

THE LEGAL EDGE

Current developments in the law which may affect you or your business

Structuring Your Business: What You Need to Know:

The structure of your business is important for business and tax reasons. For business reasons, it is important to allocate decisions and rewards to prevent disputes and allow your business to grow with few impediments. For tax reasons, the structure of your business can significantly affect profitability.

Should you incorporate? Advantages of the corporation include: limited liability, the small business income tax rate on active Canadian business income, and the capital gains deduction for an active Canadian corporation. On the other hand, the unincorporated proprietorship or partnership can be less formal, require fewer set-up costs, and increase the deductibility of losses against other income.

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Regardless of the structure, you should have a carefully written agreement with your business partner. Who will run the business? How will profits be shared? What type of contracts will the business enter? How can ownership be transferred to new people? What happens if an owner dies or becomes incapable? What happens if there is a dispute?

You should carefully review the affect of corporate tax. Briefly speaking, like an individual, a corporation is subject to both federal and provincial income tax. A corporation may also be taxed on its capital. For an individual earning money through a corporation, there is a potential for "double tax". This is because the corporation pays tax, then gives a dividend to the individual shareholder, and then the individual pays tax again on his or her income (including the dividend). For Canadian corporations, tax laws attempt to minimize the effect of double tax, by grossing up dividends in the individual's tax return to the approximate amount earned before tax at the corporate level. A tax credit is then given to the shareholder to approximate the amount of tax previously paid by the corporation (the "dividend tax credit"). Generally speaking, however, the tax is never fully "integrated" and funds can be saved by careful planning.

If you're buying or selling a corporation, you should consider the effect of an "asset purchase" versus a "share purchase". Purchasers generally prefer an asset purchase. This is because, with a share purchase, the after-tax cost is higher and the purchaser will be subject to all of the undisclosed liabilities of the vendor's business. Vendors generally prefer selling the shares of the business because the gain realized is a "capital gain" for income tax purposes.

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