

Benefits of REALTOR® Incorporation

December 5, 2019 -- TREB initiated efforts dating back to 2005, to convince the province to allow salespeople and brokers the ability to set up personal real estate corporations (PRECs). Brokerages of course have this ability, but so do Realtors in six other provinces and most industries in Ontario.

It was back in 2008 when British Columbia became the first province to allow for incorporation of those who trade in real estate. This was followed by Quebec, Manitoba, Saskatchewan, Alberta and Nova Scotia.

As it stands, this is an advantage afforded to many regulated professionals in Ontario, including doctors, architects, accountants, lawyers and engineers; and this is a benefit that TREB and the rest of the real estate industry has long lobbied for.

We're now one step closer to our goal, with the government proposing to do just that with the new *Trust in Real Estate Services Act, 2019* that will replace the *Real Estate and Business Brokers Act, 2002* (REBBA). The future of incorporation in the real estate industry in Ontario looks very promising and is currently going through the legislative approvals process. Bottom line is, there are many financial planning benefits for Realtors.

Why Does It matter?

Personal incorporation is a matter of tax fairness for Realtors, resulting in a more efficient business environment. Realtors in independent contractor relationships earning higher incomes (estimated at \$200k+ after Realtor expenses) are best positioned to benefit. However, it all depends on your personal circumstances.

Incorporation certainly has many advantages, including:

- tax deferral;
- an incentive to save and increase your net worth; and
- as an excellent vehicle for retirement savings.

However, there are pros and cons that will vary with each salesperson's or broker's situation that you should be aware of. The decision to consider incorporation requires an assessment of a whole range of factors.

Similar to other provinces like British Columbia, the Ontario PREC regulations will likely restrict the type of activities that can be carried on through a PREC. Services will likely be limited to real estate services, which will mean that the registrant cannot use the corporation to trade in stocks, engage in the business of real estate development, or hold real estate beyond what is required for providing real estate services.

There are also the annual costs, including professional fees, of maintaining a corporation with respect to financial statements, annual corporate minutes and tax returns. Despite some of these costs and limitations, incorporating can prove to be extremely beneficial for many registrants.

This may leave you wondering whether incorporation is right for your situation. If so, read on.

Impact on Registrant Liability and Other Professional Obligations

The new provisions allowing for the incorporation of PRECs will not affect consumer protection, as PRECs remain subject to all professional and ethical obligations currently under the *Real Estate and Business Brokers Act* (REBBA).

The individual registrant's professional liability will not be limited by use of a PREC. As in the case of other professions allowed to incorporate, there would be no change in the direct personal liability of the individual relating to professional liability (due to the *Ontario Business Corporations Act*), but there could be advantages of limited liability for other liabilities such as office and equipment leases.

In addition to professional liability, real estate professionals who incorporate would also continue to remain accountable and subject to other existing professional obligations, including education, insurance, Code of Ethics and other requirements.

Taxable Income and Canada Revenue Agency (CRA) Considerations

The proposed *Trust in Real Estate Services Act, 2019* regulations must be drafted properly to ensure CRA treats the income as taxable to the PREC. Income will need to be taxable to the PREC, rather than to the individual registrant, to qualify for the lower corporate or small business tax rate.

Based on factors that CRA looks to in determining independent contractor status and the typical arrangements that Realtors have with their brokerages, the main issue is to avoid CRA treating the corporate income as income from a personal services business (PSB). PSB would apply if the relationship is an "employee" relationship as opposed to "independent contractor."

In general terms, a "personal services business" (PSB) is a business in which a "specified shareholder" of a corporation provides services through the corporation in circumstances where he or she would normally provide those services as an employee.

Income must be left in the corporation to realize any benefits of incorporation and will primarily be of benefit to higher income earners. When the net income of the corporation is paid to the individual, there will be additional income tax payable by the individual, which will reduce or possibly eliminate the tax savings of earning the income through a PREC. The idea is to allow the income to grow in the PREC and pay out to the individual in lower income years, such as retirement.

Potential REALTOR® Benefits

Better Tax Rates: *ACTIVE BUSINESS INCOME* (subject to a \$500k limit to benefit from the small business tax reduction) earned by a corporation is subject to a combined top federal and Ontario income tax rate of approximately 12.5% (the combined *GENERAL* corporate tax rate is 26.5%) COMPARED to a combined top marginal *personal income* tax rate of 53.53%. The tax differential can be significant and as much as 41% – this is the main advantage. In other words, a tax deferral occurs at the top marginal bracket of as much as \$41 for every \$100 left in the PREC; and if or when you take the income out of the PREC, the tax differential would be lower than 41% since it will now be taxed in the hands of the individual and additional income tax would be due.

Greater Accumulation of Savings and Incentive to Save: As a result of tax savings, there is more after-tax money left to invest in the PREC, presenting an opportunity to increase savings. It provides an added incentive to save in order to avoid the extra tax payable upon removing money from the PREC.

Tax Deferral Opportunities with Control of Timing: The personal level of tax can be deferred for many years. The Realtor has control to remove money from the PREC in years with lower income, including retirement.

A registrant's earnings can be cyclical. The benefit of incorporating allows the PREC to retain some of its income, and in those higher income earning years when a registrant earns more than he or she needs to spend, it may be a good idea to do just that. This allows the registrant to control his or her yearly personal income, and in turn, the rate at which he or she is being taxed. Furthermore, the income that is left within the corporation is taxed at the corporate or small business tax rate, which is much lower than even the lowest personal tax rate. While a registrant will be taxed again when dividends within the PREC are distributed, the combined corporate tax and tax on dividends can be less or roughly equal to the personal income tax rate. Again, this benefit will vary depending on the registrant's specific situation and the amount of dividend distribution.

Excellent Vehicle for Retirement Savings: The above factors make the faster growth in PREC investments an excellent vehicle for savings to fund retirement when income is taxed at a lower rate. PRECs could also be a retirement planning tool by way of using the corporation to establish an

individual pension plan. In many instances, this could allow more tax-deductible pension contributions than would be available in the case of registered retirement savings plans.

Faster Repayment of Debts: The increase in after-tax income could allow for faster repayment of debts associated with the corporation.

Capital Gains Exemption: In certain circumstances, shares of a corporation earning active business income can be eligible for capital gains exemption. This would save tax on a sale of the PREC and on death. However, if the PREC accumulates significant investment assets, the exemption is not likely to be available.

Effective January 1, 2019, the lifetime capital gains exemption increased to \$866,912. As a result, every Canadian resident individual who disposes of qualifying small business corporation shares in 2019 can shelter up to \$866,912 in capital gains on those shares from tax. The actual capital gains deduction is 50% of the capital gains exemption.

Other Considerations

As mentioned, there are annual costs, including professional fees, of maintaining a corporation with respect to financial statements, annual corporate minutes and tax returns.

The impact on the sub-brokerage practice in the real estate industry will need to be examined.

DISCLAIMER: This information is of a general nature only and is not intended to be tax advice to any, nor to constitute an exhaustive list of all the tax and other considerations that could affect one's analysis.

It is important to note that PRECs are not for everyone, and the benefits will not be realized unless the registrant's financial position calls for it. If the legislation is passed into law by the Ontario legislature, and once the regulations are developed, it is strongly advised that each registrant obtain professional accounting and legal advice specific to their situation prior to making an incorporation application.

WHAT ARE THE NEXT STEPS?

After passing second reading, Bill 145 was referred to committee hearings, and will eventually be called back for the third and final reading, and then royal assent, at which point Bill 145 will become law.

Our work is not done yet. At this point, it is critical that TREB and our Members continue the pressure on the government to ensure that Bill 145, *Trust in Real Estate Services Act, 2019* becomes law.

TAKE ACTION – TO MAKE INCORPORATION HAPPEN, SEND AN EMAIL TO YOUR MPP NOW!

We need you to make your voice heard to ensure that all MPPs support Bill 145 so the legislation becomes law. Send an email to your MPP by clicking [here](#).

STAY TUNED

We will continue to provide updates as this historic bill makes its way through the legislative process, and we would like to thank all TREB Members who will join us in adding their voice to ensure Bill 145, *Trust in Real Estate Services Act, 2019* becomes law!