COMPANIES

ASSOCIATION MÉDICALE CANADIENNE
CANADIAN MEDICAL ASSOCIATION

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MD Physician Services acknowledges the significant contributions of the author of this resource document, as well as the efforts of the MD Physician Services team.

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October 2012

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KEY LEARNING POINTS

- *The basics of accounting*
- *The basics of the Canadian taxation system*
- *Tax deductions and tax credits of interest to physicians*
- *Tax instalments*
- *Incorporation*
- *Income splitting*
- *Goods and Services Tax (GST) and Harmonized Sales Tax (HST)*
- *The importance of professional accounting and tax advice*
- *Selecting an accountant*

INTRODUCTION

With residency behind you, it is important that you are introduced to the world of accounting, tax and financial management before you embark on a lifetime of medical practice. There are many stories of hard-working and talented physicians whose disposable income and net worth were greatly diminished by poor financial management and sub-optimal business decisions. By taking a vested interest in your personal and professional success, you can avoid the pitfalls that result from poor financial management.

All physicians have the aptitude to understand not only accounting and financial issues, but also many of the complexities inherent within the Canadian taxation system. What most physicians lack, however, is the experience and opportunity to learn the financial management skills that will help them to maximize their earned income and net worth. This module will explore the financial, accounting and tax concepts that physicians need to apply to their personal and professional practices to both promote efficiency and attempt to maximize after-tax income and net worth.

PHYSICIANS AS EMPLOYEES AND/OR SOLE PROPRIETORS

The vast majority of residents are employees of their hospitals and, as such, receive a salary based upon negotiations between their employer and their respective provincial association of interns and residents. If you are considered an employee, your employer is required to withhold from your salary specific amounts for income taxes, Canada Pension Plan (CPP), employment insurance (EI) and other incidentals; the remaining or net amount is provided to you each pay period, generally every two weeks. This employee status may change when you complete your training.

Once you have completed your residency, you might decide to operate your own medical practice. If so, practising medicine will also mean managing the medical practice. You will be responsible for the collection of all revenues (such as billings to the provincial Ministry of Health or Workers' Compensation Board) and payment of a portion or all of the expenses related to your practice. You will probably no longer be in an employer-employee relationship, in which someone remits source deductions (e.g., income tax, CPP and EI) on your behalf; instead, your status will be self-employed, or sole proprietor. As a sole proprietor, you will be responsible for remitting any personal income tax instalments to government authorities, and you will pay income tax on the excess of revenues over tax-deductible expenses—in other words, you will pay income tax on your business income.

Some physicians will remain employees of hospitals, governments and other regulatory authorities, and they will still be in an employer-employee relationship. Other physicians may be employees, but will also earn business income, which enables them to function as both employees and sole proprietors.

The deductibility of many expenses and the availability of tax credits are quite limited for employees, compared with physicians who are self-employed. The Canada Revenue Agency (CRA) and the Income Tax Act have criteria in place to determine the appropriate classification. It is wise to seek professional advice about your particular position—determination of your self-employed status can be complex and will vary according to your specific situation.

ACCOUNTING BASICS

Accounting—the process of analyzing and systematically recording business transactions and events in financial terms—relies on principles and practices that have existed for thousands of years. In Canada, accounting long predates the practice of income taxation, which was introduced during the First World War as a temporary measure to finance government activities, but which has persisted to the present day.

Accounting results are expressed in such financial statements as the income statement, balance sheet and cash flow statement. In addition to providing a sound basis to evaluate the past activities of an individual, organization or other entity, these reports provide a framework to make sound financial decisions regarding future actions. Governments, businesses, individuals, organizations and other entities, such as partnerships, have many uses for financial statements.

Balance Sheet

The balance sheet provides a snapshot of an individual's or organization's assets, liabilities and net worth at a single moment in time. It provides a baseline that can be compared with past and future financial positions, and it allows for evaluation of past performance and planning for future activity.

Dr. Smith, Medical Practitioner	
Balance Sheet	
As at December 31	
Cash and investments	$50,000
Total assets	$50,000
Liabilities	$28,000
Net worth	$22,000
Total liabilities and net worth	$50,000

Income Statement

An income statement is a detailed account of one's revenue and expenses for a period of time. The difference between revenue and expenses is the net income or net loss—the so-called bottom line.

Dr. Smith, Medical Practitioner	
Income Statement	
For the year ended December 31	
Revenue	
Provincial Health Plan	$200,000
Uninsured services	$15,000
Total revenue	$215,000
Expenses	
Staff	$35,000
Office rent	$15,000
Other expenses	$15,000
Total expenses	$65,000
Net income (loss)	$150,000

Because the income statement shown above does not consider income taxes, *net income* represents *net income before taxes*. Although the net income figure of $150,000 may be considered the bottom line, it does not necessarily represent the individual's after-tax take-home pay. For example, if Dr. Smith is a resident of Alberta, and makes the maximum registered retirement savings plan (RRSP) contribution of $22,450 in 2011, her federal and provincial income taxes will be approximately $36,500. This results in Dr. Smith having a net income before tax of $150,000 and a take-home pay of $91,050 (taxable income of $127,550 [$150,000 less $22,450 RRSP contribution] less $36,500 of income taxes).[1]

Cash Flow Statement

A cash flow statement is a listing of cash inflows and cash outflows, with the result being a net cash inflow or outflow. A surgeon may earn $20,000 in procedures during July and bill the provincial health plan accordingly. If the funds are not received until August, however, the surgeon's cash inflow for July will be nil ($0). This financial statement is intended to aid the analysis of the individual's or entity's short-term or cash position. It can also be useful in long-term financial management planning.

Dr. LeBlanc, Resident		
Cash Flow Statement		
For the month of June		
Items	Cash outflow	Cash inflow
Salary, net of withholding taxes, CPP, EI and other incidentals		$3,000
Rent	$900	
Loan repayment (interest only)	$800	
Food (includes entertainment, restaurants)	$400	
Automobile, parking and travel	$600	
Miscellaneous (e.g., gym, exam fees)	$200	($2,900)
Net cash inflow (outflow)		$100

[1] Income statements may be drawn up for either accounting or tax purposes. Although an expenditure may be an eligible expense for accounting purposes, it may not be an allowable expense for income tax purposes, as defined by the *Income Tax Act*. Therefore, some reconciling adjustments may be required to your accounting financial statements in order to make them appropriate for income tax purposes.

Budget

While the balance sheet, income statement and cash flow statement all deal with historical data, the *budget* refers to projected or estimated data. Although the estimated data may not prove to be entirely accurate, a budget enables an organization or individual to project and plan for future activities. The federal and provincial ministers of finance annually table a budget as their plan concerning how their respective governments will use financial resources in the upcoming year. At the end of the time period, the *actual* revenues and expenditures are compared against the *budgeted* ones, and the individuals and organizations responsible for financial management are evaluated. Business organizations and many individuals do the same thing. For example, financial institutions use budgets to evaluate a loan applicant's potential future activities and his/her ability to repay the loan.

In the same way that the figures within budgets are projected, one can also prepare estimates of cash flow, income statements and balance sheets to help evaluate and plan future activities. Accounting software programs, such as Quicken, Quickbooks and Simply Accounting, can be helpful. Spreadsheet programs, such as Excel and Lotus, can also be used for personal and professional budgeting.

Accrual Versus Cash Accounting

1. **Cash accounting** records transactions once cash is actually paid or received. The cash method of computing income is, strictly speaking, what its name suggests: income (or loss) for a fiscal period is computed by measuring cash or current cheques received, less expenses actually paid in that year. In cash accounting, the income statement and cash flow statement for a particular period will be identical. For tax purposes, only farmers and fishermen are permitted to use a cash method of accounting. Professionals who earn business income are generally mandated to use the accrual method of accounting.
2. **Accrual accounting** more accurately reflects business activity for a particular period. Under the accrual method of accounting, income is generally computed for the period during which it has been earned—in other words, when goods or services have been rendered—even though the billings for such activities may not have been collected by the end of that respective period. Similarly, expenses incurred to earn that income are deducted, whether or not they have been paid by the end of the fiscal period.

For example, billings for medical services provided in December would be counted as revenue in an accrual income statement ended December 31, even though such funds would not actually be received until January of the following year. Revenue would be recorded and an *account receivable* for the same amount would be seen on the balance sheet. Similarly, a physician may utilize a telephone in the office in December, but not pay for the service until January, when the bill is received. Although cash accounting will show no cash outflow for December, the accrual accounting method will record a telephone expense on the December income statement, along with an *account payable* to the telephone company for the same amount on the balance sheet.

Accrual accounting better matches revenues and expenses to the period in which they were earned or incurred. Finally, please note that certain professionals, including medical doctors, may elect to exclude from their income (for the current fiscal year) any work in process at the end of the year. Be sure to discuss this option with your tax advisor.

Accounts Payable
These are the amounts owed by you for products or services you have enjoyed or received. For example, at the end of the month, you would have an *account payable* to the telephone company for telephone service already received during the month.

Accounts Receivable
Amounts owed to you for services or products that you have provided are called receivables. For example, a doctor may bill the provincial medical plan for all services he/she has provided during the month of May, but, because the payment will not be made until the following month (June), the physician will have an *account receivable* from the provincial health authority as at May 31.

Accounting Or Fiscal Period
Any period in which income, cash flow and other transactions are measured is called an *accounting* or *fiscal period*. For tax purposes, self-employed physicians must follow a calendar accounting period (January 1 to December 31).

Expenses And Deductible Expenses
An expense is any expenditure incurred in a period to earn income. Although expenses may be deductible for accounting purposes, they will be *deductible for tax purposes* only if they are incurred to earn income from your medical practice, are reasonable, and are allowed by the *Income Tax Act*. Other restrictions may also apply. Furthermore, you should retain all supporting receipts and invoices related to these expenses, in case the Canada Revenue Agency requests them.

Inventory
Supplies stored and used in a business—such as tongue depressors or the paper examination table sheets in a doctor's office—represent *inventory*.

Reconciliation
Reconciliation is a process of accounting for the differences between two related accounts or balances. A pertinent example is the periodic or monthly reconciliation of a physician's billing records and Ministry of Health payments. As these two records very seldom agree, physicians should reconcile these two records on a regular and recurring basis, identifying what has not been paid, clarifying any discrepancies, and resubmitting any disputed claims to ensure payment is received for all services rendered.

Gross Income And Net Income
Gross income is a misnomer; people generally mean *gross revenues* or total earnings before expenses. *Net income* is gross income less expenses.

Interest Expense
Interest expense is interest paid on money borrowed to earn income. Interest expense, such as interest paid on money borrowed to earn investment income or to purchase medical equipment, may be deductible for tax purposes. However, interest paid on loans used to finance your medical school education is not deductible for tax purposes. (Note that the interest paid on loans to the Canada or provincial student loan programs generally qualifies for a tuition interest tax credit.) The rules surrounding interest deductibility can be quite complex. Contact your tax advisor to determine whether any interest expenses you pay are deductible.

Capital Expenditure
Businesses make *capital expenditures* when they purchase large and expensive pieces of equipment that will be utilized over several periods of time. Otolaryngologists, for example, may pay $150,000 for specialized equipment before they begin practice. For accounting purposes, the cost of such equipment cannot be *expensed* in a single year because it will be used over many years.

Instead, the otolaryngologist will expense some of the total cost each year over the entire period the equipment will be used in the practice. Apportioning the cost over a number of years is called *depreciation*.

The Canada Revenue Agency treats capital expenditures similarly. For tax purposes, however, each asset depreciates at specific rates (and by very specific rules), referred to as a *capital cost allowance.*

Net Worth

Net worth, also known as *owner's equity* or *residual earnings*, is essentially the balance of the proprietor's capital invested in the practice, plus any current-year net income (or loss), less any income drawn out of the practice as the physician's take-home pay. Overall, the total assets of the practice need to be equal to total liabilities and net worth. In the following example, Dr. Smith's net worth is $22,000 (and total assets are equal to liabilities and net worth).

Dr. Smith	
Balance Sheet	
As at December 31	
Cash and investments	$50,000
Total assets	$50,000
Liabilities	$28,000
Net worth	$22,000
Total liabilities and net worth	$50,000

Many physicians, including residents and medical students, find that their liabilities far exceed their assets and that their net worth is, in fact, a negative number. An admirable objective of effective financial planning is to incorporate practices and behaviours that serve to maximize one's net worth.

Key Message

An understanding of the basics of accounting is essential for every physician. In addition to having more control over your practice and personal life, you will be able to utilize the resources and skills of your accountant to best advantage.

TAXATION BASICS

Canada's income tax system is a relatively new phenomenon that dates back to the First World War. Ironically, attempts in the late 1980s to simplify the tax system further increased the size and complexity of the *Income Tax Act*. In the 1990s the provincial and territorial governments waded in to provide their own definitions of provincial/territorial taxable income and provincial/territorial income tax rates, so understanding the tax system has become more challenging.

The following section will explain basic terminology and outline available tax credits and deductions. This knowledge, along with tax and accounting advice from a qualified professional, will help you to minimize your income tax bills and maximize take-home income for you and your family.

Marginal Tax Rates

The concept of marginal tax rates is centred on the fact that Canadians are not taxed at the same rate for every dollar earned; the tax rate becomes progressively higher for increasing income ranges. Quite simply, your marginal tax rate is the amount of tax that you would pay on your last dollar of taxable income. If you were living in Ontario in 2012 and earned $69,000 of salary, the additional taxes you would pay on your last dollar of income would be 32.98 cents (see Table 2: 2012 Combined Federal Provincial Marginal Tax Rates: Province of Ontario in the next section) and you would keep 67.02 cents for yourself. In other words, your marginal tax rate would be 32.98%. If your marginal tax rate is 47.97% (the top

Key Message

Any physician can understand the basics of the tax system. This knowledge will help you work with your accountant to properly meet all filing requirements, minimize your income tax payable and maximize the after-tax income for your family.

marginal tax rate in Ontario for 2012), 47.97 cents of the next dollar earned would be taken for federal and provincial income taxes.

The concept of marginal tax rates generally depends on three things: your province or territory of residence, your level of income, and the type of income earned (i.e., capital gains, dividends and interest and other income). Basically, the higher your level of income, the higher the percentage of that income that will be claimed by the Canada Revenue Agency. Capital gains and dividends are traditionally taxed at lower rates than interest, business income, salaries and other income (see definitions below).

Federal And Provincial Income Tax Brackets

The federal personal income tax brackets and rates for 2011 and 2012 are outlined in the following table.

Table 1. Federal personal income tax brackets

2011 Taxable Income	2012 Taxable Income	Federal Tax Rate
$0-$41,544	$0-$42,707	15%
$41,545-$83,088	$42,708-$85,414	22%
$83,089-$128,800	$85,415-$132,406	26%
$128,801 and up	$132,407 and up	29%

The income tax brackets, as well as the rates imposed at each bracket, will vary between provinces and territories. Furthermore, certain provinces will also impose a surtax. As mentioned earlier, the combined federal-provincial tax rate is dependent upon the level of taxable income, the province or territory of residence, as well as the type of income earned (interest and ordinary income, capital gains or dividends). Identification of marginal rates becomes more complex when the combined federal-provincial rates are considered, as in this example for the province of Ontario.

Table 2. 2012 Combined Federal-Provincial Marginal Tax Rates: Province of Ontario

2012 Taxable Income Brackets	Interest And Ordinary Income	Capital Gains	Canadian Dividends	Canadian Dividends
			Eligible	Non-eligible
$0-$9,405	0.00%	0.00%	0.00%	0.00%
$9,406-$39,020	20.05%	10.03%	1.89%	2.77%
$39,021-$42,707	24.15%	12.08%	3.77%	7.90%
$42,708-$68,719	31.15%	15.58%	13.43%	16.65%
$68,720-$78,043	32.98%	16.49%	14.19%	17.81%
$78,044-$80,963	35.39%	17.70%	17.52%	20.82%
$80,964-$85,414	39.41%	19.70%	19.88%	23.82%
$85,415-$132,406	43.41%	21.70%	25.40%	28.82%
$132,407-$500,000	46.41%	23.20%	29.54%	32.57%
$500,001 and above	47.97%	23.98%	31.69%	34.52%

Earned Income

Earned income incorporates various types of income, including employment income, rental income (less any losses), self-employment income (less any losses), royalties from publications, and any alimony or separation payments received (less any such payments made by you). The calculation of earned income is often complex and may even require adjustments for certain items, such as professional dues or employment expenses. Furthermore, many sources of income are not covered by the definition of earned income, including investment income, pension income and RRSP or RRIF income.

The importance of *earned income* rests with its impact on RRSP contribution limits. For 2012, the maximum amount you can contribute to your RRSP is equal to 18% of your previous year's earned income (up to a maximum contribution limit of $22,970), plus any unused contribution room from prior years, less any pension adjustments (if applicable). Your 2012 RRSP contribution limit is indicated on your 2011 Notice of Assessment from the Canada Revenue Agency. Finally, please note that, if you are unable to maximize your RRSP contributions in the current year, you may carry forward any unused contribution room to future taxation years.

Employment Income

As employees of a hospital and/or provincial health department, medical residents earn income in the form of *employment income* (i.e., a salary). The employer calculates the deductions owed by the employee (such as income tax, CPP and EI contributions), withholds this amount from each pay, and provides the employee with a cheque for the net amount on a periodic basis. Salaried physicians are paid the same way by their employers.

Self-Employed Income

Most physicians are self-employed; the term *sole proprietor* is also used for independent contractors who have a business relationship with a customer but who also have the right to determine where, when and how their work is done. The proprietor, who must collect revenues and pay expenses, prepares a Statement of Professional Activities (Form T2032) and files this with his/her tax return. In addition, the proprietor will often be required to make regular *tax instalments* to the Canada Revenue Agency for taxes owing.

Although self-employed individuals may not be required to submit EI contributions, special note must be made of the physician's responsibility under the Canada Pension Plan. All self-employed individuals must make CPP contributions up to a maximum annual amount. Because employers must match employees' contributions to the CPP, sole proprietors, including self-employed physicians, must contribute twice the normal share of CPP (i.e., both the employee and employer contributions). However, a deduction equal to one-half of the total CPP paid by the self-employed individual may be claimed as a deduction from net income on their personal income tax return, while the second half of the CPP should be claimed as a non-refundable tax credit.

Investment Income

Investment income is a catch-all term for those revenues (and losses) that arise from the purchase of some asset or financial instrument for purposes of income generation, speculation or realization of a profit. Notable examples include purchase of Canada Savings Bonds, acquisition of shares in a private or publicly traded company, or purchase and rental of a property. Nevertheless, the tax treatment of investment income is dependent on the exact nature of that income. Taxes on capital gains tend to be most favourable, followed by dividends and interest income.

Interest Income

This is interest earned from an investment, such as a guaranteed income certificate (GIC), Canada Savings Bond or short-term deposit. Generally, *interest income* is taxed at 100% of the individual's tax rate.

Capital Gains And Losses

Capital gains are profits realized upon selling certain assets, such as shares in a company. Capital gains are generally calculated as the excess of the proceeds from the sale of the asset, less the asset's adjusted cost base. Expenses incurred on the sale or purchase of the asset may also be factored into the capital gain calculation. In addition, capital gains are generally taxed at 50% of the individual's marginal tax rate. For example, if you purchased a number of shares of stock for $500 and subsequently sold those shares for $1,500, you would realize a capital gain of $1,000. The *taxable capital gain*, however, will be $500 ($1,000 at 50%), and this is the amount that would be included in your tax return.

One may also incur *capital losses*, which are calculated in a similar fashion. Although capital losses are not taxable, the allowable portion (50% of the loss incurred) may be applied against existing taxable capital gains in the current year and, when not fully utilized in the current year, applied against taxable capital gains incurred in any of the three preceding years or in any subsequent years.

Dividend Income

Dividends are income received by shareholders of a company when profits have been distributed to investors. Dividends are further classified as "eligible" and "non-eligible". "Eligible" Canadian dividends are those received by individuals from public corporations and Canadian-controlled private corporations (CCPCs) that have been paid out of business income taxed at the high corporate rate. Dividends received from CCPCs that pay tax at the "small business rate" are classified as "non-eligible" dividends and are treated differently. (Further discussion on these terms and their tax implications is beyond the scope of this text).

Non-eligible dividends from a Canadian company, paid to an individual in the top tax bracket in 2011, are preferentially taxed at a maximum federal-provincial combined rate that ranges from about 27.71% in Alberta to about 41.17% in Prince Edward Island. Eligible dividends attract a maximum federal-provincial combined rate that ranges from about 17.72% in Alberta and the Yukon to about 34.85% in Nova Scotia.

For example, in Ontario, the top marginal tax rate that may be imposed on individuals in 2012 is 47.97%, while the top marginal rate on dividend income is 31.69% and 34.52% for eligible and non-eligible dividends, respectively. This lower tax rate for either eligible or non-eligible dividends reflects the fact that the corporation has already paid tax on the income before distributing dividends to shareholders.

Other Income

Although not necessarily a catch-all for other types of income, the tax definition of *other income* includes certain monies, such as scholarships and bursaries. For 2006 and subsequent taxation years, all amounts received in the year on account of scholarships, fellowships and bursaries may be excluded from income if they are received in connection with the student's enrolment at a designated educational institution in a program to which he or she may claim the education tax credit. (Before the 2006 federal budget, only $3,000 of such income was eligible for this tax-exemption.)

Note: The provisions of the *Income Tax Act* regarding bursaries and scholarships—particularly for those in residency or completing a fellowship—can be confusing. If in doubt, your particular situation should be discussed with your tax accountant.

Tax Credit

A *tax credit*—such as a tuition tax credit, education tax credit or the basic personal exemption—applies a set percentage of the credit amount against an individual's tax liability, regardless of the individual's marginal tax rate. Tax credits are deducted from federal and provincial taxes payable and may save the individual approximately 20% to 27% of the credit amount (depending on their province/territory of residence). The majority of these credits, however, are non-refundable. That is, if the total credits exceed your tax payable, you will not get a refund for the difference.

For example, a taxpayer, resident in British Columbia, who pays $10,000 in eligible tuition fees could apply federal and provincial tax credits totalling approximately $2,200 against his or her current year tax liability.

Tax Deduction

A *tax deduction*, such as an RRSP contribution, reduces one's taxable income, and the actual savings related to this deduction will be at the individual's marginal tax bracket. The higher the individual's income, the more that deduction will save the taxpayer.

For example, a physician in Ontario who earns more than $132,406 but less than $500,000 is in a marginal tax bracket of 46.41%. A $10,000 contribution to an RRSP could see taxes payable drop by $4,641—the marginal tax rate, multiplied by the respective expenditure.

In most instances, a tax deduction is more valuable to the taxpayer than a tax credit for the same amount.

POTENTIAL TAX DEDUCTIONS AND TAX CREDITS

What qualifies as a *deductible expense for tax purposes*? The general rules for deductibility indicate that:

1. expenses have to be incurred to earn income;
2. expenses are reasonable in amount and under the circumstances, and;
3. expenses are allowed (and not specifically denied) by the *Income Tax Act.*

Generally, personal and living expenses, capital expenditures and certain expenses specified by the *Income Tax Act* (e.g., golf club dues) are not deductible for tax purposes. It is important to get professional advice to ensure that you avail yourself of all potential tax deductions and credits. Also, retain any documents (such as receipts and invoices) that support your expenditures, as they may be requested by the Canada Revenue Agency. As a resident or fellow, you will be particularly interested in how the following expenses are treated for tax purposes.

1. **Medical library and equipment.** These are generally not deductible while you are a resident, as you will be considered an employee. Once you begin practice and become self-employed, you may transfer these items to your business at their fair market value. Depending on the nature of each asset, these costs incurred by your practice may be deducted immediately, or will need to be depreciated at specified rates over a period of years.
2. **Personal computer.** Like your medical library and equipment, once you begin to practise and become self-employed, the remaining fair market value of your

computer may be transferred to your business. You will then be able to utilize CRA-prescribed rates to claim capital cost allowance (i.e., depreciation) on the computer for the proportion that relates to business use.

3. **Automobile and travel expenses.** A resident will typically be able to claim a deduction for automobile and related costs if he/she was ordinarily required to work away from the principal place of employment, and also if that resident did not receive a travel reimbursement or allowance. For example, family medicine residents who are required to use their vehicles for house calls should have their employer complete Tax Form T2200 (Conditions of Employment) before filing their tax returns. This form will allow these residents to claim a pro rata share of all eligible expenses related to the operation of the automobile, including depreciation. The pro rata share is essentially the number of kilometres utilized for employment (i.e., the respective house calls), divided by the total number of kilometres driven in the year for both personal and business use.

Note that costs associated with travel directly to and from your principal place of employment are deemed personal in nature and are not deductible for tax purposes. Furthermore, the CRA specifies that all motor vehicle expenses should be supportable by vouchers, and also recommends that taxpayers maintain a log of kilometres driven for business and personal use.

1. **Interest on student loans.** Since 1998, interest paid on negotiated and existing Canada and provincial student loans has qualified for a non-refundable tax credit. The federal Department of Finance confirms that, once such loans have been consolidated—moved to another debt instrument, such as a line of credit or bank loan—any future interest tax credit is not possible

   Students may be eligible to claim interest paid on loans received under the *Canada Student Loans Act*, the *Canada Student Financial Assistance Act*, or similar provincial or territorial government laws for post-secondary education

2. **LMCC Parts I and II.** The fees to write either Part I or Part II of the licensing examinations of the Medical Council of Canada are not deductible for tax purposes and do not qualify for either federal or provincial tax credits.

3. **Certification examinations.** Examinations at completion of a residency program (e.g., College of Family Physicians exams at the end of family medicine or Royal College of Physicians and Surgeons exams at the end of another specialty) are deemed to qualify an individual to practise in a particular specialty. The federal budget of June 6, 2011, effective for 2011, detailed that ancillary fees and charges (e.g., the cost of examination materials) and examination fees for examinations required for obtaining a professional status (e.g., law bar or Chartered Accountant exam) or to be licensed to practise a profession or a trade in Canada are now eligible expenses to claim a non-refundable tuition tax credit. In early 2012, the Royal College of Physicians and Surgeons of Canada (RCPSC) was contacted regarding tax credit eligibility for FRCPC/FRCSC examination fees and, at the time of publication of this document, the RCPSC has confirmed that such fees paid for examinations in 2011 and subsequently will qualify for a tuition tax credit.

   Taxation of CCFP and FRCPC/FRCSC examination fees is a controversial area and a tax specialist should be consulted.

4. **USMLE Parts I, II and III.** The fees to write the United States Medical Licensing Examinations are not deductible for Canadian tax purposes.

5. **Annual dues.** Annual dues paid to the provincial/territorial medical association, the Royal College of Physicians and Surgeons or the Canadian College of Family Physicians, or to the College of Physicians and Surgeons of a particular province or territory, and which are necessary to maintain professional status, are deductible in the current year.

6. **Travel costs for interviews.** You may not claim the cost of travelling to interviews for residency or fellowship positions.

7. **Moving expenses.** Certain moving costs may be deductible, if you have relocated more than 40 kilometres closer to your new place of business, employment or school. These expenses are deductible only against income earned at this new location. Eligible moving expenses that are not deducted may be carried forward to the following tax year. Although you are not required to file moving expense receipts with your income tax return, you must be able to provide them to the Canada Revenue Agency upon request.

8. **CMPA coverage.** The annual membership fee paid to the Canadian Medical Protective Association (less any reimbursement from a provincial or other program) is deductible as an expense against business income earned as a medical practitioner. However, for an employee (such as a resident or salaried fellow) to deduct CMPA fees or other professional dues, the *Income Tax Act* requires that payment of the dues be necessary to maintain a professional status recognized by statute.

Even though CMPA dues are generally required as a condition of employment, this requirement has no bearing on the deductibility of the fees. In provinces other than Quebec, Ontario, Manitoba, New Brunswick, Saskatchewan, Alberta, British Columbia and Newfoundland and Labrador, CMPA dues are not required to maintain a professional status and therefore do not appear to be deductible. (In 2009, the College of Physicians and Surgeons of British Columbia adopted a by-law making it mandatory for their physicians to be either a member of the CMPA or have professional liability insurance.)

For salaried physicians of Quebec, Ontario, Manitoba, New Brunswick, Saskatchewan, Alberta, British Columbia and Newfoundland and Labrador, however, CMPA fees (less any rebate from a provincial reimbursement or other program) should be deductible as professional dues on Line 212 of your federal income tax return. For salaried physicians of the remaining provinces and territories, the net fees paid may be deductible as an employment expense on Line 229 of the federal income tax return, if the physician obtains a completed form T2200 from their employer stipulating that CMPA membership is a condition of employment and the employee does not receive reimbursement for his or her expenses.

Although the deductibility of CMPA premiums for physician employees has been a contentious issue with the CRA in recent years, an April 6, 2006 External Technical Interpretation (2005-0163641E5, Hewlett, Randy), noted that an employee who is required by his employer to buy malpractice insurance may deduct those amounts as an allowable employment expense, provided that the employer certifies this on a valid Form T2200.

Be sure to discuss the deductibility of CMPA premiums with your tax advisor.

Child Care Expenses

With certain restrictions, the costs of day care, babysitters, boarding schools and camps are deductible to a maximum of $7,000 per year for children under seven, and $4,000 a year for kids aged 7–16. The deduction must be claimed from the income of the spouse or common-law partner who earns the least income (except when this individual is at school, disabled, separated from you or in prison) and cannot exceed two-thirds of the spouse's earned income.

Please note that payments for medical or hospital care do not qualify as eligible child care services. Instead, these payments may qualify as medical expenses (if eligible). In addition, as a general rule, you cannot claim fees related to educational or recreational activities (e.g., skating or music lessons). That being said, depending on the circumstances, certain educational or recreational activities may be accepted by the CRA if it can be demonstrated that the primary purpose of the activity is to provide child care, thereby enabling the parent to work. Be sure to speak with your tax advisor for further details.

Retain the proper receipts for child care expenses, or your claims may be denied. Income Tax Form T778 (Child Care Expenses Deduction) should be filed with your tax return.

Tuition Expenses

Tuition fees paid during medical school or a residency program are not deductible, but are generally eligible for the *tuition tax credit.* Obtain Income Tax Form T2202A (Tuition and Education Amounts Certificate) from your university to determine allowable tuition costs. Keep in mind that fees paid for admission, application, confirmation, use of library or laboratory facilities, examinations (including re-reading) and diplomas, as well as mandatory computer service fees and certain academic fees qualify as eligible tuition fees. Other tuition fees (such as for ATLS courses and certain LMCC preparation courses) may also qualify for the tax credit. Be sure to obtain appropriate documentation for these courses from the respective administrators.

In addition to the tuition tax credit, students may also claim an education tax credit. Although full-time medical students can generally claim a federal education tax credit of $400 per month ($120 per month for part-time students), this benefit has not always been available for residents, who were considered to be pursuing post-secondary education in relation to their current employment. The March 23, 2004 federal budget removed this employment restriction, so those residents in an otherwise qualifying educational program may be eligible for the education tax credit for the 2004 and subsequent taxation years, provided that no part of the education cost is borne by or reimbursed by their employer. Generally, you cannot claim the education amount if you:

- received a grant or were reimbursed for the cost of your courses from your employer or another person with whom you deal at arm's length, other than by award money received;
- received a benefit as part of a program (such as free meals and lodging from a nursing school); or
- received an allowance for a program, such as a training allowance.

For further details, please refer to the following link: http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/ncm-tx/rtrn/cmpltng/ddctns/lns300-350/323/menu-eng.html, or consult your provincial house organization (e.g., PAR-A, PARI-MP, PAR-O, etc.) or tax advisor.

Students are entitled to carry forward indefinitely unused tuition and education tax credits. This will enable students to utilize the credit when they have sufficient income (i.e., during residency). Any amount not used in the current year by the student and not transferred to an eligible person will be automatically available to carry forward. Once income is sufficient to utilize the unused tax credits, however, they must be applied to reduce taxes payable.

Business Expense Summary

Should you become self-employed when you begin practice, you will qualify to deduct a variety of expenses against your business or self-employed income. It is important that you obtain professional advice to ensure that you avail yourself of all eligible expenditures to maximize your allowable deductions, and potentially minimize taxes payable. Expenses must be incurred for the purpose of earning income and must be reasonable. In addition, be sure to retain all vouchers and/or receipts that support these expenditures. Some deductible business expenses incurred by self-employed physicians include:

1. Accounting and legal fees
2. Advertising and promotion
3. Specified amounts for meals and entertainment (see below)
4. Annual medical licence fees and certain professional dues
5. Bank charges
6. Interest on office loans and lease payments on assets used for business purposes
7. Convention expenses (for tax purposes, you are generally allowed to deduct two conventions per year)
8. Maintenance and repairs for the office and equipment
9. Professional development
10. Capital cost allowance on your professional library
11. Office expenses
12. Capital cost allowance on specific capital expenditures (e.g., medical equipment or leasehold improvements on your office)
13. Salaries and employee benefits
14. Utilities: heat, lights, power and water related to the business
15. Insurance: malpractice, office and practice overhead
16. Certain travel expenses related to your practice
17. Home office, in certain circumstances (see below)

Travel Expenses

Self-employed physicians who use an automobile for business purposes may claim a deduction for a percentage of the operating costs related to the vehicle, including fuel, oil, maintenance and repairs, insurance, licence fees, registration and interest on a car loan. To do so, it is very important to keep a travel log, in which you record your use of the vehicle for business purposes.

To obtain the allowable business percentage of expenses, divide the total business kilometres by the total kilometres travelled in the year. Note that travel costs related to driving to and from your principal place of business (e.g., from your home to your office) are generally not deemed eligible expenses.

If you have purchased your vehicle, you can claim capital cost allowance within limits specified by the *Income Tax Act.* If the vehicle is leased, there will be limits on the deductible leasing costs.

If you use a vehicle for business purposes, you should review allowable expenditures for tax purposes with your accountant.

Home Office

A physician may deduct costs associated with a home office if it is his/her principal place of business, or if the space is used only to earn business income and it is used on a regular basis to see patients. This is a challenging area of tax law, and recent pronouncements in the tax literature have addressed this topic. Seek professional advice if you believe you may qualify to deduct a home office.

Meals, Entertainment And Promotion Expenses

Entertainment expenses, as defined by the *Income Tax Act*, are only 50% deductible—which means that those in the top marginal tax bracket could see a reduction in their tax liability equal to almost 25% of the total entertainment expenditures if these expenses are claimed on their income tax return. *Practice promotion expenses*, however, are 100% deductible, resulting in a potential reduction in tax equal to almost 50% of the expenditure made at your top marginal tax rate.

Taking an associate to dinner to discuss a particular case qualifies as an *entertainment expense*. Tax law does not consider that this warrants full deductibility and the tax deduction for such expenses is limited to 50%.

It is wise to consult a professional about how to claim such expenditures.

The Importance Of Professional Accounting Advice

Because doctors are among the top 10% of income earners in Canada and our income tax system is inherently complex, physicians are strongly advised to have a qualified tax accountant as a member of their professional advisory team. A qualified accountant should act in your best interest to ensure that your taxes owing are minimized and that your family's after-tax take-home pay is maximized.

Calculation Of Taxes Owing

Most physicians are sole proprietors, or self-employed professionals. For tax purposes, there is no distinction between a proprietor and an individual. Residents of Canada, for tax purposes, are taxed on their world income, and their taxable income includes not only business income but also income from all other sources (e.g., salary, interest or taxable portions of capital gains). For a simplified diagram, demonstrating how federal and provincial taxes payable are calculated, see Appendix 1.

Tax Instalments

Unlike employees, sole proprietors—which describes many physicians—do not have income tax taken off a paycheque and withheld at source by an employer. As such, the payment of instalments is the only method by which the Canada Revenue Agency can collect income taxes throughout the year. The payment of tax instalments for individuals must be made on March 15, June 15, September 15 and December 15 of each fiscal year.

Generally, the CRA requires instalment payments if the difference between a taxpayer's combined federal and provincial taxes payable (before applying any instalments) and total amounts withheld at source regularly exceed $3,000 year after year. More specifically, if you owed more than $3,000 on your federal return in either of the two preceding years, and you expect to owe more than $3,000 for the current year, you are technically required to make instalment payments for that current year. Also, if you are a resident of Quebec, the federal threshold of $3,000 is reduced to $1,200 in order to reflect the fact that the Ministry of Quebec will collect its own instalment payments. Generally, the CRA will send reminder notices to individuals who may be required to make instalment payments.

The *Income Tax Act* allows taxpayers to select one of three methods to calculate their required instalments.

Method 1 (Second Prior Year Method)

Each of the required March 15 and June 15 instalments is equal to one-quarter of your total tax liability two years ago. The September 15 and December 15 instalment amounts are calculated by reducing your total tax liability for the immediately preceding year by both the March 15 and June 15 instalments, and dividing this result by two. Confusing? Let's try an example (a table, explaining this case example, is available as Appendix 2).

Case Example: Second Prior Year Method

Dr. White, a vascular surgeon, completes his residency in 2010 and begins practice on July 1, 2010. His self-employed net income for the remainder of 2010 totals $100,000. Overall, his total federal and provincial tax liability for 2010 is approximately $35,000.

In 2011 Dr. White finds his net income increases to $200,000, with a federal and provincial tax liability of $76,000. In 2012 his net income reaches $250,000, which incurs a total tax liability of approximately $99,000, while professional income of $300,000 in 2013 results in a tax liability of approximately $122,000.

What will Dr. White's required tax instalments be for the 2010 to 2013 taxation years?

For the year 2010: Because Dr. White was still a resident in 2008 and 2009, it is very likely that sufficient income taxes were withheld from his paycheques in order to ensure that his yearly tax liabilities did not exceed $2,000. If we assume that Dr. White's tax liabilities in 2008 and 2009 were nil, he will not be required to make instalment payments for 2010. Instead, Dr. White dutifully remits $35,000 to the CRA in April 2011 when filing his tax return for 2010. Dr. White could have voluntarily made instalment payments throughout 2010 in order to reduce the need to make such a large lump-sum payment in April 2011.

For the year 2011: In 2009, we assumed that Dr. White's tax liability was nil; however, in 2010, Dr. White's tax liability was $35,000. As Dr. White owed more than $3,000 in one of the two prior years, and as he expects to owe well in excess of $3,000 for 2011, he will be required to make instalment payments. By using the second prior year method, the March 15 and June 15 instalment payments in 2011 will each be nil (equal to one-quarter of the 2009 tax liability of nil) while the September 15 and December 15 instalments would each be $17,500—equal to the 2009 tax liability of $35,000, less the two first instalments of the year [i.e., nil], divided by two). Because he paid instalments throughout the year, in April 2012, when filing his 2011 tax return, Dr. White will be required to pay the remaining tax liability of $41,000 ($76,000 of tax liability, less $35,000 of instalments).

For the year 2012: The 2012 instalment requirements will be calculated similarly to the calculations in 2011. For 2012, Dr. White's March 15 and June 15 tax instalments will be the amount of his tax liability for 2010 (second preceding year), divided by 4, or $8,750 ($35,000 ÷ 4). His September 15 and December 15 instalments, however, will be calculated at $29,250 each ($76,000 [his tax liability for 2011 before instalments], less the March 15 and June 15 instalments [$8,750 + $8,750], divided by 2). Overall, after having paid these instalments during 2012, Dr. White will be left with a tax liability of $23,000 payable (tax liability of $99,000 tax payable, less instalments of $76,000 [$8750 + $8750 + $29250 + $29,250]) in April 2013, when filing his 2012 tax return.

For the year 2013 and subsequent years: Dr. White's March 15 and June 15 instalments will be his tax liability before instalments for the second preceding year ($76,000 in 2012), divided by 4, or $19,000 each. His September 15 and December 15 instalments will be $30,500 each (the taxes payable for 2012 before instalments [$99,000], less his March and June 2013 instalment payments [$19,000 each], divided by 2).

Method 2 (Prior Year Method)

This method calculates each of your quarterly instalments as one-quarter of your total federal and provincial tax liability (before any tax instalments) for the immediately preceding year.

In Dr. White's case, this method would entail equal quarterly instalments of $8,750 for 2011 ($35,000 ÷ 4); $19,000 for 2012 ($76,000 ÷ 4); and $24,750 for 2008 ($99,000 ÷ 4).

Method 3 (Current Year Method)

This method lets taxpayers estimate their tax liability for the current year and submit equal quarterly payments accordingly.

You may choose the method that will result in the lowest quarterly instalment amount. If you choose Method 1 (second prior year) or Method 2 (prior year), you will avoid assessed interest and penalties, as long as your payments are properly calculated and are made on time. If you choose Method 3 (current year), however, be aware that deficient payments may result in interest and penalties—particularly if you underestimate your actual income and submit insufficient instalments.

These rules, particularly Method 1, will allow a newly graduated physician to delay payment of any tax related to self-employment income for nearly a year, and regular instalments may not start until the second full year of business. Many newly practising physicians commonly fail to save the money required for taxes, however, and once they are required to make instalments or a payment when filing a tax return, find their savings are insufficient to meet these obligations.

Many physicians wisely subscribe to the 40/30/30 rule. For every $100 earned, $40 stays in the business account to cover overhead costs, $30 is set aside in a bank account dedicated to fund income tax obligations, and $30 is kept by the physician as after-tax disposable income. You may want to consider adopting this prudent practice at the outset of your career and modify this general guideline as you see fit.

Calculating tax instalments can be complicated and many rules apply. Graduating residents should obtain the services of a tax advisor as soon as possible to ensure that they are maintaining all necessary records and satisfying all statutory requirements, including instalments.

Key Message

It is important to choose the best method of paying tax instalments, keep accurate financial records and set aside the appropriate funds each quarter to meet your tax obligations. The professional advice of a tax accountant is invaluable to a newly graduated physician setting up medical practice.

INCORPORATION

A corporation is a distinct legal entity. It is a separate taxpayer for purposes of the *Income Tax Act*, owned by shareholders and managed by directors. A corporation earns revenue from many sources, incurs expenses and can offer benefits to employees and shareholders.

In Canada, the taxation of a corporation is different from the taxation of an individual. The *Income Tax Act* allows certain types of income earned by a corporation to be taxed at a lower rate than the tax rate imposed on a physician who earns income from the same sources personally. Whereas, in 2012, the top marginal tax rate for an individual in Canada ranged from 39% in Alberta to almost 50% in Nova Scotia, the combined federal and provincial tax rate on the first $400,000 of active business income earned in Canada by a Canadian-controlled private corporation (CCPC) ranged from about 11% in Manitoba to 19% in Quebec. This lower corporate tax rate is commonly referred to as the *small business tax rate*. Although income earned by a corporation may be taxed at this lower rate, additional taxes are incurred at the level of the individual taxpayer once funds are withdrawn from the corporation (usually by way of salaries or dividends).

By the inherent concept of "integration", an individual who earns income within a corporation and pays tax at the small business tax rate but immediately withdraws all the net earnings directly as salary or dividends will generally incur about the same total taxes as if he or she had earned, declared and paid tax on this income as an individual. Although application of the concept of integration may suggest no advantage to incorporation, there may in fact be significant benefits for physicians, particularly through *tax deferral* and *income splitting.*

In simplistic terms, *tax deferral* may be achieved when corporate earnings, which are taxed at the small business tax rate, are retained within the professional corporation instead of being immediately distributed and likely taxed at a shareholder rate. Tax deferral essentially allows for the investment (and therefore growth) of funds that would otherwise have been paid to the taxation authorities. Furthermore, tax deferral can create significant tax savings if the funds are withdrawn from the professional corporation at a time when the shareholder is in a lower tax bracket, such as during retirement or a sabbatical. The following tax-deferral example is presented for illustrative purposes only.

Case Example: Tax Deferral

In 2012 Dr. Merry, a resident of Ontario, earns taxable income of $200,000 and pays approximately $73,000 in federal and provincial income taxes. However, Dr. Merry has identified that his current lifestyle needs require a yearly income of approximately $100,000.

If Dr. Merry decides to incorporate his medical practice, the corporation's net income would be approximately $100,000 (equal to the $200,000 professional income, less a $100,000 salary paid to Dr. Merry). Assuming that the corporation earns only active business income, it would pay approximately $15,500 ($100,000 times the 15.5% tax rate) in corporate income taxes, leaving $84,500 in the corporation. Dr. Merry, on the other hand, would be taxed on his $100,000 salary and would therefore be subject to a tax liability of approximately $27,000, assuming he earns no other income and has no other deductions.

The combined taxes paid by the corporation and by Dr. Merry would be approximately $42,500 ($15,500 + $27,000) in comparison with the $73,000 that Dr. Merry would have paid had he earned all income personally (without a corporation). Dr. Merry now has an additional $30,500 in savings within the corporation, which he can use to invest, or even to pay off business-related debt.

It is important to point out, however, that additional tax will be owing once the $84,500 retained in the corporation is distributed to Dr. Merry. Ideally, these future distributions will occur at a time when Dr. Merry is in a lower tax bracket than his current bracket, such as during a sabbatical or in retirement.

Incorporation is not for everyone, and several other factors must be considered when evaluating its benefits and consequences. For example, there could be additional costs related to incorporation that could reduce (or even eliminate) any tax-deferral advantage. It is important to discuss the incorporation decision with your financial consultant, as well as with your tax and legal advisors.

The potential income splitting benefits that are available through incorporation will vary between provinces, as allowed non-physician family member shareholders of a medical corporation vary between provinces and territories.

Case Example: Income Splitting

Dr. and Mr. Jones are residents of British Columbia. Dr. Jones has decided that her spouse, Ben, who has no other income, will own non-voting shares of her professional corporation. Although Dr. Jones is in the top marginal tax bracket of approximately 43.7% for British Columbia, Ben will not incur tax at this top marginal rate until he reports approximately $132,400 of taxable income. Dr. Jones currently earns professional income of $200,000 per year. As the Joneses have a large mortgage on their personal residence, they require as much income as possible to pay for personal expenses and also to maintain current lifestyle needs. Finally, for 2011, Dr. Jones must receive a salary of at least $124,700 ($22,450 RRSP maximum contribution limit for 2011, divided by 18%) in order to continue maximizing RRSP contributions for 2012.

Let's assume that the corporation pays Dr. Jones a salary of $125,000 and then distributes any surplus corporate earnings to Ben. Assuming the corporation qualifies for the small business tax rate, it would be subject to tax of approximately $10,125 ($75,000 times the 13.5% tax rate) on its taxable income of $75,000 ($200,000 taxable income, less $125,000 salary). The remaining corporate earnings available to be distributed as a dividend to Ben would be $64,875 ($75,000, less $10,125).

Depending on the province, by virtue of the dividend tax credit, a taxpayer with no other income may earn up to approximately $30,000 in dividends without incurring any tax. If taxed personally on the entire $200,000 of professional income, Dr. Jones would have incurred a tax liability of approximately $68,000. If the corporation instead pays Dr. Jones a salary of $125,000, however, and pays Ben a dividend of approximately $65,000, Dr. Jones would incur a personal tax liability of about $36,000, while Ben would pay tax of about $4,800, assuming he has no other income or deductions. Overall, this strategy would result in combined personal and corporate taxes of $50,925 ($4,800 paid by Ben, $36,000 paid by Dr. Jones, and $10,125 paid by the corporation). This results in tax savings of $17,075 ($68,000, less $50,925), in comparison with the $68,000 Dr. Jones would have paid had she earned all of the income personally.

This strategy is called *income splitting.* Dr. Jones has been able to split income that was subject to tax at her top marginal tax rate in order to have it taxed in the hands of her spouse at a lower tax rate. The ability to have family members as shareholders in a physician's professional corporation is determined by the provincial/territorial legislation and, as such, opportunities vary depending on the province or territory of residence. Furthermore, there are rules in place to discourage the implementation of certain income splitting strategies with minor children. Consult your tax advisor in order to determine the appropriate salary/dividend mix for your family.

In addition to tax deferral and income splitting, other benefits may be available. Nevertheless, incorporation may not be to every physician's advantage. A thorough cost-benefit analysis is necessary to determine whether incorporation is worth considering. When this module was prepared, physicians were allowed to incorporate in all Canadian provinces and territories except Nunavut. Because legislation, legal requirements and the costs and benefits are specific to each province and territory, any physician who is considering incorporation is strongly advised to get professional advice from tax and legal advisors.

Goods And Services Tax (GST)/Harmonized Sales Tax (HST)

The Goods and Services Tax (GST) is a value-added tax, levied by the federal government. The combined Harmonized Sales Tax (HST), also a value-added tax, is a single, blended combination of the PST (provincial sales tax) and GST, which is used in British Columbia,[2] Ontario and the Atlantic provinces of New Brunswick, Newfoundland and Labrador, and Nova Scotia. The HST is then collected by the Canada Revenue Agency, which then remits the appropriate amounts to the participating provinces.

Insured services and many other medical services are GST-exempt. This precludes physicians from having to register for GST/HST or charge and collect GST/HST. This also means that any GST/HST a physician pays on expenses or supplies is not refundable as an input tax credit (or ITC). However, the GST is deductible from income for tax purposes. In order to treat GST properly, you must have good accounting and bookkeeping practices that keep track of all expenditures.

Some physicians, however, should be wary. Certain activities—such as witness fees for court appearances, or surgical procedures that alter or enhance a patient's appearance but have no medical or reconstructive purpose and are not covered by provincial/territorial health plans—are not GST/HST-exempt. If the revenues from such non-exempt activities exceed $30,000 in any 12-month period or in any single quarter, the physician would be required to register for a GST/HST number and collect and remit GST. If in doubt, review your particular circumstances with a qualified accountant.

Until a few years ago there were unusual GST/HST implications for physicians who performed locums. In November 2000, however, the tax rules were modified so that the host doctor no longer has to charge GST/HST to the doctor who is providing locum coverage. A properly worded locum contract may eliminate potential GST/HST liability; the key is to state that the locum doctor has entered into a fee-sharing agreement with the host doctor, rather than paying a percentage split for services provided by the host doctor. To minimize and potentially eliminate GST/HST liabilities, have your tax accountant and/or lawyer review any locum contract you are considering.

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[2] It is noted that, as a result of a provincial referendum in 2011, the residents of British Columbia rejected the HST and voted to go back to the separate federal GST and old provincial sales tax; the structure of the tax and exact details of the implementation of the provincial sales tax are still unclear at the date of publication of this document.

Income Splitting

As discussed earlier, *income splitting* is the practice of shifting income subject to a high marginal tax bracket to family members who may be subject to lower marginal tax brackets. By splitting income in this manner, you can minimize the income tax paid by the family as a whole. While income splitting may be possible by way of family member shareholdings if you incorporate your medical practice, income splitting is also a possibility for non-incorporated physicians.

Example: If a doctor, resident in British Columbia, earns $200,000 and his/her spouse does not collect a salary for working at the medical office, this is what the tax liabilities will look like.

Tax Situation Without Income Splitting			
	Doctor	**Spouse**	**Total**
Income	$200,000	Nil	$200,000
Taxes	$68,000	Nil	$68,000

If the physician decides to pay the spouse a salary of $50,000 for working at the office, their tax liability will shift.

Tax Situation With Income Splitting			
	Doctor	**Spouse**	**Total**
Income	$150,000	$50,000	$200,000
Taxes	$46,000	$ 9,000	$55,000

By splitting income between the physician and spouse, the family has taken advantage of the spouse's lower tax bracket and saved $13,000 ($68,000, less $55,000) in income taxes. Note that when salaries are paid to family members, they must have actually done the work and received the remuneration. In addition, the remuneration must have been reasonable compensation for the services provided and the services must have been related to your practice.

There are other methods of split income, including:

1. **Higher-taxed spouse pays family bills.** Family bills are necessary and, unfortunately, are non-deductible expenses. If the higher-taxed spouse pays these bills, the lower-taxed spouse will retain the maximum amount of personal funds. Earnings on the subsequent investment of these funds will be in the hands of the lower-taxed spouse, reducing the overall tax cost for the family.

2. **Lower-taxed spouse invests his/her annual income.** Because income on investments outside an RRSP are generally taxable, having the obligation for the majority of these investments assumed by the lower-taxed spouse will ensure that subsequent earnings will be taxed in the hands of the lower-taxed spouse. This practice will minimize subsequent income taxes for the family as a whole.

3. **Bona fide loan to spouse.** A higher-taxed spouse may loan a lower-taxed spouse money as a bona fide loan. Then the lower-taxed spouse can invest the loan funds and earn income. If the loan is properly structured, the subsequent income will be taxed in the hands of the lower-taxed spouse and will not be attributed back to the higher-taxed spouse. The following conditions must be met, however:

- The loan is genuine and is documented by a written note.
- There is a documented schedule for loan interest repayment and a clearly defined term for the duration of the loan.
- The interest charged is reasonable and consistent with the market interest rate (see below).
- The interest charged is fully paid within 30 days of the end of the calendar year.

Please note that the market rate designated on bona fide loans to a spouse are set by the Canada Revenue Agency as a specific prescribed rate each quarter. If this strategy appears advantageous to you, ensure that you obtain the services of a qualified tax advisor prior to implementation.

Gifts to children under 18. If a physician makes a gift to a child under age 18, any interest or dividends the child earns on this gift will be attributed back to the physician, who will incur the tax at his or her marginal tax rate. If these funds are invested by the minor and subsequently sold, however, any resulting taxable capital gain will be taxed in the hands of the minor, and not attributed back to the higher-taxed physician.

Gifts to children over 18. If a physician makes a gift of money to a child over age 18, any interest or dividend earned by the adult child will be taxed in his or her hands and will not be attributed back to the parent.

4. **Spousal retirement savings plan.** There are two main tax advantages to spousal RRSPs. First, in the event that you can no longer contribute to an RRSP because of your age but you still have earned income or contribution room available and you have a younger spouse or common-law partner who is still eligible to have an RRSP, you can continue making RRSP contributions through a spousal plan.

   Second, you and your spouse or common-law partner will be able to split income upon your retirement and reduce the overall tax burden for the family unit secondary to marginal tax rates. For 2007 and subsequent years, however, a similar income splitting benefit can be achieved without a spousal RRSP; for 2007 and later years, you and your spouse or common-law partner can agree to split up to 50% of your spouse/partner's eligible pension income under certain restrictions and upon filing the appropriate elections with your tax returns.

Before You Begin Practice

Before you complete residency, you are strongly advised to find a qualified accountant to be a part of your professional advisory team. Meet with the accountant prior to beginning your medical practice to ensure:

1. You are implementing the appropriate books and records to keep track of your personal and professional finances.
2. Business bank accounts that are separate from your personal bank accounts are established.
3. You understand the accounting methods, and that you have trained staff who will keep track of all revenue and expenditures from the outset.
4. Practices are in place to ensure that appropriate money is set aside from all revenue to cover your overhead costs and tax obligations.

5. You have a schedule of the amounts and dates of any required instalment payments to the Canada Revenue Agency.

6. Regular meetings are set up with the accountant.

7. You have a detailed list of the documents you will need to provide to your accountant at specified times in the year: bank statements, cancelled cheques, computerized bookkeeping statements, paid and unpaid invoices, billing remittances and uninsured revenue listings, payroll journals, and copies of any and all leases.

8. Your accountant has reviewed and implemented all applicable tax planning strategies to enable you to minimize your tax paid and maximize after-tax take-home income for you and your family.

SELECTING AN ACCOUNTANT

Choosing the right accountant is one of the most important financial decisions that a physician will make. Although this professional may not be able to increase your total billings, a knowledgeable professional accountant will maximize the amount of income that ultimately remains in your hands. Establishing and maintaining a proper accounting system and effective tax planning are essential aspects of medical practice management, and are necessary components of personal financial planning. Although you may be familiar with some tax strategies, such as RRSPs, there are many other issues on which an accountant can provide invaluable expertise: incorporation, income splitting, tax planning and GST/HST requirements, to name a few.

Although every community has "tax specialists" and "accounting services providers", physicians should engage an accountant who has earned one of the professional designations—certified general accountant (CGA), certified management accountant (CMA) or chartered accountant (CA)—and who specializes in taxation.

Key Message

Seek advice from a professional accountant before you start medical practice to ensure that you implement the best practices for accounting, record keeping and financial management from the beginning of your career.

The best way to select an accountant is by recommendation from your peers. Talk to your colleagues. Would they recommend their accountants? Have their accountants saved them money? How much? Do their accountants seem to be up to date on the changing tax environment? Have they ever had problems with their accountants? A good accountant does not limit your interaction to having you sign your personal tax return in April of each year. A worthy accountant meets with you several times a year, optimizes any potential tax savings before December 31 of each year, and is always available to discuss concerns or opportunities.

In addition to word-of-mouth recommendations from colleagues, each MD Management office provides a list of local accountants who are recommended by other physicians. Once you have a few recommendations, it is wise to meet with the individuals. In the meetings, describe your financial situation, medical practice and objectives. Determine what each would propose to help you optimize your situation and increase your after-tax take-home income. Ask up front what the accounting services will cost and whether this accountant, or a junior or associate in the firm, will be doing most of the work.

ACTION PLAN

- **Learn and understand basic accounting terminology and concepts.**
- **Familiarize yourself with Canada's income tax system and how it applies to physicians.**
- **Obtain the professional services of a knowledgeable tax accountant.**
- **Set up appropriate record keeping for accounting and taxation purposes.**
- **Be diligent about setting aside money to pay income tax and overhead costs.**
- **Maximize your disposable income and personal net worth through good financial management and tax planning.**

RESOURCES

Resources online at cma.ca/pmcresources:

- Tax Tips For The Physician And Physician In Training

Resources available from MD Physician Services:

- Hotline: 1 800 361-9151
- A Guide to Incorporating Your Medical Practice

APPENDIX 1: HOW FEDERAL AND PROVINCIAL TAXES PAYABLE ARE CALCULATED

The following is a simplified demonstration of how federal and provincial taxes payable are calculated.

How Federal And Provincial Taxes Payable Are Calculated

	Federal	Provincial	Total	Notes
	Total income			Includes income from all sources (e.g., salary, net business income, interest, dividends, taxable capital gains, pension income)
Less	Deductions			Examples include RRSP contributions, moving expenses, child care expenses, professional dues, etc. (See Note 3.)
Equals	Taxable income	Taxable income		See Note 1.
Multiplied by	Federal tax rates	Provincial tax rates		See Table 1 for federal tax rates. Provincial tax rates are set by each province and territory.
Equals	Federal taxes	Provincial taxes		
Reduced by	Federal tax credits	Provincial tax credits		Examples include basic personal tax credit, tuition, education, medical expenses, CPP and EI tax credits. (See Note 3.)
Equals	Federal taxes owing	Provincial taxes owing (Note 2)	Total federal and provincial taxes owing	

Note 1. All provinces and territories except Quebec use the federal definition of taxable income.

Note 2. Ontario, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, and the Yukon levy provincial surtaxes, which are added to provincial taxes owing.

Note 3. See the definitions of tax credit and tax deduction.

Note 4. This table is presented for illustrative purposes only and does not necessarily encompass all relevant and required calculations needed to complete an individual income tax return.

APPENDIX 2: THE SECOND PRIOR YEAR METHOD OF CALCULATING TAX INSTALMENTS

Case Example: Dr. White And The Second Prior Year Method Of Calculating Tax Instalments[3]				
	2010	**2011**	**2012**	**2013**
Self-employed net business income	$100,000	$200,000	$250,000	$300,000
Combined taxes payable	$35,000	$76,000	$99,000	$122,000
Instalments				
March 15 instalment	nil	nil	$8,750 ($35,000 ÷ 4)	$19,000 ($76,000 ÷ 4)
April 30 payment of previous year's taxes		$35,000 payable on 2010 personal tax return	$41,000 payable on 2011 personal tax return ($76,000 taxes payable, less instalments of $17,500 and $17,500)	$23,000 payable on 2012 personal tax return ($99,000 taxes payable, less instalments of $8,750; $8,750; $29,250; and $29,250)
June 15 instalment	nil	nil	$8,750 ($35,000 ÷ 4)	$19,000 ($76,000 ÷ 4)
September 15 instalment	nil	$17,500 ($35,000 ÷ 2)	$29,250 ($76,000 – [$8,750 + $8,750]) ÷ 2	$30,500 ($99,000, less [instalments of $19,000 + $19,000]) ÷ 2
December 15 instalment	nil	$17,500 ($35,000 ÷ 2)	$29,250 ($76,000 – [$8,750 + $8,750]) ÷ 2	$30,500 ($99,000, less [instalments of $19,000 + $19,000]) ÷ 2

[3] The "combined taxes payable" amounts are presented for illustrative purposes only. Actual amounts will vary between provinces and according to the taxpayer's specific facts and circumstances.