

Information Sheet
Why Incorporate?

MOST COMMON REASONS THAT BUSINESSES INCORPORATE

1. Limited liability
 - Risk of financial loss is restricted to assets owned by corporation
 - Your personal assets such as home, Cottage, investments etc., are not exposed to lenders or creditors
 - Lenders will often make shareholders personally guarantee corporate loans (which must still be honoured)
2. Tax advantages
 - Possibility of a capital gains exemption when the business is sold, or ownership is transferred
 - Income splitting possibility through the payment of dividends
 - Increased flexibility with respect to remuneration (salary vs. dividend)
 - Business can be passed on to the next generation by way of an Estate Freeze
 - Non-calendar year-ends and bonus deferral possibilities
3. Tax deferral
 - The corporate tax rate on the first \$500,000 of business income is approximately 15.50% as compared to individual tax rates, which can be as high as 46.41%
 - This **tax deferral** only works if the money is not paid out to the shareholders (cash remains in the company for business use). Although a second level of tax is paid on a subsequent distribution of income, the ability to defer this second level of tax provides for the on-going benefits of incorporation
4. Required by customers
 - E.g. - Consulting

WHEN IS THE CORRECT TIME TO INCORPORATE?

1. Determine the potential risk of liability
 - From the beginning of business operations if risk is high
 - Depends on shareholders attitude towards risk
 - Consider shareholder's personal assets which may be exposed
2. Determine business profit potential
 - It is common for losses to occur in early years of operation
 - Corporate losses can only be applied against **corporate** income
 - Unincorporated losses can be applied against all other personal incomes
 - One may want to operate as proprietorship (partnership) and incorporate when profitable
3. Determine if business is likely to generate more cash than shareholders require personally
 - Remember that the low corporate tax rate (15.50%) is only of **benefit if the cash remains in the company** (not paid as salary to shareholders)

DIFFERENCE BETWEEN INCORPORATED AND NON-INCORPORATED ENTITIES

1. Incorporated entities

- Company is treated as a separate entity from owners (shareholder(s))
- Owners become employees of the corporation and normally receive salary/dividends
- Company must file an annual corporate tax return, shareholders file personal tax returns as usual
- Corporation is taxed at approximately 15.50% on first \$500,000 of active business income
- Corporate tax instalments may be required after the first year-end

2. Non-incorporated entities

- Calendar year-end (December 31)
- No special government filings, business results included on your personal tax return
- Proprietors "draw out" money for personal needs, but taxed on business results (at individuals marginal rate) regardless of drawings
- Tax instalments may be required after the first year-end

PITFALLS OF INCORPORATING

- With respect to investment and capital gain income, incorporating may result in a prepayment of tax
- Increase of administrative costs, including the cost of incorporating, preparation of corporate tax returns, other filings

For more information, and to connect to the Ministry of Government Services website click [HERE](#)

Please call us at 905-898-4900 if you have any questions regarding the above