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BENEFITS OF INCORPORATION

WHY INCORPORATE?

A corporation, also referred to as a company, is a distinct legal entity separate from its owners, with the authority and responsibility to invest funds, hire employees, earn profits, pay tax, etc. Earnings are totaled; business expenses are deducted and net income taxed. The rate varies from province to province, but 15 - 25% seems to be the typical for small business companies. The after tax income is either distributed to the owner/shareholder in the form of dividends or retained in the company to fund further expansion.

PRINCIPAL SHAREHOLDERS

Shareholders are the owners of the corporation as a result of their personal financial investment in the firm. The percentage of the shares they hold represents the percentage of ownership. As owners, they have a voice in the management of the company and in policy making. For example, one policy determines how principal shareholders should be remunerated.

As a principal shareholder, you could receive dividends. Although dividend income is taxable in your hands, in some cases, by the use of a dividend tax credit, you can minimize your personal income tax. Any salary or benefits received as employment income would, of course, be taxable at your hands in your personal tax rate.

Before you decide whether incorporation will benefit your business and you, the following are the general advantages and disadvantages of this form of business organization.

ADVANTAGES OF INCORPORATION:

- Financial responsibility of the shareholder generally is limited to his investment in the business.
- The 21% small business deduction applies on all businesses with annual operations of $300,000
- Additional tax credits of 5% - 6% of profits are awarded to companies in the manufacturing and processing industries respectively.
- Incorporation permits flexible tax planning: the form, the amount and the timing of remuneration (dividends or salary) depends upon the needs of the principal shareholder
- Shareholders can be eligible for plans, such as the deferred profit sharing plan, although contributions from principal shareholders are non-deductible.
- A family member can be employed by a company, benefit from a reasonable salary and become admissible for compensation and benefits, such as Canada Pension Plan and Employment Insurance, as well as a retirement plan such as RRSP's.
- The company has an indefinite lifespan, because it survives despite the death or departure of one or more of its owners. Sources of financing are more varied than those available to a sole proprietor.

Disadvantages of Incorporation

- Financial institutions frequently expect personal guarantees on small corporate loans.
- Companies are subject to a growing number of government regulations.
- Incorporation fees and taxes represent large corporate disbursements.
- The losses experienced by a company do not always reduce a shareholder's personal income.
- A proprietorship can also employ the spouse of the owner.
- Business losses cannot be claimed in your Personal Tax Return.
- Shareholders can be eligible for plans, such as the deferred profit sharing plan, although contributions from principal shareholders are non-deductible.

Incorporating Brings Many Tax Benefits

The potential tax benefits of incorporation for a small active Canadian business are twofold.

A tax deferral is possible by retaining earnings in the corporation. As well, the $500,000 capital gains exemption available for the sale of small business can only be claimed on the sale of shares of a qualified incorporation and not on the sale of a sole proprietorship or partnership.

The major non-tax benefit of incorporation, and the reason that many people incorporate, is the ability to limit personal liability on the part of the entrepreneur. While the liability of a sole proprietor or partner is unlimited, a shareholder, in most cases, has no liability for the acts of the corporation.

Creditors of the corporation can only look to its assets to satisfy their claims. While the liability considerations are not reasonably straightforward, the tax issues may sway many decisions because they are more complex.

Net income of a sole proprietorship or partnership is taxed directly in the hands of the owner. A corporation is a separate taxpayer with its own separate tax rates.