To Be or Not To Be… Incorporated

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The question of whether to incorporate your business or not is one that comes up often in the early life cycle of a business. While the best option for each business and owner varies, the factors considered in making the decision are often the same. In this article, we will explore a few of these considerations.

TAX DEFERRAL

A deferral of tax can be achieved when your personal spending needs are less than the business profits earned. This is because corporate tax rates in Ontario are currently as low as 13.5%, much lower than personal income tax rates. While a second layer of personal tax will be payable when the funds are withdrawn from the corporation to the individual shareholders, to the extent those funds are not needed personally in the near term, this lower corporate tax rate leaves additional funds available to finance the operations and grow the business.

FASTER DEBT REPAYMENT / MINIMIZE INTEREST EXPENSE

In keeping with the tax deferral concept above, the excess cash available as a result of the tax deferral can be used to pay down debt that was incurred to purchase or grow your business. By paying down the debt faster, interest can be reduced, an ultimate cost savings to your business.

FLEXIBILITY IN COMPENSATION STRUCTURING

As an incorporated business owner, you will have added flexibility regarding your compensation, including the amount of compensation you will take in a given year, and whether you will take that compensation in the form of salary or dividends. By deferring personal income tax in years with strong business performance, and withdrawing those funds from the corporation in later years when you are in a lower tax bracket, you can realize an overall tax savings. The compensation method you choose can also help you optimize your ability to contribute to RRSP accounts, the future value of your CPP retirement benefit, availability of child tax credits, deductibility of child care costs, value of SR&ED tax credits, and your overall tax burden.

CAPITAL GAINS EXEMPTION ON QUALIFIED SMALL BUSINESS CORPORATION SHARES

With advanced planning, on a future sale of the shares of your corporation, approximately $850,000 of gain in share value can be sheltered from tax through the capital gains exemption, resulting in tax savings of up to $225,000 per shareholder. There are certain qualifying conditions in order to access this tax exemption, but with proper guidance and planning, it can add a significant boost to your business sale proceeds and retirement nest egg. If your business could eventually exceed $850,000 in value, tax planning could allow the utilization of the capital gains exemption of other family members, such as for a spouse or child.

FAMILY INCOME SPLITTING

Historically, taxpayers were able to split income with members of their family through the use of dividends on private corporation shares held by family members. If the family member had minimal other income, this allowed dividends to be paid from the corporation with minimal personal income tax. Starting in 2018, the ability to achieve this tax savings have been dramatically reduced, but it still exists in certain circumstances.

LEGAL PROTECTION

Protecting your personal assets from creditors of your business is a key reason many business owners pursue incorporation. If you would like to discuss the specific scope and limitations of this liability protection, such as the impact of personal bank guarantees, your role as a director of your corporation, or how this applies to professional corporations, we would be happy to refer you to any one of the many legal professionals we work with on a daily basis.

INCORPORATING IS AN INVESTMENT

As shown above, there are many possible benefits to incorporating your business, but doing so is an investment. Professional fees commonly include one-time incorporation fees and guidance surrounding the structuring of your business ownership, annual accounting fees related to preparation of a corporate tax return and financial statements, and annual legal fees related to maintenance of a corporate minute book. If your business is already established, versus a new venture, valuation of the existing business should also be considered, and may provide tax planning opportunities. Roth Mosey has a Chartered Business Valuator in house, and we would be happy to assist you with your business valuation needs.

As with any business decision or tax plan, it is most effective when tailored to your specific business needs and circumstances. To discuss the benefits of incorporation further, please contact your Roth Mosey advisor.

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Questions?

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