TAXTALK

ONTARIO PERSONAL REAL ESTATE CORPORATIONS ("PRECs") RULES

On October 1st, 2020, the Provincial government brought forward Ontario's new rules for forming Personal Real Estate Corporations ("PRECs"). PRECs allow Real Estate Agents often referred to as Realtors to access the business advantages of incorporation, including tax and income planning benefits.

Certain regulated professions are permitted to form professional corporations under their governing regulations, including doctors, dentists and lawyers. A professional corporation is a corporation that is permitted by a professional association to provide the services of a member of that regulated profession. Realtors are regulated by the Real Estate Council of Ontario ("RECO") and are now permitted to form a PREC under the Trust in Real Estate Services Act ("TRESA").

Professional corporations allow the professionals to benefit from some of the tax advantages available to traditional private corporations while still protecting the public by ensuring that the professional remains personally responsible to their governing bodies in relation to the professional services provided through their professional corporations.

Incorporation

The professional must request and receive approval from the RECO prior to incorporation.

Some of the other requirements to be met include:

- The corporation must be incorporated under the Ontario Business Corporations Act;
- The corporation has one single controlling shareholder who owns all the voting shares;
- The controlling shareholder is registered as a broker or salesperson;
- All non-equity shares (non-voting) must be owned directly or indirectly by family members (spouse, children, parents, and trust for minor child) of the controlling shareholder or by the controlling shareholder;
- There is no written agreement or other arrangement that restricts or transfers the powers of the sole director and officer to manage or supervise the management of the business and affairs of the corporation.

Business Restrictions

The corporation's business is restricted to the practice of the profession. Any other activity must be ancillary to the professional practice, including the temporary investment of surplus funds earned by the corporation.

Potential Benefits of Incorporation

Generally an individual will incorporate for the following reasons:

- to provide the protection of limited liability, and
- to enjoy certain tax advantages, such as the lower corporate income tax rates available on income earned from an active business, the potential benefit of the capital gains exemption on the disposition of shares, and the potential to split income with family members.

Liability of Professionals

A professional corporation does not limit the professional liability of its shareholders. Acts of the professional corporation will be considered to be acts of/by the shareholders, employees or its agents. A shareholder of a professional corporation is jointly and severally liable for all professional liability claims made with respect to errors and omissions occurring during the period he/she owns shares in the professional corporation.

The legislation for professional corporations does not expose the shareholder of a professional corporation to commercial liabilities. For example, if a professional corporation was liable for a bank loan, which it was unable to pay, the bank's recourse should be limited only to the net assets of the professional corporation; that is, the shareholder should not be personally liable (assuming that the shareholder has not personally guaranteed the corporate debt).

Tax Considerations

As indicated, there can be tax advantages to incorporating a profession.

Low Corporate Tax - Small Business Deduction

Perhaps the most obvious tax incentive to incorporate is the ability to benefit from the small business deduction, and pay income tax at a combined federal and Ontario corporate rate of 12.2% (2020) on the first $500,000 of active business income as compared to the top combined marginal rate for individuals of 53.5%.

Capital Gains Exemption

Another attractive feature of incorporating is the potential to utilize the capital gains exemption to save income tax on the ultimate sale of the business/profession. The capital gains exemption is only available in respect of the disposals of qualified small business shares which can include voting and non-voting equity shares.

Each family member (including minor children), holding equity shares in an eligible PREC with unrealized gains, may be able to claim the capital gains exemption at the time of disposition of the shares of the PREC.

Whether or not the capital gains exemption can be accessed will depend on several factors, such as:

- whether the shares meet the criteria to be eligible for the exemption,
- if the shareholder has any personal impediments such as a cumulative net investment loss which may limit or eliminate the ability to utilize the exemption,
- whether a market exists for the shares, and
- how much the share price would be discounted (as opposed to the sale of assets) for possible unknown corporate liabilities, and to compensate the buyer for not obtaining an increase in the cost base of the underlying corporate assets purchased.

Possible Income-Splitting

There are two income-splitting options for PRECs:

- pay family members salary which has to be reasonable or
- issue family members dividends which may get caught by the Tax on Split Income (“TOSI”).

Other Tax Issues

It is essential to consider all the tax implications of incorporating, including any potential income tax, goods and services tax, harmonized sales tax, or land transfer tax that may be payable on the transfer of assets to a corporation.

Although business losses realized by a self-employed individual can be applied against other sources of income, the losses of a professional corporation are locked within the corporation and can only be carried back up to three years, and forward up to seven years against income of the corporation.

Other issues that may need to be addressed include:

- optimal salary/dividend mix to the owner managers,
- ensuring the shareholder understands the taxable benefit which results if corporate property is used personally, and
- ensuring the shareholder personally maintains separate accounts and records from the corporation.

Non-Tax Considerations

In addition to the tax issues, one must consider the initial legal and accounting costs of incorporating, as well as the ongoing legal, accounting and administrative costs of maintaining a corporation.

When transferring the assets (and operations) of a practice to a professional corporation, many administrative matters must be dealt with, including the need to:

- obtain federal business numbers including income tax, sales tax and payroll account;
- obtain a new Workplace Safety and Insurance Board account;
- consider whether consent is required from bankers, landlord, equipment lessors, and major creditors;
- notify insurers;
- change firm name on financial accounts, business signs and telephone listings;
- order new stationery, business cards, invoices; and
- administer changes to employee group plans.

Summary

There are many advantages and disadvantages to incorporation of a professional practice. A decision to incorporate should only be made after the pros and cons are reviewed with your professional advisors, taking into account your personal situation. If a decision is made to incorporate, then it is important to properly set up and operate the company to ensure it complies with applicable rules and regulations of the profession.

A memorandum of this nature cannot be all-encompassing and is not intended to replace professional advice. Its purpose is to highlight tax planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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