

Are you a fisherman thinking about incorporation?

Management issue paper

There are some matters you may wish to consider in coming to your decision. Please remember that every situation is unique and ultimately you should review your own situation and the costs and benefits of incorporation with your professional advisers before proceeding. This article is intended as a general guide only.

The issues involved

If your business is not incorporated, you pay personal income tax on your annual net earnings. Depending on your level of earnings, you may be paying personal income tax at rates as high as 47% on net earnings in excess of \$100,000 in a year. After paying your taxes, the amount of cash left over for living expenses and savings is greatly reduced. For fishermen who are buying a boat, license and gear, or paying off debts out of after tax dollars, high personal income tax rates can provide considerable hardship.

In general, any fisherman with significant excess earnings (i.e., more than is needed for day-to-day living expenses) or who is dependent upon after-tax cash flows for payment of debts or the purchase of boat, license and gear should consider the benefits of incorporation.

Why does incorporation help in this situation?

Incorporated small businesses can earn up to \$200,000 per year, taxed in Nova Scotia at 18.12%. This means that 82¢ approximately, on every dollar a company earns is available to pay company debts or invest in boat, license and gear.

Additionally, the corporate structure facilitates the planning of personal and family income levels, retirement and education planning, succession and estate planning.

How do you get paid after incorporation?

There are a number of possible arrangements governing the relationship between a fisherman, his/her company and the independent buyer of the catch. In the simplest situation where all income goes to the company, the fisherman will normally take a salary from the company. The company permits the fisherman to level his/her personal income from year to year, thus reducing overall income tax. Excess earnings in the company (i.e., earnings not paid out as a salary) will be taxed at 18.12%. The company's remaining after tax earnings are available for payment of debt, purchase of a boat, license and gear, or

they can be paid out as dividends to shareholders. Remember that an incorporated fisherman pays tax personally at the point in time when he/she takes money from the company in some form.

Are there other advantages of incorporation?

Where there are excess earnings, the introduction of other family members as shareholders in a company can provide for income being paid to those family members who would pay less tax on their income than the fisherman would. Some more sophisticated arrangements using family trusts and or holding companies are sometimes used.

Another advantage of incorporation arises when you ultimately sell your fishing operation. Under current rules, if you sell the shares of your company and the company has not accumulated assets that it does not require to actively fish, you may receive tax-free proceeds of up to \$500,000 in excess of what you originally paid for the shares. This tax-free gain is commonly known as the enhanced capital gains exemption.

Currently, when an unincorporated fisherman passes away holding a license that has grown in value significantly, a tax liability requiring cash can arise. If the license is to be passed on to another family member, there may be a problem in coming up with the cash to pay the taxes. The cash may eventually need to come from the sale of the license to a third party and consequently the wishes of the deceased fisherman are not met. Incorporation with proper annual monitoring by qualified accountants can avoid this problem.

What about EI?

EI, of course, is a constantly changing area. Currently, a fisherman taking a salary from his/her company will not qualify for EI. If however, the fisherman receives a portion of his/her income, such as a captain's share, directly from the independent buyer of the catch, he/she may be considered a "self-employed fisher" and thus eligible for EI. You may be a self-employed fisher in relation to the portion of your income paid to you personally if you participate in making the catch and you have ownership personally (or lease) of fishing assets such as boat or license or specialized fishing gear. A ruling can be requested from the EI ruling section of Canada Customs and Revenue Agency.

What are the drawbacks?

Undoubtedly, life becomes more complicated for the incorporated fisherman. In addition to a personal tax return, there is now an annual corporation tax return to file and possibly a trust return and holding company return. There will be decisions to make on paying salaries and dividends and constant care must be taken to avoid accumulating unnecessary assets in the company. Additionally, the fisherman should avoid situations where he/she ends up owing money to the company. All of this takes time and means staying on top of things.

The incorporation process, transfer of assets, and initial advice and consultation required to properly arrive at the appropriate corporate structure is a

significant cost. It goes without saying that in some cases it takes time to recoup costs.

If the company loses money, you cannot apply those losses to reduce personal income taxes.

Look before you leap

If you are considering incorporating, take the time to understand what you are getting involved with and make sure you work with your professional advisers to carefully structure your affairs so that you will gain access to all the possible advantages you are seeking for yourself and your family.

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