

Is a professional corporation right for you?

In recent years, changes to provincial incorporation standards have made it possible for professionals to incorporate their practices or businesses and enjoy many of the same benefits as other self-employed individuals.

Your profession's governing body or association will have its own rules and standards that must be respected when allowing its members to practice through a professional corporation. Professions that are allowed to incorporate include: doctors, dentists, veterinarians, lawyers, accountants, engineers and architects. Other professions may also be allowed to incorporate, depending on the province. For example, in Ontario social workers, social service workers and regulated health professionals can also incorporate.

Since many of your colleagues may already be operating their practices/businesses (practice) through a professional corporation, you may be asking yourself whether it makes sense to incorporate your own practice. This article provides a brief overview of the benefits of operating your practice through a professional corporation; however, it's important to seek independent legal and accounting advice before establishing a professional corporation.

Benefits of setting up a professional corporation

By incorporating your practice, you can take advantage of certain financial benefits and opportunities.

Defer personal tax – Deferring personal income tax is one of the main reasons professionals incorporate their practices. Active business income retained in a professional corporation is taxed at the small business corporate income tax rate, which is significantly lower than the highest personal income tax rate. For example, in British Columbia the small business corporate tax rate for 2014 is 13.5 per cent on the first \$500,000 of earnings, whereas the top personal tax rate is 45.8 per cent.

By retaining a portion of your professional earnings within the corporation, you defer paying income tax until a later date when the funds are withdrawn. For example, if a doctor in British Columbia earns \$350,000 a year and retains \$200,000 of those earnings within a professional corporation, income tax of \$64,600 [(45.8 per cent minus 13.5 per cent) x \$200,000] can be deferred until the funds are withdrawn. In addition, the \$64,600 will generate additional investment income within the corporation.

Professionals who are just starting their careers may spend the majority of their income establishing their practices, paying down debt and supporting their lifestyles. These individuals may prefer to postpone incorporation until such time as they have surplus cash flow that can remain in the professional corporation.

Income splitting – Depending on the province and your profession's governing body or association, you can name your spouse, children and even parents as shareholders of your corporation. If these individuals are in a lower tax bracket, you could significantly reduce your family's overall tax bill by paying out dividends to these family members. Dividends paid to family members can be used for any purpose including covering education and eldercare costs or funding a new home purchase. However, in order to avoid income attribution to the professional, dividends on professional corporation shares should not be paid to children until they have reached the age of majority.

In addition, certain family members, such as spouses and children, may also be employed by your corporation and receive remuneration for duties performed.

IPPs for retirement – Generally, your professional corporation pays you a salary in order to allow you to contribute the maximum to your RRSP each year. If additional money is required to support your lifestyle, the corporation can pay out additional income in the form of dividends.

Once you reach age 40 or older, you may want to consider establishing an Individual Pension Plan (IPP) – a company pension plan that is set up solely for your (or your and your spouse's) benefit. With an IPP you can increase your retirement assets as higher contributions are allowed than what is permitted for RRSPs and your professional corporation makes the tax deductible contributions to fund the IPP.

Pay non-deductible expenses from the corporation – It may be beneficial to have the professional corporation pay certain non-deductible expenses such as life insurance premiums and club membership dues. Using corporate earnings – that are taxed at lower corporate rates compared to more costly personal after-tax dollars – is a more cost effective way to fund these types of expenses as less pre-tax income is needed to cover the expense.

In the case of life insurance, the professional corporation becomes the beneficiary and owner of the policy. At death, the life insurance proceeds can be paid out by the professional corporation without attracting tax.

Tax effective borrowing – If you have personal debt, such as a mortgage or a line of credit, you may be able to borrow funds from your corporation on a short-term basis at a cost that is lower than your current personal cost of financing the debt. When you take a shareholder loan from the corporation, no immediate tax is payable; however, the loan must generally be repaid within one year following the end of the corporation's taxation year in which the loan was received. If the loan is not repaid within this time frame, it will be included in your income and subject to tax at your marginal personal tax rate. In order to extinguish debt owed to the professional corporation, the corporation can declare and accrue a bonus. The bonus must be paid to the professional within 179 days following the end of the corporation's taxation year in which it was accrued. Some or all of the bonus can then be used to offset the balance of the loan payable to the corporation.

There may also be a deemed interest benefit if the rate of interest paid by the professional to the corporation is less than the Canada Revenue Agency's (CRA) prescribed rate. Visit the [CRA site](http://www.cra-arc.gc.ca/interestrates/) at www.cra-arc.gc.ca/interestrates/ for the current prescribed rates.

It should be noted that there are exceptions to the income inclusion rule for certain longer term loans from professional corporations. If properly structured, qualifying loans are those received by the professional for the purchase of a vehicle to be used in carrying out his or her employment duties or for the purchase of a home for the professional's occupation. You should seek independent legal and accounting advice as to the proper structuring of loans from your professional corporation.

Limited liability – While a professional corporation does not mitigate professional liability (such as being sued for malpractice or negligence), it may provide some protection from creditors who make claims against the professional corporation.

An Attractive Business Structure

There are initial set up and ongoing tax filing and administrative costs involved in establishing and maintaining a professional corporation. However, the tax saving opportunities provided by professional corporations make them an attractive business structure option for today's professional. Many factors must be considered when deciding whether incorporation will be beneficial for your practice. Since each province and professional governing body or association has its own rules and requirements, you are encouraged to consult with independent tax and legal advisors if considering a professional corporation.

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WG-14-013 | June 2014

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