NEWSLETTER

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ADVANTAGES OF INCORPORATION

■ A corporation may be used to split income with family members who are often taxed at a lower tax rate than the individual managing the business.

A business may pay reasonable salaries to family members, whether it is incorporated or not. However, if the business is incorporated, the spouse may subscribe for common shares of the company using his or her own funds. In this way, dividends paid to the shareholder-spouse result in income splitting. Such planning is worthwhile if the spouse has a low income and cannot be paid a salary. However, consideration should be given to attribution rules that may apply.

A corporation is also a very useful tool for freezing an estate for the benefit of family members whereby the increase in the value of certain property is transferred to other beneficiaries, enabling them to use the CGD.

■ A corporation may offer certain non-taxable benefits to its employees. An unincorporated business owner may not take advantage of these benefits because he cannot be an employee of his business.

Such benefits include disability insurance premiums, premiums to a private group health insurance plan, and interest-free loans, provided that certain conditions are met. In addition, a death benefit of up to $10,000 may be paid to the surviving spouse without any tax consequences. Other tax planning measures, such as the payment of a retiring allowance or the declaration of a bonus, is also possible.

■ Because the corporate tax rate is lower, the corporations' cash requirements are thus reduced, leaving more cash for operations, acquisitions, and expansion.

■ For an individual whose income fluctuates significantly from year to year, the use of a corporation allows for the accumulation of income in the corporation, which enjoys a reduced tax rate for the years in which the individual's needs are lower. The income is then paid to the individual in a year when his other income is not sufficient to meet his needs. In this way, the individuals' income is consistent from year to year and income taxes may be minimized.

■ Given that the $375,000 CGD is available for a gain on the disposition of qualifying small business shares, carrying on a business through a corporation could be more advantageous than carrying on the business under personal name.

DISADVANTAGES OF INCORPORATION

■ Using a corporation entails some legal and accounting fees on incorporation, such as fees for obtaining the articles of incorporation, and each year thereafter, the preparation of financial statements and annual minutes.

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■ To realize substantial tax savings, the profits of the corporation must accumulate within the corporation, except where income splitting is possible.

■ Losses incurred by a corporation that does not have sufficient income to absorb such losses cannot be used by the shareholders to reduce their own personal income.

CORPORATE TAX RATES

Description	Federal Rate
Base Rate	38% of taxable income
Tax Abatement	10% reduction
SBD Rate	17% reduction available up to $400,000
Net Tax Rate	11% of taxable income

Description	Ontario Rate
Net Rate	5.5% of taxable income up to $400,000
Net Rate	8.5% of taxable income in excess of $400,000

PROFESSIONAL CORPORATIONS

■ Bill 152 allows regulated professionals to incorporate their practices. Professional incorporation confers many of the same tax and non-tax advantages enjoyed by other incorporated self-employed individuals. However, professional liability will not be limited through incorporation.

ADVANTAGES OF PROFESSIONAL CORPORATIONS

■ Professional corporations are subject to a reduced income tax rate on their 1st $400,000 of active business income.

■ Each year, a professional corporation can pay out compensation in the form of a salary, dividend or bonus.

■ Bonuses paid by a corporation can be deducted by the corporation in the current year. But payment of the bonus to the employee can be delayed for 179 days, creating income for the professional in the following tax year and generating a tax deferral.

■ The ability to utilize the $375,000 capital gains exemption upon sale of the corporate shares.

■ Within a corporation, professionals can deduct the cost of attending more than 2 conventions each year. Normally, professionals without a corporation can only write off the cost of 2 business related conventions in a year.

■ Corporations can own their own group, sickness and insurance policies allowing the premiums to be paid out of pre-tax income instead of personal after tax income if the policies are owned personally.

DISADVANTAGES OF PROFESSIONAL CORPORATIONS

■ Professional corporations cannot limit liability for malpractice.

■ To be eligible for the capital gains exemption, the potential buyer must be willing to purchase your practice as a total package.

■ Professionals with existing corporations must be careful to avoid association rules.

■ Income splitting is not possible unless your family members own shares of the corporation.

PERSONAL TAX RATES 2010

Federal Rate	Taxable Income
15%	$0 to $40,970
22%	$40,971 to $81,941
26%	$81,942 to $127,022
29%	Over $127,022

Ontario Rate	Taxable Income
5.05%	$0 to $37,106
9.15%	$37,107 to $74,214
11.16%	Over $74,214

BUSINESS AND PROFESSIONAL EXPENSES

According to Income Tax Act section 18(1)(a), in order for an expense to be deductible, it must have been made or incurred for the purpose of gaining or producing income from a business or property.

Receipts for business expenses do not need to be filed with your tax return, but should be retained in an orderly fashion for presentation on a subsequent review of your return by the tax authorities. Court decisions have continually supported the disallowance of numerous types of expenses because they were not adequately substantiated. All these cases have shown the importance of maintaining a complete record of expenses.

PAYROLL RATES

Item	Rate	Maximum
CPP	4.95%	$47,200 less $3,500
EI	1.73%	$43,200
Vacation	4.00%	NA

■ Dues and Subscriptions

Club membership dues, including initiation fees cannot be deducted if the main purpose of the club is dining, recreation, or sporting activities.

■ Meals and Entertainment

Section 67.1(1) of the ITA states that 50% of meals and entertainment is not deductible under the following conditions:

➔ cost of meals (including beverages) in restaurants, offices or elsewhere.

➔ meal allowances paid by an employer that are not included in the employees' income.

➔ cost of tickets to attend sporting, recreation and entertainment events.

➔ cost of rental of recreation or sporting events and equipment.

➔ cost of meals incurred while attending a convention, conference or other similar event.

Section 67.1(2) of the ITA provides several exceptions to the 50% restriction:

➔ your regular business is to provide food, beverages, or entertainment to customers for compensation (includes a restaurant or hotel).

➔ you bill your client or customer for the meal and entertainment costs, and you show these costs on the bill.

➔ where the amount is included in computing the income of an employee as a taxable benefit.

➔ you incur meal and entertainment expenses to provide a Christmas party or similar event, and you invite all your employees. However, there is a limit of 6 of these events each year.

➔ where the expense relates to a fund-raising event, the primary purpose of which is to benefit a registered charity.

■ **Employee Expenses**

Eligible employees who qualify under form T2200 will be allowed to claim certain expenses relating to their employment.

■ **Private Health Services Plan**

Health and dental premiums are deductible and subject to a limit of $1,500 for yourself, $1,500 for your spouse, $1,500 for household members 18 years of age or older, and $750 for household members under the age of 18.

■ **Persons Living with Disability**

To be eligible for a disability tax credit, a disability tax credit certificate form T2201 must be completed and signed by a doctor or optometrist. Usually, individuals with a severe and prolonged mental or physical impairment, lasting at least 12 continuous months qualify for the tax credit.

■ **Medical Expenses**

Medical expenses must accumulate more than 3% of line 236 net income or $2,011 whichever is less, before any tax credit occurs.

■ **RRSPs, RPPs, DPSPs and LSVCC**

Contribution limits for RRSPs and RPPs are set at $19,000. RRSP contributions must be made by March 1, 2011. ***Interest paid on money borrowed to contribute to an RRSP is not deductible.***

RRSPs, RPPs, and DPSPs will mature when the holder reaches age 71. At that time it is recommended that the holder transfer their money to an annuity or RRIF. This will prevent taxation on a lump sum of money on the year the taxpayer turns 71.

Spousal RRSPs allows the older spouse to contribute for the benefit of the younger spouse while deducting the contribution on the elder spouses' return.

LSVCCs are investments sponsored by labour organizations that entitle the contributor to federal and provincial tax credits of 15% each on a $5,000 investment for combined federal and provincial tax credits totaling $1,500.

■ **RESPs**

The income earned within this plan may be sheltered from tax for a maximum of 25 years. It is not taxable until used to finance post secondary education costs, at which time it will be included in the recipients' income.

■ **Deadlines, Penalties and Interest**

➔ Personal returns are due on or before April 30, 2011. Balance owing is due on or before April 30, 2011.

➔ Tax returns for sole proprietorships, partnerships and limited partnerships are due on or before June 15, 2011. Balance owing is due on or before April 30, 2011.

➔ Corporate tax returns are due 6 months after year end. Balance owing is due 2 months after year end.

➔ T4 payroll summary and T5 investment summary must be filed by February 28, 2011.

➔ Late filing penalty of 5% + 1% will apply to all outstanding balances owing.

➔ Repeated failure to file, a penalty of 10% + 2% will apply.

➔ Interest on all outstanding balances owing will be computed at the prescribed rate from the day on which the amount was required to be paid to the day payment was received by CRA.

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