

Fall 2005 issue

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## Professional Corporations

For several years now, professionals of all types have been permitted to incorporate their business. It is well known that incorporation can provide significant tax deferral opportunities for professionals.

### Recent Developments

The 2005 Ontario Budget announcements have increased the attractiveness of incorporation for certain health professionals (doctors and dentists). The announcements relaxed the previous requirements that only health care professionals were permitted to be shareholders of the corporation. Now, family members of physicians and dentists are permitted to hold non-voting shares in professional corporations. As a result, significant tax savings can be achieved through income splitting with family members.

### Income Tax Deferral Opportunities for all Professional Corporations

A professional corporation in Ontario pays federal and provincial taxes of about 18.6% on the first \$300,000 of business income – considerably lower than the top individual marginal rate of about 46.4% which comes into effect at approximately \$113,000 of taxable income. This 27.8% differential means that by leaving \$300,000 of taxable income in the corporation, approximately \$84,000 of income taxes can be deferred and either reinvested in the business or invested in some other security.

### Income Tax Savings Opportunities for Certain Health Care Professional Corporations

For medical and dental professional corporations, the tax advantages are even greater as a result of the 2005 Ontario Budget announcement. They can not only defer taxes, but can also achieve a real tax savings by having family members own non-voting shares in the corporation and split income with a spouse and adult children by paying dividends from the corporation's after-tax income to take advantage of possibly lower marginal rates of tax.

For example, a dentist earning income in a professional corporation could split income with his/her spouse and adult children by paying divi-

dends from the corporation's after-tax income. If the spouse and adult children have no other source of income, dividends of approximately \$31,000 could be paid to each of them free of tax. Compare this to the pre-2005 Ontario Budget situation in which only the dentist was permitted to own shares of the corporation. If in such case, the dentist paid himself \$54,000 of dividends (assuming he had other sources of income such as salary from the corporation), he would have paid approximately \$17,000 of income tax on the dividends. Accordingly, the new budget measures provide an opportunity for real annual tax savings of approximately \$17,000, as illustrated by this example.

### Other Benefits of Incorporating a Professional Corporation

The benefits of incorporating a professional practice are greater than ever. In addition to annual tax savings and deferral opportunities, a corporation can provide opportunities for estate planning. Alternatively, if the professional wishes to sell his/her practice, he/she may be able to take advantage of the \$500,000 capital gains exemption available on the sale of the shares if certain conditions are met at the time of the sale.

To learn more about this topic and other tax strategies, please contact Helen Lakkotrypis (416-969-8166 x 241) or Enzo Morini (416-969-8166 x 244) of the W&P Tax Group.

## Tax Tip: Investing in Corporations Through Your RRSP

Generally, an RRSP can invest in shares of a corporation if the shares are listed on a prescribed stock exchange in Canada or in a country other than Canada, or if the corporation is a public corporation as defined in the Income Tax Act, Canada (the "Act"). If the shares are not of the type noted, they may alternatively qualify if the corporation is an eligible corporation at the time of acquisition and through-out the period of investment, or a small business corporation at the time of acquisition. These terms are defined in the Act as follows:

An eligible corporation is generally a taxable Canadian corporation which uses all or substantially all (90% or more) of its property in a qualifying active business (i.e., a retail or wholesale business or any busi-

ness which is carried on in Canada except one where the principal purpose is to earn income from property in the form of interest, dividends, rent, royalties or gains from dispositions of property). A further requirement is that the annuitant of the RRSP or a person related to the annuitant, does not hold directly or indirectly, 10% or more of the shares of any class of the corporation or of another related corporation.

If the corporation is already 100% owned by the investor, it will not meet the criteria under the definition of eligible corporation. Furthermore, if the corporation is a newly-formed one, it has not likely begun an active business. Shares of a newly-formed corporation will not generally qualify prior to the start of an active business.

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A small business corporation is a Canadian corporation of which all or substantially all (i.e., 90% or more) of its assets, measured on a fair market value basis, are a combination of i) assets used principally (i.e., 50% or more) in an active business carried on primarily in Canada by the corporation or a related corporation; and ii) shares or debt of small business corporations that are connected with the particular corporation. Immediately after the time the shares are acquired by the RRSPs, the annuitants under the RRSPs cannot hold directly or indirectly, 10% or more of the shares of any class of shares of the corporation or of any corporations related to the corporation unless the annuitants deal at arm's length with the corporation and the cost amount of all shares is in total, less than \$25,000.

### Acquiring Non-Qualified Investments in An RRSP

The Act sets out a number of rules relating to the acquisition of non-qualified investments in an RRSP as follows:

#### **To the Annuitant**

The fair market value of the non-qualified investments i.e. the value of the shares of the corporation, at the time they are acquired by the RRSPs

is required to be included in the income of the annuitants for that year, i.e., the amount of capital invested.

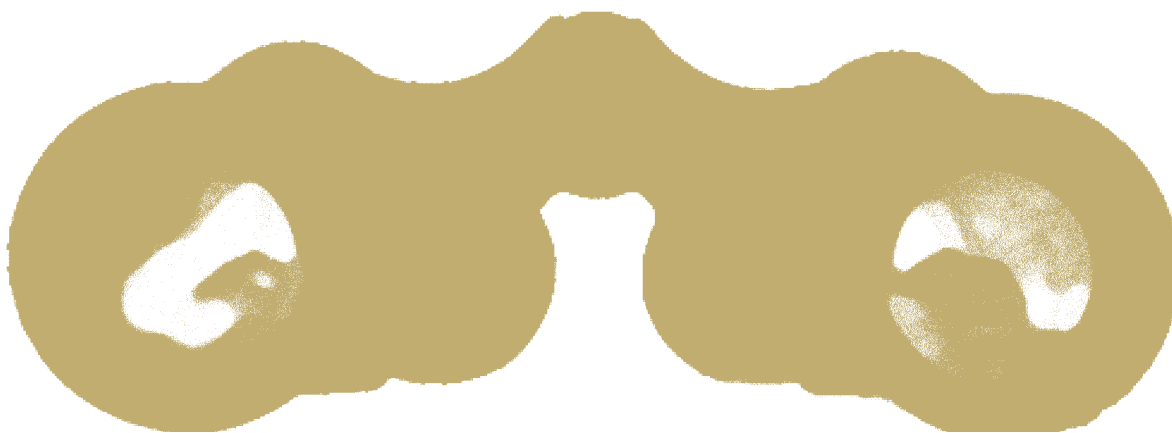
When the RRSPs disposes of the non-qualified investments, the annuitants will include the amount of the distribution in their income for the year. A deduction equal to the lesser of proceeds of disposition from the shares and the amount previously included in income, may be taken to (partially) offset the income from the "distribution".

#### **To the RRSP**

The RRSPs will be subject to tax on any dividends received from the shares of the corporation while it holds such shares. In addition, upon the disposition of the shares, the RRSPs will be subject to tax on 100% of any capital gains realized (i.e. without the benefit of the capital gains inclusion rates).

Unless the annuitants include the fair market value of the non-qualified investment in their income, a penalty tax will apply to the RRSP each month they hold the non-qualified investment. The penalty tax is calculated each month, as 1% of the fair market value of the non-qualified investment at the time that the RRSPs acquired it.

## Financial Planning



The importance of sound financial planning has never been more evident than it is today. Most of us have seen the effects of not planning properly, whether it is firsthand through losing a parent or spouse, or seeing friends experience the untimely loss of a family member. We all know what can happen if we don't take care of things before it's too late yet there is still something inside telling us to do it tomorrow.

Today, our school system has realized the importance of financial planning by offering courses in personal and household financial management and budgeting. A couple of decades ago there were no competitive mortgage rate offers from other banks or brokers. Credit cards were harder to get than filling in a form. Today, information is available at our fingertips and the consumer is better educated than ever. Armed with the knowledge they can get from a variety of sources, investors today can

do a lot of the basics themselves but the need for professional help has never been greater.

With greater competition came more products and services, each one slightly "better" than the other. Consumers sometimes find themselves drowning in too much information and administration when it comes to their finances. Investors, with their statements in hand, are saying they just can't understand what it all means. This problem is compounded when some financial planners switch people in and out of mutual funds in search of elusive higher returns. More importantly, they don't know where they are going or why they are doing this! They don't know whether all this effort will allow them to retire earlier or travel in retirement. For that matter, many people don't know whether they can retire at all and if so, for how long? Will they outlive their savings? Will they be forced to sell the family home or cottage to pay the bills? More often than not, a lack of proper financial planning is the reason they can't.

Of course all this depends on whether they live to retirement age. An integral part of the financial planning process is preparing for the possibility that we may not live long enough to retire. A financial plan all too often ignores this unpleasant aspect of life by only looking at the

investment or accumulation of money. Investment planning is just one of the components of a good financial plan.

We must take into account worst case scenarios such as: what happens if the primary bread-winner is injured and can't work or dies suddenly? What if it's the primary care-giver? The surviving spouse and family will need a supplement to their income in order to maintain their current standard of living.

The main concern most responsible people have is: "Will my family be ok if I'm not here tomorrow?". The answer to this question invariably depends on whether we have done the appropriate insurance planning within the context of the financial plan. Most dual-income families would find it difficult, if not impossible, to continue to afford their standard of living with one income removed. If they could manage, why is the other spouse still working? For a single-income family, one can almost be certain the survivors wouldn't be able to continue paying the bills, mortgage, taxes etc if their sole income source ceased to exist.

Some feel that covering the mortgage with the bank's mortgage insurance is good enough. "She'll be OK with a mortgage-free house to live in" is the popular mantra of those who don't want to see [choose to ignore]

what is right in front of them. What they fail to realize is that all the other bills will still be there next month. Bank mortgage insurance tends to be a "one size fits all" by only covering you for the outstanding balance of the loan. It only gives the survivor a house to live in rather than money on which to live (or pay for the funeral).

And what about the looming "trillion-dollar turnover" poised to begin soon and last for the next decade or so. One of the common situations will be a family cottage that has been around for years. Mom and Dad bought it 25 years ago for \$25,000 but it's worth \$500,000 today. The capital gains taxes on this property could be as high as \$110,000 today and twice that by the time they become payable. How does this family keep the cottage without the children getting a mortgage to pay the taxes or making the government of Canada their primary beneficiary? Again, the answer rests in proper insurance planning...and the earlier the better.

Every sound financial plan must ensure you or your family has an income source if you live too long, die too soon, or can't work anymore.

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## Document Retention

### Williams & Partners is going out of business.

That is, the business of creating paper. As most of you are aware, accountants create a lot of paper. At Williams & Partners, we are now in the process of destroying paper.

For years accountants recorded information on lined slightly tinted columnar paper. In an attempt to be more efficient and use less paper we started to track client information on computers, but alas continued to print more paper than we had ever created before. This is now changing.

W&P has instituted a paper destruction policy that will result in retaining our assurance files, that is audits and review engagements, for 7 years, along with the related corporate tax returns. We will also retain working papers and related tax returns for notice to reader engagements for 7 years.

All personal tax files will be retained for 5 years. We have and will continue to retain the 1994 personal tax files as they contain information on the capital gains exemption that may be needed in the future.

The policy outlined above will apply to both paper and electronic files. We are of the opinion that this policy will result in document retention that is both efficient and sufficient.

This policy also complies with the requirements of the Personal Information Protection and Electronics Documents Act (PIPEDA) which came into effect on January 1, 2004. That policy requires that personal information be retained only as long as it is required for the original specified purpose.

In furtherance of this initiative we are currently investigating a paperless or at least a "less paper" office so as to minimize the amount of paper we create. We will notify you as this work progresses.

Should you have any questions on this matter please contact Carlo De Pellegrin, CA, at 416-969-8166 ext. 232, or by email at [carlo.depellegrin@williamsandpartners.com](mailto:carlo.depellegrin@williamsandpartners.com).



December 15, 2005	Final Personal Income Tax Instalment due for 2005
December 23, 2005	TSX - last trading day of the year for settlement in 2005
December 26 to 30, 2005	Williams & Partners offices will be closed for Christmas
January 1, 2006	Happy New Year!!
January 2, 2006	Williams & Partners office reopens
January, 2006	Organize information for the preparation of your T4's and T5's
February 28, 2006	Deadline for filing T4's and T5's for 2005
March 1, 2006	RRSP contribution deadline

# CLIENT'S CORNER

## Ironhead Originals Inc.

If the name Ironhead doesn't ring a bell with you, it sure did for one of its most famous clients, heavyweight boxer Evander Holyfield. You may recall the match between Holyfield and Mike Tyson in November 1996. Ironhead Originals supplied the entire Holyfield team with signature garments, including the boxing trunks of Holyfield himself, all of which were displayed in front of a huge international audience. Holyfield beat Tyson and went on to offer great praise for his new apparel. Almost overnight more than 20 top ranked boxers were wearing Ironhead.

Ironhead is the creation of its founder Michael Regan, who started out making school team jerseys in his parent's basement. Soon thereafter he brought in high school friend Danny O'Brien, whose sales expertise has helped the company grow to where it is today. Currently the company is located in Scarborough, Ontario. In June of 2000, Ironhead opened an affiliated retail store in Vancouver's Kitsilano district, which is headed by Mike's brother Danny.

Ironhead is a truly Canadian clothing company built on integrity and quality. It manufactures orders for everything from vintage club jackets to high end retro leather coats. It has a large selection of homemade T-shirts, hooded sweatshirts, golf shirts and jackets available at its retail location, catering to people of all ages and interests. The brand produces original and creative styles of all shapes and sizes. The company keeps its product line unique by constantly mixing up colours and graphic designs, and every item sold at Ironhead is a limited edition.

Ironhead's customer list reads like a celebrity roll call, from NHL players and teams to actors like Halle Berry and Russell Crowe, and corporate clients like Mercedes and Molson. In fact, our own Bill Williams has been seen sporting an Ironhead leather jacket for several years.

For fine crafted, unique sporting apparel, give Ironhead Originals Inc. a call or visit their website at [www.ironhead.com](http://www.ironhead.com). And keep your eyes peeled for their logo the next time you watch a world class sporting event.



## New team members

Williams & Partners is pleased to announce the following new team members who have recently joined our expanding professional team:

### Helen Lakkotrypiss, CA

Helen is a former senior tax manager with KPMG where she spent 12 years after graduating from the University of Toronto's Bachelor of Commerce program in 1993. Helen is a past instructor of income taxation at the University of Toronto, the CICA In-Depth Tax Course and the ICAO School of Accountancy. Helen joined the firm as a manager in our Tax Division in September 2005.

### Andrew Salo, CA

Andrew joined the firm as a manager in September of 2005. He holds a Bachelor of Business Administration from Wilfrid Laurier University.

Prior to joining Williams & Partners, Andrew had eight years of public accounting experience with a mid-sized Toronto accounting firm. His focus is primarily on owner-managed businesses, particularly in the manufacturing, real estate and retail sectors. He has significant experience in providing a wide range of services to small and medium sized businesses operating in these diverse sectors.

### Norm Vassell

Norm joined the firm as a staff accountant in August 2005. He has over seven years of accounting and tax experience working in industry with Hewlett Packard, Ashland Canada and Maple Lodge

Farms. He is also active in teaching as a continuing education professor at Humber College.

Norm has successfully completed the CPA exam and has a Business Commerce Degree from Ryerson.

### Joyce Hahn

Joyce joined the firm as an analyst in September 2005. She is a recent graduate of the University of Toronto where she obtained her Bachelor of Commerce degree. She was Vice President of Finance of Delta Delta Delta women's fraternity, and has organized philanthropic chapter events for Families of Children with Cancer, associated with St. Jude's Hospital in Tennessee. Having obtained the necessary requirements to pursue her C.A. designation, she will be writing the Uniform Final Examinations in 2006.

### Tyler O'Donnell

Tyler joined the firm as an analyst in September of this year. He recently graduated from Wilfrid Laurier, receiving his Hon. BA designation in Economics and Accounting. Having obtained the necessary requirements to pursue his C.A. designation, he will be writing the Uniform Final Examinations in 2006.

### Zaimin Karmali

Zaimin joined the firm as a staff accountant in January 2005. She attended Wilfrid Laurier University and graduated with honours from the BBA program specializing in accounting. She brings with her over 5 years of public accounting experience and was licensed as a CPA in July 2004.

## NOTICE

Williams & Partners distributes tax tips on a regular basis via email to our clients. If you wish to be on our email distribution list for tax tips, please contact Wendy Pettey at (416) 969-8166, ext. 229, or by email to [wendy.pettey@williamsandpartners.com](mailto:wendy.pettey@williamsandpartners.com).

## CONTACT US

You can reach us by phone at 416-969-8166 e-mail at [team@williamsandpartners.com](mailto:team@williamsandpartners.com), or on-line at [www.williamsandpartners.com](http://www.williamsandpartners.com).

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