

# **Starting A Business**

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# Starting a business

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## Potential Structures

Structures commonly used to operate a business include:

- Proprietorship
- Corporation
- Partnership
- Office sharing expenses
- Trust
- Other arrangements

There is no one ideal structure as each has its own advantages and disadvantages.

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## Proprietorship

- Simplest and cheapest.
- All income and expenses reported on personal income tax return.
- Expenses are generally deductible if they are incurred for the purpose of earning income and the amounts reasonable.
- Income splitting based on reasonable remuneration for services rendered.
- Exposure to unlimited liability.
- December 31<sup>st</sup> year end.
- May not be the most tax efficient.

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## Corporation

- All income and expenses reported in corporation → first **\$300,000** (increase to **\$400,000 on 1Jan 2007**) of annual active business income subject to 17.62% corporate income tax rate. Subject to second layer of tax when dividend paid - **potential tax deferral.**
- Income splitting in the form of salary (service) or dividend (shareholding).
  - Salary or fee subject to same reasonableness test as proprietorship.
  - Dividend to spouse – beware of attribution rules.
  - Dividend to children – beware of kiddie tax and attribution rules.
  - Earned income (RRSP, child care expense, employment expense) vs. passive income (No CPP).
- Potential limited liability.
- Additional legal and accounting costs.
- May sell business or shares – multiply \$500,000 capital gains exemption with family members.

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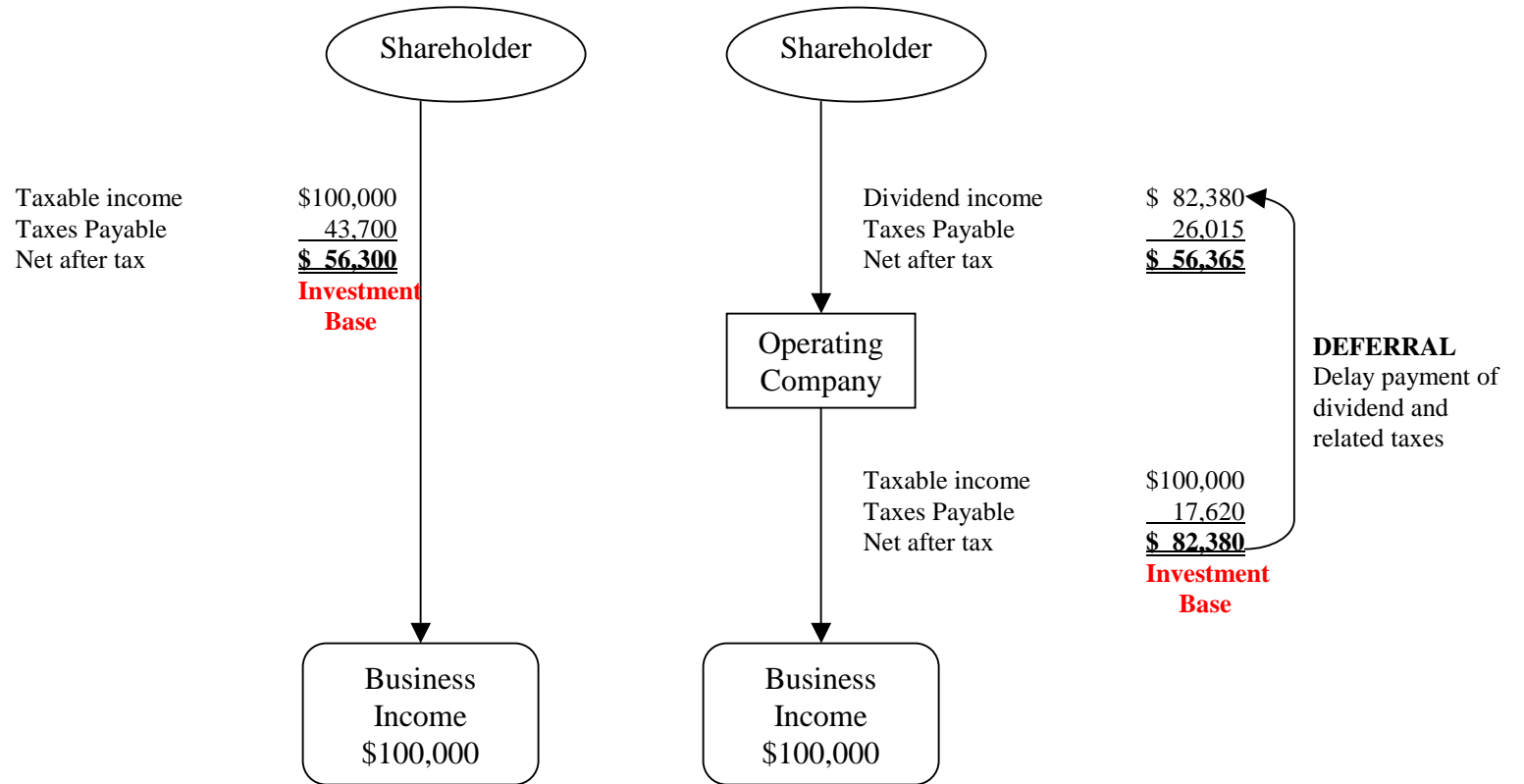
## Integration concept

	Shareholder Earn Directly	ABI \$400,000 & under	>\$400,000 non-qualifying dividend	>\$400,000 qualifying dividend	Investment Income
<b>Corporation</b>					
Corporate Income		100,000	100,000	100,000	100,000
Corporate Income Tax		-17,620	-34,120	-34,120	-41,120
Refundable Tax					-6,667
Available in Corporation		<b>82,380</b>	<b>65,880</b>	<b>65,880</b>	<b>52,213</b>
Dividend Refund					26,107
Available as Dividend to S/H		82,380	65,880	65,880	78,320
Effective corp tax		17.62%	34.12%	34.12%	21.68%
<b>Individual Shareholders</b>					
Dividend Received		82,380	65,880	65,880	78,320
Other Income	100,000				
Personal marginal rate - variable	43.70%	31.58%	31.58%	23.47%	31.58%
Tax Thereon	43,700	26,018	20,805	15,460	24,733
<b>Net After Tax</b>	<b>56,300</b>	<b>56,362</b>	<b>45,075</b>	<b>50,420</b>	<b>53,587</b>
<b>Effective tax rate</b>	<b>43.70%</b>	<b>43.64%</b>	<b>54.92%</b>	<b>49.58%</b>	<b>46.41%</b>
Corporate Deferral Benefit (cost)		26,080	9,580	9,580	-4,087
Net Flow Through Benefit (Cost)		62	-11,225	-5,880	-2,713
		0.06%	-11.22%	-5.88%	-2.71%
			<b>Current Rules</b>	<b>Proposed Rules</b>	

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## Integration & Deferral Concept



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## Holding Company

- If significant excess funds are held in an operating corporation, these funds may be exposed to business risks of the operating business → consideration should be given to establishing a holding company.
- Beware of s.74.4 – deemed interest benefit and potential double taxation
- The holding company may own shares of the operating company (directly or indirectly via trust).
- Dividends would be paid from the operating company to the holding company.
- No tax on inter-corporate dividends (must be connected: control or own more than 10% of voting and value).
- Holding company would invest funds.

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## Partnership

- A partnership is not recognized as a separate taxpayer and does not pay income tax – all income and expenses allocated to partners (partner may be an individual or a corporation) and each partner is responsible for income tax on his or her respective share of partnership income.
- Partners must share annual small business limit (general rule).
- Single layer of tax.
- Enables pooling of resources – economy of scale.
- General Partnership, Limited Partnership, Limited Liability Partnership.
- Additional costs for record keeping.

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## Joint office – share expenses

- Benefit from economy of scale (common area, one receptionist, one bookkeeper, single telephone system, etc).
- Participants responsible for share of expenses based on predetermined formula. Consider using a nominee entity to manage office and allocate to participants. Charging management fee or reimbursement of expenses may be subject to GST.
- Participants do not need to share annual small business limit.
- Normally “Eat What You Kill” arrangement.

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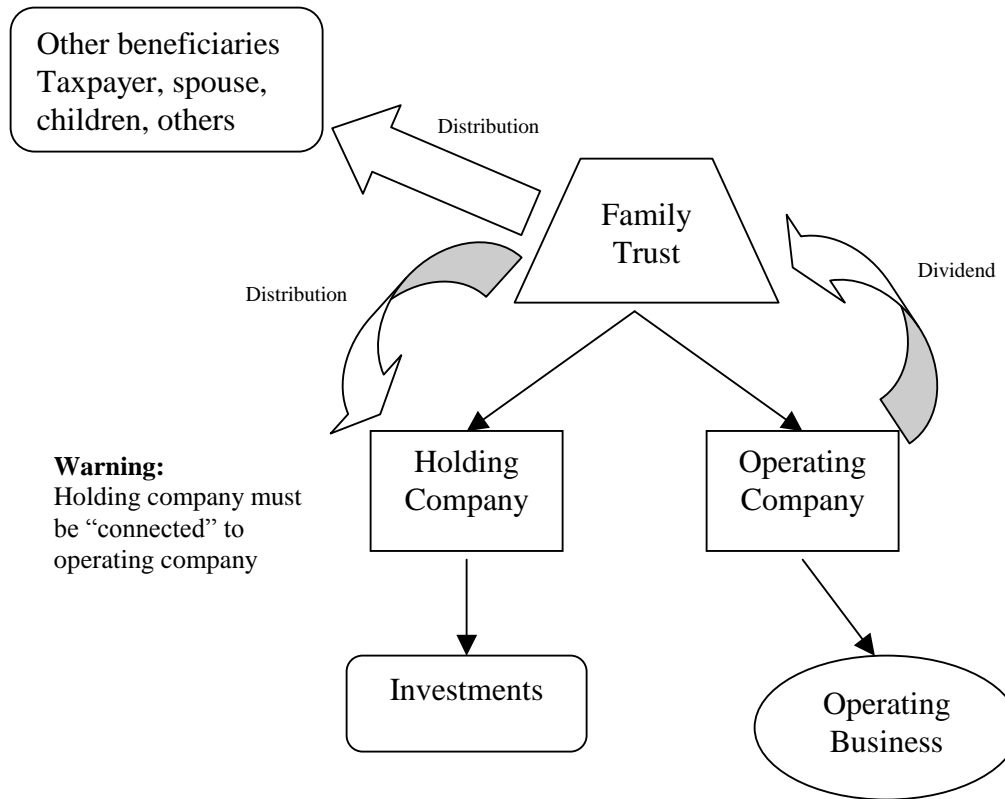
## Family Trust

- Shareholder of operating company
- Limited partner of partnership
- Parties of a trust
  - Settlor
  - Trustee
  - PEAT
  - Beneficiary(ies)
  - Others
- Discretionary vs. Non-discretionary
- Inter-vivo vs. testamentary
- Income splitting opportunities

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## Common Structure



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