

# Who said tax was fair?

The Canadian tax system is complex. It is prudent to consult an accountant and tax advisor to minimize your taxes today and plan for the future.

Heather S. Loblaw, CPA, CA



**Y**ou've studied hard at school, spent many years training, and worked endless hours, only to have the tax collector come and take half of it away. This is a frustration of many professionals; it makes it seem as though the Canadian tax system is working against them. A couple of specific frustrations are the lifetime capital gains exemption and GST, both of which I explain here, along with describing how you can still take advantage of some ways to save some tax.

## Lifetime capital gains exemption

You may have heard about the last of the great Canadian tax advantages, the lifetime capital gains exemption, which is available to business owners in Canada. The exemption allows each shareholder to realize a capital gain on the sale of company shares of up to \$892 218 (2021) tax free, a savings of approximately \$238 000 in BC.

However, Canada Revenue Agency does not give easy access to this exemption, and not every private Canadian company will qualify.

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*Ms Loblaw is a partner with Baker Tilly WM LLP in Vancouver. She enjoys working with entrepreneurs, small- to medium-sized companies, and high net worth individuals, assisting them with accounting, tax, and business issues.*

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The company must meet certain tests, including:

- The exemption is available only to individuals (not corporations) who have disposed of qualifying shares of a Canadian company.
- The individual must have owned the shares throughout the 24-month period prior to the disposition.
- All or substantially all (at least 90%) of the company's assets must be used in an active business carried on primarily in Canada at the time of the disposition.
- More than 50% of the company's assets must have been used in an active business carried on in Canada throughout the 24 months prior to the disposition.

In the case of a medical practice, a physician must find someone willing to purchase their professional corporation and practice from them, which is not that common as new family physicians can build their own practice quite easily.

It is also typical for a physician to build wealth in their company in the form of cash and other passive investments such as marketable securities, rental properties, etc. All of these would put the company offside for the asset tests noted above as they are not needed to run the business (often referred to as redundant assets). In view of these restrictions (and in the absence of advance planning), many physicians are, unfortunately, not able to take advantage of this tax exemption.

Before making any decisions as you reach retirement, it is important to contact your tax advisor to plan for tax minimization. There are tax rules that can work in your favor.

**Incorporation.** A medical practice that is carried on in the form of a professional corporation will pay only 11% corporate income tax in BC on its active business income up to \$500 000 in a given taxation year. If a physician earned that income personally, their marginal tax rate could be as high as 53.5%. As such, incorporating the medical practice can provide a tax deferral of 42.5% on the cash that the physician does not require to fund their lifestyle. If the deferred tax is invested, the deferral can amount to a significant sum over a career of, say, 30 years, which an unincorporated individual or an employee would lose out on.

### **BOX. What else can physicians do to reduce the tax burden?**

- Pay a salary to a spouse or child for services rendered to help you earn your self-employment income. This must be at a rate that you would pay another third party for similar services.
- Consider setting up an individual pension plan.
- Contribute to a registered retirement savings plan.
- Contribute to a tax-free savings account.

**Investments.** If a company pays less tax on earnings, this leaves more money to invest and earn a return on. Although passive nonbusiness income (e.g., interest, rental income) is taxed at 50.67% in BC, the company would have more money to invest initially and, therefore, would produce a greater nest egg in the end. However, it should be noted that investment income of more than \$50 000 in a taxation year can reduce the amount of income subject to the 11% rate. Generally, the low rate is available on the first \$500 000 of taxable income from the medical business. Any medical income over the \$500 000 limit is subject to a tax rate of 27% in BC.

**Refundable taxes.** Investment income (passive nonbusiness income) is subject to a higher tax rate than business income (50.67% versus 11%), but a portion of the higher rate is refunded when the company distributes taxable dividends to its shareholders. A tax pool (refundable dividend tax on hand) is created at a rate of 30.67% for each \$1 of passive nonbusiness income earned. A tax refund is available to the company at a rate of 38.33 cents per \$1 of taxable dividends paid, limited to the balance in the refundable dividend tax pool. This refundable tax approximates the tax that would be paid personally if the passive nonbusiness income were earned personally. It also approximates the additional taxes that could be paid personally on a dividend.

**Retirement.** Once a physician reaches age 65, and assuming their tax professional advised them to have their spouse as a nonvoting participating shareholder of the company, they can income split with their spouse. Thus, in retirement years, when the cash that has been invested in the company is needed, a dividend can be paid to both the physician and their spouse. This results in paying tax at lower marginal rates than if the physician had to report the entire dividend personally.

The physician will have paid tax on the corporate business income at the lowest tax rates and have been able to defer the tax on funds not withdrawn. This is a huge advantage over most Canadians who are employees and are taxed on all their income at much higher marginal tax rates.

### GST on contract work

When a physician is contracted to do work, they are typically charged an overhead fee by the third party. The overhead must have GST (5%) charged on it, and because medical services are a nontaxable supply, physician contractors are unable to recover the GST they pay. Over many years of working as a contract physician, this 5% charge can really add up. Other examples of businesses that cannot recover the GST paid include dentists, chiropractors, physiotherapists, insurance brokers, insurance companies, and banks (i.e., exempt businesses). However, as a contractor (versus an employee of a third party) a physician does receive other benefits, such as:

- Paying the low corporate tax rate of 11%, if incorporated.
- The ability to split income upon retirement (over age 65), if incorporated.
- The ability to deduct other expenses such as office supplies, medical dues, travel, and legal and accounting fees.

GST paid is also nonrecoverable if the physician operates their own medical practice directly or through a corporation. This applies to all exempt businesses and can represent a huge cost. In some cases, these businesses attempt to identify expenses that are not associated with the activity that is exempt from GST to try to recover some of the GST paid. However, this may be difficult in the context of a physician operating a medical practice. Contracting physicians are also not required to charge GST on their services, which is a benefit to patients.

The Canadian tax system is complex and can appear unfair to the average taxpayer. It is prudent to consult an accountant and tax advisor regularly to ensure you are minimizing your taxes today and planning for your future. See the **Box** for additional tax-reducing considerations. ■

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treatment, we can make a difference against antimicrobial resistance. As with much drug treatment, shorter is often better. ■

—**Abdullah A. Mamun, MD**  
BC Centre for Disease Control

—**Daniela Michel, MPH**  
BC Centre for Disease Control

—**Max Xie, MSc**  
BC Centre for Disease Control

—**Edith Blondel-Hill, MD**  
Interior Health Authority, Kelowna

—**Säde Stenlund, MD**  
BC Centre for Disease Control  
University of British Columbia

—**Jennifer Grant, MD**  
University of British Columbia  
Vancouver General Hospital

—**Lynsey J. Hamilton, MSc**  
BC Centre for Disease Control

—**David M. Patrick, MD**  
BC Centre for Disease Control  
University of British Columbia

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