



Chartered Accountants

255 Duncan Mill Road
Suite 402, North York,
Ontario M3B 3H9
Phone: (416) 510-8888
Fax: (416) 510-2699
Email: dcy@dcy.ca

Surfing Ontario's New Tax Wave

by J. Chevreau (National Post, October 2003)

Incorporation one way of avoiding McGuinty's bite

Like the province's corporations, Ontario's high-income professionals are resigned to paying significantly higher taxes under the new Dalton McGuinty administration. Since last Thursday's election, professionals have been calling to find out how to minimize the coming wave of taxes, says David Chong Yen, a North York accountant whose clientele is mainly dentists.

"Frankly, most of them voted for the Conservatives," Chong Yen says. One lost bit of relief on the personal tax front involves the provincial surtax. The Ontario surtax is higher than any other province's, and even the federal government abolished its version.

Had Ontario's Tories remained in power, the surtax would have been phased out for those earning between \$59,000 and \$70,400. Someone earning \$70,000 can expect to pay \$400 more in tax in 2004 because of the planned Liberal rollbacks, says Paul Hickey, national tax partner for KPMG.

Far harder hit are taxpayers with children in private schools. Had the Eves Tories stayed in power, the private school tax credit would have been worth \$3,500 a year for each child by 2006. Next year, someone with two kids in private school will pay \$4,622 more taxes than they would have under Eves, Hickey says.

Professionals also face higher taxes from the Liberal plan to roll back Tory cuts to corporate taxes.

Consider the tax bit if a professional's income is earned and taxed like a salaried employee.

Someone with \$400,000 would lose \$170,000 to taxes. Those at the lofty level of \$1-million will forfeit almost half - \$448,400 - to income tax.

Few high-income professionals pay that much, however. Because of various structures, doctors and dentists have flexibility in avoiding or deferring the top marginal tax rates.

Since 2001, Ontario professionals have been able to establish professional corporations (PCs). A PC is a sophisticated tax-deferral vehicle like an RRSP. The first \$225,000 of income is taxed at just 18.62% instead of the top marginal rate of 46%. After that, corporate taxes rise with profits, and the rollback to corporate tax rates will also affect those with PCs, Chong Yen says.

However, accountants and tax professionals have other techniques to rebuff the Liberal tax tide.

Dentists have three options: being an independent contractor, an employee or a professional corporation (PC). The Liberal landslide will be an impetus to push more professionals into PCs,

Chong Yen predicts.

"Given the fact taxes will not be lowered, you want to investigate the PC option more vigorously if you have virtually no personal non tax deductible debt."

Those with high debt should pay it off before going the PC route, he says.

One strategy is for the PC to establish the dentist as a salaried employee of the corporation. The dentist's PC would pay him \$85,000 a year, which allows maximization of the RRSP this year, and raise the salary in future years in line with the new RRSP maximums established in the last federal budget. Everything else remains in the corporation.

The PC also facilitates income splitting. Other family members can be paid a reasonable salary to handle certain, routine office tasks and other functions.

An alternative to PCs is a technical or hygiene service corporation, which operate the hygiene or technical service components of a dental practice. This corporation does not charge GST.

Chong Yen recommends the THSC be owned through a discretionary family trust. Profits remaining in the THSC can be paid out as dividends to individuals to facilitate income splitting among family members. More than \$29,000 of dividends can be received tax free if the individual is 18 or older and has no other source of income.

Shares of a THSC also qualify for the \$500,000 capital gains exemption and can provide protection against creditors.

Professionals can also defer taxes with retirement savings vehicles such as Individual Pension Plans (IPPs) and Retirement Compensation Agreements (RCAs). An RCA allows millions of dollars to be tax-sheltered in retirement savings, versus the current \$14,500 annual limit for RRSPs. IPPs are a form of Defined Benefit pension plan for business owners.

For those who plan to retire in foreign countries with a tax treaty with Canada (i.e. the United States) Chong Yen recommends RCAs. For those who intend to retire in Canada, Chong Yen prefers IPPs.

Despite set-up costs of \$3,000 for IPPs and \$5,000 for RCAs, "whenever tax rates become more punitive the use of these vehicles will only expand," says Trevor Parry, senior vice president for Gordon B. Lang & Associates.

David Chong Yen, CFP, CA with an international firm background and more than twenty-four years of experience, advises healthcare professionals and owner-managers. Additional information can be obtained by phone (416) 510-8888, fax (416) 510-2699, or Email david@dcy.ca.

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