



Is Incorporation Right for You and Your Business?

As you continue to build your business, you may have been giving some thought to taking your business from a sole proprietorship or partnership to a corporation. You've been hearing about some pretty appealing tax advantages, but are you getting the whole story?

If you're going to incorporate, you've got to do your homework first. It's not a step to take lightly. As a corporation, the very nature of your business changes. It becomes a distinct legal entity that is treated as a person in the eyes of the law. As such, it has many of the same rights – and obligations – of a living, breathing person.

When you're considering incorporating, you need to start by asking yourself two basic questions: how much debt is your business carrying, now and in the future; and will you be taking on any business risks that could wipe out your personal savings if things go south? If you keep these two questions in mind when weighing the pros and cons of incorporation, you'll get a better idea of whether or not it's for you.

There's no question that the advantages to incorporating are substantial:

- **Limited Liability** – This is another way of saying that you're protected against risk. Incorporating your business protects you and your personal assets from potential financial and legal disaster. This is especially important when you have high overhead costs such as rent or inventory, or your company needs substantial capital and asset-based financing. Debts held in the corporation are limited to the corporation's assets and in most cases do not extend to the shareholders.
- **Marketing Advantages** – Sometimes, your customers will feel more comfortable in giving their business to an incorporated company. It gives them an added level of confidence that they're dealing with a stable, reputable company – one that they perceive is offering a higher level of service. This may or may not be the case. For the customer, however, perception is reality.
- **Perpetual Existence** – Companies that are incorporated can outlive their shareholders. Should a major shareholder die, ownership can be transferred in an orderly manner. Individual shareholders can pass on the rights to their companies to their children and other family members. Unlike a real person, an incorporated business can endure for generations.
- **Taxes** – Many small businesses enjoy a lower tax rate than individuals. They can take advantage of any losses by using them to reduce taxes in profitable years, past or future. In other words, you can average out the taxes you're paying on your profits so you don't get a huge spike in your taxes when times are good.

There are relatively few disadvantages, but a small business needs to be aware of them, as the cost in time and money may not make incorporation worthwhile for a small business:

- **Administration** - Administration of a corporation takes up more of your time, and in some cases can cost you money. It is particularly important to maintain separate personal and corporate accounting records, which means additional accounting expenses. You are also required to elect directors, hold regular shareholder and director meetings, and keep accurate minutes.
- **Double Taxation** – While double taxation is minimized, it does exist. Income will be taxed at the company level and, in some cases, at the shareholder level if dividends are paid. If you're going to keep these taxes to a minimum, you need to know about the various ways to compensate yourself as a shareholder.
- **Expense** – There are additional costs incurred by incorporating. These include the initial incorporation fees, and the annual expense of preparing financial statements and additional tax returns for both the shareholders and the corporation.

If you want to make the right decision, you have to consider both the upside and downside of incorporation. If there are obvious benefits, either now or in the future, then making a choice is reasonably straightforward.

Before deciding, however, be sure to speak to your accountant or lawyer. Each business is different, and they'll help you make the right choice.

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