Tax Planning for Medical Professionals with Riccardo Zerbino

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Ruben: Welcome to this new episode of The Empowered Investor Podcast. My name is Ruben Antoine, and I'm joined by my co-host Marcelo Taboada. Marcelo, how are you today?

Marcelo: Ruben, I'm great. This is our first intro together. I'm super excited about today's episode. I think people are going to love it, and I certainly can't wait to share the episode.

Ruben: I'm looking forward to it as well. So we're going to cover a very interesting subject today. We are going to discuss the crucial planning stages for doctors. First of all, we're going to start with tax and financial planning matters that concern young doctors. Then we're going to discuss those matters regarding mid-career doctors. And at the end of the episode, we'll also look at pre-retirees and retired doctors. I think it's going to be very interesting. To help us with those topics, we have an expert on the show. Marcelo, can you tell us a bit about our guest?

Marcelo: Sure. Today, we have the pleasure of interviewing Riccardo Zerbino from Baker Tilly. Riccardo is a fantastic professional and an even nicer human being. I know I've had the pleasure of working with Riccardo on a few files over the years, and he's just really good at what he does. Riccardo is a tax principal at Baker Tilly. He is also a guest professor at McGill and is heavily involved in two charities: the Leukemia and Lymphoma Society and Motionball, which raises awareness for the Special Olympics. All in all, he's a well-rounded professional who gives back to the community.

Ruben: Definitely. I can see that he's involved in many initiatives for the community. As a CPA, I often get the newsletter from the CPA order, and I noticed last year that he won a CPA volunteer award. So he seems to be a very nice guy. Marcelo, why are we talking about this subject?

Marcelo: I think it's extremely important, Ruben, because doctors need a lot of planning throughout their careers. What I loved about the episode is that we tried to cover the crucial stages for every single stage that they go through. For example, young doctors who just graduated go from earning $80,000 to earning huge amounts of money. There are implications for that. Should you incorporate? What should you be doing in terms of financial planning? Then, mid-career, you start gearing up for retirement and thinking about your longer-term plan. We've covered that as well. And later stages, the sequence of where your money should come from when you have RRSPs, TFSAs, corporations. Then, we talk about some estate planning strategies. All in all, it's a great episode whether you're a young doctor or a mid-career doctor. I think there's something in there for everybody, and I can't wait to share it.

Ruben: I do agree. Even if we're talking about doctors, a lot of the principles we cover can be applied to other high earners or incorporated professionals.

Marcelo: A hundred percent.

Ruben: Exactly. I'm really looking forward to it, Marcelo.

Marcelo: Enjoy the episode.

Ruben: Enjoy.

Marcelo: Riccardo, good morning. Thank you for joining us this fine morning. Thank you for taking the time. Ruben and I really appreciate it. We're excited to have you here. It's going to be a great show. Let me get started with a very basic question. We're going to break down this episode into three parts: young doctors, mid-career doctors, and retired doctors. We're going to go through the various issues. Hopefully, you can shine some light on some of the issues that these doctors have in different stages. The first question I want to ask you is, as a young doctor transitioning from school to a career, that transition to full-time doctor can have its challenges and advantages. What challenges do you see in your experience that young doctors have early in their careers?

Riccardo: Good morning, Marcelo and Ruben. Good morning. What a transition it is. It's a really big change. You're going from all this intense studying to a really fast-paced career. From a financial perspective especially, there really is a lot to think about. You're making a substantial amount more money than you were prior to graduating, and it really can be very difficult to manage all the different pressures. We see that very often in practice, where those pressures become overwhelming and cause a lot of stress in a young doctor's life.

Marcelo: And there is some debt management to be done. Of course, you see a lot of young doctors graduating with a lot of debt, and now their incomes are extremely different from when they were residents or just students. With interest rates being so low, what advice would you have for them? Or is it a bit of both? What do you think about this?

Riccardo: I think this answer is quite different for everyone. If you have the appetite for a small amount of risk, there is the potential for a very large return because debt, to a certain extent, can be very beneficial if interest rates remain low, especially as low as they are right now. A return on your investment is likely, and the interest is deductible from a tax perspective. So this is a unique situation. Marcelo, it isn't likely to occur in any other stage of your career. Therefore, it's probably a good idea to take advantage of this right now. But this isn't for everyone. Each situation should be studied to make sure the right decision is made for each individual.

Ruben: Yeah, Rick, I guess what you're saying, and I completely agree with you, is if someone wants to not pay their debt and invest instead because over the long term, there is a better chance in terms of probability that the investment will perform better than the interest rate, they can do that. But this is basically like doing leverage investing because you're keeping some debt that you're not paying down, and you're invested in yourself. So it's not for everyone, but I totally see what you're saying where some people just don't like debt. Even if it would make sense for them to invest instead, if they don't like it, they won't sleep well at night because they know they have that $100,000 or $200,000 of student debt. Then maybe it's better for them to pay down. But for other people, it can make sense. It's funny. We get that question often, so I'm really happy that you are giving your perspective on that.

Riccardo: Exactly. Exactly. Not for everyone, but it could be beneficial.

Ruben: Generally speaking, because we are talking about debt, but just cash flow management in general. What we see sometimes with young doctors is that they've worked hard, they spend on average more time at school studying compared to maybe other paths. So they spend all that time delaying gratification, studying hard, and not making much money. They aren't entering the lifestyle of other people who are buying houses and cars after studying. So sometimes, when they are done with all that delayed gratification, they want to enjoy it really quick, really fast. Some of them go in and buy the big house right away. They buy expensive cars even if they have some debt. What is your take on that in terms of how they should manage the cash flow, ensuring they are being careful but at the same time transitioning from earning maybe $80,000 to $400,000 depending on the specialization? Do you have any advice on how they should do that and what they should be careful about?

Riccardo: Yes. Of course, that change in lifestyle is dramatic and can be very difficult. I think staying focused on your career objectives and seeking professional assistance as early as possible in your career is essential. It's impossible to be an expert in every domain. So having the right people in place really gives you the peace of mind to be able to excel at your job, which is so important and requires a significant amount of focus. This is what people like us are here for—to help with these types of decisions and provide peace of mind for young doctors and anyone else in that type of situation.

Ruben: Definitely. I agree with you that doctors have their own expertise. Some of them do have some financial interest and enjoy reading about it, but at the end of the day, most of them are really busy. If they are willing to delegate some part of the management of their finances to people they trust, they are better equipped to make good decisions at the beginning of their careers. Definitely, that will pay off over the long term.

Marcelo: We've seen also, Ruben, that some doctors early in their careers hear other doctors in their profession. I'm sure you, Riccardo, have heard the same where there is a misconception about certain things like maybe you should pay all your debt before you start investing. The vehicles that they have available to them like the RRSP, when you start using those vehicles, you're not only getting the big tax deduction at a very high marginal tax rate, but you're also getting the long-term return of the stock market or whatever investment you choose. Sometimes you need a professional, even if there's a behavioral side to it and people are not comfortable with debt. You need a professional to explain to you in very simple terms the two scenarios. If you decide to go against or with them, that's a different story, but at least you're making an informed decision.

Riccardo: Precisely. And I think also a lot of what they hear from the rumor mill or from other professionals, it could have been very good advice in the 1980s or in the 1990s. And something very useful back then may no longer be in effect right now. The tax laws change so quickly, and everything, even the interest rates, is so different that it can cause a real different strategy right now for young doctors.

Ruben: Rick, you just mentioned tax. There's a question we get often from young doctors about incorporation. They often ask, "Everyone around me, all my peers, are incorporating their companies. Should I do it? When should I do it? What are the pros and cons?" So let me ask you: Do you think that all doctors should be incorporated? And if yes, when should they start thinking about that?

Riccardo: Again, I will never give a definitive answer. It really does depend, though. A lot of the advantages are no longer available. So I really don't think the answer is the same for everyone. Timing is everything here. Generally, the corporation discussion happens when doctors start to have excess funds. Before this point, a corporation doesn't have much use and should be tabled until—

Ruben: What do you mean by that? When they can save in the corporation? Is that what you mean?

Riccardo: Yeah. If they're using every dollar they're making, the corporation just doesn't have much use. So those excess funds in the corporation are what signify that the timing is right. Incorporation still has some definitive roles. It can still be used as a tax deferral vehicle and shelter some of the liability of the individual because a corporation is treated as a separate entity in Canada. However, corporations come with additional costs and administration. Without the proper setup, administering a corporation can be cumbersome and costly, adding to an already overwhelming workload for a young doctor. So it's very important that the setup is done correctly. If that's the case and there are excess funds, I think as a tax deferral vehicle, it can be excellent.

Ruben: And just to clarify, by tax deferral, you mean that because the corporation is being taxed at a lower rate, a young doctor may have more money to invest in the corporation right away instead of being paid directly at a higher tax rate, so they would have a lower amount to invest. Is that what you're referring to?

Riccardo: Absolutely. If a doctor takes the money directly at the individual level, they'll be taxed at a very high rate. Any funds left in the corporation will be taxed at a much lower rate, leaving you with a larger piece of the pie to invest in.

Ruben: Makes sense.

Marcelo: What you're saying basically is if I'm a young doctor and I'm bringing in, let's say, $400,000 and I'm spending every dollar I'm making and I'm stuck with a huge tax bill at the end of the year, maybe it's not smart to incorporate. But if I'm not spending every dollar I'm making and I'm left with a big amount that I'm just saving in regular vehicles, maybe it would make sense to incorporate. Because you have that avenue where that money you're saving is not going to get taxed at the personal level, which could be up to a 52% marginal tax bracket, right?

Riccardo: Absolutely. It's important here. So we're talking about excess funds. There's no real magic number, but once you have enough left over to administer the corporation and there are still funds being left over in the corporation, that will give you this lower tax rate. That's when you can start taking advantage of this.

Ruben: Let's use this to switch gears to the next stage. Let's say the career of a doctor, mid-career doctors. We are talking about the corporation, Rick. A couple of years ago, there were tax regulation changes that affected some of the advantages doctors, but also most entrepreneurs, have when they have a corporation. In Quebec, for example, corporations don't have access to the small tax rate if they don't reach a certain number of hours worked. There are other regulation changes regarding the income earned from investments in a corporation. So does it still make sense for a doctor to incorporate when you take all those new changes that created tax disadvantages and removed some of the incentives to incorporate? Does it still make sense for doctors to incorporate?

Riccardo: Yes. This one I can answer straight up without saying, "It depends." So yes, absolutely. The tax deferral component of a corporation still exists.

Very broadly, any excess funds in a corporation on a given year will be subject to tax at a much lower rate than funds extracted directly to an individual. As you were alluding to, those reforms that passed, the passive income, and the minimum hours in Quebec—yes, there are disadvantages or no longer tax advantages that used to exist. In broad terms, splitting income with a spouse or another related party is no longer possible. The tax rate is slightly higher for corporations in Quebec that don't have more than three employees. It's actually by hour. It's 5,500 hours, but we say three employees because when you have three employees, usually the hours are above the 5,500 threshold, and you do get the lower tax rate. So from a general perspective, there are some advantages that no longer exist, but the deferral component is still substantial and shouldn't be ignored. The tax rate is still lower, so there is a possibility of deferring tax for many years into the future. Therefore, a corporation does still make sense.

Ruben: I see. Not as advantageous as before, but there are still some advantages that justify incorporation.

Riccardo: Still substantial ones, I would say.

Marcelo: So I think that's a great segue for the next question. A lot of doctors and financial professionals struggle with this one because it's never clear-cut. As a mid-career doctor, your income is very high. What is the most efficient way of saving for retirement? You'll have some money left in the corporation, of course, but should you still use RRSPs? Should you do it just in the corporation? What are your thoughts around that?

Riccardo: I'm a big proponent of the RRSP. I think any social advantage a government like Canada gives you should be used to its maximum. As a first step, even if you have a corporation, maxing out your RRSP is likely the best option. It usually results in the highest tax savings, given the changes to corporate tax rates we just discussed. In Quebec, you lose the small business deduction if the corporation doesn't have 5,500 hours of salary. Given that, the higher tax savings will always come from the RRSP. So maxing that out first is certainly a good option. One of the challenges we've seen is that individuals are not thrilled with the administration around this. They need to take dividends out every year to max out the RRSP, and that can get cumbersome if the setup is not there for dividends to be taken out. One practical solution we do around this type of problem is a lump sum a few years later. In year three or year five, once the RRSP room has accumulated, one dividend could be paid, and we can max out the RRSP at any given point in time. This lowers the administration and simplifies the process because you only do it once every couple of years.

Ruben: That's a really good point. I never thought of that. It's like maxing the RRSP but balancing the administration headaches that come with it. So you do it once in a while every three years. That's a really good point. On that, Marcelo, I would like to add something because I get that question as well from my clients: should I invest in the Corp or in the RRSP? What you just said is exactly that. Over the long term, the RRSP has been proven to make sense. But there's also a regulatory risk of keeping money in the corporation because governments change all the time. They tend to change tax law. We saw that a couple of years ago, and it may happen again, especially after all the support given because of COVID. We need to get some money somewhere, and having a lot of wealth in corporations is popular for politicians to go after. Compared to if they were to change rules in RRSPs, most people have RRSPs, so they would have millions of voters who would be angry. So they should not touch that. But corporations, things can change again in the future. So just by moving money out from the corporation to put in RRSP, it's also mitigating against that regulatory risk. It's not tax-related, but I think it's a good point to mention.

Marcelo: That's a great point, Ruben, but we also agreed not to talk about politics. So you did that today, but that's okay.

Ruben: I didn't name any parties. I just said government.

Marcelo: But it's true. It's easier to vilify people making money and corporations. You see it now in the campaign. I saw today in the news that the Liberals want to charge taxes on the banks. It's a good marketing technique. They're not calling it a tax; they're calling it a recovery dividend. So that was interesting.

Riccardo: I think doctors are in an even more unique position because they're small business owners and professionals, two groups often “targeted” in tax changes. They need to be very careful. I think that's an excellent point. The RRSP does allow you to pull out a lot of money from the corporation.

Ruben: So now that we all agree that RRSP is a good tool for saving and investing while also using the corporation, Rick, to invest in the RRSP, you need to take the money out. Doctors and everyone who owns a corporation can take money out by paying themselves a salary or a dividend. People are always asking themselves, "What should I do?" Accountants always say, "It depends." Run us through the general rule of thumb and the pros and cons of paying yourself a dividend versus a salary.

Riccardo: The best answer is usually to take out enough salary to maximize social benefits like the Quebec pension plan and to maximize your RRSP contribution room. Then convert to dividends on any amounts above this because they're taxed at a lower tax rate. That's the general rule of thumb. The pros and cons are similar: salary allows you to contribute to these plans, while dividends do not, but dividends are taxed at a lower rate. If an IPP is part of your future plans, it's important to take enough salary, or else you won't be able to set one up in the future. That's another important aspect of the salary.

Marcelo: I'm glad you mentioned the IPP because that was my next question. If you're a doctor mid-career, settled on the RRSP debate, saving through the corporation, maxing RRSPs, doing all the right things, what are your thoughts on setting up an IPP? What is it? Who, why, and when?

Riccardo: I think an IPP is an excellent way for an owner-manager, specifically doctors, to use corporate funds—pre-tax funds—to invest in a pension. An IPP is great for business owners who hit their RRSP contribution limit and need an alternate way to build retirement income while still using a tax-sheltering umbrella. An IPP typically becomes interesting after 45 years old. It can be a great retirement tool if certain criteria are met. Speak with your advisors to ensure this pension plan works for you. It's an excellent way to create retirement income.

Marcelo: Just for clarity, the IPP is the Individual Pension Plan, right?

Riccardo: Correct.

Marcelo: So, Rick, the IPP criteria require some RRSP room and salary over the years before you can even begin thinking about one, right?

Riccardo: Yes, absolutely. You need T4 income, reported annually on a T4 statement. When you're a doctor with a corporation, you must have paid yourself salary over the years, or this won't work.

Marcelo: Once you've set the IPP, that replaces the RRSP. Instead of contributing to the RRSP, you contribute to the IPP, right?

Riccardo: Correct. The contribution room is typically higher than it would have been in an RRSP.

Marcelo: Very important to know.

Ruben: The IPP is like a boosted RRSP. Doctors with wealth in their corporation and RRSPs can use it as another tax-deferred investment account. Is that what we're saying?

Riccardo: Yes, you hit the nail on the head. It's a way to create more contribution room above an RRSP and continue contributing until age 65.

Ruben: It's like a boosted RRSP. Perfect. Let's talk about the latest stage in the financial life of a doctor—retirement. What should doctors be thinking about in retirement? What are the challenges? Regarding the corporation itself, is it still a good tool during retirement?

Riccardo: At this stage, doctors and their corporations become investment vehicles. Lifestyle plays a big part here, depending on how much you need to live and what lifestyle you wish to continue. Many live off their other investments, leaving the corporation as an investment vehicle, earning investment income on its holdings. You can still live off your other investments like RRSP, IPP, TFSAs, or other personal assets. You try to live off those first while the corporation continues earning investment income, using it in the future or as an estate plan.

Ruben: General considerations apply to all retirees: financial planning, looking at where to start taking money, the sequence of withdrawal in a tax-efficient way to fund retirement. You mentioned estate planning. What's your view on what doctors should look at and be careful about regarding estate planning?

Riccardo: An estate plan often comes into play. If the intention is to integrate the next generation, this freezes the value of the company at a point in time, and all future appreciation goes to the next generation. The frozen shares are held by the original owner (the doctor) and are equal to the corporation's value at the time of the freeze. This allows the corporation to continue paying dividends up to that value, with tax applied only on the dividends. It's an income-smoothing tactic for retirees, with tax only upon death.

Marcelo: Is the estate freeze a strategy every doctor should look at if there's a family to leave assets to, or does it depend on individual intentions?

Riccardo: Both. Not every person should do an estate freeze. It depends on your intentions. If you want to freeze the tax liability at death or integrate the next generation, an estate freeze is useful. If you need all the money in your lifetime or there’s no next generation, maybe there's no use for an estate freeze. Tailor these plans for each person.

Marcelo: We do see scenarios where a doctor retires and decides to enjoy all the fruits of their labor without leaving anything to their estate. In that case, the estate freeze becomes futile, right?

Riccardo: Absolutely. After working so hard, you should benefit from the fruits of your labor.

Marcelo: It's important to mention that on top of basic estate planning like having a proper will, the estate freeze isn't the only strategy to follow.

Ruben: I agree. When talking about estate planning, the first area to look at is having a will and a mandate. Without that, there are issues when you pass away. Before saving on the last tax liability through an estate freeze and other strategies, the first thing we ask all our clients is if they have a will and a mandate. If not, we help them put that in place.

Marcelo: Rick, sometimes young doctors hear rumors or follow advice from their parents, who are also doctors, about setting up a family trust. What are your thoughts on that? Do they still make sense?

Riccardo: From a tax perspective, family trusts used to be great tax deferral vehicles, but this is unlikely to result in current tax benefits. Professional corporations are unlikely to be sold, so you can't shelter any capital gain. Income splitting with family members is no longer allowed, rendering the trust ineffective for doctors. There may be other reasons, like legal or asset protection, but solely from a tax perspective, family trusts don't make sense for professional corporations. Unless there's a specific non-tax reason, trusts don't provide tax savings.

Ruben: Interesting.

Riccardo: Yes, many incentives have been removed regarding corporations and trusts compared to the past. Tax laws are ever-changing, so we need to be careful and keep an eye on them to ensure we still benefit from these vehicles.

Ruben: Does this make your job more interesting or give you more headaches?

Riccardo: It depends. Both. Sometimes interesting, sometimes headaches.

Marcelo: Rick, thank you for your time and expertise. We've worked on a few files together, and you're great with clients. Thank you for sharing your knowledge with us. Ruben, my key takeaway is the importance of working with an advisor. It adds peace of mind to the process, often overlooked.

Ruben: I agree. Rick, thanks a lot. It was insightful. I'll share what I've learned with my doctor clients. My key takeaway is similar: doctors should seek guidance from accountants, lawyers, and advisors to avoid costly errors and be well set up for the future.

Marcelo: Rick, what's your takeaway?

Riccardo: Having the right people in place gives you peace of mind and allows you to excel at your job. It was a pleasure doing this with both of you. Thank you for the opportunity.

Marcelo: Thanks, Rick.

Ruben: Thank you, Rick.

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