

## The CORPORATE Toolkit

# The Incorporation Question

Accountants are constantly asked “Is it better to incorporate?” The answer is a resounding, “It depends”.

The decision to incorporate is a complex, yet vital step, in the development of your business. This decision is best considered at the start-up of your business with the help of a professional. Together, you can evaluate whether or not to incorporate immediately or defer it to a more advantageous time.

### Advantages of Incorporation\*

- Tax deferral.** Corporations can utilize the bonus mechanism, which can **defer** income into the future.
- Lower rate of tax.** Corporations qualifying for the Small Business Deduction (SBD), enjoy a lower rate of tax on profits\*\* that are left in the corporation.
- Increased tax flow.** Corporations that qualify for the SBD can reinvest more income into the business because of the lower rate of tax on profits. This increased cash flow can reduce the risk of failure in the early years.
- Income splitting with family members.** With the correct share structure, income splitting among family members is sometimes possible.
- Flexibility in reporting income.** Corporate profits can be distributed as salary or dividends or a combination of both.
- Limited liability.** Personal assets are generally not put at risk provided there are no personal guarantees and all source deductions are paid up.
- Perception.** The corporate structure gives the perception of professionalism and stability.
- Indefinite life.** A corporation continues to exist if the owner dies.
- Your choice of year-end.** In its first year, a corporation can arbitrarily chose the year-end that is the most advantageous.
- \$971,190 Capital Gains Exemption on Qualifying Small Business Corporation Shares.** May be available on the sale of shares of the business.

### Disadvantages of Incorporation\*

- Tax deferral is not a tax saving.** Profits in the corporation are taxed at a lower rate only if they are left in the corporation. Once profits are distributed to the owner/manager or shareholders, they are taxed at the personal level and the tax saving is reduced or lost.
- Operating losses.** Corporate losses cannot be utilized on your personal income tax return to reduce income from other sources.
- Incorporation costs.** Costs will vary depending on whether a law firm is used or you do it yourself online. Legal costs usually start at \$1200 and annual filing fees start at \$350. It is important to seek professional advice on the share capital structure to maximize future tax savings and avoid reorganization costs in the future.
- Increased paperwork.** A formal accounting system is required to complete and file the T2 Corporation Income Tax Return. Setting up the system effectively will reduce bookkeeping time and provide valuable financial information. The trend towards formal systems has increased for all business structures and this may be a cost that would be incurred anyway.
- Increased legal and accounting fees.** Corporations must make annual filings with the Minister of Finance and must maintain a Minute Book. Annual legal costs usually start at \$350/yr and annual filing fees start at \$45. Accounting fees vary for the preparation of financial statements and the corporate tax return.

\* This is not an exhaustive list

\*\* Income must meet the requirements of S125(1) of the *Income Tax Act*

This information is current to February 2023. It is of a general nature and is not intended to address the specific circumstances of a particular individual. You should not act on this information without appropriate professional advice after thorough examination of a particular situation. E&OE