

Business & Careers

Incorporating firm can bring tax relief



Vern Krishna
Tax Views

A professional corporation allows professionals — such as doctors, dentists, lawyers and accountants — to provide their services to clients through a corporate entity, rather than personally.

The corporate entity must be created under the auspices of provincial or territorial corporate statutes and comply with rules determined by provincial regulatory bodies. The rules typically control the structure and operation of such entities to ensure that they do not violate, or circumvent, professional codes of conduct and practice.

For most professionals, the most compelling reason for incorporating is to benefit from corporate tax advantages. The principal advantage from a professional corporation is tax deferral. The difference between the tax payable by incorporated and unincorporated professional practices is significant. Individuals pay tax on their business income at progressive marginal tax rates.

For example, in 2016, the top combined federal/provincial marginal tax rate on ordinary income is about 53.53 per cent in Ontario for income that exceeds \$220,000, (47.70 per cent in B.C.; 48 per cent in Alberta for income that exceeds \$300,000). In contrast, the combined federal and provincial corporate rate of tax is approximately 15 per cent on the first \$500,000 of professional business income and 26.5



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per cent on income above \$500,000.

The spread between personal and corporate tax rates allows professionals to defer tax if they leave their income in the corporation. Since business partners must share the \$500,000 limit between themselves, the full benefits of incorporation accrue primarily to sole practitioners and small partnerships.

Tax deferral is a real and substantial tax saving, which can accumulate into very significant amounts, but only if the individual does not immediately require all of his or her earnings for per-

sonal use. The deferral stems from the ability of the shareholder to leave some of the after tax corporate earnings in the corporation. The magnitude of any deferral depends upon the reinvestment rate and the length of time that the corporate entity accumulates its after-tax income. Thus, professionals can use tax deferral as a surrogate pension plan.

Incorporation also enhances remuneration flexibility and allows the owner-manager to choose between receiving compensation as salary or dividends, which have very different tax consequences. For example, professionals may want sufficient salary income to allow them to contribute to a Registered Retirement Savings Plan (RRSP) and Canada Pension Plan (CPP). In other circumstances, an individual may prefer dividends if he has a cumulative net investment loss (CNIL) and wants to claim the capital gains exemption.

The costs of administration may, however, outweigh the tax advantages if the professional needs to extract all of the professional cor-

poration's business income in each year.

Depending upon the applicable provincial legislation, professionals may be able to use a holding company (Holdco) to own the shares of a professional corporation and siphon off professional earnings to the holding company through tax-free dividends. This will reduce shareholder risk in the professional corporation and allow the saved cash to accumulate in the Holdco. To be sure, there is no real risk in leaving surplus funds to be reinvested in the professional corporation itself if the professional shareholder is fully and adequately insured against negligence. A Holdco, however, adds greater certainty to the structure.

There are opportunities in some provinces to split income between family members, but such structures should take into account the attribution rules and the special "kiddie tax" on certain income that minors can earn from such structures. The kiddie tax can neutralize any benefits from splitting business income in corporations in which the parents participate actively.

Professional regulators may also restrict the use of holding companies. For example, the Law Society of Upper Canada requires the ownership of shares in a holding company to be restricted to licensees. Shares in a holding company may not be owned by family members or non-licensees. In addition, the business of a holding company must also be restricted to holding the shares of the professional corporation. Applicants who intend to use a holding company must submit the articles of incorporation for the holding company along with their application for a certificate of authorization to the law society for approval.

The shares of a professional corporation that qualifies as "small business corporation" (SBC) may be eligible for the lifetime capital gains exemption when the shareholder disposes of his or her shares. In general terms, a SBC is a Canadian-controlled private corporation that uses all, or substantially all, of the fair market value of its assets in an active business in Canada. The exemption is worth \$824,176 in 2016, and is indexed thereafter.

There are also some disadvantages of incorporating and operating through a professional corporation. For example:

- Expenses of incorporation;
- Annual maintenance of corporate entity;
- CRA payroll deductions and monthly remittances;
- HST registration and remittances; and
- Corporate accounting and tax returns.

Professionals will need to evaluate their personal circumstances and income levels to determine if a professional corporation suits their business needs. Generally, the advantages should outweigh the incremental administrative, organizational and incidental costs associated with professional corporations.

The key factor, however, is the amount of money the professional is able to leave in the corporation to accumulate without incurring the additional dividend tax upon extraction of the corporate funds.

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Employee: Strong rules needed, but allow for some flexibility

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lines in the sand. There are occasions, he says, when employees need to be able to make personal calls or deal with urgent private matters. "It's about getting people to be accountable and making them understand they can text family and friends but just keep it to a minimum," Dormer says.

Stuart Rudner, an employment lawyer and founding partner of Rudner MacDonald in Toronto, concurs. "You would never really question someone for taking a quick call from their child after school or making a quick call to their spouse to see if they need to pick up milk. You can't have an absolute ban on that kind of thing, but every-

one's got to be reasonable."

Rudner adds that personal communications should not interfere with an employee's ability to do their work or with anyone else's.

Rules also apply somewhat differently to support staff who work fixed hours such as 9 to 5 than they do to lawyers who work by billable hours. "For lawyers, the line between personal and professional is really blurred if it hasn't been obliterated completely," Rudner points out. "They're responding to e-mails when they're working at home and conversely when they're in the office they're dealing with personal matters."

So if a lawyer sends texts or books a vacation while in the

office, that's probably fine so long as they get their work done and service their clients appropriately, Rudner says.

If rules are breached, Rudner recommends employees be given very clear warnings that their behaviour in unacceptable and repeat incidents will lead to discipline up to and including dismissal. He adds that collective agreements tend to set very clear parameters whereas under common law employers need to carefully examine circumstances such as length of employment and an individual's record in that particular workplace.

Inna Koldorf, an employment lawyer and founding partner of Koldorf Stam in Toronto, says

management needs to have a conversation about their expectations and level of tolerance, and then policies and parameters need to be clearly spelled out to employees in a manual that doesn't just sit in a binder.

"Some really big companies have no tolerance at all, and cell-phones and all devices are banned and most social media sites are blocked," Koldorf says.

"What's more common is employers trying to find some sort of balance to allow employees some flexibility with personal use but ensuring productivity remains high."

Koldorf says smaller companies have an easier time navigating the personal use of technol-

ogy, and her own firm — with two other lawyers and two support staff — is comfortable with staff keeping in touch with friends and family so long as work gets done.

"I check my own phone throughout the day and there's an expectation that employees can do the same, and we haven't had a problem with anybody doing this excessively," Koldorf says.

"If you give employees the space to use their devices and social media a little bit to ensure they keep connected with their social group and with their family, while ensuring that their productivity remains high, then you can have a pretty happy workplace."