This resource is provided as a supplement to the PowerPoint slides presented to physicians at the recent session at the Ottawa Hospital.

PROFESSIONAL CORPORATIONS FOR PHYSICIANS

Background of Professional Corporations in Ontario

The purpose of my presentation today is to discuss the legal nature of a corporation and in particular, a professional corporation under the Ontario Business Corporations Act. I will also highlight some matters of particular concern for physicians practising as a “Participating Physician” and member of a departmental Practice Plan under an alternate funding plan (AFP).

Legislation was first enacted in November of 2001 to permit professionals to incorporate where permitted by their governing body. In February of 2002, members of the Regulated Health Professions were permitted to incorporate and the College of Physicians and Surgeons of Ontario passed the necessary by-laws to allow physicians to incorporate their practice in September of 2002.

Significant amendments were made to the governing legislation that came into effect on January 1st, 2006 that permitted “family members“ to now own shares in a physician’s professional corporation. The amendments are not without some problems, particularly those created as a result of their prohibition on shares for non-infant family members being held in a trust.

The Professional Corporation (PC) as a Separate Entity

A corporation is recognized at law as a separate legal entity, distinct and apart from the directors, officers and shareholders of the corporation. Consequently, its shareholders, directors and officers will not be liable for any debts or liabilities of the corporation. There are however, exceptions and these generally deal with situations relating to trust funds (GST, PST, source deductions) held by the corporation or where the directors or officers knowingly participate in the commission of an offence.

In the case of a PC, although the PC is the medical practitioner delivering the clinical services, the individual physician will remain personally liable for any professional liability. Consequently, the liability of the physician will be the same whether the clinical services are provided by a PC or by the physician directly. The physician will not incur personal liability to ordinary creditors of the PC (i.e. non-professional liabilities) unless he or she provides a personal guarantee. These types of liabilities are generally not of great concern to physicians and it is unlikely that a physician would incorporate solely for the purpose of limiting his or her liability to creditors.
Permitted Activities
For many years now the charter for a business corporation, whether federal or provincial, need not contain any description or restrictions with respect to the nature of the activities that the corporation may carry on. There are of course exceptions and these are generally in federally regulated businesses such as banking, transportation and insurance.

Given the purpose of PC’s, the legislation prohibits PC’s from carrying on any business other than the actual practice of the relevant profession and activities that are “related to or ancillary to the practice of the profession, including the investment of surplus funds earned by the Corporation”.

There is still some uncertainty as to what would fall within an investment of surplus funds. Most accounting and legal practitioners would agree that ski chalets in Mont Tremblant, cottages in the Rideau Lakes or other “investments” which are primarily for the personal use of the physician would not fall within this definition. The purchase of real estate from which the physician carries on his or her practice might however come within the definition of related to or ancillary to the practice of the profession. The situation becomes more ambiguous where an investment is not related or ancillary to the practice of the profession and a significant portion of the funds used to acquire it are borrowed rather than coming out of the surplus in the corporation.

Tax advisors will generally recommend against using the PC as a real estate investment vehicle in any case, particularly where there is any prospect of selling a practice as it may preclude the use of the small business capital gains exemption. There are ways in which the physician can move these surplus funds into another corporation tax free and use this other corporation to make real estate investments. In addition to eliminating the possibility of being offside with the restrictions on activities for PC’s, using a non-PC corporation would also allow for more flexibility and opportunities for estate planning and income splitting (e.g. family trusts for a spouse and/or adult children).

Share Structure and Permitted Shareholders of PC’s
The recent amendments to the legislation referred to above that came into effect at the beginning of this year now permit members of the physician’s family to hold non-voting shares in the PC. The definition of family member includes the shareholder’s spouse, children or parents. The primary advantage in allowing other family members to be shareholders will be the ability to income split through the payment of dividends on the shares held by the other members of the physician’s family. In doing so, the dividends will be taxed in the hands of the other family members who could presumably be at a lower marginal tax rate than the physician.
There are, however, a number of things to be kept in mind including the rules regarding attribution of income contained in the *Income Tax Act*.

When issuing shares it is important to consider that a corporation does not have an inherent right to repurchase the shares nor does the physician have any right to acquire the shares held by an adult child or spouse, or parent for that matter. Any such right to purchase must be attached to the shares when issued through carefully drafted share provisions or alternatively, the shareholders must enter into a unanimous shareholders agreement which contains such rights in favour of the physician. Generally, the former approach is more cost effective.

This may be further complicated where the corporation also owns real estate or significant assets which could appreciate in value and therefore drive up the value of the shares held by the other family members if the shares have full participation rights. That is to say, that their value will increase as the value of the company itself increases and they participate in this growth.

**Transferring your Practice to a PC**

It is first important to realize that if you are currently an employee, in all likelihood, any professional corporation established by you would be considered a “personal service corporation” under the Income Tax Act and certain tax benefits will not be available to you.

Where incorporation is recommended, it is important to ensure that the details are looked after. CRA has no hesitation in taking advantage of situations where the paper trail does not support the manner in which the individual has filed his or her tax return.

The basic documentation required to implement the conversion of your practice to a PC is as follows:

1. **Incorporation of the PC**
   
   The first step in this process is to incorporate the PC. You’ll need to determine the appropriate share structure that will depend on the number of family members, the opportunity for income splitting and other family circumstances. For example, where the physician has a spouse who works and is taxed at the same marginal tax rate or children also in that tax bracket, there is little opportunity for income splitting. In that case, the physician would draw out of the PC, as salary and/or dividends, the amount he or she requires to live on with the balance of the PC’s earnings remaining in the PC. The earnings left in the PC will only have been taxed at approximately 18% (after application of the Small Business Deduction), and the deferred tax (i.e.
deferred until earnings are distributed to the physician) can be invested much in the same way, as is the case for an RRSP.

The Corporation will need to obtain a business identification number with Revenue Canada, establish a bank account, etc. The physician will also then need to apply to the College for a Certificate of Authorization. Although this process originally took up to two (2) months, the turn around time has been significantly reduced and is now approximately 10-14 days from the time the application is received by the College.

2. Transfer Agreement

This Transfer Agreement is between the physician and the PC. The Agreement will provide for the purchase by the PC of the assets used by the physician in the physician’s practice in exchange for shares issued by the PC to the physician. This transfer is carried out on a tax deferred rollover basis as provided for under Section 85(1) of the Income Tax Act.

In order to take advantage of the benefits of Section 85, it is necessary for the physician to file an election form with CRA that indicates that the physician has elected to transfer the assets at their “tax value” with the result being that no tax is triggered on the transfer of the assets to the PC.

Once the PC takes over the medical practice, all billings and revenue derived from the practice are taxed in the hands of the PC. The Corporation will now be operating the medical practice. Consequently, all contracts, leases for equipment or premises must now be in the name of the PC and not the physician’s name personally.

The physician will become a salaried employee of his or her PC. It is imperative that the physician enters into a written Employment Agreement with the PC although the terms of the agreement need not be too precise. The amount of salary will generally depend on what the physician needs to live on and his or her ability to have part of the family income derived from dividends paid on shares held by other family members.

Implication regarding Physician’s status as Participating Physician under an AFP and as Member of a Practice Group

A significant number of the physicians at the hospital are “Participating Physicians” under the AFP entered into with the Ministry of Health several years ago. One of the requirements of the AFP was that each of the physicians had to be a member of a departmental practice plan as defined under the AFP. Many of you were already members of some form of
departmental practice plan that was constituted as a partnership or some type of unincorporated association.

You will probably all be aware that certain departments are in the process of applying for tax rulings on new structures that will allow a restructuring of the departmental practice plans so as to allow physicians to take advantage of the tax benefits of providing clinical services through a PC. Various tax rulings have already been given in other jurisdictions, as well as in Ontario for other professions, that support the use of what is now being applied for, at least in respect of the delivery of clinical services.

It is beyond the scope of this discussion to get into this issue in any more detail however no doubt there will be further news in this regard towards the end of the summer or early September. We anticipate that affected physicians will need to get incorporated and obtain the Certificate of Authorization from the College in the early fall in order that any re-structuring can be implemented for January 1, 2007.

It is important that physicians keep in mind that simply incorporating isn’t enough. As mentioned earlier, there are requirements to transfer the practice assets to the Corporation and ensure that it is now the Corporation that is the “medical practitioner” for the purposes of delivering the services. It is almost certain that changes will need to be made to the practice plans to accommodate their re-structuring. In addition, it is possible that some amendments will be required to the AFP, as the PC will now be delivering the clinical services portion of the package of services provided by a Participating Physician under the AFP. Failure to have the proper arrangements with the practice plan will seriously affect the desired tax outcomes.

Copies of this presentation can be found on our Web site at:
www.nelligan.ca/e/cor_professionals.cfm

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Sherlynn Akitt, a tax expert from the accounting firm Ginsberg Gluzman Fage & Levitz, presented the second portion of this presentation focusing on the tax benefits and issues relating to the taxation of Professional Corporations. Her presentation is available at www.ggfl.ca/docs/profcorpphyson0606.pdf