

The Navigator



Wealth
Management

RBC Wealth Management Services



Aaron Fennell, MBA, CFA
Investment Advisor
aaron.fennell@rbc.com
416-313-6397

RBC Dominion Securities Inc.
181 Bay Street, Suite 2350
Toronto, ON M5J 2T3
www.aaronwfennell.com
866-605-3295

Wealth planning for health-care professionals – The peak earning years

On July 18, 2017 the federal government released a consultation paper proposing a number of strategies which target private corporations with regards to income splitting, multiplication of the lifetime capital gains exemption, holding a passive investment portfolio inside a private corporation, and converting a private corporation's regular income to capital gains.

Generally, effective for 2018 and later taxation years, the government has proposed to limit income sprinkling to family members receiving "reasonable" compensation from a private corporation. The proposed measures extend the tax on split income rules (often known as "kiddie tax") to adults and limit the multiplication of claims to the lifetime capital gains exemption.

The government is also seeking input on possible measures to eliminate the tax advantage of investing undistributed earnings from an active business in a private corporation. If enacted, these measures may result in a disincentive for investing passively within a corporation.

The strategies discussed in this article may be affected by the proposed measures in the consultation paper and the accompanying proposed legislation. If you are an owner of a private corporation you should consider the potential impact of the proposed measures and discuss the implications with your qualified tax advisor.

Whether you are a new graduate, working as an associate, running your own practice or approaching retirement, tax, financial and retirement planning will always play a key part at every stage of your career. As your personal, professional and financial situations evolve, you should ensure that you've done appropriate planning to help you achieve your goals and objectives throughout the different stages of your professional life. This article addresses the relevant issues you may face when you are in your prime earning years and you are well positioned to strategize on how you will use the excess funds earned in your practice.

This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.

Peak earning years

In your peak earning years, your priorities will most likely include minimizing taxes, mitigating risks and accumulating wealth. If your practice is generating more income than you need to maintain your current lifestyle and/or you have a spouse, child above 18 years of age, and/or a dependent parent, any or all of whom are in a low tax-bracket, you may wish to consider incorporating your practice if you have not done so already.

Some of the main advantages of incorporating are the tax advantages. These include the opportunity to defer tax by leaving surplus earnings in the corporation; the ability to draw dividend income from a corporation; the opportunity to income split after-tax corporate earnings by paying dividends to adult family members who are shareholders of the professional corporation (PC); and, the potential to multiply the capital gains exemption on an eventual sale of shares of the PC.

Potential tax deferral

Perhaps the most significant advantage of using a professional corporation is the ability to defer taxes. The income you earn as a sole proprietor is considered professional income and taxed in your hands in the year it is earned. If you practice through a PC, the income is taxed in the corporation. If the income earned is below the business limit, it is subject to the small business deduction and taxed at a lower corporate rate of between 10.5% - 18.5%, depending on the province. Professional income earned in the corporation in excess of the business limit will be taxed at the general corporate rate of between 26% - 31%, depending on the province of residence. Since income earned at the corporate level is taxed at a lower rate than personal income (for those subject to high effective tax rates), a tax deferral opportunity exists when

the income is taxed in the corporation (at the lower rate) and is not distributed to the shareholder. The deferral ceases when a dividend is paid to you and you pay the personal tax on that dividend.

For example, assume that a practice generates \$500,000 of taxable income during the year and the professional requires \$180,000 to fund their personal expenses. In addition, assume the individual's effective tax rate is 40% and the corporate tax rate on active business income subject to the small business deduction is 15%.

As a sole proprietor, you are subject to tax personally on the taxable income of the practice (i.e., \$500,000). The after-tax income would be available to fund your personal expenses and

the excess would be available for savings or personal objectives.

In a PC scenario, the corporation would pay you a salary⁽¹⁾ of \$300,000 (which, assuming an effective personal tax rate of 40%, results in an after-tax income of \$180,000) to fund your personal expenses. For purposes of this illustration only, we will ignore payroll taxes. The excess income would be subject to tax in the corporation at the small business rate. The corporate after-tax income would be retained within the corporation and be available for making capital expenditures, funding working capital or making current and future investments.

The following table summarizes the cash flows for the two scenarios:

	Sole proprietor	Professional corporation
Corporate income		\$500,000
Less: salary		(300,000)
		200,000
Less: corporate tax (15%)		(30,000)
Funds available for reinvestment		170,000
Personal income (practice or salary)	\$500,000	\$300,000
Less: personal tax (40%)	(200,000)	(120,000)
Less: personal expenses	(180,000)	(180,000)
Funds available for reinvestment	120,000	Nil

(1) It is possible in this scenario that the corporation could pay corporate tax on the \$500,000 of taxable income in the corporation and distribute a dividend from the after-tax earnings that would net you, after-tax, \$180,000. The decision as to whether to receive a salary versus dividend is dependent upon the effective personal and corporate tax rates applicable in your province of residence. A professional tax advisor can assist in determining the optimal remuneration structure.



In certain instances, if incorporation of a partnership makes sense, the partnership can be transformed into a PC on a rollover basis without adverse tax consequences to the partners.

As the example above demonstrates, earning income through a PC and leaving surplus funds in the corporation can result in a significant tax deferral. In our case there is \$50,000 of additional funds available.

In order to achieve the tax advantages mentioned above, your business structure must involve a PC. If you are currently practicing as a sole proprietor, you will need to transfer your practice over to a PC, which may possibly be done on a tax-deferred basis.

Practical issues in structuring a professional corporation

The Income Tax Act (the Act) allows for several tax-deferred transfers involving taxable Canadian corporations, which includes PCs. If you already have a non-incorporated professional practice and you want to transfer it into a PC, you must first establish a corporation (with the help of a legal professional) and obtain the appropriate license or permit from your professional governing body. You should contact your professional governing body regarding conditions of incorporation specific to your profession in your jurisdiction. Once the PC has obtained the appropriate licence or permit, you may transfer the practice assets to the PC. This transfer is done pursuant to a purchase and sale agreement, such that you are transferring assets over to the corporation for fair market value consideration. The consideration received by you can be in the form of a promissory note, preferred shares and/or common shares of the PC. It may be possible to transfer assets on a tax-deferred basis by electing under subsection 85(1) of the Act and filing the appropriate tax election forms within the appropriate time limits with the Canada Revenue Agency (CRA) and Revenu Quebec (if resident in Quebec).

If you are an individual partner of a partnership and wish to

incorporate, you must first form a PC licensed to carry on the practice of your profession by applying to the appropriate governing body. You can then transfer your interest in the partnership to that corporation. Your interest in the partnership is considered capital property and is therefore may also be eligible for transfer into a corporation on a tax-deferred basis under subsection 85(1) of the Act.

In certain instances, if incorporation of a partnership makes sense, the partnership can be transformed into a PC on a rollover basis without adverse tax consequences to the partners. Pursuant to subsection 85(2) of the Act (which works similarly to subsection 85(1)), the partnership would transfer its property to a PC for consideration that includes shares of the PC. The partnership would then distribute the shares of the PC and any other assets received on the rollover to its partners. The partners would thereby become shareholders of the PC and would personally hold any other assets distributed to them by the partnership.

It is essential that the proper elections are filed correctly and on time to ensure that the transfers between you and your PC are done on a tax-deferred basis if this is your goal. You should consult with a qualified tax professional when restructuring your professional practice and engage a qualified valuator when determining the fair market value of the assets to be transferred, such as the value of the goodwill in your practice.

GST/HST issues

There are a number of Goods and Services Tax (GST)/Harmonized Sales Tax (HST) issues faced by medical and dental professionals and their PCs. The application of the GST/HST rules must be determined on a case-by-case basis. Depending on the type of services and supplies provided by you on behalf of your

The Articles of Incorporation are a legal document which sets out a corporation's purpose and regulations.

PC, the supply of property or service may be GST/HST taxable, exempt or zero-rated (taxable at the rate of 0%). For example, while most healthcare and dental services are exempt from GST/HST, the sale or supply of medical devices such as hearing aids and artificial teeth are zero-rated. Moreover, surgical services rendered for cosmetic purposes and not for medical or reconstructive purposes are subject to GST/HST. It is important to know which goods and services are taxable and at what rate, not only to determine whether the PC should charge GST/HST on the goods and services you provide but also to determine whether your PC is eligible to claim input tax credits on the GST/HST paid on the inputs and disbursements made by your PC. You should speak with a qualified tax professional with expertise in the area of excise tax to ensure your PC is complying with the GST/HST regulations and is claiming credits that are available to your PC.

Corporate share structure

The Articles of Incorporation are a legal document which sets out a corporation's purpose and regulations. It also sets out the number and various classes of shares that the corporation can issue and generally describes the rights, privileges, restrictions and conditions attached to the shares of each class. Examples of different rights and restrictions are:

- Voting rights;
- Participation in corporate surplus – shareholder's right to receive dividends;
- Redemption feature – corporation's right to buy back the shares for a fixed amount;
- Retraction feature – shareholder's right to sell the shares back to the corporation for a fixed amount;

- The right to cumulative dividends – cumulative dividends accrue each year even when they are not declared or entirely paid out to shareholders;
- The right to non-cumulative dividends – the right to non-cumulative dividends is extinguished if the directors do not declare the dividend in the period to which it relates (for example, by the end of the year); and
- The right to receive the residual property of the corporation on wind up and dissolution.

Most corporations have a number of different types of shares authorized for issue, each with its own characteristics. A corporation may authorize an unlimited number of common shares to be issued. Preferred shares are a class of corporate capital stock which normally hold priority over common shares in terms of dividend payments and in distribution of the corporate assets on liquidation. Typically, the common shareholders have the right to a portion of the remaining assets of the corporation after any creditor claims against the corporation have been settled.

The type of share to be issued by your corporation will depend on a number of factors, including the availability of the capital gains exemption on the sale of the shares, the need for asset preservation, the use of the small business deduction, and the general share ownership restrictions imposed by the provincial legislative bodies. Consult with a legal advisor to determine what type of share is appropriate in your circumstances.

Introducing family members to the corporation as shareholders

Depending on the corporate structure permitted in your jurisdiction by the appropriate regulatory body, family

It is important to note that there are restrictions as to who can own shares of a PC depending on which jurisdiction the PC is authorized to practice in.

members may be able to become direct shareholders or indirect shareholders of a PC through the use of a holding corporation or a trust. Shares can be acquired by family members through subscription to certain shares from treasury or through acquisition of existing shares from the professional or other shareholders of the corporation, if applicable. Shares of the PC must be acquired at their fair market value, otherwise various provisions of the Act may apply resulting in undesired tax consequences.

New professional corporation

For a newly incorporated PC, planning is likely limited to identifying the types of authorized capital required, the subscription prices to be charged for shares, and the persons who will subscribe for the shares.

A newly incorporated PC will have no value prior to issuing shares; therefore, the directors can issue shares at a nominal value.

Once the assets are transferred to the corporation, the value of the corporation is equal to the value of those assets transferred in less debts of the corporation for example a promissory note issued to the professional. The net value of the assets now in the corporation is represented by the shares held by the professional as consideration for the assets transferred in.

Existing professional corporation

If the fair market value of the shares of the PC is not a nominal amount, family members who wish to become shareholders of the PC may not have sufficient capital available to acquire an interest in the corporation. You may be able to use an estate freeze to overcome this issue. An estate freeze can be implemented in various ways. One common technique to achieve an estate freeze is through the use of a share exchange whereby the

professional exchanges his or her existing shares for fixed value special/preferred shares of the PC, with a redemption price equal to the fair market value of the existing shares. A valuation may be necessary if the existing PC is to be reorganized to admit new shareholders.

When you transfer property, such as ordinary common shares, to a corporation in return for fixed redemption-price special/preferred shares, the value of that exchanged property (the “old” common shares) is effectively frozen in the new special/preferred shares. New non-voting common shares of the PC with nominal or negligible value are issued in favour of your family members, holding company or family trust, where applicable. To avoid the income attribution rules from applying, the new common shareholder(s) (family members, holding company or trust) should use their own funds or borrow to subscribe for these new shares and repay the loan and accrued interest with their own funds or dividend payments received from the PC. Estate freezes can be effected without triggering any immediate tax liability because the transfers to the corporation can be done on a rollover basis.

It is important to note that there are restrictions as to who can own shares of a PC depending on which jurisdiction the PC is authorized to practice in. For more information, please refer to the section on “Who can hold shares other than the professional?” You should speak with a legal advisor before restructuring your PC to include your family members as shareholders. A legal advisor should be consulted regarding whether the corporation’s Articles can accommodate the proposed shareholder change and the process required to implement the change.

Who can hold shares other than the professional?

Each provincial jurisdiction has legislation governing the PC that includes restrictions on direct or indirect share ownership of the PC. The following table shows who can own shares of the medicine and dentistry PC other than the professional, including a trust or a corporation, in each jurisdiction:

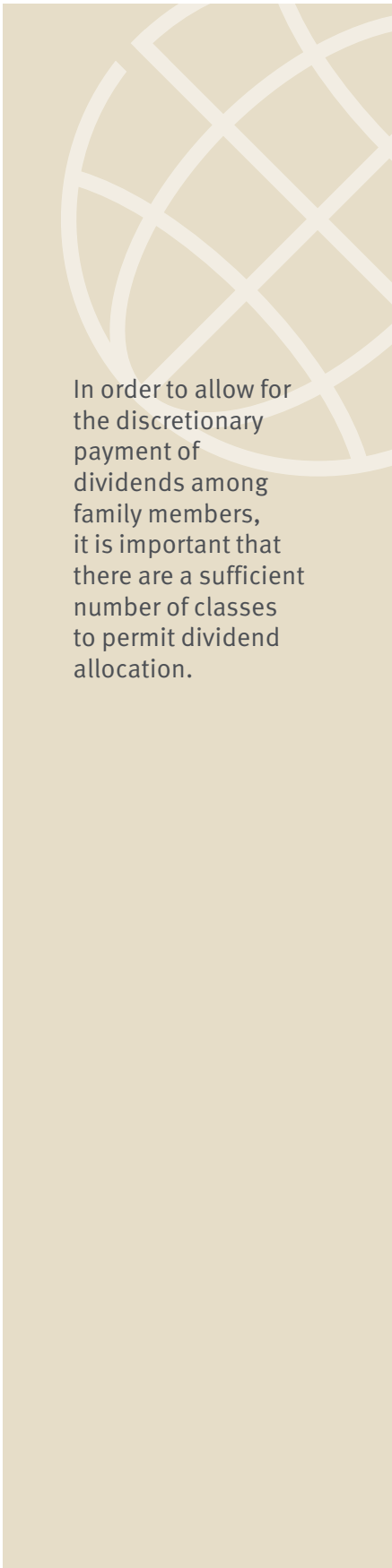
Jurisdiction	Spouse/ Common-law partner *	Child of Professional	Parent of Professional	Trust for minor children	Trust	Corporation
Alberta	Yes	Yes	No	Yes	No	No
British Columbia	Yes	Yes	Yes	Yes	Yes	Yes
Manitoba	Yes	Yes	No	No	No	Yes
New Brunswick	Yes	Yes	Yes	Yes	Yes	Yes
Newfoundland and Labrador	Yes	Yes	Yes	No	No	No
Nova Scotia **	Yes	Yes	Yes	Yes	Yes	Yes
Ontario	Yes	Yes	Yes	Yes	No	No
Prince Edward Island	Yes	Yes	Yes	Yes	Yes	Yes
Quebec	Yes	Yes	Yes	Yes	Yes	Yes
Saskatchewan	Yes	Yes	Yes	Yes	Yes	Yes

* The definition of spouse and common-law partner depends on the jurisdiction, but generally includes a person married to the professional or with whom the professional is living in a conjugal relationship outside marriage for a certain time period.

** In Nova Scotia, there are no restrictions as to who can own shares of a corporation engaged in the practice of dentistry other than the restriction that the majority of voting shares of the corporation are beneficially owned by one or more licensed dentists. For a PC carrying on the practice of medicine, its shares may be beneficially or legally owned by any person.

Source: Provincial legislation, regulations and legislative proposals, 2016.

It should be noted that shares owned by persons other than the professional would have to be non-voting in order to comply with regulatory requirements. Most provinces only permit the professional to own voting shares of the PC.



In order to allow for the discretionary payment of dividends among family members, it is important that there are a sufficient number of classes to permit dividend allocation.

Income splitting by paying dividends

Professionals often plan on using the PC's retained earnings to fund post-secondary education for their children. If the professional is the sole shareholder of the PC, the dividend paid by the PC would be subject to tax in their hands at their marginal tax rate. If other family members are shareholders of the PC and their taxable income is nominal or nil, significant tax savings can be achieved by paying dividends to them and having the dividends taxed in their hands.

If the PC's professional income is less than \$500,000, in 2016, dividends of approximately \$8,400 to 32,800 (depending on the province of residence) can be paid to an adult child (i.e., child age 18 at the end of the year or older) tax-free provided that he or she has no other income. If the PC's professional income is in excess of \$500,000, the average tax-free dividend that can be received increases to approximately \$25,000 to \$50,000 (depending on the province of residence).

In order to allow for the discretionary payment of dividends among family members, it is important that there are a sufficient number of classes to permit dividend allocation. The Articles of Incorporation must provide that dividends can be paid to one class of shares to the exclusion of the other classes.

The advantage of paying dividends to family members rather than paying them a salary is that a distribution of dividends is not subject to the reasonableness test. A payment of salary would have to be reasonable in the circumstances and be based on the work performed by the family member whereas a payment of dividends is only restricted by the PC's ability to meet certain solvency tests and by the share attributes of the shares held by the family member

shareholder. Therefore, a family member shareholder can receive dividend income from the PC without being employed by the PC.

It is also important to ensure that no dividend is paid where a pre-existing entitlement to that dividend exists. An example of a pre-existing entitlement is an outstanding cumulative dividend. Where a freeze share (i.e., a share issued as part of an estate freeze that represents part of the value of the corporation prior to the estate freeze) has been issued, no dividend can be paid on other classes of shares that would reduce the fair market value of the freeze share below its redemption value or that would result in the corporation not having the necessary net assets for the redemption of the freeze share. For this reason, dividends should not be paid to family members who subscribed for non-voting shares out of retained earnings that existed at the time of the share subscription. Dividends should only be paid to an individual from earnings arising while the family member is a shareholder.

Be mindful of corporate attribution

Corporate attribution rules apply when an individual transfers or lends property to a corporation and one of the main purposes of the transfer or loan is to benefit a spouse or a related minor child (which includes a grandchild, niece or nephew for the purposes of these rules) who owns 10% or more of any class of shares in the corporation. If corporate attribution applies, then the individual who transferred or lent the property to the corporation is deemed to have received interest income in the year equal to the CRA prescribed rate of interest for the period on the amount of the transferred property or loan.

Generally, where a freeze has occurred to benefit a spouse or a related minor child who owns 10% or more of any class of shares in the PC, the professional would be required

The payment of dividends from a PC to a minor child is discouraged because of the tax rule on split income (also known as the kiddie tax rule).

to include in his or her income a deemed interest amount based on the value of the preferred shares distributed to the professional as part of the estate freeze.

This attribution rule does not apply if at least 90% of the PC's assets are used in the active business of the practice and not for passive investment purposes. The deemed interest income may be reduced by any interest received from the corporation or taxable dividends paid to the professional on the preferred shares. Therefore, it is important to consider the application of corporate attribution and the steps which may need to be taken to overcome this issue.

Be mindful of kiddie tax

The payment of dividends from a PC to a minor child is discouraged because of the tax rule on split income (also known as the kiddie tax rule). Under this rule, a minor child who receives certain dividend payments from a Canadian corporation whose stock is not listed on a stock exchange (i.e., a privately held company) is taxed on the dividend at the highest personal marginal tax rate. The parent is also jointly and severally liable with the child for the taxes payable on the split income.

Association Rules

Professional income earned in a PC is considered active business income for tax purposes and where the income is below the business limit (\$500,000 at the federal level and \$500,000 at the provincial level, except for Manitoba where it is \$450,000 and Nova Scotia where it is \$350,000 in 2016), the PC can claim the small business deduction. The small business deduction reduces the corporate tax rate to between 10.5% - 18.5%, depending on the province of residence. Any professional income over the small business limit is taxed at the general rate of between 26% - 31%, depending on the province of residence. The business limit must be

allocated between corporations that are associated with each other in a taxation year.

The association rules are complex and include several deeming rules. The following are just common examples of a variety of ways a PC can find itself associated with another corporation.

- **Common control.** If you own all the voting shares of your PC and also have a controlling interest in another incorporated business, both corporations will be associated and will be required to share one small business limit.
- **Cross-ownership.** If you own a PC and your spouse controls another corporation and you own 25% or more of any class of shares of the corporation controlled by your spouse, either directly or indirectly as a beneficiary of a discretionary trust or shareholder of a wholly owned holding corporation, the corporations will be associated for tax purposes.
- **Child/trust look-through rules.** For the purposes of the association rules, a parent is deemed to own the shares owned by their child who is under the age of 18. The rules also deem each beneficiary of a discretionary trust to own all the shares that are owned by the trust. Together, these rules provide that the parent of a child under 18 years of age owns all the shares held by a discretionary trust of which the child is a beneficiary. If you and your spouse own a corporation and you set up a family trust that holds the shares of another corporation with minor beneficiaries, both corporations may be associated.

There may be ways to avoid the application of the association rules, such as issuing only shares of a "specified class" in certain instances. However, in addition to the above association rules, the Act also contains



If a substantial portion of your PC's payroll expenses can be attributed to the development of the PC's dental or medical clinical innovation or research, the PC may be eligible to receive benefits under the SR&ED program.

an anti-avoidance provision that provides that if it may reasonably be considered that one of the main reasons for the separate existence of one or more corporations is to reduce the amount of tax that would otherwise be payable, then the corporations are deemed to be associated.

The association rules are very complex and you should seek advice from a qualified tax professional to determine whether these rules may apply in your circumstances.

Acquire another practice

If you enjoy running a practice and would like to expand your operations, you may consider investing in another practice. The purchase of the target practice can be structured as an asset purchase or a share purchase. If the seller is selling you the assets of the professional practice, you can either make the purchase as an individual buyer or you can first incorporate a new PC or use your existing PC to buy the assets. If the vendor is selling you the shares of a PC, you can incorporate another PC or have your existing corporation buy the shares from the vendor and subsequently merge the two PCs together to form one corporate entity. Although there is no tax advantage to having two separate PCs as both corporations would have to share one small business limit due to the association rules, having two separate practices in two legal entities may provide you with greater flexibility down the road should you decide to sell the practice later on.

There are a number of options to consider when you are deciding on how to fund the acquisition of a second or subsequent practice. Speak with a qualified financial advisor to help you consider your options.

SR&ED Program

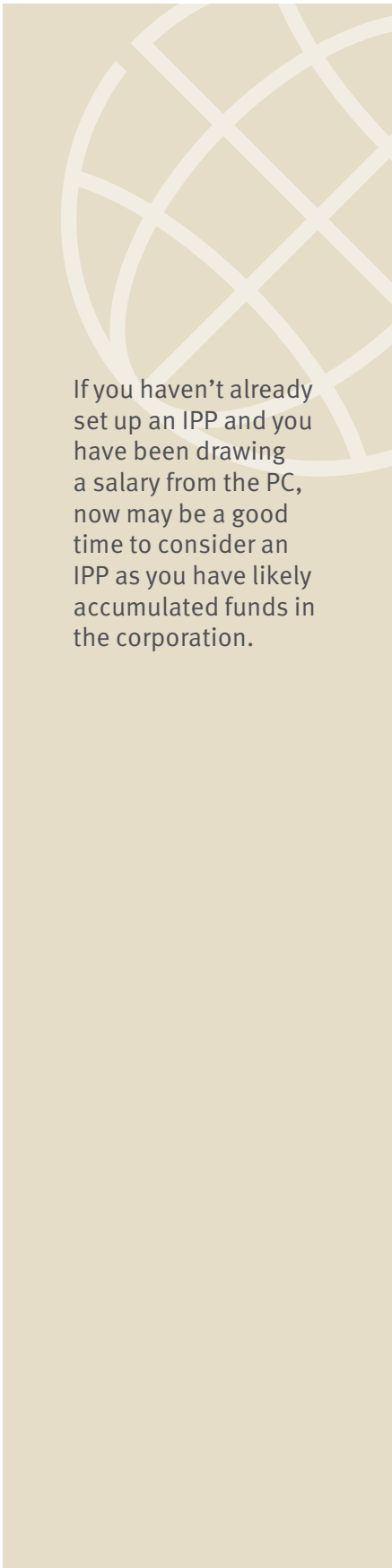
If the PC earns revenue from clinical activities and research, the PC may be able to increase its cash flows with the

Scientific Research and Experimental Development (SR&ED) incentive program. The SR&ED incentive program was established to encourage Canadian businesses of all sizes and in various industries to conduct research and development in Canada. Medical and dental industries are among those that are eligible for the SR&ED incentive. The program does not provide a grant but provides assistance in the form of a refundable investment tax credit, a reduction of taxes payable, or both, based on the allowable SR&ED expenditures claimed. To qualify for this incentive program, the work must advance the understanding of scientific knowledge or technology, address scientific or technological uncertainty and involve a systematic investigation or search by qualified personnel.

If a substantial portion of your PC's payroll expenses can be attributed to the development of the PC's dental or medical clinical innovation or research, the PC may be eligible to receive benefits under the SR&ED program. If you think you may qualify for this incentive program, you should contact a qualified professional with specialized SR&ED experience and knowledge for more information on how you may be able to benefit from the SR&ED incentive.

Surplus cash

Taking advantage of the tax deferral benefit of retaining funds in a corporation may ultimately lead to a buildup of surplus cash in the PC. Unfortunately, there are limited investment options for a PC since its activities are restricted to carrying on the practice of the profession and activities related to or ancillary to the practice of the profession. Although the investment of surplus cash earned by the PC is allowed, in some jurisdictions, the PC may not be allowed to invest in or hold real estate not used by the practice. In provinces where a holding corporation is permitted to hold shares of a PC,



If you haven't already set up an IPP and you have been drawing a salary from the PC, now may be a good time to consider an IPP as you have likely accumulated funds in the corporation.

the PC may be able to move excess funds to a holding corporation via a tax-free intercorporate dividend and the holding corporation can then invest in real estate opportunities or other investments (i.e., marketable securities). In all other provinces, the only way to remove the funds from the PC is to distribute the funds via a taxable dividend to the shareholder who can then use the after-tax cash to invest in real estate. This method is not effective as there is an up-front payment of tax.

Setting up a holding company

As stated previously, in some provinces, a holding company can own shares of a PC. A holding company that is properly positioned between a professional and a PC can have many uses. It can be used to distribute ownership interest; facilitate an estate freeze; provide a degree of creditor protection by holding excess cash, investments, insurance policies or land (note that a holding company cannot provide creditor protection against professional malpractice); possibly allow for income-splitting; and, potentially facilitate the use of the capital gains exemption. When used in conjunction with professional advice, it may be able to provide greater flexibility in succession and estate planning.

Setting up a family trust

Where available, there are several benefits to having a family trust as a shareholder of your PC. For example, there is an opportunity for income splitting and tax minimization. Dividends can be paid from the PC to the family trust and allocated to and taxed in the hands of the adult children or grandchildren beneficiaries, who may have little to no income. There is also the opportunity for family members to have indirect ownership in the practice through the control of a trustee. The option of holding shares


of a PC in a trust is not available for PCs governed by certain provincial regulatory bodies. (For more information, please refer to the section on "Who can hold shares other than the professional?")

A family trust can also be used by the professional to split income with their low-income family members without the trust holding shares of the PC. However, the funding of the trust would have to come from you using after-tax monies. If structured properly, you can shift investment income and capital gains earned on the funds that would otherwise be taxed in your hands at a high marginal tax rate, to the hands of your low-income spouse, children, nieces/nephews and/or grandchildren.

Implementing an Individual Pension Plan (IPP)

If you haven't already set up an IPP and you have been drawing a salary from the PC, now may be a good time to consider an IPP as you have likely accumulated funds in the corporation. An IPP is a defined benefit pension plan that a PC can set up for a professional. It is usually set up for one individual member but the benefits can also be extended to your spouse, if they are employed by the PC. In certain situations, an IPP can provide greater annual contribution limits than an RRSP. Contributions made to an IPP are also deductible against the PC's income. An IPP is ideally suited for professionals over the age of 40 and whose typical earnings are at least \$144,500 (2016 threshold) per year.

In addition to annual contributions, your PC can potentially make a large contribution when the plan is initially setup to cover your previous years of service (as far back as 1991 or the year of incorporation, whichever is later) prior to the IPP being established. Additional tax deductible contributions may also be made to the IPP to make



The advantage of a PHSP is that payments made by the employer are tax-deductible and the professional is not required to include any of the payments in his/her income.

up for investment returns in the plan that are less than the 7.5% expected actuarial interest rate (in some provinces, this additional contribution is a requirement).

Assets in an IPP may be protected from creditors; however, they may be subject to locking-in provisions during retirement.

Note that any asset protection strategy should be undertaken when there is no creditor claim or potential creditor claims in order to reduce the risk that the creditors will be successful in their claims. It is essential you speak with a qualified legal advisor before exploring the asset protection options available to you.

Private Health Services Plan (PHSP)

The PC can establish a PHSP for the professional who is also an employee of the PC. A PHSP is basically a plan established by an employer under a contractual arrangement with an insurer or a self-insured arrangement under which the employer pays for employee medical expenses (e.g., medical, dental, vision care, hospital care). The advantage of a PHSP is that payments made by the employer are tax-deductible and the professional is not required to include any of the payments in his/her income. Since the professional is also a shareholder, it is important that the amount is not considered to be a shareholder benefit; otherwise, the payments would become a non-deductible expense to the PC and a taxable benefit to the professional. To avoid the risk of the benefits paid under the plan being considered as a shareholder benefit, the benefits under the PHSP should be consistent with that which would be offered to an arm's length employee performing similar services.

Corporate owned life insurance

If you need life insurance, for example to provide income

protection for survivors, fund buy-sell agreements or pay capital gains tax on death, a corporate owned, tax-exempt insurance policy may be a solution. Life insurance premiums are generally not tax-deductible. However, it is usually less expensive to fund the policy using after-tax corporate dollars as opposed to after-tax personal dollars. Provided the corporation is both the policyholder and beneficiary of the insurance policy, the professional will generally not be assessed a shareholder benefit. For example, if the professional corporation's tax rate is 15% and the professional's effective tax rate is 40%, corporate owned insurance allows for the funding of the policy using \$0.85 after-tax rather than \$0.60 after-tax where the policy is personally owned and the policyholder is in a high tax bracket. In the event of the death of the professional whose life is insured under the corporate life insurance policy, the non-taxable death benefit is paid to the corporation, which increases the corporation's capital dividend account by the amount of the insurance proceeds received in excess of the policy's adjusted cost base. The balance in the capital dividend account may be paid tax-free to the surviving shareholders.

If you plan on selling the shares of your PC, you should consider holding the life insurance policy in a holding corporation (if applicable) and not in your PC. Speak with a life licensed professional to determine if insurance makes sense in your circumstances.

Conclusion

As a professional that has operated your practice for a number of years and have started accumulating excess funds in your practice, you may want to consider tax minimization strategies such as income splitting. Speak with a qualified tax advisor to consider your options and to determine if there are ways to maximize your after-tax earnings and savings.

Please contact us
for more information
about the topics
discussed in this
article.



This document has been prepared for use by the RBC Wealth Management member companies, RBC Dominion Securities Inc. (RBC DS)*, RBC Phillips, Hager & North Investment Counsel Inc. (RBC PH&N IC), RBC Global Asset Management Inc. (RBC GAM), Royal Trust Corporation of Canada and The Royal Trust Company (collectively, the "Companies") and their affiliates, RBC Direct Investing Inc. (RBC DI) *, RBC Wealth Management Financial Services Inc. (RBC WMFS) and Royal Mutual Funds Inc. (RMFI). *Member-Canadian Investor Protection Fund. Each of the Companies, their affiliates and the Royal Bank of Canada are separate corporate entities which are affiliated. "RBC advisor" refers to Private Bankers who are employees of Royal Bank of Canada and mutual fund representatives of RMFI, Investment Counsellors who are employees of RBC PH&N IC, Senior Trust Advisors and Trust Officers who are employees of The Royal Trust Company or Royal Trust Corporation of Canada, or Investment Advisors who are employees of RBC DS. In Quebec, financial planning services are provided by RMFI or RBC WMFS and each is licensed as a financial services firm in that province. In the rest of Canada, financial planning services are available through RMFI, Royal Trust Corporation of Canada, The Royal Trust Company, or RBC DS. Estate & Trust Services are provided by Royal Trust Corporation of Canada and The Royal Trust Company. If specific products or services are not offered by one of the Companies or RMFI, clients may request a referral to another RBC partner. Insurance products are offered through RBC Wealth Management Financial Services Inc., a subsidiary of RBC Dominion Securities Inc. When providing life insurance products in all provinces except Quebec, Investment Advisors are acting as Insurance Representatives of RBC Wealth Management Financial Services Inc. In Quebec, Investment Advisors are acting as Financial Security Advisors of RBC Wealth Management Financial Services Inc. RBC Wealth Management Financial Services Inc. is licensed as a financial services firm in the province of Quebec. The strategies, advice and technical content in this publication are provided for the general guidance and benefit of our clients, based on information believed to be accurate and complete, but we cannot guarantee its accuracy or completeness. This publication is not intended as nor does it constitute tax or legal advice. Readers should consult a qualified legal, tax or other professional advisor when planning to implement a strategy. This will ensure that their individual circumstances have been considered properly and that action is taken on the latest available information. Interest rates, market conditions, tax rules, and other investment factors are subject to change. This information is not investment advice and should only be used in conjunction with a discussion with your RBC advisor. None of the Companies, RMFI, RBC WMFS, RBC DI, Royal Bank of Canada or any of its affiliates or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. © Registered trademarks of Royal Bank of Canada. Used under licence. © 2016 Royal Bank of Canada. All rights reserved. NAV0101 (11/16)