Ownership Structuring to Buy Real Estate

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Introduction

As a CPA and CFP, Bruce Hurst has extensive experience in managing and directing RHN's business advisory and accounting services for a number of investors of real estate holdings, Personal Real Estate Corporations (PRECs) and income tax preparation for investors and real estate brokers.

Bruce is a real estate investor and he understands its complexities, which allows him to communicate with our clients at a level of understanding that maximizes their accounting requirements while offering sound professional advice. Bruce enjoys providing the personal touch to each professional relationship he builds.

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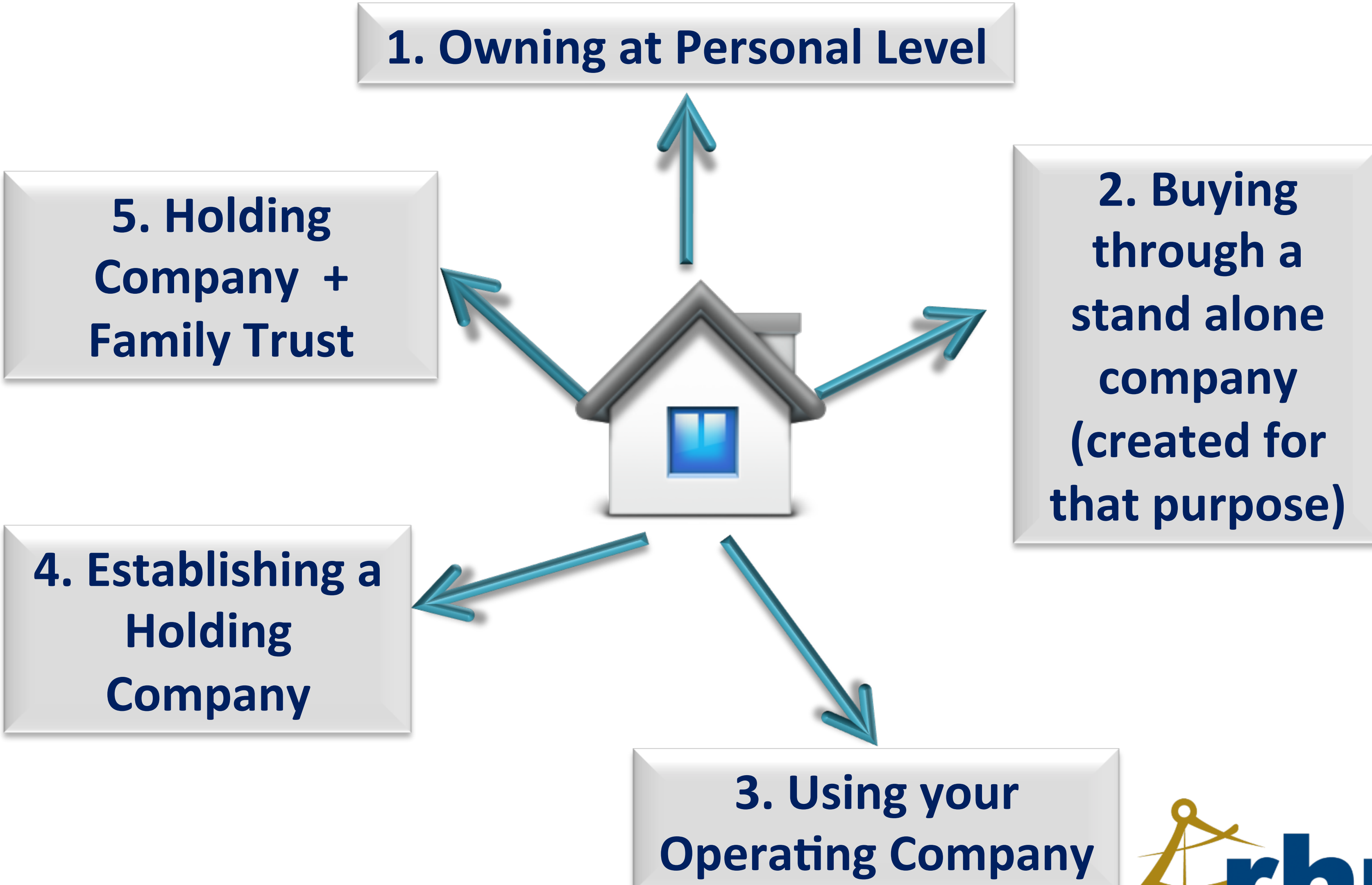
Corporate Tax Rates

YEAR	Small Business	Rate	Active Income	Rate	Investment
2011	Up to $500,000	13.50%	Over $500,000	26.50%	44.67%
2012	Up to $500,000	13.50%	Over $500,000	25.00%	44.67%
2013	Up to $500,000	13.50%	Over $500,000	25.00%	44.67%
2014	Up to $500,000	13.50%	Over $500,000	26.00%	45.67%
2015	Up to $500,000	13.50%	Over $500,000	26.00%	45.67%

Personal Tax Rates 2015

Income	Salary/Interest	Capital Gains	Eligible Dividends	Regular Dividends
Up to $37,869	20.06%	10.03%	-6.84%	7.61%
$37,869 to $44,701	22.70%	11.35%	-3.20%	10.73%
$44,702 - $75,740	29.70%	14.85%	6.46%	18.99%
$75,741 - $86,401	32.50%	16.25%	10.32%	22.29%
$86,402 - $89,401	34.29%	17.15%	12.79%	24.40%
$89,402 - $105,592	38.29%	19.15%	18.31%	29.12%
$105,593 – $138,586	40.70%	20.35%	21.64%	31.97%
$138,587 - $151,050	43.70%	21.85%	25.78%	35.51%
$151,051+	45.80%	22.90%	28.68%	37.98%

Investing in Real Estate



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Investing in Real Estate

1. Owning at Personal Level

Owning at Personal Level

- Generally speaking, investing in residential rental property is best done through individual ownership.
- Reason – personal tax rates, even at the highest rates (43.7%) are better than corporate tax rates (46% on investment income). Most people in lower tax brackets
- Generally not enough income generated to support cost of operating company.

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Owning at Personal Level

EXCEPTION TO THIS CONCEPT

- If an excess amount of cash assets have built up in the corporation and:

- There is no way of extracting the cash without triggering high rate personal income tax.

- In this situation, using your corporation makes sense IF it is not an operating company.

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Owning at Personal Level

PROs

- ✓ Simple
- ✓ Can be held jointly with spouse for income splitting
- ✓ Least expensive – no corporation to maintain
- ✓ Mortgage rates tend to be more favourable
- ✓ If it operates at a loss then losses can offset other personal income
- ✓ Simplify estate matters

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Owning at Personal Level

CONs

- Cash for down payment might be locked in your company
- Down payment will likely come from after tax dollars
- Possible liability exposure
- Exposure to creditors

Investing in Real Estate

2. Buying through a stand alone company (created for that purpose)

Buying Through a Stand Alone Company

- In limited circumstances it might make sense to hold residential real estate in a separate company.
- For example there might be multiple owners so having one corporate name on title might be simpler.

Buying Through a Stand Alone Company

PROs

- ✓ There are very limited advantages to owning residential real estate in a corporation that is not connected to an operating company. Generally reserved for operating real estate such as an office building or warehouse

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Buying Through a Stand Alone Company

CONs

- Profit is usually insufficient to justify the costs of creating and maintaining a company for this purpose.
- The risk exposure is generally minimal and is normally mitigated by proper insurance coverage.
- Tax rate on profit is high (46%).
- Removal of after tax profits subject to more personal tax.

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Investing in Real Estate

3. Using your Operating Company

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Using Your Operating Company

PROs

- ✓ Cash for down payment is available and you do not have to use personal resources.
- ✓ Down payment is coming from low taxed (13.5%) after-tax corporate dollars instead of highly taxed after-tax personal dollars.

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Using Your Operating Company

CONs

- Probably makes the company ineligible as a Qualified Small Business Corp. – not eligible for $800,000 capital gain deduction.
- More difficult to sell Opco with real estate included due to increased price.
- Real estate asset subject to company creditors.
- You usually don't want to sell the real estate; retain for retirement income purposes.
- Rental income still subject to high tax rate.

Investing in Real Estate

4. Establishing a Holding Company

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Establishing a Holding Company

- Holdco uses the cash to buy the real estate
- Generally do not leave much profit in Holdco (tax 46%) – pay salaries to family members

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Establishing a Holding Company

PROs

- ✓ Down payment comes from tax free inter-corporate dividends. (13.5% already paid by Opco.)
- ✓ Passive investment assets kept separate from active income – QSBC preserved.
- ✓ Retirement asset kept separate from saleable operating company.

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Establishing a Holding Company

CONs

- Rental income still taxed at high rate but high rate of tax can be reduced by paying dividends (Refundable Dividend Tax On Hand).
- Expensive to operate a corporation with one rental property in it so it works best with multiple assets.

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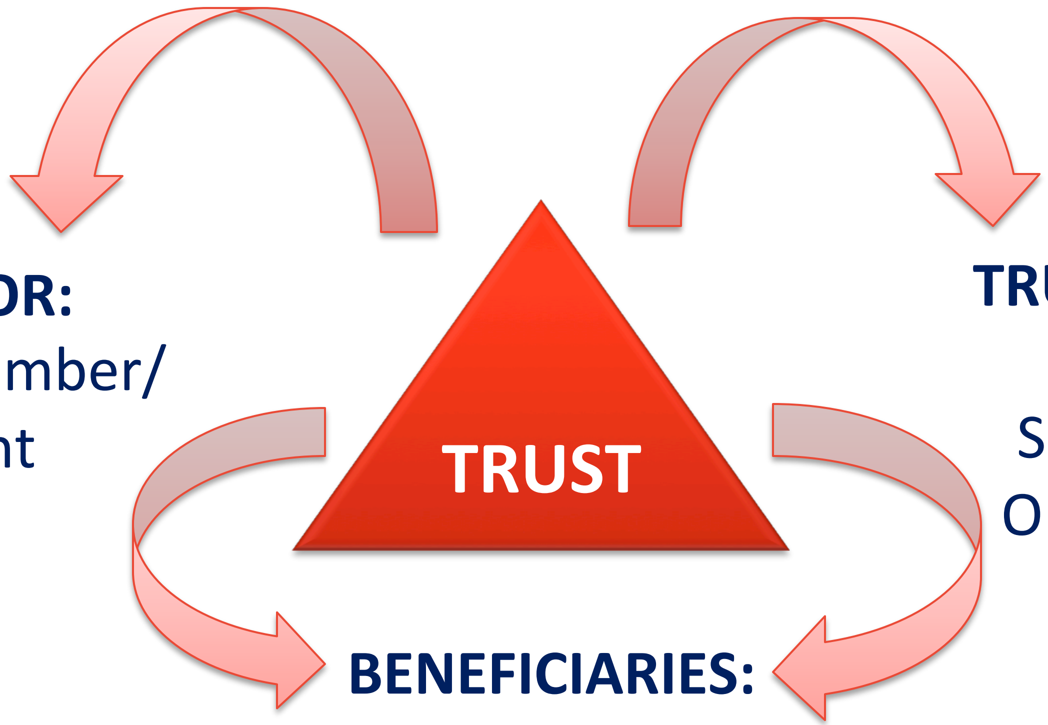
Investing in Real Estate

5. Holding Company + Family Trust

Establishing Holding Company & Family Trust



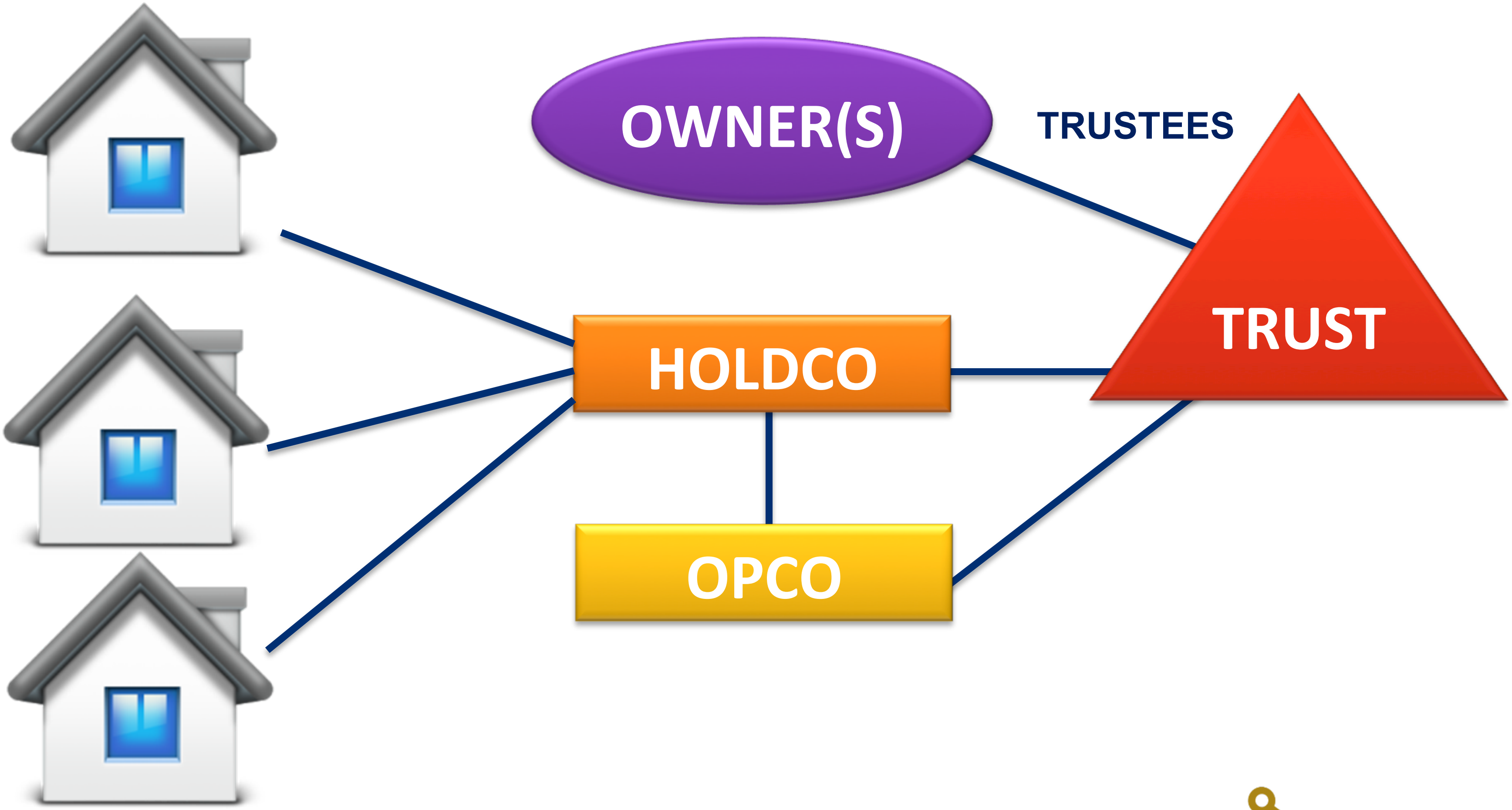
SETTLOR:
Family Member/
Parent

TRUSTEE(S):
Owner
Spouse +
One other

BENEFICIARIES:
Owner
Spouse
Children
Possibly Holdco

<u>Note</u>: *After 21 years = deemed disposition of trust property*

Establishing Holding Company & Family Trust



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Summary

- Easiest and least expensive to establish this structure at the beginning of your operating company or just as it is starting to become profitable.

- Seek PROFESSIONAL ADVICE from your TAX ADVISOR before proceeding.

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Bruce A. Hurst, CFP, FCPA, FCGA

Shareholder

bhurst@rhncpa.com

604-273-9338

www.rhncpa.com