



Investments: Should I Incorporate My Business?

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Once you begin working for yourself either as a contractor, consultant, self-employed person or small business owner, the question will arise: Should I incorporate my business? There are three major questions to ask: Are there tax advantages to incorporating? What are the costs and benefits of a corporation? Are there legal or other liabilities that a corporation can protect compared to personal assets?

Tax Considerations

Corporations pay taxes like people do. One key difference is that corporations can write off expenses against income, thereby lowering the amount that would be subject to income tax. A business that is not incorporated can also do this. A second difference is that tax rates are different than for people, and income can be kept inside the corporation until it is distributed as salaries or dividends to shareholders. This introduces options as to whether the tax rate is better for a corporation or an individual. There are also different exemptions and credits based on what industry the corporation is in, and what size the company is. There are favourable tax credits for small corporations and those that are based in Canada and are private (Canadian Controlled Private Corporations). A third difference is that businesses can expense debt if it is used for financing. This is also true for self-employed individuals and sole proprietors but they will typically have to share expenses with their personal costs unless they have a dedicated premises and equipment. As the corporation gets larger in size, there are also considerations for multiple jurisdictions and possibly different tax rates according to where a corporation is located. This tends to be the case for corporations that are larger and have been in business for a while. A self-employed person or sole proprietor can also benefit from different tax rates in multiple jurisdictions.

Costs of Incorporation

Due to the dedicated nature of the corporation, there are a fair amount of costs that arise when setting up the entity. First, the corporation has to be registered federally or provincially. Which one you choose will depend on where you want to do business in Canada and whether you want to expand beyond Canada. (2) Much of the decision will depend on the nature of the business, where the clients are, how the location affects the good or service is produced and what other rules affect your business in different provinces. After the initial registration, you may have to apply for a GST/HST number. This is also the case for the sole proprietor. The

corporation will need its own bank accounts separate from the shareholders and directors to keep the records clean. These accounts typically are more expensive than personal bank accounts due to more paper work involved in monitoring them. Corporate accounts would also have their own cheques or credit cards if necessary. Corporations will need someone to keep track of their documents including corporate by-laws, minutes of meetings and any additional licenses that are required (3)(4). If the corporation is hiring employees, there are additional considerations (3)(4).

Legal Liabilities

People may incorporate to protect their assets by limiting what can be taken in a lawsuit. The corporation would technically provide the good or do the service, so if someone is not happy and wants to sue the provider, the assets of the corporation would be at risk. If this provider is a sole proprietor, then the assets of the person would be at risk as well, which would include all of the personal assets since the business and the person cannot be distinguished in terms of ownership. This is one of the key reasons why corporations exist. The risk of a lawsuit will vary depending on how likely it is that someone will get injured or harmed, and how likely someone would sue in the first place. There are also sub-issues related to the legal issue such as insurance and transparency. Corporations may need to exist in certain industries in order to qualify for insurance against certain types of risks, and assets may need to be clearly defined to provide that insurance. How effective a corporation is in deflecting lawsuits and protecting personal assets should be discussed with a lawyer to make sure that the corporate structure will benefit you.

Additional Considerations

A corporation is its own legal “person”. This means that it will have its own records, tax returns, GST/HST collection, bank account and assets/liabilities. A self-employed person, contractor or small business owner can operate a business under their own name and it can be tax compliant. A corporation must be registered as a separate entity and it will be treated as such. The link between the people who operate the corporation and the corporation itself will come from the status of the shareholders and corporation directors who are named when the corporation is set up. If you are a business that generates less than \$30,000 in a given year, there would be no GST/HST collection in most cases (1). Since a corporation is a “separate person”, all dealings with the corporation and the officers/directors must be documented and provable to a third party. This will mean more paperwork and more diligence required in keeping records. There will also be two sets of records: one for the corporation and one for the owner/directors who operate it.

Partners

A corporation may also allow for more transparent record keeping in cases where there are many partners. If the dynamic of the partners changes over time and a new partner may want to buy in or exit the corporation, this may be easier to do if the records are kept separate. The

same issues can come up with partnerships. If the partners are shareholders, the shares can be bought and sold privately to facilitate changes and the valuation may be easier since it is being updated regularly rather than having the partners value the company themselves when a transaction is desired. The more people get involved in the company, the more useful a corporation may be in settling disputes or keeping the operation organized.

In summary, a corporation should fit the situation you are in at the time when you decide to incorporate. There are certain scenarios where incorporation is better than not, and vice versa. It is recommended that all of the questions get asked and the process gets followed through from setting up the corporation, annual requirements and windup of the corporation to make sure that surprises are kept to a minimum. It is also important that any changes that need to be made can be made easily.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what your options are. **Note: This site is intended for people who want to learn about the world of investments and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**

Sources

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