ONTARIO HEALTH LAW

TAX ADVANTAGES OF PHYSICIAN PROFESSIONAL CORPORATIONS

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Why Have a Professional Corporation ("PC")

Physicians who carry on their medical practice in Ontario personally pay income tax at a rate in excess of 46%. Such physicians are not permitted to split income with family members, except to pay "reasonable salaries" to family members who provide actual services to the practice. Such salaries are frequently attacked by Canada Revenue Agency ("CRA"). By incorporating a PC to carry on the medical practice, a physician can achieve significant tax advantages by way of paying tax at a much lower corporate tax rate (18.6% rather than 46.4%) and income splitting with family members by paying dividends (which themselves are taxed at a lower rate).

What are the Legal Requirements for a PC

A PC is incorporated under the Ontario Business Corporation Act (the "OBCA") as a regular corporation. However, a PC is subject to a number of special rules and restrictions pursuant to the OBCA and the Regulated Health Professions Act. Some of the key restrictions and requirements are as follows:

i. A physician must be the sole director, officer and own all of the shares with general voting rights;

ii. The name of the corporation must include the physician's surname plus "Medicine Professional Corporation";

iii. Other family members (spouse, children, parents and trust for minor children) can own non-voting shares
(recent change to legislation);

iv. A Certificate of Authorization for the PC from the College of Physicians and Surgeons of Ontario is required;

v. The physician remains personally liable for all professional matters relating to the practice; and

vi. The activities of the PC must be limited to carrying on a professional medical practice (and related matters and investments).

Are There Any Non-Tax Advantages

The main advantages and reasons for establishing a PC are income tax related. However, although the physician remains personally liable for professional matters, the PC does offer some advantages of limited liability for non-professional matters, such as if the PC borrows money and enters into agreements, such as an office lease and equipment leases.

How does the Lower Corporate Tax Rate Result in Tax Savings

A corporation (including a PC) can earn up to $400,000 per year of active business income at the 18.6% tax rate. This provides a tax savings of approximately 27.8%, compared to the personal tax rate in Ontario that applies if the physician earns the practice income personally (46.4%). This lower tax rate applies only to income left behind in the PC.

What Can You do with Money Left over in a PC

There are a number of efficient uses for the extra after-tax dollars left in the PC. If, for example, a physician is able to leave $50,000 of profit per year in the PC, there will be significant tax savings. The after-tax amount left to invest inside the PC would be approximately $40,700, rather than $26,800, if the $50,000 was earned personally by the physician. This represents a tax savings of $13,900 per year. This after-tax amount can be invested in the PC the same way it would be invested personally by the physician and provides an excellent, tax-efficient method to build up investments more quickly and save for retirement.

Also, the additional after-tax income left in the PC allows the PC to pay off debts more quickly than if the income was earned personally by the physician and provides a tax-efficient method to pay certain non-deductible expenses (life insurance premiums and some entertainment expenses).

How Can You Income Split with a PC

Physicians are allowed to split income with other family members, such as a spouse, parents, children and trusts for minor children. The income splitting is achieved by having the family members own non-voting shares of the PC that can receive dividends as determined by the physician. Dividends are taxed more favourably than other types of income. An individual with no other income can receive up to approximately $30,000 of dividends tax-free. Dividends can be paid most tax-efficiently to family members who do not have significant other income.

What Factors do you need to Consider when setting up the Share Structure:

It is extremely important that the share structure of the PC be set up with advance planning at the outset, in consideration of the following:

i. Flexibility for changing circumstances of family members;

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ii. Flexibility to pay dividends to whatever family members are selected each year by the physician;
iii. Ensuring that the physician retains complete control of the PC;
iv. Allowing the physician to cancel the shares of family members if the circumstances warrant (i.e. marital problems);
v. Establishment at the time of incorporation of multiple classes of shares, so there is a separate class for each family member (allowing complete flexibility as to dividends payable to each family member); and
vi. Establishing special classes of shares to be issued to the physician on the transfer of goodwill and other assets relating to the practice, such as equipment.

Are There Any Other Tax Advantages

The most significant tax advantages available to a PC are generally the corporate tax rate advantage and the income splitting advantage. However, there are additional possible tax advantages, such as creating an individual pension plan, tax deferral (to next year) by bonus accruals, use of non-calendar year end, no GST payable on dividends and no requirement for dividend recipients to perform reasonable (i.e. any) services.

How Can You Transfer Assets and Agreements to the PC

Since the medical practice will be carried on by the PC, it is necessary to consider what assets and agreements need to be transferred from the physician to the PC. In order to avoid possible tax problems, it is necessary that goodwill relating to the medical practice be transferred from the physician to the PC. Also, it is necessary to consider if there are other assets, such as equipment to be transferred to the PC. Finally, one must consider what agreements there are relating to the practice, such as office lease and equipment leases, which should be transferred to the PC.

Summary

A PC can offer significant income tax savings to a physician. However, it is important that there be proper tax planning in advance by the physician, accountant and lawyer. On the legal front, the lawyer must implement the corporate share structure properly, in order to achieve the maximum tax savings, provide the most flexibility for changing circumstances and to avoid the various tax traps that can apply.

The fees relating to the planning, structuring and preparation of legal documentation associated with a PC will vary depending on the situation.

If you would like to consider the suitability of a PC for your situation, please contact William S. Bernstein at (416) 865-6675 or wbernstein@gardiner-roberts.com.

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