Incorporation

Who, When, How, and Why?

This module will provide a brief overview of the benefits of incorporation and the process to incorporate. It will cover these specific issues:

- What is a corporation?
- Benefits of incorporation
- Corporation vs RRSP
- When you should incorporate
- Incorporate or pay down debt
- Income taxes
- The process of incorporation

What is a corporation?

- A corporation is a separate legal entity
- It files its own financial statements and tax return
- You become a shareholder and an employee of your corporation
- A corporation is complex so the benefits must outweigh the cost

Benefits of incorporation

The two main advantages of incorporation are tax deferral, by leaving earnings in the corporation, and tax savings through income splitting

- Most physicians are in the top 1% of income earners in Canada
- You will be in the top tax bracket and will pay over 45% in tax on the income that falls in the top tax bracket
- A corporation pays a much lower rate of tax (currently at 13.5%) than an individual (>45%) so taxes can be deferred and reduced by incorporating and leaving some of your professional income in the corporation
- You can also income split with family members with incorporation. Income splitting allows you to pay funds, usually as a dividend, to a family member who is in a lower tax bracket than you are
- Saving taxes by paying a lower rate of tax and income splitting allows you to build up wealth quicker
- The amount you save in your corporation becomes part of your pension plan to provide you with an income in the future when you stop working
- Most physicians will have 4 mains sources of income when they retire.
    - The funds saved in your corporation
    - The funds contributed to your RRSP
    - CPP
    - OAS
- The amount you save in your RRSP and corporation will form the bulk of your pension income.

Corporation vs RRSP

A corporation is very similar to a RRSP. They are both used to reduce your taxes and increase your savings.

- If you leave earnings in a corporation you reduce your taxes to 13.5%. If you contribute to your RRSP you reduce your taxes to nil on the amount you contribute
- There is a cost to set up, and annual cost to maintain, a corporation. There is no cost to set up a RRSP and a minimal annual cost to maintain
- There is no limit to how much earnings you can leave in a corporation. You can contribute less than $25,000 per year to your RRSP
- An RRSP is more beneficial than a corporation for tax savings and cost. However, an annual maximum contribution of $25,000 will not be sufficient to provide you with an adequate income when you retire
- In summary, most self-employed physicians will, at some point in their career, need to incorporate to build up the additional savings required for retirement

When should you incorporate?

It is beneficial to incorporate when the reduced taxes are greater than the additional cost of being incorporated

- A corporation, like a RRSP, is a vehicle to save money
- You must be in a position to save money
- Incorporation is usually beneficial if you can leave $30-40,000 of earnings per year in the company
- This is on top of your annual RRSP limit
- If you have a large amount of carry-forward RRSP room you should contribute this amount to your RRSP before incorporating
- If your spouse does not work at all then there is enough tax savings through income splitting to make incorporation beneficial without leaving any earnings in the corporation

Incorporate or pay down debt?

Often physicians will have a student loan, other debt or a mortgage. The question they have is whether they should they focus on paying down the debt or incorporate and leave some of the earnings in the corporation, which means it will take longer to pay down the debt.

- From a tax perspective, given low interest rates, it is usually beneficial to incorporate and take longer to pay off your debt
- The reason for this is through incorporation your are reducing your taxes by more than 30% on earnings left in the corporation. With low interest rates the increase in corporate savings from the reduction in taxes is much greater than the additional interest paid on the debt
- It can be worth delaying incorporation if you can get your debt paid off in 2-3 years and this is a high priority to you

Income taxes

- As a non incorporated physician you must pay quarterly instalments towards your personal taxes on your self employed income
- Quarterly instalments are based on the prior year's taxes payable
- After incorporation you will no longer be required to make quarterly instalments
- Your corporation will deduct the appropriate amount of tax and CPP from your salary and remit it to Canada Revenue Agency monthly
- Your corporation will be required to make monthly instalments towards its corporate taxes payable on corporate earnings left in the corporation

Salary vs. dividends

A common question is whether you should received a salary or dividend from your corporation

- Through the tax integration rules the amount of tax paid by the corporation and individual are the same for salary and dividends
- With salary 100% of the tax is paid by the individual
- With dividends the tax is shared between the corporation and the individual
- The advantageous of salary is that it qualifies the Dr for RRSP room that allows them to qualify for the BCMA contributory RRSP program. Under this program the BCMA will contribute to your RRSP
- Salary also qualifies for CPP
- Dividends are usually paid to the Dr's spouse or children as it is difficult to justify a salary to them for the work they are able to provide to the medical corporation

Process of incorporation

It is recommended you use a lawyer to incorporate your practice to make sure it is structured properly. The steps required are:

- Get approval from the College of Physicians
- Determine which family members will be issued shares for income splitting
- Certain documents such as a transfer agreement and employment agreement should be considered as part of the incorporation process
- Open a corporate bank account once the incorporation is complete
- Determine the optimal amount of salary and dividends to be paid
- Set up proper books for the incorporated practice

This module was kindly provided by Saskia Muller and Selena Nisbet of Galloway Botteselle & Company: www.gbco.ca