The Tax Benefits of a Personal Real Estate Corporation

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There have been many discussions recently about the ability for real estate agents to now incorporate themselves, including a recent article penned by my colleagues. As part of the discourse, it's important to explore certain tax benefits derived from Personal Real Estate Corporations ("PRECs"). In this first part of a multi-article series, I explore the ability to defer taxes by having a PREC retain all or a portion of the income earned by the real estate agent.

In Ontario, the top marginal tax rate for income for individuals is 53.53% in 2020. A PREC, however, may only have to pay up to 26.5% tax on such income in the first instance, while additional tax is only owing when the individual takes that money out of the PREC for his/her personal use. The different tax rates in the first instance (53.53% to 26.5%) results in the ability to defer tax so long as funds are retained in the PREC.

So, for example, if a real estate agent were earning $400,000 each year, he/she would be paying taxes in the aggregate of ~$180,000 (~45%) on such income. Every additional dollar of income would attract 53.53 cents of tax. If, alternatively, he/she earned that income in a PREC, taxes of up to only ~$105,000 would be owing in the first instance. (Assuming the real estate agent has no other sources of income, personal taxes in the amount of ~$78,000 would be owing if the ~$295,000 was subsequently taken out of the PREC by way of dividend.) Rather than paying the Canada Revenue Agency immediately, the $75,000 of deferred taxes ($105,000 vs $180,000) could be re-invested by the PREC.

The analysis doesn't stop there. Many people rely on their income to support their everyday living expenses. If the real estate agent needs $220,000 to personally live off (i.e., the after-tax income he/she was previously earning), the use of a PREC would actually be *detrimental* to the agent. The aggregate tax paid by the agent and the PREC in a year would exceed that which he/she would have otherwise paid had he/she earned the income personally. (The Canadian corporate tax system is based on perfect integration, but the integration is never perfect and right now there is over-integration, meaning more aggregate corporate and personal tax is paid if all of the income earned by a corporation in a year is distributed to its shareholder(s) in the same year. In the example above, aggregate corporate and personal taxes of ~$183,000 would be owing instead of the $180,000 if nothing had been done at all.)

But what if the agent only needed a portion of his/her income to support his/her everyday living expenses? If, for example, he/she only required $100,000 of after-tax income, he/she would only need to receive a dividend in the amount of $110,000 from the $295,000 after-corporate-tax dollars in the PREC, allowing him/her to retain a significant portion of his/her income in the PREC and take advantage of that lower corporate tax rate.

In conclusion, if a real estate agent doesn't require any or all of his/her annual income to fund his/her personal living expenses, the use of a PREC can have a significant impact in terms of personal finances. The other articles in this series will discuss additional tax benefits associated with the use of a PREC.

If you have any questions or would like information on estate planning and tax planning for your estate, contact Matthew Getzler in our Tax and Wills and Estates Groups at mgetzler@mindengross.com.