BUSINESS PATHWAYS

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Presented by:

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# Understanding incorporation: What you need to know

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# Agenda

- Employment vs. self-employment
- Typical structures for physicians:
  - Sole-proprietor
  - Professional Corporation
- Why should you incorporate?
- Setting up your Professional Corporation

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# Employment vs. Self Employment

Employee:

- T4
- Deductions withheld at source by employer
- No expense deductions
- File personal income tax return
- RRSPs

# Employment vs. Self Employment

Self-Employed Individual:

- Deductions not withheld at source by employer
- All CPP premiums paid by individual
- Not eligible for EI
- Allowed to deduct all business expenses
- Must report income on a calendar year basis

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# Proprietorships

- No separate legal entity – simply an extension of the individual
- Most commonly used by new doctors due to levels of personal debt
- Unusual for full medical practices to be run as a proprietorship
- Proprietors taxed at marginal income tax brackets – highest rate in BC is 53.5%

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# Professional Corporation (Stand Alone)

Most common structure:

- Individuals own “shares” of the PC. The shares can be owned by doctor and spouse
- PC owns medical assets and all medical activities transacted here
- Small business deduction tax rate of 11.0% in BC
- Can choose fiscal year end
- No limited liability for malpractice

# Should you incorporate?

## CORPORATION - ADVANTAGES

- Tax deferral/savings
- Income splitting  (TOSI since 2018)
- Easier to budget yourself


## CORPORATION - DISADVANTAGES

- Increased legal and accounting fees
- Increased paperwork and administrative hassle
- If no deferral and no income splitting, just costs without the benefit

# When should you incorporate?

- Income splitting with family members is difficult with more restrictive rules, but may be available to you based on your specific situation.

- Purchasing a property or clinic

- Earnings are greater than the amount needed to support lifestyle and/or debt payments

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# Divide and Defer

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## How your Professional Corporation can save you money

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# Tax Savings vs. Tax Deferral

- A tax savings is simply a tax you don't have to pay
  - e.g. tax saved by income splitting

- A tax deferral is a tax that is paid at a later date, such as taxes on the retained earnings of a company.

# Defer

- When you earn active income in a PC and do not remove it, it is taxed at the corporate rate:
  - BC top individual tax rate on self employed income is 53.5%
  - BC corporate tax rate is 11.0%

- The money left in a PC can be invested and removed later
  - $100,000 earnings personally leaves $46,500 to invest
  - $100,000 earnings left in PC leaves $89,000 to invest

- Add in the power of compound interest.  Assume a 5% after tax return for 25 years
  - $46,500 becomes $157,000
  - $89,000 becomes $301,000

- Tax savings occur when we can take the money out of the corporation at a lower tax rate than is currently available.

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# Tax deferral

- Example: Physician earns $250,000 and requires $10,000 per month in after tax dollars to fund personal expenses

| | Unincorporated | | Incorporated | |
|---|---|---|---|---|
| | Personal | | Personal | DPC |
| Earnings | $250,000 | | $175,000 | $75,000 |
| Tax | (89,400) | | (55,000) | (9,000) |
| After tax cash available | 160,600 | | 120,000 | 66,000 |
| Personal cash requirement | (120,000) | | (120,000) | NIL |
| Net savings | $40,600 | | NIL | $66,000 |

- Tax deferral achieved:
  - Year 1 - $25,000 of taxes deferred @ 6% return = $1,500 of additional annual income
  - Year 10 - $250,000 of taxes deferred @ 6% return = $15,000 of additional annual income

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# Divide

- Canadian tax system is not based on family income but on individual income
- A couple earning $60,000 each will pay less tax than if one of them earned $120,000 and the other didn't work
- This is a result of individual marginal tax brackets and the different tax rates applied to each bracket
- How much can you pay your spouse? A "reasonable amount" can be paid to your spouse. Under the 2018 budget rules, income splitting has become more restricted.

# Income splitting

- Example: Physician earns $250,000 and spouse earns $30,000

| | No Income Splitting | | | | With Income splitting | | |
|---|---|---|---|---|---|---|---|
| | Physician | Spouse | **Total** | | Physician | Spouse | **Total** |
| Personal income | $250,000 | $30,000 | **$280,000** | | $140,000 | $140,000 | **$280,000** |
| Personal income tax | 89,400 | 3,300 | **92,700** | | 39,300 | 39,300 | **78,600** |
| | | | | | | | |
| Savings | | | | | | | **$14,100** |

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# Budget Changes – Income splitting

- Income splitting is allowed under the following conditions:
  - When a doctor turns 65, they can income split with their spouse
  - Where a capital gain qualifies for the Capital Gains Deduction
  - Where shares are inherited
  - Where shares are received as part of a marital breakdown
  - Where an individual can prove they are actively engaged in the business
  - Where the amount received is reasonable for work performed or is a reasonable return

# Financing a building purchase

- Principal repayments on loan are made with after tax corporate dollars
- Consider the situation where a Medical Professional Corp (MPC) borrows $1,000,000 to purchase a building

| | MPC with SBD | MPC with no SBD | Personal |
|---|---|---|---|
| Earnings before tax | 1,123,596 | 1,369,863 | 2,150,538 |
| Tax rate | 11% | 27% | 53.5% |
| After tax funds available to pay debt | 1,000,000 | 1,000,000 | 1,000,000 |

# Budget Changes - Business Limit – Reduction

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- Small business deduction provides preferential tax rate active income up to $500,000
- The business limit will be reduced by $5 for every $1 of investment income that exceeds $50,000
- The business limit will be eliminated when $150,000 of investment income is earned
- Policy is clear
  - *If you have $150,000 of investment income, it likely translates capital that isn't utilized in an active business. Therefore, if the capital isn't being deployed in an active business, the accumulation of new capital should not be subject to the low corporate tax rates that continue to cause income tax deferral.*

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# Budget Changes - Business Limit – Reduction

Table 2

**Active business income qualifying for the small business tax rate under new business limit ($)**

| Business Income | Investment Income | | | | |
|---|---|---|---|---|---|
| | 50,000 | 75,000 | 100,000 | 125,000 | 150,000 |
| **50,000** | NOT AFFECTED | | | | 0 |
| **75,000** | | | | | 0 |
| **100,000** | | | | | 0 |
| **200,000** | | | | 125,000 | 0 |
| **300,000** | | | 250,000 | 125,000 | 0 |
| **400,000** | | 375,000 | 250,000 | 125,000 | 0 |
| **500,000** | | 375,000 | 250,000 | 125,000 | 0 |

Note: Assumes that the corporation has less than $10 million of taxable capital.

# Setting up your PC

- Receive permission from the College (4-6 months)
  - Assistance from accountant, lawyer, and Business Pathways
- Open/set up Business Bank accounts and Credit Cards
  – Important to keep business and personal separate
- Registration with the CRA for:
  – Corporate tax
  – Payroll
  – GST → likely not applicable (only for non-medical services such as report writing, etc.)

NOTE: Special considerations required for those with US citizenship or green card

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# What can I deduct?

- your salary, as well as any other staff;
- the corporation's payroll remittance;
- professional dues and fees;
- malpractice insurance;
- continuing education costs;
- business meals and entertainment;
- membership dues for yourself;
- cell phone;
- office supplies;
- tax-free automotive allowance up to 61¢ per kilometre for the first 5,000 kilometre then 53¢ per kilometre thereafter, or alternatively we can deduct a percentage of actual expenses.
- office rent or cost sharing;
- computer and other equipment;
- annual general meeting;
- medical expenses incurred under a PHSP;

Keep in mind all expenses have to be reasonable, incurred for the purpose of earning income and not be personal in nature.

# Salary vs. Dividend

- Salary
  - Deduction for the company
  - Generates RRSP room
  - Higher personal tax rate
  - Requires CPP contributions
  - Tax and CPP remitted regularly

- Dividend
  - Paid with after tax money from the company
  - Lower personal tax rate
  - No tax withheld at source

# Questions?

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