



Pilgrim Accounting Inc.

PROFICIENCY IN ACCOUNTING

NEWSLETTER

WHEN IS IT THE RIGHT TIME TO INCORPORATE YOUR BUSINESS?

At Pilgrim Accounting, our small and medium-sized business clients run the full range of those starting out, those gaining momentum, and those anticipating significant growth.

Many small business clients come to us initially as a sole proprietor of a company and at some stage, they ask for advice on when they should incorporate.

This is an important issue to discuss with your accountant because there is a great deal of misinformation circling about on this topic. Some see incorporation as a step associated with prestige.

I honestly have had people ask to prepare the paper work for incorporation because they liked the sound of having Inc. after their business name.

Still others, fearful of the additional bookkeeping required, shy away from it because someone along the way told them it wasn't worth the trouble, and they end up paying thousands in taxes that they could have saved had they moved ahead with it.

Regardless of how big your business is or how fast it is growing, a key factor in deciding whether or not to incorporate comes down to whether or not you need to use your profits to sustain yourself and your company, or whether you can leave them in the business.

If you are doing well, but you are withdrawing every dollar you make to support yourself and pay your expenses, then you will not really benefit from the lower corporate tax rate that results from leaving money in the business.

Businesses have lower tax rates than personal taxes, so that is the crux of the matter.

If your business is growing, but not highly profitable, you might want to put off incorporation until you see a steady stream of profits and can forecast that that profit level will be sustained in the future.

There is another aspect to incorporation that should also be considered. Are you planning to sell your sole proprietorship and do you want to reap the rewards of the enhanced capital gains exemption? If that is the case, incorporation could be an excellent idea. The lifetime limit for capital gains prior to 2014 in Canada was \$750,000, but since then it is being indexed yearly. For 2015, for example, it was \$813,600.

There are other factors to consider as well. If you want to take advantage of income splitting by paying dividends to members of your family, which involve a lower tax rate than employment income, then incorporation may be a good idea.

However, if you are incorporating to manage risk of product liability that your insurance won't cover, this is not a foolproof plan. Remember that all directors of the company will still be personally liable. Seek the advice of a legal representative who specializes in such matters before you make your decision based on this argument.



The downside of incorporation is that there is more accounting needed, notably annual reports, and if you have not factored that cost into your equation, it could impact your bottom line substantially.

But if you have a reliable accounting services that is keeping your records up to date throughout the year, the stress of complying is considerable reduced.

Contact us for advice!

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