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Incorporation of Your Dental Practice Part 1 - Volume 7 by David Chong Yen (Nov. 2002)

This is the first of a two part article addressing issues surrounding the incorporation of a dental practice.

OVERVIEW

The following issues will be addressed over the course of the next two articles:

1. Tax and other benefits of incorporating which will be addressed in this issue
2. Prerequisites
3. Restrictions, traps and disadvantages.

1. Benefits of Incorporating

The main tax benefits of incorporating can be summarized as follows:

- a) **Low corporate tax rate** of 19.12% on the first \$200,000 of taxable income (revenues minus expenses); compared with the top personal tax rate of 46.41%.
- b) **Flexibility with respect to remuneration** (salaries vs. dividends, as well as being able to time when salaries and dividends are paid); the incorporated professional can choose between dividends and salaries. The corporation serves much like a tap enabling you to time when salaries and dividends are paid to yourself. The optimum mixture of dividends and salaries will be affected by the following constraints:
 - i. In order to utilize one's \$13,500 RRSP contribution limit, \$75,000 of salaries is required.
 - ii. Generally speaking, salaries should be paid to the professional in order to reduce the taxable income of the professional corporation to \$200,000.
- c) **\$500,000 Capital Gains Exemption** may be available when you sell the shares of the professional corporation or if the professional dies (whichever comes first);

- d) **\$10,000 death benefit** can be received tax-free by the professional's surviving spouse; the corporation is able to deduct this amount as an expense in the calculation of its income;
- e) **Home office expenses** restrictions appear to apply to individuals, but not corporations;
- f) **A non-calendar year end** may be used by corporations, thereby enabling the deferral of income, and hence income taxes;
- g) **One-time deferral** is available as no tax installments are required during the first fiscal year of the professional corporation;
- h) **Tax deferral** is available. An individual in the top tax bracket can defer approximately \$55,000 of taxes by retaining \$200,000 of income in the professional corporation (i.e. $\$200,000 \times (46.41\% - 19.12\%)$). Also, **Tax deferral** is available since the professional corporation can receive a tax deduction for services rendered by the professional to the corporation in one fiscal year while the tax bill of the individual professional may be deferred until he/she receives the salary or bonus which could be up to 179 days after the fiscal year end of the professional corporation;
- i) **Enhance your retirement income** by using a professional corporation. Specifically, a professional corporation may make tax-deductible contributions to an individual pension plan or it may establish a retirement compensation arrangement (RCA). Contributions to the RCA are subject to a 50% tax which is refundable to the RCA when it distributes monies to the beneficiaries;
- j) **No employment insurance** is payable on salaries paid to the professional if the professional owns more than 40% of the professional corporation.

Limited Liability

An incorporated professional may be able to protect oneself from suppliers and lease liabilities if he or she does not personally guarantee payment. However, the incorporated professional will be liable for all professional malpractice claims made against the professional corporation.

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This article is intended to present tax saving and tax planning ideas and is not intended to replace professional advice.