

Introduction to medical practice incorporation



MD Financial
Management



Is this guide for you?

Learn more about
incorporation at
md.ca/incorporate

You should read this guide if you're a Canadian physician who is:



new in practice and wants to find out more about incorporating your medical practice; or



practising, paying down debt and thinking about building wealth.

Why physicians incorporate their medical practice



Many businesses incorporate to take advantage of certain benefits, but there's more to think about when incorporating a medical practice.

As a physician, you'll typically have a heavy tax burden that could make it more difficult to reach your long-term financial goals.

Incorporating your medical practice can help you defer some of your immediate tax burden and thus speed up your retirement savings.



You can rely on MD's incorporation expertise

There is a lot to consider when deciding whether to incorporate or not. Our expertise is working with physicians, so we understand the complexities that you face. We're here to help you.

MD Financial Management (MD) has a long history of providing physicians with guidance, advice and practical solutions regarding incorporation. As your wealth grows and your finances become more complicated, we'll work with you to maximize your financial well-being.

While incorporation is one way to increase your wealth, it can also make your financial picture more complex. MD can help you effectively address financial planning with an incorporated practice.





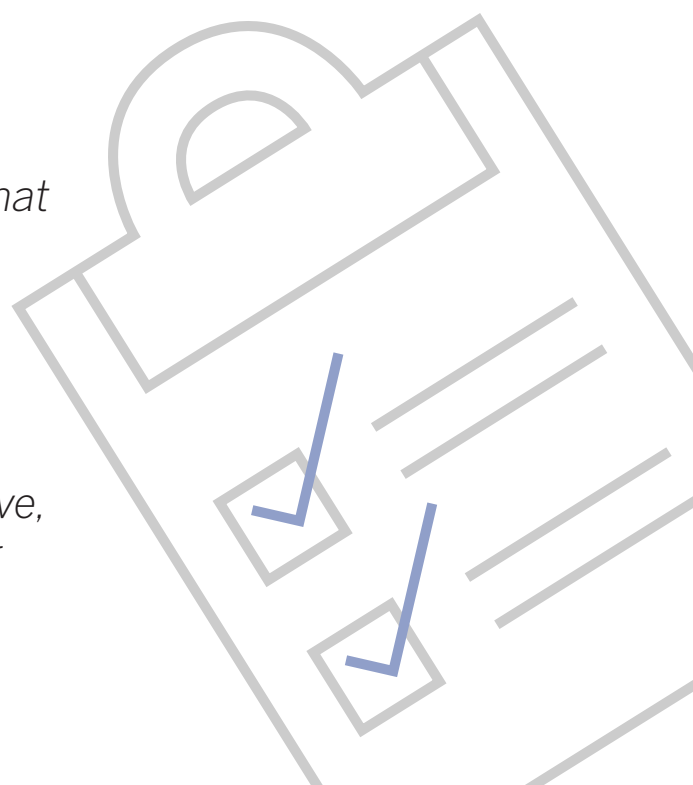
Could incorporation be
right for you?



Work with your MD Advisor to help you decide whether incorporating is right for you.

These six questions will give you a better idea. See how many you answer “yes” to.

- ☒ *Are you earning significantly more than what you need for daily living?*
- ☒ *Is your income based on the traditional fee for service model?*
- ☒ *Do you want to save more money than is allowed in your RRSP and tax-free savings account?*
- ☒ *Do you think you could benefit from income splitting with your spouse after you turn 65?*
- ☒ *Do you have assets or business debt that you could better pay for with corporate dollars?*
- ☒ *Do you have plans (travel, parental leave, sabbatical, etc.) that might cause your income to vary from year to year?*





Understanding medical professional corporations

When you incorporate, you create a legal corporation that owns your medical practice. It means that you become a shareholder and a director or employee of the corporation.

The corporation is a separate entity. You, the physician, control it, but the corporation independently earns income and pays tax on it. There are two main points to be aware of regarding this separation between physician and corporation:

1. The corporation is a separate taxpayer under the *Income Tax Act* (Canada), and certain types of income earned by a corporation may be taxed at a lower rate than if earned by a physician personally.
2. A corporation is owned by its shareholders. While all voting shares are typically physician-owned, a spouse and children (and potentially others, depending on your province or territory) can become shareholders and own non-voting shares.

How it works



You, the physician



You create the corporation



You (and other shareholders) own the corporation

You make the decisions



You are personally responsible for your services



You may be a director, company officer or employee of the corporation



It is separate from you, the physician

Your corporation is a legal entity in the eyes of the law



The corporation owns your medical practice



It can owe and pay taxes; it files its own tax return



It can own property and insurance policies



Your medical professional corporation



Why a physician would want to incorporate

To get significant tax advantages. Medical professional corporations benefit from the small-business tax rate, which is about 12%, depending on your province or territory. You pay this lower rate now on your practice income (up to \$500,000 but this varies by province). The money you saved on tax can be invested through your corporation, where it will grow. You will pay more tax later when you withdraw money from your corporation, but you will already have enjoyed the tax deferral benefit.

To build retirement savings faster. Incorporating your medical practice can help you keep more of your earnings and grow wealth more effectively. While registered plans like RRSPs and tax-free savings accounts are a tax-efficient way to save for the future, you might want to save more than these plans allow.

To accelerate business payments. Let's say you have some large business expenses, like buying into a medical building, acquiring costly medical equipment or offering substantial employee benefits. While there is no getting around these expenses, you may be able to pay for them—or the financing used to acquire them—more efficiently from inside the corporate structure, using the corporation's funds.

Case study: the tax deferral advantages of incorporating

Maria,* age 35, is a general practitioner with annual earnings of **\$300,000** (after overhead expenses but before taxes). She plans to work for another 30 years.

Maria estimates her annual financial needs to be around **\$114,500**. She would also like to be able to maximize her RRSP contributions (**\$26,500**) and tax-free savings account (**\$6,000**).

To meet these requirements, Maria would need **\$147,000** of after-tax personal cash.

Tax impact if Maria's practice is unincorporated

If Maria earns her professional income personally (e.g., in an unincorporated medical practice), she would pay an estimated annual amount of tax of **\$108,000**.

This would leave her with around **\$192,000** of after-tax personal cash, which, after accounting for living expenses, RRSP and TFSA, leaves her with **\$45,000** that can be invested.

Tax impact if Maria's practice is incorporated

If Maria incorporates, the medical professional corporation (MPC) earns **\$300,000** (after overhead but before taxes) and pays **\$4,000** in additional administrative costs each year.

Maria pays herself a salary of **\$212,000**, which allows her to maintain her desired lifestyle (**\$114,500**) and maximize her RRSP (**\$26,500**) and TFSA contributions (**\$6,000**).**

Maria leaves **\$84,000** of the MPC income in the corporation, which is taxed at the small business tax rate. That rate is considerably less than her personal tax rate.

In this scenario, the total after-tax cash available for investment, inside the corporation, is **\$73,920**. This exceeds the amount of cash available for investment if Maria remained unincorporated by **\$28,920**. This is known as the tax deferral advantage.

*The hypothetical case study is for illustrative purposes only and does not represent actual clients. Any resemblance to actual people or situations is purely coincidental.

**These are the maximum contribution amounts for 2019.



Unincorporated

Personal

Net practice income (after overhead)	\$300,000
RRSP contribution	(\$26,500)
Personal taxes payable**	(\$108,000)
After-tax personal cash	\$165,500
Living expenses	(\$114,500)
TFSA contribution	(\$6,000)

After-tax personal cash available for investment **\$45,000**

Maria has **\$28,920** more cash available for investment if she incorporates

Incorporated

Corporate

Net practice income (after overhead)	\$300,000
Annual administrative costs	(\$4,000)
Physician salary	(\$212,000)
Practice taxable income	\$84,000
Corporate tax rate*	12%
Corporate taxes payable	(\$10,080)

After-tax corporate cash available for investment **\$73,920**

Personal

Physician salary	\$212,000
RRSP contribution	(\$26,500)
Personal taxes payable**	(\$65,000)
After-tax personal cash	\$120,500
Living expenses	(\$114,500)
TFSA contribution	\$6,000

Total after-tax cash available for investment (personal and corporate) **\$106,420**

*This is an average tax rate and assumes the small business tax rate applies to all active business income (no reduction due to passive income rules).

**This is an estimated amount of tax payable. The actual amount will vary depending on the individual's province/territory and personal tax situation.

Maria's cash available for investment

Unincorporated

Personal non-registered investment account	\$45,000
RRSP	\$26,500
TFSA	\$ 6,000
Total	\$77,500

Incorporated

Corporate investment account	\$73,920
RRSP	\$26,500
TFSA	\$ 6,000
Total	\$106,420

Tax deferral advantage

Incorporated	\$106,420
Unincorporated	(\$ 77,500)
	\$28,920



Other strategies that can boost the value of your corporation

We've established that the main advantage of incorporating is having lower tax rates to speed up saving for retirement or help pay for business costs. But there are some things you can do to make incorporating even more worthwhile:

Banking: Your corporation will need a bank account and may need credit and other banking services. Your MD Advisor can refer you to a banker familiar with medical professional corporation needs, which may bring advantages.

Asset location: Where should you invest your corporation's assets? Different types of investments have different tax consequences, and your MD Advisor can show you the best way to invest.

Spousal RRSPs: These can be a way to help grow your retirement savings. A spousal RRSP is a way of splitting income with a lower-income spouse and thus reducing taxes. Those savings can be invested through your corporation.

Income sprinkling: A physician who has turned 65 and is still incorporated can pay dividends to a lower-income spouse, thus reducing taxes. In some situations, the spouse and/or children may qualify for income sprinkling even before the physician is 65.

Insurance: A life insurance policy (term or permanent) bought with corporate funds can have several benefits. The lower tax rate applied to those funds makes this a more efficient way to pay for the insurance. And if you name the corporation as beneficiary, the death benefit is tax-free and could be used to pay your final tax bill, donate to charities, etc.

Research tax incentives: If research is part of your work, being incorporated gives you access to better federal R&D tax incentives.

The costs and extra administration of incorporating

When you set up a corporation, you'll incur some start-up costs as well as ongoing ones. There are also extra administrative tasks, mostly associated with the corporation's recordkeeping and bookkeeping. Your team of MD professionals and specialist partners (e.g., accountant, lawyer, tax specialist) have a wealth of experience with incorporation and can tell you more about the following:

Initial fees

- Legal and accounting fees
- Other disbursements (fee to the professional licensing body; cost of corporate minutes book; corporate registration; obtaining consent to practice medicine through your corporation)



Annual fees

- Legal services
- Accounting services



Ongoing administration

- Corporation shareholder agreement

Separate tax filing

- Filing annual tax return for the corporation
- Preparing T4 and T5 income tax slips
- Paying tax instalments
- Remitting monthly source deductions on salaries paid to you (the physician) and other employees





Avoid surprises: Be aware of these potential snags

Passive income: The tax deferral benefits that apply to your practice income generally don't apply to passive income earned by the corporation. As a result, corporate investment income is taxed at rates similar to the top personal tax rate.

Malpractice and liability: Generally speaking, a corporation is liable in the case of a lawsuit, not its shareholders. But this is not true for physicians, as they remain personally liable for malpractice.

U.S. persons: If you're a U.S. person practising in Canada, you may not benefit from incorporation to the degree a Canadian person will, because of certain reporting requirements. Your MD Advisor can tell you more about this.

Partnerships and group practices: If you enter into a partnership or group practice, you may not be eligible for the small-business tax rate. These group arrangements are more complex, so it is important to ask before incorporating how they are treated for tax purposes.

Structure of your corporation: Other shareholders can create issues related to corporate attribution and documentation. To ensure your interests are protected, get professional tax and legal advice before structuring your corporation. Your MD Advisor and incorporation team can help direct you to the specialist professionals you'll need.

Lifetime capital gains exemption: It is rare that a medical professional corporation will qualify for this.

Where should you go from here?



If you're considering incorporation, your MD Advisor can help you understand whether it makes sense for your situation—before you start paying accountant fees. If you've already decided it makes sense for you, we're here to help you take the next steps.

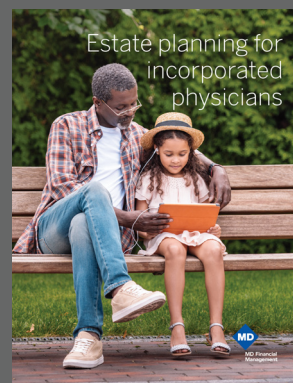
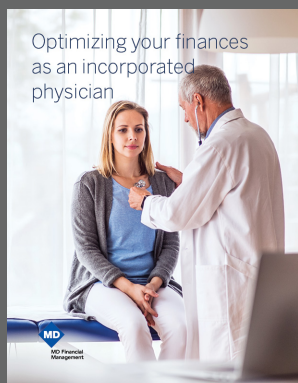
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MD can meet all your financial planning needs.

As your MD Advisor begins to work with you, he or she develops a clear understanding of your current situation and future objectives, and then collaborates with a team of specialists to engineer your customized wealth management strategy—including incorporation, if it's right for you.

As your financial situation evolves and becomes more complex, your MD Advisor will serve as the point person to monitor and update your comprehensive financial plan as required. And, when the time comes, we can help you transition to retirement or manage estate issues.

See the three other guides in this series:



Contact your MD Advisor to learn more about incorporation.

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