Fall 2013

In our newsletter, we try to offer a variety of current information and helpful business advice. We welcome any comments.

Incorporating – Is it for you?

Is incorporation a smart business move or will it mean more time and expense in satisfying annual filing requirements without any benefits? If done for the right reasons the potential drawbacks will be offset by these benefits:

- ♦ Small businesses engaged in active business activities can defer taxes by incorporating. The combined federal and Ontario rate is 15.5% for income under $500,000 and 26.5% for income above $500,000. The highest marginal tax rate for individuals is 46.4% which could mean huge tax deferral opportunities if money is left in the corporation.
- ♦ Upon the sale of a qualifying business you can use the Lifetime Capital Gains Exemption and not pay tax on up $750,000 (increasing to $800,000 in 2014 and indexed after that) of capital gains resulting from the sale.
- ♦ Incorporation means your company has its own separate legal identity. Creditors of the business can sue the corporation, but not its owner(s). Unfortunately some creditors will demand personal guarantees from the shareholders which make the shareholder legally responsible for the businesses debt.
- ♦ You have the ability to declare a bonus and delay paying the payroll taxes up to six months after your year end.
- ♦ A corporation experiences a smoother transition on the death or retirement of an owner. Unincorporated partnerships can face difficulties and expenses should one owner die or leave the business.

Voluntary Disclosure Program

The Voluntary Disclosures Program (VDP) allows taxpayers to come forward and correct previous omissions in their dealings with Canada Revenue Agency (CRA). Taxpayers who make a valid disclosure will not be charged penalties or prosecuted with respect to the disclosure. However, any taxes owing plus interest will still be payable.

The CRA imposes four conditions which must be met before a disclosure qualifies under the program:

- Must be voluntary in nature
- Must be complete
- A penalty must apply
- Must be one year past due

The disclosure is made by completing Form RC199 and attaching all supporting documents.

CRA will also accept a "no-name" disclosure from a taxpayer. CRA can, at the taxpayer's request, consider the information provided and can then advise the taxpayer on the possible tax implications. The taxpayer can then decide on whether they would like to proceed with a full disclosure.

Nobody likes paying taxes but the VDP allows taxpayers to "come clean" without the sometimes onerous penalties and without the risk of further prosecution.

Principal Residence Exemption

When a taxpayer sells a real estate property it triggers a taxable capital gain when the selling price is higher than the cost. The capital gain is calculated as the proceeds of disposition less selling costs less the original cost of the property. Half of the capital gain is taxable. However, this capital gain can be reduced if the property is designated as a principal residence.

A principal residence is any housing that is inhabited by the taxpayer, spouse or children at any time during the year. If a taxpayer owns more than one residence, they can only designate one residence per year. It is most beneficial to designate the residence with the highest capital gain per year.

The principal residence exemption calculation is:

(1 + # of years designated / # of years owned) x the capital gain

If a home has been owned since before 1972, only the increase in value since December 31, 1971 is used to calculate the gain before deducting the principal residence exemption. A taxpayer and spouse may only designate one principal residence between them for each tax year after 1981. For years prior to 1982, each individual taxpayer can designate one principal residence.

Optimal Salary/Dividend Mix

As a small business owner, you must decide how much money to take out of your company in the form of salary or dividends. Every situation is unique but there are a number of factors to consider in your decision:

- First and foremost is the after tax-income you require to fund your lifestyle.
- How much you plan on contributing to your RRSP. Salary income generates RRSP contribution room while dividend income does not.
- Whether you would like to contribute to Canada Pension Plan (CPP) or not. Salary income requires contributions to the CPP (both employee and employer portion) while paying yourself a dividend does not.
- Income tax at source is withheld on salary but not on dividends. This could mean additional taxes payable when you file your personal tax return if you take dividends.
- Salaries to family members must be reasonable to be deductible while dividends do not. Therefore, dividends provide for greater income splitting possibilities.
- You may need “earned income” such as salary for other reasons such as to claim child care expenses. Dividends generally don’t count for “earned income” calculations.

Please contact us to determine your optimal salary/dividend mix.