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Marmer Penner Inc. Newsletter

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BUSINESS FORM OVER SUBSTANCE – SHOULD IT IMPACT *GUIDELINES* INCOME?

A separated spouse who is starting a new business venture has the choice of operating it through an incorporated entity or an unincorporated entity. There are tax and liability issues to be considered, of course. However, there are also *Child Support Guidelines* issues if it is held that corporate losses in a controlled corporation should not be considered in determining a support payer's income. Consider the following situation:

Dentists have been permitted to incorporate for a few years already and many now operate under corporations named something like "Dr. John Smith Dental Professional Corporation". Dr. Smith's income usually includes a mix of salary and dividends from his corporation. There may also be a pre-tax income or loss amount in the corporation in a given year. Prior to incorporating, most dentists reported their income as professional or partnership income directly on their personal income tax returns. The amount drawn by the dentist had no impact on his or her income.

Let's now examine the case of two dentists – Dr. Robert Bicuspid and Dr. Cathy Canine. Both have existing successful incorporated practices earning about $300,000 per annum. Each is about to start an identical second practice using personal savings for the start-up costs. Dr. Bicuspid incorporates a second company for his new practice which loses $50,000 in the first year of operations. Dr. Canine decides to operate her new practice as an unincorporated proprietorship in order to benefit personally from the $50,000 loss in the new practice. If corporate losses are considered, then each has $250,000 of income in the first year of the second practice. If corporate losses are not to be considered, then Dr. Bicuspid's income is $300,000 while Dr. Canine's is still $250,000. In addition, Dr. Bicuspid will pay more personal income tax than Dr. Canine.

It seems inequitable that Dr. Bicuspid, with a higher tax burden, should pay more child support than Dr. Canine simply because of the business structure he has chosen. If corporate losses are not to be considered, then support-paying spouses should consider starting new businesses as unincorporated ventures until start-up losses are out of the way.

A second issue to consider is the issue of capital losses. If these are incurred personally or in a separate corporation, they may not be considered in determining *Guidelines* income. Let's return to our two dentists. Each still has their lucrative practice earning $300,000 annually and, over the years, both dentists have saved $500,000 personally. Dr. Biscupid invests the $500,000 personally in shares of Research In Motion and incurs a $75,000 capital loss one week later when he sells. Dr. Canine lends the money to her professional corporation which loses the same $75,000 on the same investment. Dr. Biscupid will report $300,000 of income for the year and a $75,000 capital loss personally which, if capital losses in excess of capital gains are not considered, will result in *Guidelines* income of $300,000. Dr. Canine's loss was in her corporation so her pre-tax corporate income is reduced and thus may report her *Guidelines* income as $225,000.

Once again, there may be an incentive to organize one's affairs in a fashion to reduce the risk of not benefiting from losses.