

# **The Canadian Dental Protective Association**

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**2000 Annual General Meeting**

**Dinner and Seminar**

**“Incorporation...Is It Right For You?”**

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## Professional Corporations and Other Provinces

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- ✦ In 1997, approximately 65% of all registered dentists in British Columbia were incorporated.
- ✦ Other provinces where dentists can incorporate include all provinces in Canada except for Ontario and Quebec and Ontario has announced its intentions to allow for such incorporation.
- ✦ Problem: The Income Tax Act has not caught up with the provinces (i.e. reserve carry forward for professionals)

## Corporations Generally

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- ◆ **Tax Rates/Tax Deferrals/Tax Deductions**
- ◆ **Estate Planning**
- ◆ **Capital Gains Exemption**
- ◆ **Limited Liability**

## Differences Re: Professionals

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- ✦ **No limited liability for dentists**
- ✦ **Professionals must own shares (no income splitting, no estate freeze, unless professionals are involved)**
- ✦ **Reserve amount may be brought into income**

## Top Marginal Rates In Ontario For Individuals

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	Year 2000	Year 2001
Ordinary Income	47.86%	47.57%
Canadian Dividends	32.31%	32.12%
Capital Gains (Post Feb.27/2000)	31.91%	30.90%

# Combined Corporate Federal and Ontario Tax Rates

<b>COMBINED CORPORATE FEDERAL AND ONTARIO TAX RATES</b>		
	<b>2000 (POST MAY 2/2000)</b>	<b>CALENDAR 2001</b>
<b>ACTIVE BUSINESS INCOME UP TO 200K</b>		
FEDERAL	13.12%	13.12%
ONTARIO	7.00%	6.50%
<b>TOTAL</b>	<b>20.12%</b>	<b>19.62%</b>
<b>ACTIVE BUSINESS INCOME BETWEEN \$200K TO \$240K</b>		
FEDERAL	29.12%	22.12%
ONTARIO	19.50%	6.50%
<b>TOTAL</b>	<b>48.62%</b>	<b>28.62%</b>
<b>ACTIVE BUSINESS INCOME BETWEEN \$240K AND \$300K</b>		
FEDERAL	29.12%	22.12%
ONTARIO	19.50%	19.00%
<b>TOTAL</b>	<b>48.62%</b>	<b>41.12%</b>
<b>ACTIVE BUSINESS INCOME BETWEEN \$300K AND \$500K</b>		
FEDERAL	29.12%	29.12%
ONTARIO	19.50%	19.00%
<b>TOTAL</b>	<b>48.62%</b>	<b>48.12%</b>

## Combined Corporate Federal and Ontario Tax Rates

<b>ACTIVE BUSINESS INCOME BETWEEN \$500K AND \$600K</b>		
FEDERAL	29.12%	29.12%
ONTARIO	14.50%	19.00%
<b>TOTAL</b>	<b>43.62%</b>	<b>48.12%</b>
<b>ACTIVE BUSINESS INCOME OVER \$600K</b>		
FEDERAL	29.12%	29.12%
ONTARIO	14.50%	14.00%
<b>TOTAL</b>	<b>43.62%</b>	<b>43.12%</b>



# Combined Corporate Federal and Ontario Tax Rates - Example

TAX ON DISTRIBUTION OF \$10,000 OF ACTIVE BUSINESS INCOME ELIGIBLE FOR FEDERAL SMALL BUSINESS DEDUCTION – YEAR ENDING DECEMBER 31, 2000		
	<u>E.H.T. ON FULL SALARY</u>	<u>NO E.H.T.</u>
<b>DIVIDENDS</b>		
CORPORATE TAX	2,045 <sup>(1)</sup>	2,045 <sup>(1)</sup>
INDIVIDUAL TAX	2,571	2,571
<b>TOTAL</b>	<b>4,616<sup>(2)</sup></b>	<b>4,616<sup>(2)</sup></b>
<b>SALARY</b>		
INDIVIDUAL TAX	4,694	4,786
E.H.T.	191	-----
<b>TOTAL</b>	<b>4,885<sup>(3)</sup></b>	<b>4,786<sup>(3)</sup></b>
TAX SAVINGS	269 (2.69%)	170 (1.70%)
TAX DEFERRAL	2,840 (28.40%)	2,741 (27.41%)
TAX SAVINGS <sup>(3) - (2)</sup>		
TAX DEFERRAL <sup>(3) - (1)</sup>		
ASSUMES TOP MARGINAL TAX RATE FOR INDIVIDUALS		

# Combined Corporate Federal and Ontario Tax Rates - Example

TAX ON DISTRIBUTION OF \$10,000 OF ACTIVE BUSINESS INCOME ELIGIBLE FOR FEDERAL SMALL BUSINESS DEDUCTION – YEAR ENDING DECEMBER 31, 2001		
	<u>E.H.T. ON FULL SALARY</u>	<u>NO E.H.T.</u>
<b>DIVIDENDS</b>		
CORPORATE TAX	1,962 <sup>(1)</sup>	1,962 <sup>(1)</sup>
INDIVIDUAL TAX	2,597	2,597
<b>TOTAL</b>	<b>4,559<sup>(2)</sup></b>	<b>4,559<sup>(2)</sup></b>
<b>SALARY</b>		
INDIVIDUAL TAX	4,666	4,757
E.H.T.	191	-----
<b>TOTAL</b>	<b>4,857<sup>(3)</sup></b>	<b>4,757<sup>(3)</sup></b>
TAX SAVINGS	298 (2.98%)	198 (1.98%)
TAX DEFERRAL	2,895 (28.95%)	2,795 (27.95%)
TAX SAVINGS <sup>(3) - (2)</sup>		
TAX DEFERRAL <sup>(3) - (1)</sup>		
ASSUMES TOP MARGINAL TAX RATE FOR INDIVIDUALS		

# Combined Corporate Federal and Ontario Tax Rates - Example

TAX ON DISTRIBUTION OF \$10,000 OF ACTIVE BUSINESS INCOME ELIGIBLE FOR FEDERAL SMALL BUSINESS DEDUCTION (INCOME BETWEEN \$200K AND \$240K) YEAR ENDING DECEMBER 31, 2001		
	<u>E.H.T. ON FULL SALARY</u>	<u>NO E.H.T.</u>
<b>DIVIDENDS</b>		
CORPORATE TAX	2,862 <sup>(1)</sup>	2,862 <sup>(1)</sup>
INDIVIDUAL TAX	2,293	2,293
<b>TOTAL</b>	<b>5,155<sup>(2)</sup></b>	<b>5,155<sup>(2)</sup></b>
<b>SALARY</b>		
INDIVIDUAL TAX	4,666	4,757
E.H.T.	191	-
<b>TOTAL</b>	<b>4,857<sup>(3)</sup></b>	<b>4,757<sup>(3)</sup></b>
TAX COST	298 (2.98%)	398 (3.98%)
TAX DEFERRAL	1,995 (19.95%)	1,895 (18.95%)
TAX COST <sup>(2)</sup> - <sup>(3)</sup>		
TAX DEFERRAL <sup>(3)</sup> - <sup>(1)</sup>		
ASSUMES TOP MARGINAL TAX RATE FOR INDIVIDUALS		

# Succession Planning

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## Estate Freezes

- ✦ **Generally: Corporate shareholders can fix the value of a company at a particular point in time, take shares worth that amount, and provide growth shares to, for instance, family trusts**
- ✦ **For Professionals: Only dentists can own shares, according to the Ontario Budget and this will limit who can own "growth" shares.**

## Succession Planning

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### Sales and the Capital Gains Exemption

- ✦ **\$500,000 of gain is tax free**
- ✦ **Although the reserve may be brought into income when a dentist leaves practice, if a dentist is contemplating this in any event, the practice can be "rolled" into a corporation and shares of the corporation can then be sold**
- ✦ **The reserve amount is disappearing over time**

## Advantages of Incorporation

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- ✦ **Absolute tax savings of approximately 2% (in 2001) on the first \$200K of corporate income if after tax corporate income is distributed by way of dividends**
- ✦ **tax deferral of approximately 28% (in 2001) on the first \$200K of income if after tax corporate income is left inside the corporation**

## Advantages of Incorporation

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- ✦ **Tax deferral of approximately 19% (in 2001) on income between \$200K and \$240K if after tax corporate income is left inside the company**
- ✦ **ability to invest with the retained earnings of a corporation**
- ✦ **ability to transfer other assets to the corporation and extract retained earnings from the corporation**

## Advantages of Incorporation

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- ✦ **Use of capital gains exemption on sale of practice**
- ✦ **ability to pay for non-deductible business expenses (e.g. Club dues, life insurance premiums) from after tax income**
- ✦ **private health insurance plan deductibility**



## **Disadvantages of Incorporation**

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- ✦ **Loss of 10 year reserve re:  
December 31, 1995 income**
- ✦ **limited benefit in incorporating  
partners of larger partnerships due  
to sharing of small business  
deduction**
- ✦ **incorporating practice may result  
in associating other companies**

## **Disadvantages of Incorporation**

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- ✦ **No limited liability for professional**
- ✦ **no income splitting with other family members due to requirement that only professionals may be shareholders**
- ✦ **additional professional fees re: transfer of practice to corporation and annual fees**

## Summary

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### Why Do It?

- ✦ Small tax savings if income distributed
- ✦ Tax deferral if income left inside corporation
- ✦ Ability to invest with retained earnings
- ✦ Ability to pay for certain non-deductible expenses and certain other deductible amounts
- ✦ Use of capital gains exemption on sale of the practice
- ✦ Estate freeze possibility and income split possibility but only if family members are also dentists

## **Favourite Revenue Canada Targets on Audit**

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- ✦ **salaries to family members**
- ✦ **automobile expenses**
- ✦ **entertainment expenses**
- ✦ **home office expenses**
- ✦ **interest expenses**
- ✦ **lack of documentation re:  
management companies, technical  
service companies**
- ✦ **income declaration**

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