ADVI

By Alison MacAlpine

Follow this step-by-step process to incorporate your business.

"INCORPORATED." It's a single word that announces to your world of clients and business associates that you've arrived. That you've taken steps to make your practice as tax-efficient as possible. That you're planning well in advance for your own succession. That you're bigger than just one financial advisor.

But what are the restrictions on incorporation? How can you determine if it's the right move for your financial advisory practice? What are the steps you must complete if you decide to take the leap? And what can you do to maximize the benefits after you're a corporation?

These are all important questions to answer if you're considering adding that magical word, "Incorporated," to your company name. While this article will help you explore the issues surrounding incorporation, you should always obtain professional advice from an accountant and a lawyer before transforming your business into Advisor Inc.

CAN I INCORPORATE?

This first question is complex. Insurance agents have been able to incorporate for many years, but when it comes to selling investments and, specifically, flowing investment commissions directly into an incorporated company, the rules are in flux.

Many financial advisors registered with the Mutual Fund Dealers Association of Canada (MFDA) have been able to incorporate their practices in the past because of a suspension to MFDA Rule 241, which states that commission payments must be made directly to individuals. Alberta and New Brunswick opted not to suspend this rule, so MFDA advisors in those provinces cannot receive mutual fund commissions in a corporation. The suspension period in the other provinces is set to expire in December 2006.

Financial advisors registered with the Investment Dealers Association (IDA) have never been able to incorporate. However, in May 2003, the IDA changed its by-laws to allow advisors to operate either in a traditional employer/employee relationship, or in a new principal/agent relationship—though the "agent" still could not be an incorporated company.

More recently, in January 2006, the IDA Board of Directors approved by-law amendments that would allow IDA advisors to incorporate. These proposed amendments are pending approval by the securities commissions, and the MFDA, IDA, and financial advisors across the country are awaiting the verdicts. "We're

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hoping that there will be a final, national decision made by the Canadian Securities Administrators (CSA) on this issue before the suspension period expires, so that we have time to adjust it if we have to, and our members have time to adjust it if they have to," says Karen McGuinness, the MFDA's Toronto-based vice-president of compliance. She adds there is the possibility of a further extension of the Rule 241 suspension, but that a definitive answer would be preferable.

should I INCORPORATE?

Having the right to incorporate doesn't mean it makes financial sense for you to do it.

One of the most significant benefits of running an incorporated business is that it gives you the opportunity to defer taxes on money that remains within the corporation. Tim Cestnick, a principal with WaterStreet Group Inc., and author of *Winning the Tax Game*, says the average tax rate across the country paid by a corporation on its active business income is about 18%, while an individual may pay income tax of 46%. Therefore, the deferral tax advantage when a business owner leaves income inside a corporation is somewhere between 25% and 30%, depending on the province.

"My general rule is if you can earn $30,000 or more of profits that you can leave in the company and not take out, then it's probably worth your while incorporating," says Cestnick. He explains this is because your deferral tax advantage on $30,000 will be roughly $9,000, which should cover the costs of setting up and maintaining your corporation. Cestnick estimates expenses may amount to about $1,500 to incorporate, $2,000 to $3,000 for annual financial statement and tax return preparation, and $3,000 to $5,000 in annual bookkeeping costs.

Evelyn Jacks, founder and president of The Knowledge Bureau in Winnipeg, adds another layer to this advice. She says it's critical for advisors to get a clear picture of their federal and provincial tax rates in their businesses, personally, and in their households. "Take the time to really contemplate all of your advantages," she advises. "You will probably find that you're on a path to potential after-tax wealth creation, but you do have to understand the nuances of integrated personal and corporate tax rates, and that's going to take some time."

As you run the numbers, remember the 2006 Federal Budget raises the amount a small business can earn at the federal 12% tax rate to $400,000 from $300,000, effective January 1, 2007. Even better, that 12% tax rate will decrease to 11.5% in 2008 and 11% in 2009. Additionally, your corporation may benefit from the enhanced

Continued on page 20

Continued from page 19

gross-up and dividend tax credit announced in the same budget.

HOW DO I INCORPORATE?

Assuming you're allowed to incorporate and that it makes sense for your individual situation, the actual process is straightforward. Some of the 10 steps below can be completed simultaneously, while the professionals advising you can provide specific guidance about the requirements for your own company.

1 Engage the services of an accountant or lawyer. Suggests Cestnick: "It's probably good to talk to the accountant first because the accountant may have ideas about what the share structure should look like."

2 Decide whether to incorporate provincially/territorially or federally. Some advisors believe provincial incorporation will restrict them from doing business outside their own jurisdiction. Cestnick says that's not necessarily true, qualifying that provincial incorporation may be less expensive than federal incorporation. And better yet, he says, you can change your corporate jurisdiction if it ever becomes necessary for you to be incorporated federally.

3 Select your corporate name. Kerreigh Ernst says this is an important branding opportunity that he wishes he had exploited more fully when he incorporated his Oakville, Ont. insurance practice—Kerreigh Ernst Insurance Agencies Ltd.—in 1976. He was more creative when naming the investment side of his business, Unique Investment Network Inc., incorporated in 1997. "Each and every one of us has a brand. It's determined by your personality," he says. "You should determine the brand that you are and in some way incorporate that into the name of your company."

4 Arrange for a name search. Unless you are incorporating a numbered company, your corporate name will need to be vetted through the Newly Upgraded Automated Name Search (NUANS) system before you submit it, along with your articles of incorporation, to the appropriate provincial or federal government office.

5 Complete and file the articles of incorporation. Drawn up with the assistance of your lawyer, these legal documents establish details such as the number and classes of shares the company can issue, the number of directors who will be appointed and any restrictions on what activities the company may engage in. They must be filed with the government and accompanied by the appropriate fee and supporting documents.

6 Establish the structure of your corporation. Your lawyer will help you draft and arrange for the approval of corporate by-laws, the issuance of shares, the election of directors and the appointment of corporate officers, among other details. The decisions you make at this stage can help to position your corporation for tax-saving benefits later on.

7 File all the other necessary paperwork. Whether your company is incorporated provincially or federally, it will need a federal Business Number. You will also need to register provincially any names your company uses other than the corporate name. Talk to your lawyer about any further legal requirements.

8 Set up your record-keeping processes. "The record-keeping is one of the reasons why most people don't incorporate," says Scott Plaskett. But Plaskett doesn't think advisors should be deterred by the additional reporting requirements of an incorporated company. The Toronto-based senior financial planner and CEO of IRONSHIELD Financial Planning Inc. does stress that advisors should make sure they understand their accounting software thoroughly and set it up properly from the start so it captures the information they need.

Also consider the creation of the corporate minute book, a binder that includes documents such as your articles of incorporation, corporate by-laws, minutes from shareholder and directors' meetings, shareholder and directors' resolutions, and share-transfer register. You may also need a corporate seal that can be stamped onto legal documents to establish their validity.

9 Visit your bankers. Take your articles of incorporation with you and open your corporate bank account. If you want other people to be signing officers, with the right to access this account, arrange to have them accompany you to your meeting so their signatures can be added to the bank's documents.

10 Advise your clients and business associates that your corporation is up and running. Jamie Golombek, vice-president of taxation & estate planning at AIM Trimark Investments, emphasizes that you shouldn't try to conceal the transition in an attempt to simplify things for

Continued on page 22

Continued from page 20

people. Your incorporation should be visible because, going forward, your company must offer the services you may have been offering personally to your clients. That means that, at a minimum, your letterhead must change, outgoing cheques to suppliers must be drawn from your corporate bank account, and incoming cheques must be payable to your corporation. Cestnick suggests you also check to see if any formal agreements and contracts you've made with clients or business partners need to be re-signed.

HOW DO I MAXIMIZE THE BENEFITS OF INCORPORATION?

"Most people underutilize their corporate strategies," says Jacks. "We're all so busy trying to make money and to hit our revenue targets that we don't always give a lot of thought to diversification of our own income and the value of the equity that we're building. And within a corporate structure we have so many more opportunities on both of those fronts."

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> —SCOTT PLASKETT

Some of the simple strategies she suggests advisors consider to maximize the benefits of incorporation include setting a fiscal year-end in the second half of the year, so that bonuses can be deducted by your company in one tax year and taxed in your personal hands 180 days later in the next tax year. She says it's also very important to establish the most advantageous mix of salary, dividends and bonuses in any given year.

In addition, Jacks points out corporations provide valuable income-splitting opportunities. Your company can pay family members reasonable salaries for the work they do. Beyond that, depending on your share structure, you may be able to pay dividends to your spouse and adult children. If they have no other income, significant amounts of these dividends may be tax-free. Jacks advises against paying dividends to minor children because this will attract the "kiddie tax."

Shares of your corporation can be held by a family trust, which may be important to protect your business from your children's marriage breakup and bankruptcies. Meanwhile, investments can be kept within a holding company inside your corporation—and this, says Cestnick, is very important to keep active business income and investment assets separate within the company.

Golombek says it's best to set up mechanisms such as a family trust or holding company at the outset so you don't have to revisit the corporation's structure five or 10 years later. He adds advisors may be able to save taxes on an absolute basis by having the corporation pay for non-deductible and partially deductible business expenses, because you don't have to earn as many pre-tax dollars within the corporation (with its favourable tax rate) to pay for any given expense.

Looking toward the future, Jacks says that as an employee of your own corporation you may be able to set up an individual pension plan to enjoy higher contribution limits than an RRSP. And when the time comes to transfer your business to a new owner, each shareholder within your family (including a family trust) may be entitled to the $500,000 capital-gain deduction on the sale of your qualified Canadian-controlled private corporation.

In other words, if you, your spouse and two adult children are shareholders, a potential $2 million gain could be tax-exempt if your corporation qualifies for the deduction.

Finally, keep in mind that the benefits of incorporation aren't all financial. As Plaskett puts it, "It made me look at things as a business. It wasn't just me; it was bigger than me. A lot of times people are not able to separate the personal from business activities, and that whole process of incorporating really gives you a sense of confidence. Now you have this other entity that you're in charge of."

"Being able to tell other business owners that you are incorporated, that you are an established entity, that you aren't an individual—I think that's very important," adds Ernst. "It demonstrates to clients and the business world that you're in business for the long term, not the short term." AE

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