



STRUCTURING YOUR BUSINESS

Part Four—What You Need to Consider on Startup

So, you have decided to go out on your own and start your own business. Now what? First, it's important to lay the proper foundation for your business from the very beginning. Your business is a separate entity from you and should be treated as such. One of your goals should be to grow a business that can survive on its own without your day-to-day contributions. That way when you grow to the point that you can't manage it all on your own, you can easily add extra management to the team and continue to grow. One of the first questions should be whether you want to set it up as a proprietorship or corporation.

Proprietorship vs Corporation

When you start out there are two ways to operate your business: as a proprietorship or an incorporated business—and each comes with pros and cons.

A proprietorship means you operate your business as an individual and have full liability for the operations. The income earned by the business is taxed with your personal income in the year it is earned at your personal tax rate. There is limited separation between you and your business. Many people first starting out set up their business as a proprietorship as the cost of maintaining the business is less expensive and you only have to file one tax return annually. If you do decide to structure it this way, remember to open a GST account and start collecting GST if you are selling taxable services greater than \$30,000 per year.

The main advantage to incorporating is the limited liability of the incorporated company. Unlike the sole proprietorship, where the business owner assumes all the liability of the company, when a business becomes incorporated, an individual shareholder's liability is limited to the amount he or she has invested in the company. Of course, with incorporation comes increased expenses, paperwork and filing an extra tax return for the business.

When Should I Incorporate?

As a subcontractor, you may be asked to incorporate your business sometimes sooner than it makes business sense. The main reason for this in the forest industry is to pass the liability of WorkSafeBC rates and other safety program costs to the subcontractor business. Contractors do not want their rates affected by accidents caused by subcontractors. This is not the end of the world since business tax rates are much lower than personal tax rates, so if your individual marginal tax rate is high and you don't need the funds for personal use, you can elect to leave money in the business and take it out later when your personal tax rate is lower.

Let's Look at a Scenario

Joe is a faller and has been offered a contract to provide falling services as an incorporated business. Joe has previously worked as an employee and made \$145,000 annually. Until now he paid personal tax on the earnings and paid into a RRSP as a savings measure. Joe needs \$100,000 annually for living expenses.

To prepare for the new venture Joe will need to incorporate his business using a lawyer for a cost of about \$1,500. Once incorporated, he will need to register for GST, WorkSafeBC and payroll. Additionally, Joe should speak with an accountant if he has significant assets to move into the new business as they can help do this on a tax-deferred basis. In this case, Joe only has a small amount of gear, so no special tax work is involved, he can simply sell/move over the business assets to the incorporation at fair market value.

Now that he is registered, Joe will need to file work safe reports, as well as corporate tax returns, GST returns and payroll reports (T4 slips) with Canada Revenue to stay in compliance. He will also need to keep his books up to date to support these reports. It is a good idea to discuss how to do this with your accountant before business operations start.

Joe will also need to negotiate his faller rate. He will need to make more than

the \$145,000 annually he made as an employee elsewhere since now he must cover WorkSafeBC payments and other costs of his business.

Once Joe starts operations he has cash in the corporate bank account but must pay himself to cover his personal costs. There are two ways to do this: dividends vs salary. The advantage of salary is that you will pay tax over the course of the year and the salary is a deduction within your business. By taking a salary, you contribute to the Canada Pension Plan as well as grow your retirement savings.

Dividends are from the after-tax proceeds of your business, so you pay a lower rate on them personally, but with the corporate tax you pay, the overall tax effect would be almost the same had you taken a similar salary. Dividends do not contribute to the CPP, so you will need to save for retirement on your own.

Joe can take the \$100,000 he needs to live each year and leave the remaining income in the business where the corporate tax is a much lower rate. Then, if he has a slower year, he can then take funds out to live on from prior years, essentially making his business a savings account. This will be taxed at his personal income tax rate, which if properly planned can be lower than if he took all the funds in one year.

Conclusion

Once you have decided to take the step of starting up a business on your own you should seek the advice of a professional to help you make the best business decisions for your situation. The wrong decisions can have adverse effects in the future.▲

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