SAMA CONFERENCE
Tax and the Doctor

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Contents

Introduction

- **Reasons in the past for becoming a doctor**
  - Parents wishes
  - Earning potential
- **What has changed**
  - Decrease in earning potential of a GP
  - Choice is now due to the love of the profession and making a difference
  - More reasons to study to a Specialisation
- **What is the impact of this**
  - More you earn, the more tax you pay
  - Legally minimise taxes
  - Types of taxes – Income Tax, CGT,VAT, PAYE, etc

Income Tax Explained

- **Payable if you earn a taxable Income**
- **<u>Scenario 1</u>**
  - If you are employed then your employer will deduct PAYE
  - PAYE is calculated on your final tax liability
- **<u>Scenario 2</u>**
  - If you are Self employed
  - You will need to work out the Taxable Income

Income Tax Explained Continued

Tax Income Calculation	
Gross Income	XXX
Less: Exempt income (Section 10)	(XX)
Income	XXX
Less: Deductions and allowances (Section 11 – 19 and 23)	(XX)
Add: Taxable portion of Capital Gains (Section 20)	XXX
	XXX
Less: Assessed Loss brought forward if applicable (Section 20)	(XX)
Taxable income or (Assessed Loss)	XXX

Income Tax Explained Continued

Tax payable

- calculated on a sliding scale starting at 18% to 41%
- Self employed individuals need to be registered for Provisional Tax
- Provisional Tax is payable in August and February
- Tax will be estimated
- If there is a shortfall need to pay it over in 7 months
- Interest will be charged if shortfall is not paid
- Interest rate is 9.25% p.a.
- Penalties of 20% are charged when there has been a under estimation

Other Statutory Taxes

- **Value added**
- **Pay as you earn**
- **Capital Gains Tax**
- **Donations Tax**
- **Estate Duty**

Value Added Tax (VAT)

- Applicable if your practise exceeds R 1 million
- VAT is levied at 14%
- What is Output VAT ?
- Does VAT need to be calculated on Medical Aid Tariffs ?
- What is Input VAT ?
- De- registration
- The Payment Basis vs the Invoice Basis

Pay as you earn (PAYE)

- The Tax that is deducted from salary of a employee
- The amount for PAYE is determined by the tables issued from SARS
- 2 ways that you can deal with Locums
  - 1)Part time – flat rate of 25% is used for PAYE
  - 2) Locum Agencies – PAYE is not your responsibility

Capital Gain Tax (CGT)

- Tax that is applicable if a capital asset is sold
- Tax was introduced on the 1st October 2001
- How to determine your CGT = Base Cost less Net Proceeds from the sale of asset
- What is Base Cost
  - Cost of the Asset post GGT date add any other costs
  - If asset was purchased before 1 October 2001
    - Valuation
    - Time apportionment
    - 20% of Proceeds

Capital Gain Tax (CGT) continued

- Exclusions – R 30 000 pa and R 300 000 on death
- Primary Residence – R 2 Million Rebate
- CGT included in Taxable Income at 33% therefore Effective Tax rate – 13.7% (33% X 41%)

Donations tax

- Tax on Donation
- Rate of Tax used is 20%
- Exemption
  - 100 000 per annum
  - Between Spouses
  - PBO’s (limited to 10% of your taxable income)

Estate Duty

- Tax on a deceased persons estate
- Estate Duty is levied at 20%
- Exemptions
  - 3.5 Million
  - Any bequest to the spouse
- To minimise estate duty a trust can be created
- Need to be careful when creating a trust may be penalised with CGT or Donations tax
- Pegging the value of the assets
- Control is the overriding factor of the trust in SARS eyes.

To incorporate or not incorporate ?

- The Companies Act allows for medical practitioners to incorporate
- Aspects of an incorporated company
  - There is no limited liability - Professionals are personally liable
  - All shareholders must be directors
  - Advantages of incorporating
- Example

Example of Doctor who incorporates

- A doctor operates his practice in his own name as a sole proprietor.
- Assuming he has a bond of R2 million on his home.
- He then sells his medical practice to an incorporated entity (company) for an amount of R2 million goodwill.
- The company now owes him R2 million and this amount is reflected as a liability to the doctor in the books of the company.
- The company now approaches a bank to fund the purchase of the R2 million goodwill and the bank then lends the company the R2 million, using the house as security.
- The money is then paid to the company, which in turns repays the R2 million loan to the doctor who now goes and settles the home loan of R2 million which he originally had.
- So what's the difference?

Example of Doctor who incorporates continued

- The doctor (through the company) still owes the bank R2 million
- if the company goes into liquidation, the doctor is still personally liable for the loan
- However, the difference is that when the doctor had the home loan in his personal capacity
- the interest on the home loan was not tax deductible because it was a personal expense and not an expense incurred in the production of income.
- However, now that the loan is in the company, the interest will be tax deductible because the interest is incurred in the production of income, being interest on the loan to purchase the goodwill.
- Then there were other advantages as well. Since the doctor who is now a director of the company, can now also be regarded as an employee of the company.
- So all the fringe benefits that would apply to the other employees of the company, will apply to the director (the doctor) as well because he is also an employee of the company.
- These benefits such as medical aid contributions, pension or provident fund contributions paid by the company on behalf of the employee, free use of assets, free use of motor vehicle, etc., were either not taxable, partly taxable or taxed at favourable rates in the past. These benefits are not taxed.

Example of Doctor who incorporates continued

- The practice of transferring your medical practice to a company, may not be advantageous any more,
- since the goodwill amount will be treated as a capital gain and subject to CGT.
- However, one needs to look at the tax savings on the interest deduction over the term of the loan and compare that with the CGT that is payable.
- However, one also needs to look at the possibility that SARS will disallow this tax structure because of the connected party principle which SARS is applying quite vigorously these days.
- **Let's see how this will work on the above figures.**
  - The interest on the loan over 5 years at an interest rate of 10% will be approximately R600 000.
  - The tax savings on this will therefore be R246 000 (600 000 X 41%) over the five years, ignoring the present value of money.
  - Capital gains tax on the R2 000 000 goodwill will be R273 400 (2 000 000 X 13.67%).
  - The doctor will therefore be paying R27 400 more and taking into account the present value of money, the doctor will be worst off.

Example of Doctor who incorporates continued

- This structure was very attractive when there was no CGT.
- Therefore, selling your existing practice to a company, may not be a good idea for tax purposes.
- From a fringe benefit tax point of view, this is a “no go” because almost all the loop holes relating to fringe benefits are now closed and all these fringe benefits are now taxable.
- However, there may be merit for a doctor who goes into practice for the first time, to incorporate, or if you not too concerned about CGT.

Example of Doctor who incorporates continued

- Let's see what will be the tax effect of a doctor who incorporates:
- Assuming a doctor has fee income of R2 000 000 and deductible expenses of R1 000 000.
- Therefore, the taxable income would be R1 000 000 (R2 000 000 – R1 000 000).
- **The tax on this will be:**
  - Tax on the R 701 300 = R208 587
  - Plus: 41% on the amount exceeding R701 300 (R298 700X 41%) = R122 467
  - Total Tax (If he does not incorporate) = R331 054
  - Tax Rate: 33.1%

Example of Doctor who incorporates continued

- If the doctor incorporates, the company will be making this profit and the company can pay the doctor a salary for offering his services to the company.
- Assuming the company pays the doctor a salary of R701 300
- **The company will pay the following taxes:**
  - Profit before director's salary = R1 000 000
  - Less: Director's Salary = R701 300
  - Taxable Profit = R 298 700
  - Tax @ 28% = R83 636
  - Income after Tax = R215 064
- **Now the doctor declares the profit as a dividend to himself.**
  - Dividends Tax (R215 064 X 15%) = R32 260
- **Total Tax of the Company (R83 636 + 32 260) = R115 896**

Example of Doctor who incorporates continued

- **Total tax of doctor and the company:**
  - Salary = R208 587
  - Company Tax = R83 636
  - Dividend Tax = R32 260
  - Total Tax = R324 483
- **Therefore a saving of R6 571 (R331 054 – 324 483)**
- **This is an effective tax savings rate of 2.20% (6 571/298 700)**

Example of Doctor who incorporates continued

- **This can be reconciled as follows:**
  - Profit of Company = R100
  - Tax @ 28% = R28
  - After Tax Profit = R72
  - Dividends Tax (72 X15%) = R10.80
  - Effective Tax Rate of Company = 38.80%
  - Marginal Tax Rate of Individual = 41.00%
  - Difference = 2.2%

Example: Doctor who places the assets in a separate company

- However, there may still be other ways for clever and efficient tax planning. Here is one example:
- Let’s assume that a doctor uses quite expensive medical equipment.
- Instead of acquiring the equipment in the name of his practice
- he sets up a separate company to hold the assets.
- The shares of the company can be held in his name, the name of his wife or in the name of a trust.
- The directors of the company can be him and his wife or just his wife.
- The company will then charge a rental to the doctor for the use of the assets and this rental to the doctor will be tax deductible for him.
- This rental, on the other hand will be taxable in the company and the company will be able to claim the wear & tear allowance on these assets as a tax deductible expense, together with other expenses of the company.
- The company can also pay the directors a salary for running the company, which will be tax deductible and the director or directors will include this salary in their taxable income for the year.

Example: Doctor who places the assets in a separate company

- Let's say a doctor runs a dental practice and has dental equipment of say R500 000.
- Instead of buying this equipment in his own name (the practice),
- he sets up a company where his wife is the sole director.
- The company acquires the equipment for R500 000 and charges the doctor a monthly rental of R15 000.
- Let's assume the equipment can be written off for tax purposes over 5 years straight line.
- Assume the doctor's fees for the year is R2 million and his deductible expenses
- Assume the doctor has other taxable income that puts him into the super tax bracket of 41%.

Example: Doctor who places the assets in a separate company

- **The doctor would have to pay tax calculated as follows:**
  - Fee Income = R2 000 000
  - Expenses = (R1 000 000)
  - Depreciation of Equipment = (R100 000)
  - Taxable Income = R 900 000
  - Tax @ 41% = R 369 000

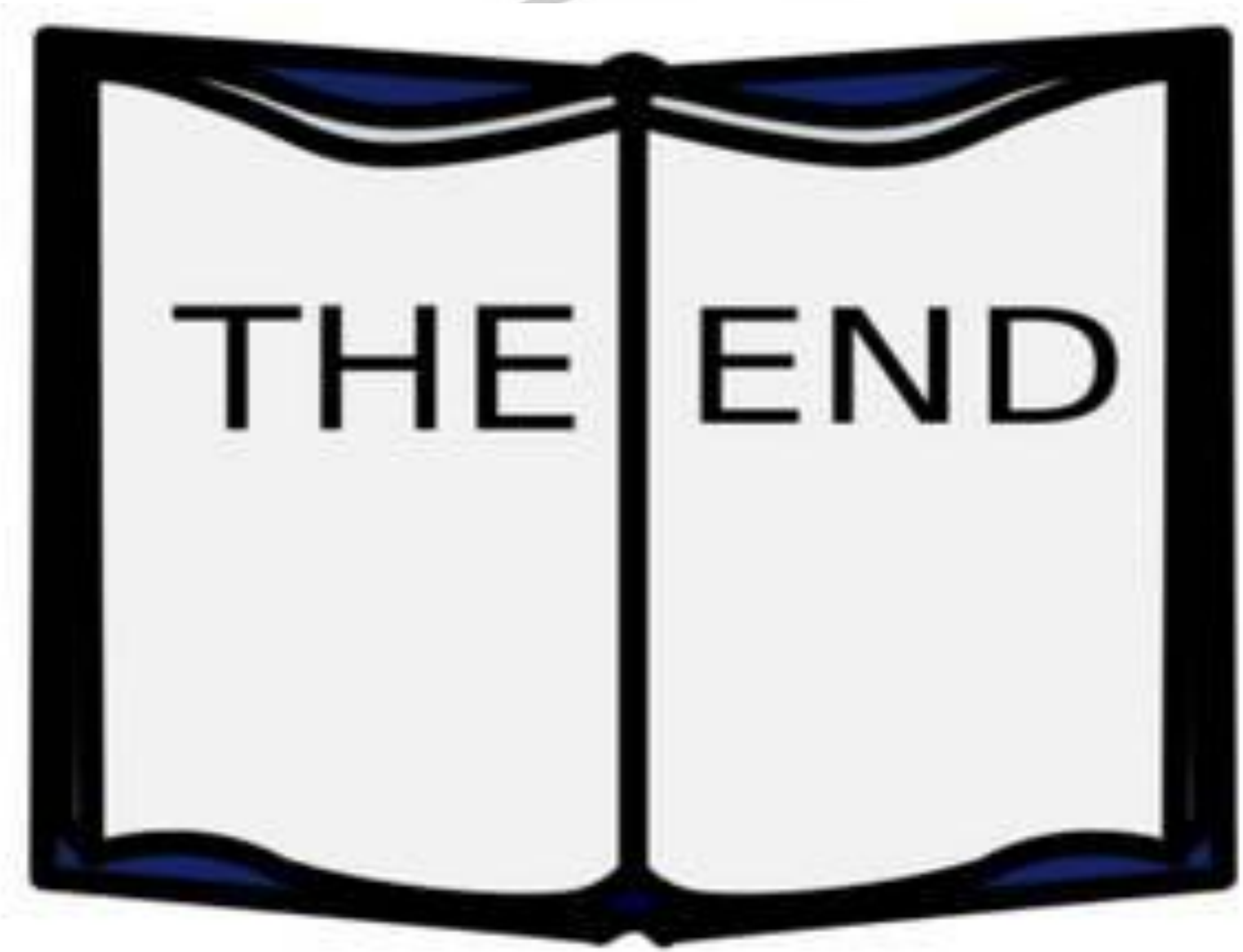
Tax payable by Doctor

- If he acquires the equipment in the name of a company where his wife is the only shareholder and director, the situation would be as follows,
- assuming the wife receives a monthly director's salary of R5 000 from the company. Assume also the wife has no other income.
- **The tax payable by the company would be as follows:**
  - Rental Income (R15 000 X 12) = R180 000
  - Depreciation = (R100 000)
  - Profit before Director's Salary = R 80 000
  - Director's Salary to the wife (R5 000 X 12) = (R60 000)
  - Taxable Income = R20 000
  - Tax thereon @ 28% = R5 600
  - Net Income after Tax = R14 400

Tax payable by Doctor continued

- Assume the company declares all this after tax profit to the shareholder as a dividend, then the dividends tax would be R 2 160 (14 400X 15%)
- Therefore the total tax payable by the company would be R7 760 (5 600+2 160)
- **The doctor's taxable income would now be:**
  - Fee Income = R2 000 000
  - Expenses = (R1 000 000)
  - Rental of Equipment = (R180 000)
  - Taxable Income = R820 000
  - Tax @ 41% = R336 200
- **Total tax of doctor plus company would be R343 960 (336 200 + 7 760)**
- **Therefore tax savings would be R25 040 (R369 000 – R343 960)**
- **NB. The wife will not be subject to tax because her income of R60 000 is below the tax threshold of R70 700 before tax is payable.**

Questions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