Hendry Warren LLP
Chartered Professional Accountants

Personal Real Estate Corporations (PRECs)

Prepared October 2021

PERSONAL REAL ESTATE CORPORATIONS (PRECS)

The following is for informational purposes only and should not be relied on as a substitute for professional advice tailored to a specific set of facts. Legislation in force at the time of writing is the basis for this memo, however such legislation is subject to change.

INCOME TAX PLANNING AND YOUR PREC

A corporation creates tax efficiencies in certain circumstances:

1. Income Tax Deferral – Business income earned through a corporation is subject to two levels of tax: corporate tax and personal tax. To give the personal taxpayer credit for the tax already paid by the corporation, personal tax on corporate distributions is less than personal tax on business income earned personally. Tax rates are integrated to ensure that a dollar earned by a sole proprietor is taxed at approximately the same overall rate as a dollar earned corporately and distributed to the shareholder. The key difference when a PREC is introduced is that the personal level of tax does not occur until the shareholder receives a distribution. Therefore, a portion of the tax otherwise payable by a sole proprietor on business income can be deferred by retaining profits in the PREC. The top personal tax rate for residents of Ontario is 53.53% which applies to income earned over $220,000 in a given year. The corporate income tax rate applicable to the first $500,000 of active business income earned each year by a PREC is 12.2%. To the extent that profits can be retained in your PREC, over 40% tax can potentially be deferred.

2. Income Tax Savings – An absolute income tax savings may be achieved to the extent that income is personally withdrawn from your PREC in a year when your income is lower such that your marginal tax rate is lower as well. Common planning is to retain funds in the PREC to take advantage of the deferral describe above. In retirement when income is low, funds can then be withdrawn such that the effective tax rate that applies is less, providing an absolute savings in addition to the deferral benefit.

3. Income Smoothing – Where income varies year to year due to market conditions, extended leave, or other conditions, a PREC allows you to smooth your personal income by controlling how much you draw from the corporation each year. This helps ensure that you best use your personal graduated income tax rates, even in years where income may be lower.

4. Income Splitting – PRECs may facilitate income splitting with low income family members. Where income can be spread amongst various family members, the overall personal tax burden of the family is reduced as the effective tax rate that applies is reduced by accessing lower graduated tax rates of each family member. Effective in 2018, the government introduced rules which taxes family members at the highest rate of tax if they receive a dividend from a private corporation unless specific exclusions are met. This greatly reduces the ability to split income. However, there are exclusions to these rules which do allow for income splitting:

a. If the active person in the business is 65 or over, income can be split with their spouse, regardless of the spouse's age. This is meant to allow small business owners the same ability to split dividend income from a corporation as pensioners can do with eligible pension income.

b. If the family member is active in the business and 18 years of age or older, income can be split with that family member. Generally, being active in the business would require the family member to work 20 hours or more per week on average throughout the year.

With proper tax planning, a PREC can provide significant tax advantages.
We can work with you to ensure your tax situation is optimized.

INSTALMENTS

Corporate income tax instalments are a prepayment tax based on the PREC's tax payable in the previous year. If corporate tax payable for the immediately preceding year was greater than $3,000, monthly payments are required before the last day of each month. Instalments can be paid through CRA's online MyPayment service. They are calculated based on prior-year tax payable using one of three methods. You may use whichever method results in the smallest total instalments. We can assist in advising you each year on the appropriate amount to remit. It is worth noting that you were not required to make corporate income tax instalments in your first year of operating your PREC.

VEHICLES

Given the amount of travel required in your industry, it is common for PREC owners to wonder whether they should own their vehicle personally or through their PREC. The ultimate decision depends on a number of factors, including but not limited to the number of business kilometers driven relative to total kilometers driven, the type of vehicle driven, whether the vehicle is leased or purchased, and the cost of the vehicle. We would be pleased to discuss with you the best arrangement for your business.

In all cases, you should maintain a mileage logbook detailing the purpose, length, and location of all business trips. You should also document the total kilometers travelled in the year (i.e. odometer readings). CRA will ask to see this document if they audit your PREC's vehicle expenses.

HOME OFFICE

If you have an office in your home that is used to earn business income, your PREC may deduct a pro-rata share of household expenses, like property tax and mortgage interest, based on the square footage of your home office as a percentage of the total square footage of your home. There are limitations on the home office expenses that may be deducted against employment income, therefore, you may consider having your PREC reimburse you for the home office expenses that you pay on its behalf.

RECORD KEEPING

All business owners can find themselves short on time and inundated with work at some point in the year. The pressures of running a business can lead to difficulty managing the books. Here are some "Do's" and "Don'ts" you can use to keep your records organized:

1. DON'T use a personal bank account or credit cards for business expenses. When it comes time to calculate your net income for the year, it can be difficult to delineate business expenses and personal expenses.

2. DO open a business bank account and apply for a business credit card. For the reasons discussed in item 1, keeping your business expenses in one place will make it much easier to have accurate and complete accounting records. Well organized records will allow for better outcomes in the event of a CRA audit

3. DON'T throw away receipts. Receipts substantiate the business purpose of a charge in the event of a CRA audit. CRA auditors have the right to disallow any expenses that are not supported by a receipt, resulting in higher taxes owing. A credit card statement with a charge for "Walmart" does not provide enough information for the CRA. Receipts also provide information on HST paid, which can generally offset HST owed when your PREC files its HST return. You are required to keep receipts for 7 years.

4. DO use bookkeeping software to automate the process of tracking your expenses and save yourself time. We recommend Quick Books Online but there are other good options available as well.

HARMONIZED SALES TAX (HST)

If you were an HST registrant before incorporating your PREC, you should register the PREC for its own HST number online through CRA's MyBusinessAccount service. We can assist with the registration process as well. The corporate HST number should be used going forward.

As with income tax, you are required to remit sales tax instalments if you owed more than $3,000 of sales tax on your prior-year HST return. The instalments are due one month after the end of each fiscal quarter. The amount is ¼ of the previous year's balance owing or ¼ of the estimated balance owing for the current year, whichever results in the lowest total instalments.

REMUNERATION

If you take money our of your PREC, you generally need to classify the withdrawal as a salary or dividend and report the income on your personal tax return. The ideal remuneration mix is dependent on a number of factors:

1. Salary payments are subject to CPP. Payments into CPP made now are converted into a stable source of income in retirement.

2. Salary creates RRSP room, while dividends do not.

3. The personal tax deduction for childcare expenses is limited to earned income, such as salary.

4. No source deductions are required for dividends. Source deductions for income tax and CPP need to be withheld from a salary and remitted to CRA.

5. Dividends can trigger a refund of corporate tax paid on investment income. Salary does not trigger a refund of these corporate taxes, so the current-year tax impact of a dividend may be lower if there is a corporate ERDTOH/NERDTOH balance.

We can work with you to ensure that your remuneration strategy is optimized each year.

IMPORTANT DEADLINES

Item	Deadline
HST return (Annual filer) and payment	3 months after fiscal year end
T4/T5 slips and information return to report salary/dividends paid	February 28
Payment of corporate tax owing after instalments	End of the second month after fiscal year end (2 months) *3 months is afforded to PRECs with under $500,000 of income in the previous tax year
Personal tax return (T1) and payment	April 30 – as a sole-proprietor, your personal tax filing deadline was historically extended until June 15. This extension does not apply if income is now earned in your PREC
Payroll deductions for salaries and bonuses	15th day of the month following the month in which the remuneration is paid
Corporate tax return (T2)	6 months after fiscal year end

CONTACT

Hendry Warren LLP

881 Lady Ellen Place (Suite 200)
Ottawa, ON
K1Z 5L3

www.hwllp.ca
info@hwllp.ca
(613) 235-2000