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A Potential Pitfall of Selling Shares

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We are often approached by dentists who have decided to sell their practice – now. They figure their affairs are in order as they incorporated a number of years ago and they wish to sell shares to keep their taxes to a minimum from the sale.

Let us say that their practice is worth $750,000. I look at their balance sheet and notice that they have investments located in their practice valued at $1,000,000. This is a problem!

There is a tax provision for professional corporations that limits non-practice assets to less than 50 per cent of the value of the practice including the investments. The example above would be in contravention of that tax provision and the dentist would not be permitted to participate in the $750,000 no tax situation with the sale of shares. This is called the 50 per cent rule. The dentist would have to clear out the investments from the practice two years prior to the sale of the shares of the practice.

It is a nice plan to leave profit from the practice, in the practice, with only a 16.5 per cent tax rate of the professional corporation. But keep your accountant informed as to when you intend to sell your practice so that the accountant can have you come on side regarding the 50 per cent rule. Also, there is a 90 per cent rule whereby non-practice assets must be under 10 per cent of the sale on the date of sale.

We are currently working with three dentists who are in contravention of the 50 per cent rule. They have all decided to **not** sell shares and pay the taxes from an asset sale of their practice but will draw out the investment money in the future when their tax rate is lower.

In summary, keep your accountant informed about your sale intentions so that he or she can work with you to avoid paying more taxed than would otherwise be necessary.

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