In 2001 the Ontario government changed its laws to allow the incorporation of professional practices. If you are a recent graduate, currently practicing as a sole practitioner or in a practice group, or you are about to move into Ontario, you may wish to consider incorporating your practice and carry on practice as a “Professional Corporation”. There are many advantages to incorporating a professional practice.

**What is Incorporation?**

Incorporation involves the creation of a new legal entity: the “corporation”. Shareholder(s), such as the practitioner and, under certain circumstances, his or her family members, own the corporation’s shares, and the corporation owns the practice. The practitioner usually then also becomes an employee, director and officer of the corporation.

**Reasons to Incorporate**

Incorporating your Professional Corporation has significant tax saving potential such as income splitting with a spouse or children or you can “save” your money inside the corporation.

**Tax Savings**

The basic premise is to retain money within the corporation when it would otherwise be taxed at a high personal rate, and withdraw it during retirement or a sabbatical when a lower personal tax rate applies. From an estate planning perspective, corporation assets can generally be addressed through your will. In Ontario, the shares can be flowed through a second will that specifically deals with corporate assets. This second will is generally not subject to any probate fees or related taxes that may be applicable in Ontario. This will also generate significant tax savings to your beneficiaries.

**Deferral of Income Tax**

Under tax legislation, a corporation is a legal entity and separate taxpayer. Corporate tax rates are approximately 30% lower than personal income tax rates (depending on your province of residence). Retaining money inside of a corporation as Corporate Surplus can be an excellent way to defer income taxes and build wealth inside your company. A Corporate Surplus is referred to as “tax deferred funds” because at some point they have to be withdrawn from the corporation to be taxed at personal income tax rates. However, the long term tax deferral compounding effect can be powerful. This is the same principle that makes RRSP’s so attractive. If you’re in a lower tax bracket at retirement, you will realize an absolute tax savings when funds are withdrawn.

Incorporation generally allows the practitioner to pay the lower small business corporate tax rate on up to the first $500,000 of active business income earned within the corporation. The tax rate on this first portion of income varies from province to province, but the combined federal and provincial tax is generally about 15%. This means that after a business has deducted all eligible expenses, any investment income is taxed at a lower rate than it would be if it were instead taxed in the hands of an individual.

Worth noting is that the corporation, and not the individual practitioner, has benefited from the reduced rate. For the individual to receive income personally, the corporation would have to pay the individual a salary, bonuses or dividends. As an officer of the corporation, the practitioner makes the decision as to when and what type of remuneration to pay from the corporation. The important thing to remember is that incorporating is optimized when corporate earnings are retained within the corporation.

**Income Splitting with Family Members**

If you cannot accumulate money in your corporation, you are still able to benefit from
incorporating your practice by splitting income with family members.

Income splitting is achieved by having the immediate family members (spouse, parents, adult children) own non-voting shares of the PC that can receive dividends as determined by the controlling shareholder. As noted above, dividends are taxed more favourably than other types of income. An individual with no other income can receive up to approximately $32,680 of dividends tax-free.

Dividends can be paid most tax-efficiently to family members who do not have other significant income. Income splitting with minor children is limited due to the Income Tax Act rules commonly known as the “kiddie tax” rules.

Salaries paid to family members must represent reasonable payment for the services being rendered, which means they must be comparable to an amount that would have been paid to an arm’s-length person for similar services. However, the payment of a dividend does not have to conform to such a test as these can only be paid to shareholders.

**Individual Pension Plans**

An individual Pension Plan (IPP) is a registered defined benefit pension plan funded by corporate assets with the goal of providing post-career income. In a Practitioner’s mid-40’s, IPP contribution rates are higher than Registered Retirement Savings Plan (RRSP) contribution rates, and carry the benefit of allowing additional one time contributions to an incorporated Practitioner’s retirement plan. IPPs are creditor-proof.

**The Legal Requirements for a Professional Corporation**

A PC is incorporated under the Ontario Business Corporation Act (“OBCA”) as a regular corporation. However, a PC is subject to a number of special rules and restrictions pursuant to the OBCA and relevant Acts governing the profession. Some key restrictions and requirements are:

- A practitioner must be the sole director, officer and own all of the shares with general voting rights. Other family members (spouse, children, parents and trust for minor children) can own non-voting shares
- The name of the corporation must include the practitioners surname plus the wording “Professional Corporation”
- Certificate of Authorization for the PC from the practitioner’s governing body is required
- The physician remains personally liable for all professional matters relating to the practice
- The activities of the PC must be limited to carrying on a professional medical practice (and related matters and investments)

**Incorporating your Practice in Ontario**

The process of creating a professional corporation can be complex. It is best undertaken with advice from legal and accounting experts. A qualified lawyer can help you through the required steps by:

- Incorporation of the Professional Corporation with the Ontario government and performing all the required steps
- Completing the Application for the Certificate of Authorization
- Obtaining a “Certificate of Status” for your corporation
- Completing the Statutory Declaration
- Filing of all documents with the respective governing body of your profession
- Dealing with the governing body in case of any issues or problems with the Application for Renewal
- Reporting back to you upon receipt of the Certificate of Authorization

Your lawyer can assist with matters that arise during and after the incorporation process and provide you with peace of mind that all the required steps for incorporation have been carried out to meet the legal requirements with professional diligence.
Factors to Consider When Setting Up the Share Structure

It is extremely important that the share structure of the PC be set up with advance planning at the outset, in consideration of the following:

- Flexibility to pay dividends to whatever family members are selected each year by the professional
- Ensuring that the professional retains complete control of the PC
- Allowing the professional to cancel the shares of family members if the circumstances warrant (i.e. dissolution of marriage/death)
- Establishment at the time of incorporation of multiple classes of shares, so there is a separate class of each family member (allowing complete flexibility as to dividends payable to each family member)
- Establishing special classes of shares to be issued on the transfer of goodwill and other assets relating to the practice, such as equipment, to the professional corporation

Other Tax Advantages

The most significant tax advantages available to a PC are generally the corporate tax rate advantage and the income splitting advantage. However, there are additional possible tax advantages:

- Creating an individual pension plan
- Tax deferral (to next year) by bonus accruals
- Use of non-calendar year end
- HST is not payable on dividends
- No requirement for dividend recipients to perform reasonable (i.e. any) services

Transferring Assets and Agreements to the PC?

Since the practice will be carried on by the PC, and to avoid possible tax problems, it is necessary that Goodwill relating to the practice be transferred from the practitioner to the PC. Also, it is necessary to consider if there are other assets, such as equipment to be transferred to the PC. Finally, one must consider what agreements there are relating to the practice, such as office lease and equipment leases, which should be transferred to the PC. Your lawyer and accountant can take care of these decisions in consultation with you.

Summary

With proper tax planning in advance in consultation with your accountant and lawyer, a PC can offer significant income tax savings. On the legal front, the lawyer must implement the corporate share structure properly, in order to achieve the maximum tax savings, provide the most flexibility for changing circumstances and to avoid the various tax traps that can apply.

The fees relating to the planning, structuring and preparation of legal documentation associated with a PC will vary depending on the situation. However, the cost of implementation is usually offset by the tax savings in the FIRST year of implementation.

As you can see there are many advantages to the incorporation of a professional practice. A decision to incorporate should only be made after the pros and cons are reviewed with your professional advisors, taking into account your personal situation.

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