



*By Denny Yuen, CGA, BBA*

Individuals incorporate not only for legal reasons but also for tax purposes as well. A corporation is a distinct legal entity and the income derived by the entity will be taxed first at the corporate level and then again at the personal level when it distributes its after-tax income to its owners/shareholders. If the corporation is considered a “small business corporation” and its shares are “qualified small business corporation shares”, many advantages exist such as low tax rates for the first \$ 200,000 of active business income, ability to claim allowable business investment losses, and the \$ 500,000 capital gains exemption. In British Columbia, the combined 2002 federal-provincial corporate income tax rates for Canadian-controlled private corporations with business income under \$200,000 is 17.62%.

Corporations can also utilize the flexibility of a different fiscal year end, loss carryforwards, and income splitting. Various transactions can be structured so that income will eventually be distributed to the owners/shareholders at the lowest possible tax rates and consequently, highest return on investment. Such arrangements include payments in the form of salaries, repayment of shareholders loans and capital dividends. Remunerating a salary or a reasonable management fee to reduce the corporation's income to \$200,000 and having the rest declared as a dividend to maximize the dividend tax credit would lessen the tax burden. Since the salary is earned income, the owner/shareholder can then contribute to a Registered Retirement Savings Plan to claim further deductions on his/her personal tax return.

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