Medicine Professional Corporations

The use of corporations by doctors and lawyers is a relatively recent regulatory concession. Historically, medicine and law were considered more vocational than commercial. Client relationships were sacrosanct and corporations, with their commercial connotations and limited liability, anathema. And so, doctors and lawyers, through their respective self-governing bodies, were denied the benefits of incorporation. This has, however, changed in recent years. Today, doctors and lawyers can incorporate their practices and thereby access certain tax benefits widely available to others. As the tax benefits available to doctors and lawyers differ significantly in favour of doctors, this article focuses exclusively upon the medical profession and the tax planning opportunities available to its members.

To begin, there are three tax benefits of incorporating a medical practice, generally known as a “medicine professional corporation”. These are:

- maximizing investment capital and paying off debts;
- income splitting; and
- accessing and multiplying the lifetime capital gains exemption.

It should be noted at the outset that medicine professional corporations do not limit a doctor’s liability for malpractice. One’s professional responsibility is in no way lessened. Liability is, however, limited in other respects, such as in relation to trade creditors and lenders—provided, of course, that no personal guarantee is given.

MAXIMIZING INVESTMENT CAPITAL AND PAYING OFF DEBTS

Use of a medicine professional corporation provides greater after-tax profits with which to either pay off the practice’s debts or to invest. The corporate tax rate on income from a medical practice is generally 15.5% whereas the corresponding personal rate is 49.53%. By leaving income in the corporation, the taxpayer therefore has an additional 34.03% to either invest or apply against the corporation’s debts. Earnings on the corporation’s investments would then be taxed at 46.2% while distributions would be taxed in the shareholders’ hands at 40.13%. This higher corporate rate on investment income is intended to offset the tax deferral otherwise achieved by investing through a corporation. That tax is then partially refunded when the income is passed through to the shareholder so that the net tax approximates the tax otherwise payable had the shareholder held the investments directly. Again, then, the primary benefit lies in increasing the corporation’s investment capital by 1/3 or correspondingly increasing the corporation’s ability to pay down its debts.

The above statement of rates includes various assumptions. All rates represent the combined Federal and Ontario rates applicable before any changes to be announced in the February, 2015 federal budget speech—which follows the time of writing. The 15.5% rate applies to active business income earned by Canadian-controlled private corporations on the first $500,000.00 of annual income, which would generally include all professional income earned by medicine professional corporations. Active business income above that threshold is taxed at 26.5%. At the shareholder level, the 49.53% rate is the top marginal rate applicable to individuals on annual income above $220,000.00.

It is important to note that investing must be subordinate to the primary medical purpose of the medicine professional corporation.

INCOME SPLITTING

When medicine professional corporations were first introduced, income-splitting was not permitted since only members of the College of Physicians and Surgeons could hold shares. That restriction was soon lifted, however, so that medicine professional corporations may now be used to allocate income among immediate family members. Given the graduated personal tax rates, allocating income among lower-income earners results in lower overall tax. Provided that the income-splitting is handled properly, such tax planning is entirely acceptable, having been ratified by the Canadian courts and the Canada Revenue Agency.

One should, however, be aware of the “kiddie tax”. Individuals below the age of 18 (in tax parlance, individuals who have not attained the age of 17 years “before the year”) are subject to tax on dividends at the top marginal rate applicable to individuals. This tax applies equally to taxable shareholder benefits. One cannot, then, effectively split income with one’s minor children.

ACCESSING AND MULTIPLYING THE LIFETIME CAPITAL GAINS EXEMPTION

The lifetime capital gains exemption refers to an exemption available to individuals (not trusts) from tax on the first $800,000.00 of proceeds realized upon the disposition of “qualified small business corporation shares”. In general, the shares of medicine professional corporations would qualify such that the use of incorporation represents a significant tax savings upon a sale of the practice. Since only 50% of capital gains are taxable, this results in a deduction of up to $400,000.00 against taxable income which, at the top marginal rate, represents a cash savings of up to $198,119.00.

If shares have been issued among family members then the sale proceeds must be allocated accordingly, and the lifetime capital gains exemption is effectively multiplied. If one is married with three children then the above $200,000.00 cash savings becomes $1,000,000.00.

As a practical matter, purchasers may prefer to buy the assets rather than the corporation in order to avoid any “skeletons in the closet” and to be able to depreciate the purchase price. In this circumstance, the benefit of the lifetime capital gains exemption is not lost; rather, it becomes leverage to negotiate a higher sale price in order to compensate for the lost tax savings.

CONCLUSION

Much remains to be said about the incorporation and use of medicine professional corporations. These corporations are governed not only by the *Business Corporations Act* (Ontario) by also by the *Health Professions Procedural Code* and regulations under the *Regulated Health Professions Act*. And, of course, layered above all is the *Income Tax Act* (Canada). If, therefore, one is interested in learning more about incorporating a medical practice, it is essential to consult an advisor well-versed in both corporate and tax law as well as the medical profession’s governing legislation and regulations.

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