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Setting up a Personal Real Estate Corporation

What haven't you considered?

Real estate agents and brokers have historically been prohibited from carrying on their business through a corporation. However, with the passing of Bill 145, Ontario's real estate professionals will now be permitted to incorporate by setting up a Personal Real Estate Corporation (PREC). The benefits of incorporation can be considerable, including the opportunity to defer up to 40 percent in personal taxes. To take advantage of those benefits, however, there are some traps you'll need to avoid. Here are five key steps you can take to get it right.

1 Determine if incorporation is right for you

Incorporation confers a range of tax planning and other benefits. Key among those is the ability to defer taxes. For a real estate agent in Ontario, the highest marginal tax rate on earnings over $220,000 is approximately 53.5 percent. Earning income through a PREC, however, would allow the corporation to pay tax on the income earned inside the corporation

at rates ranging from
12.2% to 26.5%
in 2020.

You could even use the savings for additional corporate investments, giving you the opportunity to enhance your wealth over time.

Is a PREC right for you?

Despite these benefits, a PREC won't be right for everyone. At a high level, incorporation likely makes sense if you're an agent who:

- Has income in excess of personal spending requirements
- Wants to take advantage of income tax deferral opportunities
- Wants to invest excess cash in income-producing assets
- May be able to split income with family members
- Wants to take advantage of the $883,384 lifetime capital gains exemption

Your next move

Meet with your Grant Thornton tax advisor to conduct a cost-benefit analysis to determine if incorporation is right for you.

2

Follow the tips and avoid the traps when choosing an ownership structure

If you use excess cash to purchase real estate or other income-producing assets, incorporation may give you the ability to more effectively structure your real estate holdings. You may also be able to split income with your family members, such as a spouse or adult children, by paying them dividends or a salary. You just need to remember these strategies can be quite complex.

For instance, tax treatment varies for "buy and hold" vs. "property flipping" transactions. While flipping property generates business income, buy and hold can generate passive income (e.g., rents, interest or royalties)—which attracts higher tax rates. If your passive income exceeds certain thresholds, the PREC may even lose the ability to claim the small business deduction.

There are also strict rules related to tax on split income that you'll need to comply with. If this is done incorrectly, you may lose the tax advantages you were trying to capture.

> Proper planning is key to avoiding these traps and realizing the tax benefits of incorporation.

Your next move

Plan ahead for how you'll structure your corporation and future investments. We'll work with you on tax-efficient planning that meets your overall objectives.

3 Know the value of your assets in advance

To take advantage of the tax opportunities that come with incorporation, real estate professionals will likely transfer most of the assets they currently own into the PREC. Notably, this transfer must take place at fair market value. Determining this value may be simple enough for your tangible assets, such as property holdings or existing investments.

However, it's not as straightforward for your intangible assets. What is the value of your business goodwill, for instance? How about your current listings or your advertising and employment contracts?

Assigning value to these assets in advance will be critical as it could impact the tax treatment of your PREC.

To determine the value of intangible assets, professional valuators typically take a wide range of factors into account.

Given the complexity of this calculation, it's important to get help when assigning values to your intangible assets before they're transferred to the corporation.

Your next move

Determine the value of the assets being transferred to the corporation. A certified business valuator at Grant Thornton can assist you in this determination.

4 Make sure your tax and legal advisors work together

To set up a PREC, you'll need to engage a lawyer to create a transfer agreement to transfer your assets from your sole proprietorship into the corporation, as well as to draft and file articles of incorporation and related resolutions. Although these are uniquely legal activities, the decisions you make at this stage will affect how the corporation is taxed. As such, your tax and legal advisors should work together from the outset.

With proper collaboration, for instance, your tax advisors can help make sure that your share structure is set up to take your future needs into account. That way, if you decide to do an estate freeze at a later date, you won't have to amend your articles of incorporation at that time. Similarly, your accountant will know what the CRA typically looks for on review of your documentation, and can help you meet their expectations from the start.

Your next move

By bringing your tax and legal advisors together, they can provide you with professionally aligned advice on how to move forward with incorporation.

5 Plan ahead

Although setting up a corporation can be exciting, it's also fraught with complexities. Assessing if incorporation is right for you is only the first step. From there, you'll need to decide on an appropriate ownership structure and take time to determine the value of your assets in advance. There are also countless traps you must avoid if you hope to take advantage of the tax benefits associated with incorporation."

Planning ahead is the best way to get it right. By getting started early, you'll be ready to hit the ground running as soon as the legislation passes.

That's why it makes sense to meet with your Grant Thornton advisor as soon as you can. To get the most out of the meeting, come prepared to share the following information:

- Your 2019 personal income tax return (and your spouse's, if applicable)
- An outline of your monthly expenditures, after tax
- An overview of your current real estate investment holdings, current contracts and active real estate listing
- Your retirement savings goals

Your next move

To realize the advantages of setting up a PREC, book a consultation with your Grant Thornton advisor today.

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