



**ROTH
HRYWKIW
FIDEK** LLP

CHARTERED PROFESSIONAL ACCOUNTANTS

Is Incorporation Right for my Business?

It happened. It finally happened.

Five months into the pandemic, you finally lost your job.

There were some doubts early on, but things seemed like they were trending upwards.

All of a sudden, you're not sure where your next pay cheque is coming from.

No fear! You're resourceful and have been planning for this day for a while.

You've spent some spare time considering turning your passion into a business.

You're ready to go. Excited to provide your goods or services to the community.

Now seems like as good a time as ever to take the leap!

How do I start? Can I just open a business and hit the ground running? Should I care what business structure I use?

Time is of the essence, let's get right to it!

Making the decision to start a business is huge. Deciding which business structure to open under is also huge! Looking at the pros and cons of incorporation, thru the use of everyday examples, I'll get you off on the right foot.

Advantages of Incorporation

1. Limited liability
2. Tax savings and deferrals
3. Access to multiple Lifetime Capital Gains Exemption (LCGE)
4. Estate planning



**ROTH
HRYWKIW
FIDEK** LLP

CHARTERED PROFESSIONAL ACCOUNTANTS

Disadvantages of Incorporation

1. Incorporation costs
2. Ongoing costs
3. Administrative costs
4. Losses are more difficult to use

Example #1 - Concerned about Liability

Your new business will be engaged in the residential cleaning services sector. While the services you provide are not overly risky to your customers, you are exposed in other areas.

Exposure stems from potential unwarranted theft claims.

Depending on your client base, incorporation may not be necessary early on. Instead, you could use a waiver form in conjunction with your standard contract. Additionally, it would be advisable to carry a sufficient insurance policy to protect your business. Ensuring that you operate in an ethical manner will go a long way.

Additionally, remember that certain government liabilities cannot be avoided even if you operate as an incorporated business. These include unpaid wages, payroll remittances, GST collected but not remitted, and others.

Conclusion: Based on liability alone, incorporation doesn't appear to be beneficial here.

Example #2 - Business Earns More Than You Need

For this example, we'll presume you are starting a tech consulting company. You have high hopes for your business and predict that it will produce more cash than you need for personal expenses.

If your business profits out pace your personal spending needs, incorporation would allow for tax deferral opportunities.

Profits taxed inside the corporation would attract a much lower tax rate than if taxed personally. This allows you to grow your business with cheaper after tax cash, thus boosting the growth rate.

Conclusion: If you expect your personal expenses to be less than net profits of the business, it would be wise to discuss your plans with an accountant.



ROTH
HRYWKIW
FIDEK LLP

CHARTERED PROFESSIONAL ACCOUNTANTS

Example #3 - You are Your Business

This example looks at a business owner, such as a painter or other service provider, who sees their business value tied directly to them. This includes the owner's skills, relationships or another non-transferable attribute.

If there is no opportunity to pass these skills on to a child or if relationships end when the owner retires, incorporation may not offer benefits.

Conclusion: Unless there is another pressing reason to incorporate, this business owner will likely be better off operating as a proprietorship to avoid costs and administrative burdens.

Example #4 - Expecting Losses

If you are opening a business and expecting losses early on due to large outputs on advertising, interest on loans, rent, and other fixed costs, it may be beneficial to operate as a proprietorship initially.

Losses in a sole proprietorship can be applied against other sources of income. If the loss is incurred within a corporation, it can only be carried forward and applied to future years.

Conclusion: If you expect your business to experience a loss in the first couple of years, it is likely beneficial to start out as a sole proprietor. Should the business become successful in future years, the operation and assets can be rolled into a corporate structure at a later date.

Example #5 - Real Estate Rental Business

In this example, we'll presume that you haven't lost your job due to the pandemic. Rather, you're looking to invest some funds in a rental property. Should you hold the property in a corporation or personally?

If you don't plan on hiring more than 5 employees, rental income would be taxed as investment income in a corporation. While there are mechanisms in the *Income Tax Act* to reduce corporate tax when profits are paid out via dividends, this can result in cash flow issues.

Other benefits of holding rental property personally include: obtaining a mortgage is typically easier and if you live in the house before/after renting, it may qualify for the principal residence exemption, thus lowering capital gains tax on sale.



ROTH
HRYWKIW
FIDEK_{LLP}

CHARTERED PROFESSIONAL ACCOUNTANTS

Conclusion: Unless you plan to hire 5 employees, there is likely little benefit in setting up a corporation to hold a single rental property. Similar to Example #4, if your rental operation increases in size, it is possible to roll the properties into a corporation in the future.

Wrapping it Up

When deciding to open a business, there are a number of factors to consider when deciding on the structure of the operation.

The factors are not always clear and the outcomes can vary depending on your unique situation.

Having the right structure in place can help your business succeed both in the short and long-term.

By: Jared Pilon CPA, CGA