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Should I incorporate my medical practice?



It's a question you may have asked yourself, but the answer can be elusive. The opportunity to save tax is certainly attractive, yet it's necessary to analyze your personal financial situation and consider the risks and rewards before committing to a course of action. At MD, we help physicians make informed decisions about incorporating every day.

When you decide to incorporate your medical practice, you create a corporation that “owns” your medical practice, and you become a shareholder, director and employee of the corporation. The two biggest potential advantages of incorporation are the opportunities to defer taxes by keeping some of your income within the corporation, and to reduce your family's overall tax bill by splitting your income with family members.

MD advisors are experts in the field of incorporation—we've been helping physicians decide whether or not to incorporate, and helping incorporated physicians integrate their corporations with their financial plans, for years. Here are some of the critical factors we will help you assess on the path toward making your decision, and potentially carrying through with incorporation.

TAX DEFERRAL DEPENDS ON YOUR CASH FLOW

As a self-employed physician, the money you earn is taxed at your marginal personal tax rate—up to 45% in most provinces. However, as an incorporated physician, up to the first \$500,000¹ of active business income earned from

your medical practice and retained within your corporation is eligible to be taxed at an average rate of only about 16% for 2010, depending on your province.

For example, in 2009, Dr. Black earned \$250,000 from her medical practice and paid personal tax of \$97,764². In 2010, Dr. Black decided to incorporate. This year, she will again earn \$250,000, but will opt to receive \$150,000 in salary and bonuses, on which she will pay personal tax of \$51,204 and keep the remaining \$100,000 within her corporation, which will pay corporate tax of \$16,000. As a result of incorporation, Dr. Black will lower her total annual tax bill to just \$67,204 in 2010 from \$97,764 in 2009.

Dr. Black's corporation will be left with \$84,000 in retained earnings, which it may invest on her behalf. This money will eventually be taxed at Dr. Black's personal rate when she withdraws it; however, if she waits until retirement, she may be in a lower tax bracket. And, in the meanwhile, she will benefit from having more of her money invested and growing. These are the tax deferral opportunities offered by incorporation.

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In order for this strategy to be beneficial, however, you must have enough income from your practice to draw a salary that covers your needs—such as your mortgage, personal expenses, RRSP contributions and other costs—and still have enough left over to shelter within your corporation. So the first step is to speak with your MD advisor and tax professional to analyze your cash flow, and determine whether you will benefit from tax deferral.

INCOME-SPLITTING DEPENDS ON YOUR FAMILY

Certain non-physician family members are permitted to be (non-voting) shareholders of a professional corporation³. This enables income-splitting, which can significantly reduce your family's overall tax bill.

In order to implement this strategy, you need at least one eligible family member, such as a spouse or adult child, who is in a lower tax bracket. In fact, the less taxable income they have, the better. That way, you can reduce the salary you take from your corporation (which is likely to be taxed at the highest marginal rate) and instead pay the equivalent sum to a family member in the form of a dividend, which will attract a lower rate of taxation.

The net result is more after-tax money in your family's hands. Prior to implementing any income-splitting strategy, be sure to speak to your tax advisor to ensure that attribution rules under the *Income Tax Act* will not undermine the benefits available to your family.

TIME, MONEY AND COMPLIANCE

There are legal and set-up fees involved in creating a corporation, as well as ongoing accounting, administration and compliance costs. So it's important to make sure that the benefits of incorporation in your particular situation will more than offset these costs.

CONSIDER INCORPORATION CAREFULLY

The advantages to incorporating your medical practice can be significant. However, there are a number of questions you should ask first.

ASK YOURSELF:

- ▲ Am I a good saver?
- ▲ Do any income-splitting opportunities exist?
- ▲ Am I comfortable with change?
- ▲ Do I have business debt?
- ▲ Am I well organized financially?
- ▲ Do I have a good relationship with my accountant/lawyer?

ASK YOUR ADVISORS:

- ▲ Can I incorporate my practice?
- ▲ Should I incorporate?
- ▲ What are the limitations of incorporation in my province?
- ▲ What legal structure should I have?
- ▲ Who can be a shareholder of my corporation?
- ▲ What happens to my existing partners?
- ▲ What happens if I retire or die?
- ▲ What happens in the case of marital breakdown?
- ▲ How will I set up the books?
- ▲ What does it change? For me? For my patients? For my family?

For objective advice about incorporation, please speak with your MD advisor.

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TAX-EFFICIENT INVESTING

In order to make the most of tax-deferred investing within your corporation, you need to take a holistic view of your personal, family and corporate investment assets. For example, your corporation may have a different time horizon, risk tolerance and tax profile than your RRSP account or the non-registered investments that you own jointly with your spouse. Your MD advisor can help make sure that you hold the right types of investments in each of your portfolios in order to take full advantage of the potential tax savings.

RETIREMENT AND ESTATE STRATEGIES

Professional incorporation is a long-term undertaking. For example, there's no sense making financial decisions that will reduce your tax bill today if you're going to end up creating an unmanageable tax liability at some point in the future. A corporate-owned insurance policy is just one example of a retirement and estate strategy that your MD advisor may recommend, as it can provide the unique opportunity to earn tax-free compound growth on your corporate assets during your lifetime, and help preserve the inheritance for your beneficiaries in the future.

Your MD advisor will also help to make sure that the pursuit of solid investment growth during your working years is followed by a plan to generate steady, reliable retirement income down the road.

TAX AND LEGAL KNOWLEDGE

It's important to be aware of shifting tax and legal conditions that may affect your corporation, so that you can not only remain in compliance with relevant tax laws, but also take advantage of new opportunities that may arise. Working with an MD advisor, you'll have our professional "eyes and ears" on your side, helping to coordinate with your tax and legal advisors to make sure you realize the maximum benefit of your professional corporation.

Deciding whether or not to incorporate and effectively managing the affairs of a corporation can be a complex matter. This will require advice from your tax and legal advisors, as well as your MD advisor. We have the knowledge and experience to help you make the right decision with confidence, and to ensure that your corporation is properly integrated with your overall financial plan for many years to come.

QUESTIONS?

CONTACT YOUR MD ADVISOR.

md.cma.ca ▲ 1 800 267-2332



¹ Provincial small business limits may vary from the \$500,000 federal limit.

² Tax rates are based on the 2009 Ontario and federal personal tax rates. Only federal and provincial basic tax credits are included. Actual amounts will vary from taxpayer to taxpayer.

³ Alberta residents only: On January 14, 2010, the Legislative Assembly of Alberta reported that Bill 53, adding family members of shareholders of professional corporations in Alberta, has received Royal Assent but has not yet been proclaimed law.

The information provided in this document is current as of January 1, 2010. It does not replace the tax/legal advice given by a professional advisor. Clients are strongly encouraged to seek their own professional guidance prior to implementing any tax strategy and prior to incorporating their medical practice.

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