TAB 9

Professional Corporations

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Professional Corporations
by Sheila M. Crummey of McMillan LLP[1]

With the myriad of income attribution rules in the *Income Tax Act* (Canada)[2] (the "ITA"), there are very few tax planning opportunities for professionals. The ability to incorporate a professional practice does create some ways to minimize and defer income taxes for professionals, including lawyers. Hopefully this paper will therefore be of interest not only in order to better serve clients who carry on a professional practice, but also to provide the lawyer with sufficient information to determine if it is worthwhile to incorporate his or her own legal practice.

Professionals Who May Incorporate

The *Business Corporations Act* (Ontario)[3] ("OBCA") was amended in 2000 to permit certain professionals to incorporate their professional practice. Only those professions governed by the following statutes may incorporate:

1. *Regulated Health Professions Act*
2. *Certified General Accountants Association of Ontario Act*
3. *Chartered Accountants Act*
4. *Law Society Act*

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[1] I would like to thank Carl Irvine, an associate in our tax group, for his review of this paper and very helpful comments which have been incorporated into the paper. However, any errors that may remain are mine alone.

[2] *Income Tax Act* R.S.C. 1985, C1 (5th Supplement, as amended)

[3] R.S.O. 1990, c. B. 16

5. *Social Work and Social Service Work Act*
6. *Veterinarians Act*

In addition, where the practice of a profession is governed by a statute and the statute expressly permits the practice of the profession by a corporation, the professional may incorporate the practice, such as architects[4] and engineers.[5]

The governing body that regulates the particular profession sets out the conditions that must be met to obtain a license to incorporate.

No Limitation of Professional Liability

Subsection 3.4(1) of the OBCA expressly provides that there is no limit on professional liability by virtue of incorporating a professional practice. Moreover, section 3.4 of the OBCA deems the acts of a professional corporation to be the acts of the shareholders, employees or agents of the corporation and makes a person who is a shareholder jointly and severally liable with the professional corporation for all professional liability claims made against the corporation while the person was a shareholder. Where the rules permit a spouse or child of a professional to become a shareholder (as is the case for medical doctors and dentists), this may be of concern to the family member who is a shareholder for income-splitting purposes only and has no control over how the practice is conducted. Professional liability insurance may be available to satisfy a claim but one can imagine that damage awards may well exceed the

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[4] *Architects Act*, R.S.O. 1990 c. A. 26, section 12

[5] *Professional Engineers Act*, R.S.O. 1990, c. P. 28 section 13 and Reg. 941 sections 47-49

insurance coverage. Where a non-professional spouse is contemplating separation, he or she may want to divest himself or herself of shares of a professional incorporation to limit personal exposure to professional liability claims.

Limited liability is available for claims unrelated to professional errors and omissions, such as trade payables, office lease costs and bank loans not personally guaranteed by the shareholders.

Tax Benefits

There are several significant tax benefits to incorporating a professional practice, include tax deferral, income splitting and possible access to the lifetime capital gains exemption for qualifying shares of a small business corporation.

Deferral of Tax

The primary benefit of incorporating is accessing the lower rate of corporate tax on active business income. In Ontario, the top combined rate of tax for individuals is 46.4% while a corporation earning active business income in Ontario pays only 16.5% on the first $500,000 of active business income. If the professional can afford to leave income in the corporation to be invested, the deferral advantage is significant. The 30% tax rate differential can permit the professional to invest far more than if the income were earned personally. However, income earned on the investments held in the corporation is taxed at a slightly higher rate of 47.13% in 2009 than the top personal rate of 46.4%. The corporate rate on investment income is slated to decline to 44.71% by 2014. It is anticipated that Ontario will change the dividend tax credit to align with the federal dividend tax credit resulting in more perfect tax integration by 2014. This means that the initial deferral advantage of retaining after-tax active business income in the professional corporation will not be eroded by a higher corporate tax rate on investment income by 2014.

To illustrate the tax deferral advantage, assume Dr. Smith earns $300,000 in net professional income after expenses. He needs at least $150,000 to fund his lifestyle expenses, after maximizing his RRSP contributions of $21,000 in 2009. Assume his taxable income is $270,000 after deducting his RRSP contribution. He will pay tax of $111,345[6] leaving $167,655 to fund his lifestyle. Dr. Smith could afford to invest only $17,655 in a non-registered investment account. If he earns $270,000 as salary from his professional corporation, he uses $21,000 to contribute to his RRSP and is left with $249,000 taxable income. He pays approximately $97,000 in personal tax[7] leaving him $151,111 after-tax income to fund his lifestyle and $25,050[8] to invest within the professional corporation. This is approximately 1.5 times what is available to invest if his professional income were earned outside of the professional corporation. Obviously the greater amount of professional income that can be left in the professional corporation, the greater the deferral advantage.

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[6] $97,889 tax is payable on first $250,000 of taxable income and $13,456 is payable on the balance of $29,000, for a total of $111,345

[7] Combined federal and Ontario tax on $250,000 is $97,889 in 2009

[8] $30,000 taxable corporate income is taxed at 16.5% leaving $25,050 after-tax corporate income to invest

The same deferral advantage is available if the after-tax corporate funds are used to invest in a mortgage on a condominium or other form of building used as office space to operate the professional practice.

The professional will want to maximize his or her RRSP contributions and possibly take advantage of the opportunity to contribute to a Tax Free Savings Account ("TFSA"). Funds will have to be withdrawn from the corporation as salary or bonuses to permit a maximum RRSP contribution which is based on the individual's earned income. A TFSA can only be held by individuals but can be funded from any source.

Personal Services Business Rule

The deferral advantage is only available if some of the income earned by the professional corporation is retained in the corporation for investment purposes and the professional income is characterized as active business income. If a professional is employed, the personal services business rule[9] may be an obstacle. The small business rate is denied to a corporation if the shareholder is considered an "incorporated employee". Where the shareholder was rendering services as an employee to one employer, any attempt to incorporate and convert what would otherwise be employment income to active business income will not be successful. Subparagraph 18(1)(p) of the ITA further penalizes the incorporated employee by severely restricting the deductions that can be claimed in respect of income earned by the personal services business. If the professional corporation employs more than five fulltime employees

[9] SS. 125(7) ITA

through the year, it will not be considered to be a personal services business and the professional income earned by the corporation would be eligible for the small business deduction.

Professional Partnerships

Where the professional is a member of a professional partnership and wishes to incorporate the professional practice, care should be taken to reorganize the professional partnership in a manner that preserves the small business deduction for the professional corporation. Canada Revenue Agency ("CRA") has issued two advanced income tax rulings[10] which clarify that a professional partnership may reorganize through the use of professional corporations to multiply access by its professional partners to the small business deduction. These rulings are based on using a structure whereby the professional incorporates a company which then enters into a contract with the partnership to provide professional services to the partnership. The professional remains a partner of the professional partnership and is employed by the professional corporation. What is critical to the structure is a provision in the partnership agreement that prohibits the professional corporation from becoming a partner. This is important in order to avoid the application of the "specified partnership income" rules which, if applicable, would require each professional corporation that was a partner in the professional partnership to share the small business deduction. It is worthwhile to review these rulings to be sure the reorganization of a professional partnership is implemented correctly to ensure the tax results desired. The partnership agreement may need to be amended and contracts entered into between

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[10] ATR 2006 – 0202101R3 and ATR 2006 – 0201551R3

the professional partnership and each professional corporation. Each professional who incorporates must ensure the appropriate contracts are in place to evidence that the professional is an employee of the professional corporation which, in turn, is contractually obliged to render professional services to the partnership. If the partnership provides administrative support to the professional practice, these arrangements should be properly documented in the contract between the partnership and the professional corporation.

There are costs to incorporating, including the requirement to file a corporate return annually, the need to establish a payroll system and remit withholding tax, employment insurance, etc. on salaries paid to the professional and any other employees hired by the corporation. Therefore the additional professional fees for maintaining the corporate structure must be factored in when assessing the deferral advantage.

Capital Gains Planning

Each individual is entitled to a lifetime capital gains exemption of $750,000 in respect of a disposition of qualifying shares of a small business corporation (the "CGE"). For many professionals there is little opportunity to take advantage of this exemption.

There are a number of technical requirements in order for shares of a corporation to be eligible for the exemption. The first requirement is that at least 90% of the fair market value of the assets of the corporation be used to carry on an active business at the time of disposition. If the professional is retaining after-tax corporate income in the corporation to take advantage of the opportunity to defer tax, passive investments may be accumulated which are not used to carry on the professional practice. It may not take long to be offside the 90% rule disqualifying a disposition of the shares from eligibility for the CGE.

The goals of deferring tax by taking advantage of the small business deduction in respect of the professional income and taking advantage of the CGE are difficult to reconcile and are often mutually exclusive. Where the professional is acquiring office space or other assets used to carry on the professional practice, the twin goals of tax deferral and eligibility for the CGE may be possible to achieve because the after-tax corporate income will be invested in "active business assets" rather than passive investments that may put the corporation offside the 90% rule.

Given that many professionals are not able to sell their professional practices at retirement for a variety of practical reasons, the professional may not expect to ever be in a position to sell the shares of the professional corporation and will not be concerned about the shares qualifying for the CGE.

One of the techniques often used to ensure an operating company maintains its status as a small business corporation is to ensure that the individual holds shares directly and also indirectly through a holding company. After-tax profits in the operating company that would be used to invest in passive investments can be paid as a dividend to the holding company on a tax-free basis and invested there ensuring that the operating company can always meet the 90% asset test. This technique may not be available to be used to purify a professional corporation where shares in a professional corporation must be held <u>only</u> by the professional personally or, where permitted, by certain family members or a trust for a minor child or children of the professional. While the OBCA allows the shares to be held indirectly by the professional, different regulatory bodies take different positions on this. The Law Society of Upper Canada ("LSUC"), for example, indicates on their website that they will allow a lawyer to hold shares of a professional corporation through a holding company, however the business of the holding corporation must be limited to holding shares of the operating company[11]. Query whether the "business" restriction on the holding company would prevent the holding company from reinvesting surplus funds? It should be noted that the LSUC accepts that the business restriction on the operating company (that it be limited to the practice of law) does not prohibit the operating company from reinvesting surplus funds. Arguably the same reasoning should apply to the holding company. Therefore, purification may be possible for lawyers. Other regulatory bodies have taken the opposite position[12]. The only way to purify a professional corporation is by paying dividends to the shareholders. Unless the shareholder is a corporation that is not subject to Part IV Tax or unless the dividend is a capital dividend, it will be taxable, eliminating the deferral advantage originally achieved by retaining after-tax professional income in the corporation. Therefore, professionals who incorporate their practice and whose regulatory body prohibits a corporation from holding shares in the professional corporation will find it difficult to take advantage of the tax deferral benefit and the CGE.

It is important to note that the professional corporation may not carry on any other business apart from the practice of the particular profession and the investment of surplus funds. Thus, the surplus funds cannot be used to invest in other active businesses.

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[11] See http://rc.lsuc.on.ca/pdf/membershipServices/certAuthInfoSheetLawyer.pdf

[12] The College of Physician and Surgeons of Ontario prohibits a corporation from holding shares in a professional corporation which carries on the practice of medicine. See www.cpso.on.ca/members/membership.

Income Splitting Advantages

Currently in Ontario the only professionals who are permitted to issue shares to non-professional family members are doctors and dentists. To date, lawyers and other professionals are not permitted to issue shares in a professional corporation to individuals who are not licensed to practice the profession making it impossible to income split through a professional corporation for professionals other than doctors and dentists. There may be some opportunity to income split using a separate management corporation in which a spouse and children hold shares either directly or through a family trust. Where there are two or more corporations in which family members hold shares, it is important to be aware of the association rules. If the professional corporation is associated with the management company, the two corporations would have to share the small business deduction. Where it is important to ensure that both companies have access to the full $500,000 small business deduction, care would have to be taken in structuring the share ownership. For example, the professional could own 100% of the shares of the professional corporation and the spouse and/or children could hold 100% of the shares of the management corporation. Obviously, the professional must be comfortable giving full control of the management corporation to family members. Risk can be managed by crafting the terms of the management contract to control the level of management fees paid by the professional corporation with appropriate termination provisions.

To state the obvious, income splitting is advantageous because individuals are taxed at progressive rates on their income in Canada. There are currently four basic rates of federal tax as follows:

up to $37,885	-	15%
$37,886 to $75,769	-	22%
$75,770 to $123,184	-	26%
$123,185 and over	-	29%

Ontario levies tax based on three basic rates as follows:

up to $36,020	-	6.05%
$36,021 to $72,041	-	9.15%
$72,042 and over	-	11.16%

Ontario also imposes a surtax of 20% of tax liability in excess of $4,257 and a surtax of 36% of tax above $5,370. It is clearly advantageous for income to be split among family members to take advantage of lower rates of tax, thereby reducing the overall family tax bill.

Our income tax rules have been designed to minimize opportunities to split income. The income attribution rules, in particular, are the primary tool by which the government prevents what it considers to be undue tax advantages derived from income splitting.

For doctors and dentists, permitting a spouse and adult children to hold non-voting shares in the professional corporation permits the corporation to flow dividend income to these family members and permit the dividends to be taxed in their hands. If an individual has no other source of income, he or she can receive approximately $37,775 of "non-eligible" dividends or approximately $69,830 of "eligible" dividends without paying tax. Assuming the professional corporation has earned income which is eligible for the small business deduction, such income must be tracked through the Low Rate Income Pool ("LRIP"). To the extent there is a positive balance in the LRIP account, any dividends declared are considered "non-eligible" and subject to a higher rate of tax. Very likely most, if not all, of the dividends paid out of the professional corporation will be non-eligible. However, the ability to pay out $37,775 of non-eligible dividends to spouses and adult children produces a significant tax benefit to doctors and dentists.

Kiddie Tax

A tax on "split income" was introduced in 2000 to levy the top rate of tax on certain types of income[13] earned by a minor child through various income-splitting arrangements. This tax would apply to any dividends paid to a family trust that held shares in a professional corporation which were allocated to a minor child. Parents are jointly and severally liable for the tax if they were actively engaged in carrying on the business that was the source of the income paid to the minor child.

Therefore no tax advantage exists at the moment to involving minor children as beneficiaries of a family trust that holds shares in a professional corporation. However, the "kiddie tax" ceases to apply in the calendar year when the child turns 18. It may be worthwhile to create a trust for a minor child that is issued shares on incorporation so that when the child reaches age 18, dividend income can be paid to the child. Assuming the dividend is non-eligible,

[13] See section 120.4 of the ITA. The definition of "split income" includes dividends, partnership and trust income

the child can receive almost $38,000 without paying any tax if the child has no other source of income. This would fund post-secondary education in a cost-efficient manner. The other point to note is that currently the regulations that apply to doctors and dentists only allow a trust to hold shares for a minor child. Once the child reaches age 18, the shares must be distributed to the child. The parents must be comfortable with the child becoming a direct shareholder in the professional corporation and receiving the dividends directly.

Spousal Attribution

The professional may want to issue non-voting shares to his or her spouse to enable the spouse to earn dividends. To avoid spousal attribution, the spouse must pay for the shares with his or her own funds. If non-voting shares are issued on incorporation before the corporation has any value, the shares can be issued for nominal consideration. Where the spouse will be employed by the professional corporation and will be earning a salary, it may not be very important to pay dividends as the spouse will likely be receiving a salary in the $30,000 range and any dividend income paid will attract tax. The goal in income splitting is of course to use each family member's low to middle tax rates, thus a spouse who earns up to approximately $75,000 has made full use of the lower two rates of federal tax and the low and middle rates of Ontario tax. There is little downside to a spouse acquiring non-voting shares that carry a right to dividends as it provides flexibility in tax planning for the spouses. The non-voting spouse should be aware of the risk of personal liability that flows from holding shares in a professional corporation.

Corporate Attribution

The other important income attribution rule to be aware of is the corporate attribution rule[14]. This rule is designed to penalize an individual who has transferred or loaned property to a corporation, the shares of which are held by a spouse or minor children (among others). A small business corporation is exempt from this rule. At the outset, before the professional corporation acquires significant passive investment assets, it will likely qualify as a small business corporation so this rule will not be of concern. However, since one of the main reasons to incorporate a professional practice is to accumulate investments in the corporation from the after-tax corporate income not required to fund the professional's lifestyle, the corporation will eventually fall offside the definition of a small business corporation[15] which requires that at least 90% of the fair market value of the assets of the corporation are used to carry on an active business.

If the professional expects to invest the after-tax corporate income not required to fund the family's lifestyle, then the corporate attribution rule must be kept in mind. The rule of thumb would be to avoid having the professional transfer or loan any property to the professional corporation. To the extent that a transfer or loan of property is made by the professional to the corporation and a spouse or minor child holds shares, the professional must be paid dividends or interest annually on the shares or on the loan to avoid corporate attribution. The corporate

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[14] ss. 74.4(2) of the ITA

[15] ss. 248(1) of the ITA

attribution rule only applies if the corporation is not a small business corporation and there is an income-splitting purpose behind issuing shares to a spouse or minor child. In general, the main reason why a spouse and/or minor child would acquire shares in a professional corporation is to achieve effective income splitting so the purpose test is usually met.

If corporate attribution applies, the lender or transferor is deemed to have received a taxable benefit calculated by multiplying the fair market value of the property loaned or transferred by the prescribed rate outstanding for the applicable period. To illustrate, if the professional transferred office equipment worth $100,000 to the professional corporation for voting common shares and as of December 31, 2009 the professional corporation ceased to qualify as a small business corporation, the professional would be deemed to have received a taxable benefit calculated as follows: $100,000 x the prescribed rate in effect for each quarter of 2009. If the professional had received dividends on the common shares during 2009, the benefit is reduced by 5/4 of the taxable dividends received.

The corporate attribution is onerous because if the professional received no dividends and no dividends were paid to the spouse and children who are also shareholders, the application of the rule results in double tax for the professional who is taxed on income he or she did not receive and this occurs even though the professional corporation was not used to income split during the year.

Life Insurance Planning

Most professionals purchase life insurance and disability insurance. If the professional corporation owns the life insurance policy and is the designated beneficiary under the policy, the premiums can be paid out of the cheaper after-tax corporate income. When the professional incorporates the professional practice, it is worthwhile to consider transferring life insurance policies to the corporation. Caution should be exercised because a transfer of the policy may be a taxable event if there is a policy gain in respect of the life insurance policy. Term life insurance, which is the most common form of life insurance, does not have a policy gain but other forms of life insurance (e.g. universal life insurance) may have a policy gain and it is prudent to confirm with the life insurance company whether the transfer of a particular policy would trigger a policy gain.

Any investment income earned in the corporation is taxed at the top corporate rate. Consideration should be given to investing excess funds retained in the corporation into an exempt life insurance policy. This type of life insurance has both an insurance and an investment component. The investment component earns investment income inside the policy which is exempt from tax. At the death of the life insured, the corporation receives the life insurance proceeds which can be paid out to the deceased shareholder's estate as a tax-free capital dividend. In addition, the corporation may be able to borrow against the cash value of the policy to fund dividends or bonuses.

In general, it is better for the professional to retain personal ownership of disability policies. This is because disability policies are designed to replace lost income when the professional is too ill to carry on the professional practise. If the corporation pays the premiums, the professional will be receiving a shareholder benefit[16] and would be taxable on that benefit. The corporation would derive no benefit from being the owner of the policy as disability payments would be payable only to the professional personally.

Retirement and Pension Planning

A self-employed professional usually has no pension plan and must rely solely on saving for retirement through RRSPs. A professional corporation has the ability to make a tax-deductible contribution to an individual pension plan or to set up a retirement compensation arrangement. These options expand the ability of the professional to save for retirement and are only available to corporations. Life insurance is a key component to funding these types of retirement vehicles.

Probate Planning

The other benefit to incorporating the professional practice is the ability to dispose of the shares of the corporation through a separate will, thereby avoiding the Ontario estate administration tax ("probate tax") on the death of the shareholder. As value builds up in the professional corporation, saving probate tax will be a benefit although, with probate tax at 1.5%, it is not as significant as the benefit derived from deferring income tax on the corporate revenue that can be retained in the corporation.

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[16] See ss.15(1) of the ITA

Should the Professional Incorporate?

Before incorporating the professional practice, the professional should do a cost benefit analysis to compare the tax deferral advantages, the potential income-splitting advantages (including the possibility of accessing the CGE for the professional and other family members), and the retirement savings advantages against the costs to incorporate and maintain the corporate structure. Like all good tax planning, it is important to implement and maintain the structure properly. Some professionals may not want the additional complexity unless they can quantify the tax benefits and be assured that the benefits outweigh the costs.

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Professional Corporations

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Benefits of Incorporating a Professional Practice

– Deferral of tax
– Access to capital gains exemption
– Income splitting opportunities
– Life insurance planning
– Retirement planning

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Disadvantages of Incorporating a Professional Practice

- Complexity
- Costs to incorporate and maintain corporation
- Payroll remittances
- Avoiding application of
  - shareholder benefit rules
  - income tax attribution rules
  - "specified partnership income" rules
  - personal services business rules

Professionals Who May Incorporate

- Medical doctors and other healthcare professionals governed by the *Regulated Health Professions Act*
- Accountants
- Lawyers
- Social workers
- Veterinarians
- Architects
- Engineers
- Any other professionals whose governing statute expressly permits it

No Limitation of Professional Liability

- OBCA deems the acts of a professional corporation to be the acts of the shareholders, employees or agents of the corporation
- Limited liability is available for claims unrelated to professional errors and omissions
  - trade payables
  - office lease costs
  - bank loans <u>not</u> personally guaranteed by shareholders

Deferral of Tax

- 16.5% rate on first $500,000 of active business income
- Top personal rate is 46.4% which applies to income over $126,264
- 30% rate differential permits investment of more after-tax corporate income than would be available to invest personally
- Investment income taxed at 47.13% in Ontario corporations
- Corporate rate will decline to 44.71% by 2014

Deferral of Tax continued …

- Assume $300,000 of net professional income <u>after</u> expenses
- Professional needs $150,000 to fund lifestyle
- Professional contributes maximum to RRSP

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Deferral of Tax continued …

- If professional earns $300,000 personally
  - contributes $21,000 in 2009 to RRSP
  - personal taxes = $111,000
  - this leaves $168,000 after tax
  - can save $18,000 o/s RRSP

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Deferral of Tax continued …

- Assume professional corporation earns $300,000 and pays salary of $270,000 to professional
  - professional contributes $21,000 in 2009 to RRSP
  - Professional pays $97,000 in personal tax
  - Corporation pays $4,950 in tax
  - Corporation can invest $25,050
  - $7,050 more to invest!

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Deferral of Tax continued …

- After-tax corporate income can be used to invest in land, buildings, equipment and other assets used to carry on the professional practice

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Deferral of Tax continued …

- Priority should be given to contributing to RRSP and TFSA
- These accounts must be held personally
- RRSP contribution room depends on "earned income"

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Capital Gains Planning

- Lifetime $750,000 CGE
- Technical requirements include 90% of FMV of assets be used to carry on active business
- Active business assets include office space, equipment, etc.
- Active business assets do not include passive investments, i.e. cash, stock portfolio, GICs, etc.

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Capital Gains Planning continued …

- Must dispose of shares of qualifying small business corporation to claim CGE
- Is the professional likely to sell the shares of the professional corporation?
- Death will trigger a deemed disposition

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Capital Gains Planning continued …

- Goal of taking advantage of deferral opportunity may conflict with goal of using CGE
- Can the professional corporation be "purified"?
- "Purifying" a small business corporation requires regularly removing passive investments to meet 90% test

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Capital Gains Planning continued …

- Inserting a holding company between the professional and the professional corporation would permit effective "purification"!
- Medical doctors are prohibited from issuing shares in a professional corporation to a corporate shareholder
- Lawyers may be able to allow a holding company to be a shareholder of the professional corporation
- Check regs governing the professional practice before issuing shares to a holding company

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Income Splitting Advantages

- 2009 Progressive Tax Rates

– <u>FEDERAL</u>

up to $37,885	-	15%
$37,886 to $75,769	-	22%
$75,770 to $123,184	-	26%
$123,185 and over	-	29%

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Income Splitting Advantages continued …

– 2009 Progressive Tax Rates

– <u>ONTARIO</u>

up to $36,020	-	6.05%
$36,021 to $72,041	-	9.15%
$72,042 and over	-	11.16%

Income Splitting Advantages continued …

– If Ontario resident individual has no other source of income:
  – $37,775 of "non-eligible" dividends can be received tax free
  – $69,830 of "eligible" dividends can be received tax free

Eligible vs. Non-Eligible Dividends

- **Eligible**: paid from “high rate” corporate income, e.g. investment income
- **Non-eligible**: paid from “low rate” corporate income, e.g. active business income
- Professional corporations will generate “low rate” income
- Must clear out “low rate” income <u>before</u> paying “eligible” dividends

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Kiddie Tax

- Dividends paid to children under 18 will be taxed at top rate
- Kiddie Tax prevents income-splitting with minors
- Still worthwhile issuing shares to a minor (or a trust for a minor) to be in a position to pay dividends when child turns 18
- Cannot issue shares after incorporation when value has built up without doing an estate freeze

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Spousal Attribution

- If issuing shares to a spouse of a professional, spouse must pay FMV for shares to avoid spousal attribution
- Issue shares on incorporation for nominal cost before value builds up in corporation
- Can pay spouse and other family members a salary if they render services to professional corporation
- If salary is paid to spouse, dividends may put spouse into higher rate bracket

Corporate Attribution

- If professional transfers or loans property to the professional corporation, corporate attribution rules could apply
- Applies where a spouse or minor child/ children are shareholders
- < 10% of shares of a class will not trigger corporate attribution but family members who are not licensed professionals generally hold a separate class of non-voting shares

Corporate Attribution continued …

- If corporate attribution applies:
  - lender/transferor is deemed to receive taxable income
  - creates potential for double tax!!
  - see paper for formula to calculate taxable income

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Life Insurance Planning

- If professional corporation is owner of the life insurance policy, premiums can be paid from after-tax corporate income
- **Caution**: Be sure no tax is triggered on a transfer of life insurance policy by professional to the professional corporation
- Transfer of life insurance policy could trigger corporate attribution if spouse and/or minor children are shareholders!

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Retirement Planning

- Professional corporations can contribute to an individual pension plan and/or a retirement compensation arrangement
- This presents another deferral opportunity
- RRSP may not be enough to provide adequate retirement income!

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Probate Planning

- Shares of professional corporations can be disposed of in a separate Will to avoid probate tax
- Probate tax is only 1.5%
- This is an additional benefit, but not as valuable as the deferral opportunities

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Disadvantages of Professional Corporations

- Costs to incorporate and maintain structure
  - payroll remittances for salary paid to professional and any family members
  - may need employment contracts
  - if professional partnership exists, need to avoid specified partnership income rules
  - annual financial statements and corporate tax returns
  - annual renewal of certificate of authorization

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Disadvantages of Professional Corporations continued …

- Shareholder benefit rules
- Personal services business rules
- Complexity!

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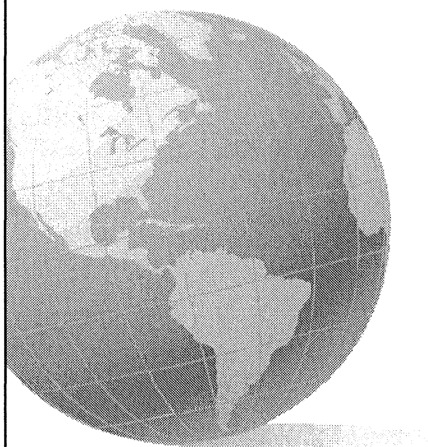

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