Implications of 2024 Federal Tax Changes for Physicians

Submission to the Deputy Prime Minister and Minister of Finance

May 30, 2024
Introduction

On Apr. 16, 2024, the Honourable Chrystia Freeland, deputy prime minister and minister of finance, delivered the 2024 federal budget (Budget 2024), entitled Fairness for Every Generation.

Among other tax measures of significance, it was announced that the capital gains inclusion rate for capital gains realized on or after June 25, 2024, would increase from one-half (50%) to two-thirds (66.67%) for trusts and corporations, and from one-half (50%) to two-thirds (66.67%) for individuals on the portion of capital gains realized in the year exceeding a $250,000 threshold.

The impact of the capital gains proposal introduced in Budget 2024 is particularly alarming for physicians and their medical professional corporations, in which every dollar of realized capital gains will be subject to a higher inclusion rate.

If implemented, the capital gains proposals will undoubtedly add undue pressure and financial strain to physicians, threatening their well-being and undermining the stability of the Canadian health care system as a whole.

Summary of recommendations

To address these pressing concerns, we strongly urge the government to reconsider the proposed capital gains tax adjustments.

Specifically, we recommend the following:

1. A full repeal or exemption of the increased capital gains inclusion rate for medical professional corporations.

2. Alternatively, at minimum, tax measures should be introduced that allow individual taxpayers to share the $250,000 capital gains threshold (at which point the higher capital gains inclusion rate of two-thirds would begin to apply) with medical professional corporations they control, with yearly indexing of the threshold to account for inflation.

For purposes of implementing either of these recommendations, the definition of a “medical professional corporation” must be carefully considered to ensure that it captures a corporation that carries on or previously carried on the professional practice of a medical doctor, and that it also recognizes the other corporate entities established as part of the medical practice structure.

By implementing these recommendations, the government can further demonstrate its enduring commitment to health care at the time when it is needed most.
Medical professional corporations

More than 50% of Canadian physicians have incorporated their medical practices as a means of effectively delivering health care to Canadians. Incorporating a medical practice is a long-standing and well-accepted practice in Canada, which came about gradually province by province. For example, medical practitioners in Saskatchewan were not permitted to incorporate until 2000, following negotiations with the Saskatchewan Medical Association and the College of Physicians and Surgeons of Saskatchewan to address the difficulty in recruiting and retaining physicians at that time. In some cases, provisions for incorporation have been part of negotiated fee settlements with provincial governments designed to lower overall health system costs.

It is widely known that the use of a corporation can provide a tax deferral for individual shareholders where funds are left in the corporation instead of being fully extracted as dividends or salary. Much has been said about the supposed “advantage” that medical professionals have, as more money can accumulate in a corporation for investment purposes because of the lower rates of corporate tax. However, what is less widely known is that medical professionals often reinvest these funds in their practice, and they rely on them to self-fund time away from work for sick leave, maternity or parental leave, vacation and retirement. For example, most physicians don’t have access to employer-funded pensions. Therefore, professional corporations play a significant role in providing a physician with the security they require to save for their retirement.

Where professional corporations have been utilized, a change to the capital gains inclusion rate is ultimately a retroactive claw-back tax on retirement savings and it undermines compensation arrangements that had been agreed to by physicians and their provincial and territorial government counterparts.

Coupled with the impact of the 2017 tax changes, Canada’s inflationary environment and the current state of our health care system, the proposed increase to the capital gains inclusion rate will cause further financial deterioration for physicians at all stages of their career (students, new physicians, established physicians and retiring physicians).

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*a* Since 2017, according to the Bank of Canada, the costs of running a practice as well as personal expenditures have increased by an estimated 23%, a rate that far outpaces negotiated fee increases over the same period.
Medical professional corporations are unique. Physicians don’t have the ability to simply increase their fees to make up for tax increases, as other professionals may be able to do. They work for the public good and their fees are regulated by provincial agreements. Through their corporations, physicians pay for critical health infrastructure on which all Canadians depend (e.g., examination rooms, stethoscopes, tongue depressors and other consumable medical supplies, technology, and security and privacy infrastructure). In addition, the ability to save for retirement may be more important for physicians than for other small business owners, as physicians are typically unable to utilize the lifetime capital gains exemption. Owing to the current physician shortage, and in particular the shortage of family physicians, it is extremely difficult if not impossible for a physician to find a purchaser for the shares of their medical professional corporation, which negates the possibility of being able to use the lifetime capital gains exemption.

Physicians in Canada

What does the path of a physician currently look like?

1. Student
2. New physician
3. Established physician
4. Retiring physician

According to a recent national survey, over six million Canadian adults do not have a family physician or nurse practitioner they can see regularly for care. This represents approximately one in five Canadians.
**Student**

A typical medical practitioner completes four years of undergraduate studies, four years of medical school and two to five years of postgraduate residency training, depending on their specialty. The average medical practitioner will become a licensed physician at 28–30 years of age, after investing $300,000 in their postsecondary education (usually in the form of student loans).

Today, physicians are commencing practice in a stressful environment that is continuously overcapacity and underfunded. Early-career physicians begin their career with record levels of debt in a high-interest environment, at a time when affordable housing can be almost impossible to find, and they are entering a complex delivery model with stresses created by a myriad of factors, including an aging and growing population. An increase in the capital gains inclusion rate would result in students having less confidence about their ability to plan for their retirement and to invest and engage in the health care system. The Canadian Resident Matching Service has already noted a decline in the percentage of Canadian medical graduates selecting family medicine as their first-choice discipline (31.4% in 2024 versus 38.0% in 2015).

**New physician**

A typical new physician operating their own practice works an average of 60 hours per week. Physicians are often self-employed, which means they have to self-fund any maternity or parental leave, sick leave or other time off. They are also required to fund their own health and dental benefits.

Contrary to public perception, it is common for “new to practice” physicians to have minimal funds available for savings after they cover the costs of operating their practice and their personal expenses, including repaying student debt and saving for a home. These physicians may postpone incorporation given that they have no additional funds to set aside.

An increase in the capital gains inclusion rate would hinder the ability of new physicians to save and invest in their practice, including practice infrastructure and medical equipment, and in their personal future. This is causing some physicians to rethink their career choices and look for alternatives that would provide more equitable compensation, such as working in industry, practising in another country or reducing their hours and commitment levels for certain roles that are expected of them.

The Canadian Institute for Health Information has publicized the fact that many health care providers are burnt out and leaving the profession because of resource constraints caused by the COVID-19 pandemic, an aging and growing population and a health care system that is operating at or over capacity.
Established physician

A typical established physician operating their own practice will continue to work an average of 60 hours per week. Any maternity or parental leave, sick leave or other time off remains self-funded, and an established physician is still required to fund their own health and dental benefits. Additionally, when a physician takes leave, they continue to have to cover the ongoing infrastructure costs even though they are not generating income. The scarcity of locum physicians to cover practices means that most physicians will have to halt care delivery to their patients while they are on leave.

An established physician will typically have savings available to invest. Many will choose to invest in their practice in the form of medical equipment, land, building(s) and additional medical personnel for their operations. If the capital gains inclusion rate increases, less funds will be available to make these investments, ultimately requiring physicians to re-evaluate their investments in their practices and their retirement plans. This may lead physicians to make different work and lifestyle choices that will put further strains on the health care system. The health care infrastructure that community-based physicians fund for the public good is not easily replaced.

Retiring or retired physician

Owing to the shortage of physicians, there is little to no ability for a retiring physician to sell their practice, which means they will be unable to utilize their lifetime capital gains exemption. As a result, physicians must rely solely on what they can save to fund their retirement.

Unlike employees in other businesses, retiring physicians will not have benefited from contribution matching toward pension plans throughout their career, and many will not have a sizeable RRSP account from which to draw. As a result, for most physicians, funds for retirement must come from savings held in their personal professional medical corporations.

Retiring physicians have planned and saved for their retirement throughout their career assuming that the capital gains inclusion rate will be 50%. Physicians’ savings are most often held in a professional corporation rather than a pension plan, and therefore an increase in the capital gains inclusion rate will have a direct impact on their retirement income. Physicians nearing retirement have a new predicament that may involve realizing capital gains earlier than expected. This would require a physician to reduce their net assets before retirement so they can pay tax now with the hope that their overall net worth in retirement will be unchanged when they sell capital investments later at a potentially higher capital gains inclusion rate of 66.67%.
CMA recommendations

CMA recommendations:

1. A full repeal or exemption of the increased capital gains inclusion rate for medical professional corporations.

2. Alternatively, at minimum, tax measures should be introduced that allow individual taxpayers to share the $250,000 capital gains threshold (at which point the higher capital gains inclusion rate of two-thirds would begin to apply) with medical professional corporations they control, with yearly indexing of the threshold to account for inflation.

Subsection 248(1) of the Income Tax Act (ITA) includes the definition of a “professional corporation” as a corporation that carries on a professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor.

In support of the above CMA recommendations, a “medical professional corporation” will also need to be defined.

As a starting point, the definition of a medical professional corporation should include any corporation that:

- currently is or previously was a professional corporation of a medical doctor; and
- has assets that were primarily derived directly or indirectly from income of a medical doctor and/or a medical doctor’s professional corporation.

In addition, the definition of a medical professional corporation should be broad enough to include the following situations (as described in the example below, for illustrative purposes):

- a corporation that, at any given time, was a professional corporation of a medical doctor;
- a corporation where, at any given time, more than 50% of the fair market value of the corporation’s assets was attributable to assets used in an active business carried on by either one or more medical doctors or professional corporations of a medical doctor;
- a holding company that owned shares of a professional corporation of a medical doctor, at any given time;
- a corporation whose assets were primarily derived, directly or indirectly, from the income of either a medical doctor(s) or a professional corporation(s) of a medical doctor(s); and
- a corporation where substantially all the shares of that corporation are held, directly or indirectly, by a medical doctor.

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b The tax on split income rules in ITA section 120.4 consider income sources for the purposes of applying those rules.
The statement above that the definition of a medical professional corporation should include any corporation that “previously was a professional corporation” is important because when a physician retires or ceases practice for other reasons (disability, lifestyle choice, etc.), their professional corporation will not renew its medical licence and/or certificate. In most provinces and territories, if the professional corporation is not holding a licence or certificate to practise medicine, the professional corporation is required to change its legal name so that the corporation is no longer identified as a professional corporation. Typically, the professional corporation is renamed as a numbered company, or the physician chooses another suitable name. In addition, the physician is no longer considered a medical doctor.

The definition of a medical professional corporation also needs to be flexible enough to include physicians who operate in different regulatory frameworks across Canada.

In British Columbia, for example, the Health Professions Act¹ provides the regulatory framework for physicians in BC. In Ontario, the Regulated Health Professions Act, 1991, and the health profession-specific acts (Medicine Act, 1991) apply to regulate physicians practising in that province.² An example will best demonstrate why the definition requires flexibility.

**Example**

Dr. Bursey incorporated a medical practice in Ontario after graduating and has practised in southern Ontario for the last 10 years. Dr. Bursey and her family have decided to relocate to BC to pursue new professional opportunities.

While visiting BC in search of housing recently, Dr. Bursey met with her new accountant and new lawyer to discuss how to set up her professional affairs. During the meeting, Dr. Bursey was given the following advice:

- Dr. Bursey could “continue” or transfer the former Ontario professional corporation from Ontario to BC.

However, because of differing provincial regulatory rules, Dr. Bursey was also presented with the following two alternatives:

- The existing Ontario professional corporation could be converted to an investment holding company once Dr. Bursey stopped practising medicine in Ontario. Dr. Bursey understands that the Ontario professional corporation would continue to exist under a different name, and while it could no longer be used to carry on the business of a medical practice, it could continue to hold her savings.

- If Dr. Bursey would like to practise in BC with a professional corporation, she would have to incorporate a new company and register it with the College of Physicians and Surgeons of British Columbia.

Dr. Bursey has different options in BC when incorporating her practice than she did in Ontario. In Ontario, the professional corporation shares could only be held by Dr. Bursey herself and her immediate family. However, in BC, the shares of the professional corporation operating Dr. Bursey’s medical practice could also be held by:
• a holding company if certain conditions were met with respect to the shareholdings; and/or
• a family trust, which is also not an option in Ontario.

Dr. Bursey likes the idea of having an investment holding company to hold the assets she accumulated from her Ontario medical practice, as well as a BC professional corporation to run her medical practice. Therefore, she has chosen to convert her Ontario professional corporation to an investment holding company. She will hold the shares of her BC professional corporation directly rather than incorporating a new holding company.

Dr. Bursey will also be joining a group of physicians who have incorporated a separate company, which they collectively own. This company holds the real property that is used for their clinic space and office. As her savings are currently held in her former Ontario professional corporation, she has decided to have the former Ontario professional corporation invest in the health care space. At this point in her career and because of the tax on split income rules, Dr. Bursey has decided not to utilize a family trust.

Even though Dr. Bursey is forgoing a holding company or family trust to own the shares of her new professional corporation in BC, her situation is complicated because she has converted her former Ontario professional corporation into a holding company that is now a sister company to her new BC professional corporation. The sister company will invest with arm’s length physicians in a company that was set up to hold the investment in health care real estate while mitigating commercial risk that the physicians could assume with such an investment.

The above example illustrates one of many ways a physician can structure their medical practice because of differing provincial and territorial regulations. It is therefore important for the medical professional corporation definition to be sufficiently broad to recognize that a physician’s accumulated assets from their medical practice can be owned through one or more different entities. This will help ensure equitable treatment of physicians across Canada, regardless of where they practise or how they structure their affairs.

**Conclusion**

More than half of Canada's physicians have incorporated their medical practices, with the percentage in some provinces and territories reaching as high as 70%. Running a community-based medical practice involves many expenses, which incorporated physicians manage using negotiated medical service fees. Typical expenses encompass staff salaries, benefits, professional services, rent, utilities, equipment, all medical supplies used in patient care, licensing, and insurance. These overhead costs can easily amount to 40% of a physician’s total gross revenue.

The proposal to increase the capital gains inclusion rate from one-half to two-thirds for corporations will affect tens of thousands of community-based physicians.
The federal government has indicated its support for improving the health system for those working in it and patients accessing it through the historical funding announced in 2023 and the completion of bilateral agreements with provinces and territories in 2024. The proposal to increase the capital gains inclusion rate for community-based physicians is a step backward and will undermine the stability of the health system.

Involving physicians and other health care professionals in the design and ongoing evaluation of the tax framework would ensure that the framework remains responsive to the evolving needs and realities of the medical profession.

The 2017 tax changes, the increased costs stemming from inflation, the realities of our post-pandemic health care system, and now an increase in the capital gains inclusion rate all compromise the health care system. These factors financially erode the contributions of Canada’s physicians at a time when investment in health care is required.

References


Appendix 1 – Scenarios

Figure 1. Sixty-seven-year-old family physician in British Columbia

After a long career in medicine, and yearly earnings that are probably far below those of the targeted top 0.13% of Canadians, this physician has accumulated approximately $1.7 million of retirement savings as part of their incorporated medical practice structure and just over $1 million in an RRSP. Over the course of a 20-year retirement, these savings will provide only a modest pre-tax retirement income for the physician.

In addition, the proposed increase to the capital gains inclusion rate will reduce the physician’s after-tax retirement savings by up to $84,000.

<table>
<thead>
<tr>
<th>Practising Family Physician in BC (67 years old)</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical Professional Corporation - Billings</td>
<td>$ 294,000</td>
<td>$ 244,000</td>
<td></td>
</tr>
<tr>
<td>Medical Professional Corporation - Overhead</td>
<td>$ 99,000</td>
<td>$ 98,000</td>
<td></td>
</tr>
<tr>
<td>Medical Professional Corporation - Net income before tax</td>
<td>$ 195,000</td>
<td>$ 146,000</td>
<td></td>
</tr>
<tr>
<td>Holding company - Revenues</td>
<td>$ 82,000</td>
<td>$ 49,000</td>
<td></td>
</tr>
<tr>
<td>Holding company - Expenses</td>
<td>$ 21,000</td>
<td>$ 19,000</td>
<td></td>
</tr>
<tr>
<td>Holding company - Net income before tax</td>
<td>$ 61,000</td>
<td>$ 30,000</td>
<td></td>
</tr>
<tr>
<td>Holding company - Retirement assets</td>
<td></td>
<td></td>
<td>$ 1,691,000</td>
</tr>
<tr>
<td>Holding company - Unrealized capital gain on retirement assets</td>
<td></td>
<td></td>
<td>$ 850,000</td>
</tr>
<tr>
<td>Holding company - Increase in taxable cap. gain amount due to 2024 Budget</td>
<td></td>
<td></td>
<td>$ 142,000</td>
</tr>
<tr>
<td>Additional combined corporate/personal tax due to higher inclusion rate</td>
<td></td>
<td></td>
<td>$ 84,000</td>
</tr>
<tr>
<td>Personal RRSP balance</td>
<td></td>
<td></td>
<td>$ 1,040,000</td>
</tr>
</tbody>
</table>
Figure 2. Forty-four-year-old family physician in British Columbia

This newly practising physician began practising in a small community in rural British Columbia in 2017 and incorporated their medical practice in 2021. In addition to managing a demanding family medical practice, the physician spends one to three months per year working in the Northwest Territories or Yukon, away from their children and spouse.

This physician does not represent the 0.13% of Canadians targeted by the proposed tax changes to capital gains; however, as they progress in their career, their ability to save for retirement and their family’s well-being will be affected by the increase to the capital gains inclusion rate applicable to every dollar of capital gains realized by the professional corporation.

<table>
<thead>
<tr>
<th>Practising Family Physician in Rural BC (44 years old)</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Medical Professional Corporation - Billings</strong></td>
<td>$340,000</td>
<td>$360,000</td>
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<tr>
<td><strong>Medical Professional Corporation - Overhead</strong></td>
<td>$136,200</td>
<td>$155,200</td>
</tr>
<tr>
<td><strong>Medical Professional Corporation - Net Professional Fees</strong></td>
<td>$203,800</td>
<td>$204,800</td>
</tr>
<tr>
<td><strong>Medical Professional Corporation - Retained Earnings - end of year</strong></td>
<td>$189,000</td>
<td>$274,000</td>
</tr>
</tbody>
</table>
Figure 3. Impact of capital gain inclusion rate proposal

The following table demonstrates the after-tax gain available to an individual, compared with the same capital gain being realized within a long-standing medical professional corporation in Ontario and then subsequently being distributed to the shareholder by way of dividends.

<table>
<thead>
<tr>
<th>Tax Fairness Example (Professional Corp vs. Individual)</th>
<th>50% inclusion rate</th>
<th>67% inclusion rate</th>
<th>Individual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gain</td>
<td>250,000</td>
<td>250,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Taxable capital gain</td>
<td>125,000</td>
<td>166,668</td>
<td>125,000</td>
</tr>
<tr>
<td>Corporate tax (Fed &amp; ON)</td>
<td>62,709</td>
<td>83,612</td>
<td></td>
</tr>
<tr>
<td><strong>Dividend distribution</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>After-tax proceeds</td>
<td>187,291</td>
<td>166,388</td>
<td></td>
</tr>
<tr>
<td>Capital dividend</td>
<td>(125,000)</td>
<td>(83,333)</td>
<td></td>
</tr>
<tr>
<td>Dividend refund</td>
<td>38,333</td>
<td>51,111</td>
<td></td>
</tr>
<tr>
<td></td>
<td>100,625</td>
<td>134,167</td>
<td></td>
</tr>
<tr>
<td>Personal tax</td>
<td>48,038</td>
<td>64,051</td>
<td>66,913</td>
</tr>
<tr>
<td><strong>After-tax proceeds</strong></td>
<td></td>
<td></td>
<td>183,088</td>
</tr>
<tr>
<td>Disadvantage</td>
<td>(5,501)</td>
<td>(29,639)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-2.2%</td>
<td>-11.9%</td>
<td></td>
</tr>
</tbody>
</table>
Appendix 2 - Testimonials

Family physician on why operating their own clinic doesn’t make sense anymore:

- “I’m a family physician, and I could name 10 friends and colleagues whom I know have already closed their clinics due to the work-pay imbalance, choosing to do better paying work instead. By making it harder to save for retirement, even more will be encouraged to make that type of switch. People don’t realize it, but family physicians have a ton of job prospects outside of clinics. Right now, in most provinces, hospital-based work tends to pay 50% more with more time off/fewer off-hour obligations. Emergency rooms tend to pay 100% more than clinics. We can work in all sorts of subspecialty clinics. And now, there are increasing numbers of private work options.”

Family physician on access to care within the community:

- “A group of physicians stood up a family medicine group (FMG) to offer primary care services outside of the hospital. Our FMG employs other clinicians and support staff and supports the local economy of the community we serve. When the time comes to retire and pass on my practice to another physician, I’ll pay a higher tax rate than if I’d decided to buy the duplex across the street from my practice! That’s why young physicians don’t want to go the same route. The government needs to realize that physicians are investing in what is essentially the gateway to our health care system. If the next generation of physicians decide to opt out of a model that penalizes them, we’ll end up with a shortage of health care infrastructure that will curtail access to care.”

Emergency physician on reducing patient care:

- “I’m an emergency physician and I submitted an application for two non-clinical jobs today. I will still see patients half-time but with all my gigs I’m working 70 hours a week and for 46¢ on the dollar after taxes, before expenses, it’s not worth it. My urban hospital will be cutting emergency physician staffing by 40% this summer as we can’t recruit anyone.”

Retired specialist on saving for a disabled child:

- “Some years ago, I established a trust for a disabled child. Given that capital gains will be increased for the trust that exists for my disabled child, it means that when I die, the federal government will be taking appreciatively more money than is presently the case from my child. I am not in the category of a wealthy family head trying to protect family assets. This is a totally different situation. I’m not in that situation. I’m trying to protect my daughter.”
Family physician on the impact on retirement savings:

- “I am already 70 years old and thinking of retiring in the next year or two but how will I retire with capital gains tax? I am not rich in any way; I just had enough to retire but giving CRA 8% more from my retirement income puts me in big problem. I don’t think I will ever be able to retire.”

Specialist on the lack of benefits available to non-salaried physicians:

- “Doctors can’t do that [save for retirement with a pension]; we can only afford to take four months maternity leave, no parental benefits. You fund your own sick days, your own parental leave... part of having a medical corporation is being able to do that.”

Specialist on how proposed changes don’t account for fixed fee schedules impacting physician remuneration:

- “Physicians are not working in a free-market situation. Fee schedules are highly controlled across the country and have not kept pace with cost of living over the last decade or two... In such a market, the increase in capital gains taxes on physician private corporations while, at the same time, not allowing physicians to charge what a free market would be willing to pay for their services is like taxing physicians twice.”

Retired family physician on how this will impact the ability of future generations of physicians to retire:

- “My son is a gynecologist. He is now 52–53. He would love to be able to retire at 60, but there is no way he could do it before 65–70. He will continue for as long as possible. Some places stop surgeons at age 65. That is a real pressure on him. He is quite depressed and disillusioned with continuing to do medicine. He would love to get out of medicine altogether.”