



Exciting tax news for realtors

On January 22, 2008, the provincial government approved regulatory amendments to the Real Estate Services Act that will finally allow individual real estate licensees (“licensees”) the opportunity to incorporate their businesses beginning January 1, 2009. This announcement, though long overdue, is welcome news as it will soon give licensees access to the significant income tax benefits that almost all other businesses enjoy through incorporation.

By John Groenewold, CGA, CFP, TEP

Up to this point, real estate licensees were part of a small group of individuals, including investment brokers and mutual fund salespersons, whose ability to incorporate was either prohibited or restricted. For the investment brokers and mutual fund salespersons, their fight continues. But for licensees, a new day is dawning and with it comes some fantastic opportunities to reduce income tax!

Advantages of Incorporation

Although there are a number of advantages available through incorporation, the two main benefits that licensees may realize through incorporation are tax deferral and income-splitting.

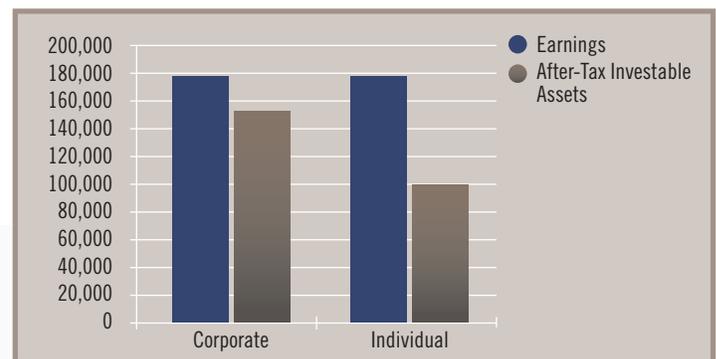
Tax Deferral

Simply put, a tax deferral is a benefit that a licensee may realize if they are earning more money than they need to live on. The amount of the benefit available depends on how much money can be saved for investment and the “spread” between corporate and personal tax rates.

The highest marginal tax rate applied to an individual resident in BC is currently 43.7%. By comparison, a corporation resident in BC earning active business income up to the “business limit” of \$400,000 now pays tax at only 14.5%. The difference of roughly

29% represents the maximum potential tax deferral available when active business income is earned and retained in the corporation. Clearly this is a substantial benefit and the tax deferral opportunity available can significantly accelerate your accumulation of wealth.

For example, an individual generating income subject to the highest tax rate in BC would need to earn \$177,620 in order to have \$100,000 after-tax to invest in a non-RRSP investment. However, the same \$177,620 of active business income earned and retained by a corporation would leave \$151,865 after-tax. Therefore, through incorporation there would be “extra” after-tax cash of \$51,865 available for investment. That’s a 52% increase, just by saving corporately! Earned on an annual basis, the additional cash available would produce a significantly larger pool of investments and as the old saying goes, “it takes money to make money”.



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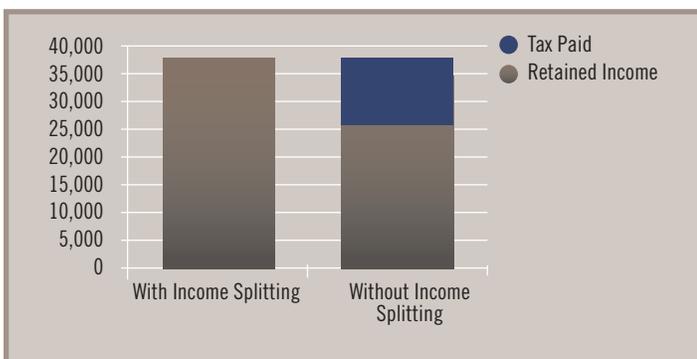

While the tax deferral benefit is significant, it's important to remember that it doesn't necessarily represent true tax savings. When cash is ultimately withdrawn from the corporation, personal tax is generally paid. However, it's often possible to effectively "crystallize" all or a portion of the tax deferral into true tax savings by either:

- i) income-splitting with family members who are subject to a lower rate of tax, or
- ii) withdrawing cash from the corporation at a time when you are subject to a lower marginal tax rate (e.g., maternity/paternity or during retirement).

Income-Splitting

Even if you need all of the income that you currently earn to pay for personal living expenses and you have little ability to save, incorporation may still provide considerable benefits where income-splitting opportunities are available. Income-splitting is achieved when income that would otherwise be taxable in your hands is allocated to a spouse or other family members. The purpose of income-splitting should be to equalize marginal tax rates, where possible, with other family members in order to ensure that the minimum amount of tax is paid on money required to fund personal living expenses. Depending on the circumstances, income-splitting may be achieved through salaries, dividends, or a combination thereof.

Where a corporation pays a salary, it must be "reasonable" in light of the services that are provided to it. Dividends, on the other hand, are paid as a right of share ownership and are not subject to a reasonableness test. Therefore, it is often more effective to income-split using dividends rather than salary. With the combination of the basic personal tax credit and the dividend tax credit, an individual resident in BC with no other sources of income can currently receive dividends of approximately \$38,000 tax-free. By comparison, an individual at the highest marginal tax rate in BC would pay tax of \$12,000 on the same \$38,000 dividend. In this scenario, that's true tax savings of \$12,000!



What's more is that the tax savings may be even greater where a larger dividend is appropriate or when the income-splitting benefit can be increased by including multiple family members as shareholders of the corporation.

Recommendations

Creating and implementing an effective tax strategy is one of the key components of a successful financial plan and incorporating your real estate business may be a giant leap forward. However, it's critically important to make sure that your incorporation is properly planned in order to maximize the benefits available to you. If you would like to discuss how the benefits of incorporation apply to your specific situation, please contact any one of the individuals listed below. Alternatively, if there are a number of people within your firm that you think would benefit from a group discussion we'd be happy to make a presentation at either your office or ours.

Lastly, the Real Estate Council has indicated that they will begin accepting applications for incorporation starting in November 2008. Because of the substantial benefits available through incorporation, we expect that a landslide of applications will be made. That said, it would be wise to have your incorporation plan completed as soon as possible so that it can be submitted on November 1, 2008.

We look forward to the opportunity to be of service to you in achieving your financial goals!

Sincerely,

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If you are interested in attending a complimentary hot breakfast and information session this fall, please contact Lanie Collins at Nicola Wealth Management at lcollins@nicolawealth.com or by phone at 604.739.6450.

Date, Time & Location:

Thursday September 25th 8:00-9:30a.m.

Tuesday September 30th 8:00-9:30a.m.

Tuesday October 7th 8:00-9:30a.m.

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