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Professional Corporations in Ontario

Originally the primary purpose for a business to incorporate was to limit the potential personal liabilities that could arise against a business owner. However the ability to incorporate for professionals such as doctors and dentists specifically does not create any additional protection on professional liability. Professionals still need to protect themselves through due diligence and professional liability insurance.

There are however some potential advantages of incorporating in regard to saving or **deferring income taxes**.

In Ontario private companies pay tax on business income at a rate of about 18.6%. The top marginal rate for individuals is about 46.4%. If the professional can afford to leave behind income in the company the income left in the corporation would be taxed at only 18.6% and the company can build up a greater amount of savings in less time than an individual who is taxed directly. This however is only a tax deferral in that once the professional takes these earnings out of the company at a later stage in the form of a dividend, most or all the tax previously saved would then be paid. It should be noted that investment income earned on these “savings” would be subject to a higher rate of tax than business or professional income and in all probability should be taken out of the corporation annually in the form of a dividend.

The big change that was introduced for 2006 allows doctors and dentists to do some significant **income splitting**. These professionals can now incorporate and issue non-voting shares to family members. Whilst one can not use a family trust, shares can be issued to minors “in-trust”. However the income tax rules do not make it worthwhile issuing dividends to children until the year they turn 18. If the doctor has a lower income spouse, parents, grandparents or adult children, the doctor could possibly, each year pay varying amounts of dividends to the various family members. This creates an excellent opportunity to pay dividends to students who are invariably in low tax brackets. A $30,000 dividend to a student might incur no taxes, yet the parent professional would have paid $10,000 on this same dividend. The company needs to be created with the correct structure to allow this type of dividend “sprinkling”. Since the dividends are taxed in the hands of the recipients they will pay either no tax or very little compared with the 32% tax paid by the professional in the top income tax bracket.

To really benefit immediately from incorporating, higher income professionals should ideally have low income adult family members who they support or they have bought their homes and fully paid off their mortgages. On every $10,000 left behind in the company they would defer $2,800 of income taxes. On every $10,000 paid to a low income adult dependent they could have a permanent saving of as much as $3,000.

Another consideration is that by building up savings in a company a professional may be able to remove the savings from the company at a later date when perhaps his or her income is low. This may be in a “sabbatical year”, or perhaps in early retirement. This would indeed allow for more tax savings than an unincorporated professional would experience.

Conclusion

This short article gives a brief insight into some of the considerations regarding incorporating a professional practice. It would be best to review these matters and have a discussion with Gary Friedlander or Jack Kurin of our office at 416-492-1881. They could advise you in regard to your personal situation and go over some of the benefits and disadvantages of a professional corporation. They could also guide you through the whole process of creating your own professional corporation.

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