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To Incorporate or Not? That is the Question

Written by: Melanie Cockle, CPA, CA

You're working, earning money. You've heard talk, or maybe read, about the idea of becoming incorporated. You're wondering if it would be right for you! In making this important decision, you'll need to consider the implications – and the pros and cons – of incorporation.

First, take a realistic look at your income

Is the income you earn from your employment or your business sufficient to warrant incorporation?

Say your income is only covering living expenses. In that case incorporating may not be beneficial, as you won't have extra income to shelter. But generally, if you would be able to leave more than $50,000 of your income in your Company, then incorporating *would* be beneficial. You could take advantage of lower corporate tax rates and cover the cost of incorporating on the retained funds.

The corporate tax rate on income in an incorporated business tends to be lower than the individual personal income tax rate. Look at it this way: The higher your net income, the more advantageous it is to incorporate.

By incorporating your business, you have greater flexibility in determining when you personally receive income – and what form of income you receive, i.e., salary or dividend or management fee. You'll also have opportunities for income-splitting with family members (discussed below in more detail). And you may have more opportunities for tax deferral and/or business expense deductions for a corporation than on your personal tax return.

In making the decision to incorporate – or not – consider where you are or will be working. You may work in an office where everyone else is incorporated, so you would also be expected to.

Now, decide on share structure

You've made the decision to incorporate. Now you need to decide on the share structure of the Company. A tax advantage of incorporating is the ability to income-split. A shareholder of a corporation does not have to be active in the business to receive dividends. In fact, incorporating may give you the ability to split income with your spouse and/or your children. This, in turn, gives you the opportunity to redistribute income from family members in a higher personal tax bracket to family members in a lower personal tax bracket.

You may also hire family members in your business. You'll pay them *reasonable compensation* to income-split. Reasonable compensation generally means the amount you would pay an unrelated party to perform those services.

Please note that, in incorporating a Company, you must follow provincial professional body requirements. We suggest you review the incorporation structure with a lawyer to ensure compliance with all professional body regulations.

Looking ahead, when you sell your shares in your Canadian Controlled Private Corporation (CCPC), the capital gains on the disposal of those shares could be tax-free.

Your business, yes – but a separate legal entity

Like all professional industries, your Company must address the concern of *liability*. Your incorporated business will be a separate legal entity. Creditors or legal actions go against your corporation and its assets, as opposed to your personal assets (with some exceptions). Creditors and others cannot sue shareholders for liabilities incurred by the corporation. Professionals must still protect their work from errors or mistakes by acquiring professional liability insurance. This generally includes *malpractice insurance*, and *errors and omissions insurance*. You're well advised to seek legal and insurance advice in these matters.

Benefits, but also drawbacks

With incorporating you'll enjoy great benefits – but also face some drawbacks:

Incorporating costs money. Sure, you can incorporate on your own. But you'd be much better to get the help of a lawyer and an accountant. That way, you'll ensure proper structure right from the start.

Incorporated entities have more filing requirements. You must file an annual tax return and corporate registry annual report, as well as T4 and/or T5 information returns for payroll or dividends paid.

Taking money out is costly. While it is relatively easy to transfer cash into a corporation, it can be costly to move money out.

Losses in your incorporated company can't be claimed personally. You can only use losses to offset future business income. These losses can be carried forward for 20 years.

Incorporating or not depends on your personal situation. To determine the most opportune time, you're best to evaluate the pros and cons. You may decide not to incorporate. But, as your business or work grows, the need for you to incorporate may become greater. For that reason, periodically revisit the question of whether to incorporate.

Melanie Cockle, CPA, CA is a Senior Manager with Manning Elliott LLP. To speak with Melanie call ***604-895-8574*** *or mcockle@manningelliott.com.*