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Setting up a professional corporation can be easy and financially beneficial. But it doesn't come without risks and potential pitfalls. Here are some of the most important benefits to incorporation in regard to tax planning and retirement, and a few drawbacks.

Tax Planning

1. Tax deferral on corporately retained earnings:
Professional income is active business income eligible for the small business deduction of $500,000.
As long as the money stays in the business, personal tax won't be due on the amount until it's paid out to shareholders (the kids or a spouse).
It's best to leave at least $50,000 a year in the business to justify the cost of incorporating.

2. Income splitting:
Some professions allow family members to hold non-voting shares. In these cases a spouse or child (over 18) who is not active in the business can share a part of the professional corporation's after-tax income by receiving dividends on shares they own directly or indirectly.
If children are 18 or older and earning income that puts them in a low tax bracket, the family will pay less tax overall than if the professional personally earns all the income.
And paying family members dividends instead of a salary should be considered in some cases because salaries paid are subject to reasonableness tests. Dividend payments are not.

3. Tax savings with cheaper non-deductibility
Consider having the corporation incur non-deductible expenses such as life insurance premiums and entertainment expenses. Since a professional corporation pays tax at a lower rate than an unincorporated professional, the cost of non-deductibility is less.

Retirement

1. Dividends after retirement
It's not imperative that a person closes their professional corporation when they retire; funds can be left in the professional corporation to grow. The company can retain the earnings and pay them out as dividends.

2. Individual pension plans (IPP)
An incorporated professional can have a pension plan established by the corporation for their benefit. Contributions are made to this plan instead of an RRSP.

3. Probate tax
In some provinces, creating a corporation can significantly reduce probate taxes at death, using a secondary will to address the transfer of shares after death.

Cons
There are some great benefits to incorporating, but it isn't without drawbacks.

Start-up and annual costs may be high:
Although entrepreneurs can use a government self-service website to incorporate for as little as $200, a lawyer is usually needed to set up a professional corporation. A simple incorporation typically costs about $1,000, but the process can cost upwards of $3,500.
The cost of moving existing assets into a corporation can run between $5,000 and $7,500.

Additional tax returns are needed:
You will be required to fill out a T2 for corporate returns. You will also need to file an annual corporate financial statement, which can cost

$1,500 - $2,500.

Although it is relatively easy to transfer cash into a corporation, it can be costly to move money out:
The Income Tax Act allows most assets to be transferred into a newly formed corporation on a rollover basis. Removing assets often has significant income tax consequences.

An accountant and/or financial planner can help determine if incorporating makes sense. Being a business owner is an exciting endeavor, and incorporating can make it feel “official.” Before taking that step, it's best to evaluate the pros and cons to determine the most opportune time.

Rona Birenbaum has worked in financial services for over 20 years within the Credit Union, full-service brokerage and independent Financial Planning industries. She is an Honours graduate of York University's Business School, a Certified Financial Planner (CFP), and fully licensed Insurance and Investment Advisor.
Email: rona@caringforclients.com
Linked In: http://www.linkedin.com/in/ronabirenbaum
Twitter: @Caring4Clients
Website: www.caringofrclients.com