The TaxLetter®

Vol. 34, No. 9 | Your Guide to Tax-Saving Strategies | Single Copy: $10.00 September 2016

FINANCIALPLANNING

Tax-saving Strategies for Business Owners

Save Your Money

Mark Halpern, CFP, TEP

For the first time in the history of our beautiful country, many Canadians are paying taxes at a marginal rate of more than half of their earnings, as governments gobble up more than we get to keep. A recent study by the Fraser Institute contained this startling fact: the total tax bill of the average Canadian family has increased by almost 2,000 per cent since 1961.

If you live in Ontario, for example, and earn more than $220,000 annually, you lose 53.53 cents on every dollar earned above that threshold. More taxes come into play if you have investments like GICs, bonds and real estate income, which are taxed at the highest rate.

Mark Halpern is a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and one of Canada's top life insurance advisors. He is CEO of WEALTHinsurance.com® and illnessPROTECTION.com®, with special expertise for business owners, entrepreneurs, medical professionals and high-net worth individuals and their families. He can be reached at 416-364-2929, toll-free at 866-566-2001 or mark@WEALTHinsurance.com.

On the corporate side, once money is taken out of your company, you often have to pay a taxable dividend personally. If it's considered an "eligible" tax dividend (eligible for the dividend gross-up and tax credit) you are taxed at 39.34 per cent and if it's an ineligible tax dividend, the government takes 45.3 per cent.

If you are single, widowed or divorced, another significant tax liability comes into play upon your death when there is a full income inclusion and more than half of your hard-earned RRSPs or RRIFs are lost to taxes, shrinking your final estate.

Most people aren't aware of their tax liabilities. A business owner who recently came to see me about estate planning used his annual business profits to invest in real estate and had assembled a portfolio of about $30 million. He had every detail about each property committed to memory, but was completely unaware that his estate would be hit with a $6-million capital gains tax liability when he dies.

This article examines some tax-saving strategies available to your business. All of them are fully endorsed by the government and don't require a lot of your time or ongoing management.

Assemble a team

Get a team of knowledgeable and experienced professionals to help you. The same way it takes a village to raise a child, it takes intelligent, forward-thinking individuals to help manage your tax and debt level now and on your final tax return. Many professionals are excellent problem solvers and very good at what they do, but sometimes they are reactive rather than proactive. My suggestion is to use those with a 360-degree view of what you need and come with credentials you can trust.

Dividend vs. salary

If you own a corporation, you are probably paid by a combination of salary (plus bonus) and dividends.

If you opt to be paid by salary, it's deductible to your corporation. Dividends, on the other hand, are paid from after-tax corporate profits. You need to think twice to ensure you have the best mix of salary and/or dividends for your specific circumstances.

In addition, there are now two tax rates that can apply to dividends, depending on whether they are considered eli-

gible or regular dividends. "Eligible" dividends receive enhanced federal and provincial dividend tax credits, which reduce the amount of tax owing. Some dividends are not considered "eligible" – such as those paid by small business corporations.

Corporate-owned life insurance

There are many reasons for an incorporated business owner to own a life insurance policy, including key person insurance, funding of any capital gains tax at death and wealth creation, to name but a few.

The corporation itself can be a beneficiary of a life insurance policy, with the corporation paying for the premiums and collecting the proceeds on death. Like all insurance policies the proceeds are not taxable. Under certain circumstances, an equal amount can be added to the company's Capital Dividend Account and paid out tax-free to shareholders as a capital dividend. (The CDA is a surplus account that gives shareholders designated capital dividends, tax-free.)

Corporate-owned life insurance is often used by private companies to fund buy-sell agreements that come into play when a shareholder dies. Life insurance can be used to buy out the shares of the deceased person's family members.

Immediate Financing Arrangements (IFA)

If you are turned off at the idea of paying premiums for life insurance and favour using your money for business purposes, an IFA (the subject of my March 2016 column) can be an ideal solution. It's an efficient mechanism that can improve cash flow, provide access to cash, and carry tax-free benefits for your family and other heirs.

Here's a recent client example: A successful entrepreneur needed a substantial amount of permanent life insurance but was unprepared to take money out of his business to pay the premiums.

He was earning close to 25 per cent on the funds used in his business, so he was understandably reluctant to reduce his income to buy life insurance.

We arranged sufficient life insurance coverage and structured an IFA that covered 100 per cent of the insurance premiums. He continues to invest his own money in his business, not insurance premiums. The effective net cost of his life insurance is the tax-deductible interest cost only, and amounts to less than 4 per cent of the true premium.

Personal Pension Plan

Better than an RRSP, or an Individual Pension Plan (IPP), a Personal Pension Plan (PPP) is a combination pension plan designed and structured for business owners and incorporated professionals, such as doctors, dentists, lawyers, accountants, pharmacists and other professionals who draw T4 income.

It allows you to save significantly more than you can under the current RRSP system as well as save taxes, with contributions tax deductible to the company (and in some cases, to the member). With a PPP you know exactly how much you will be getting every month when you retire, regardless of the ups and downs of the stock markets.

In fact, because your company makes up any shortfalls with additional tax deductible contributions, you are guaranteed to receive a steady average return of 7.5 per cent a year. If the investment returns drop below that 7.5-per-cent threshold averaged over three years, additional tax-deductible top-up contributions are made by your company to bring the plan into balance.

Every year, you can decide whether to continue with the defined benefit method or move to a defined contribution arrangement, under which the contributions you make are set but without a fixed amount upon retirement. All fees are also tax deductible to your company (something not permitted under RRSP rules) and you can claim large additional tax deductions if you decide to retire early.

Health benefits

A Private Health Services Plan (PHSP) is a government benefit available to the self-employed and incorporated business owners. It can be used for employees as well as the owner's immediate family. This benefit would be in the shareholder's capacity as an employee. If not, it would be considered a shareholder benefit. Contributions made by the corporation for their employees are deductible by the corporation. There is a list of allowable medical expenses, but basically, a PHSP covers the same expenses applied under the medical expense tax credit.

There is no insurance underwriting involved which means neither the business owner nor employees can be turned down due to pre-existing health conditions.

Income splitting via a prescribed rate loan

With soaring tax rates on investment income, many people are turning to prescribed rate loans as a way to split investment income, such as dividends and capital gains. This strategy involves a loan from the higher-income spouse to the lower-income spouse that is put into a trust. The loan is set at a "prescribed" rate set by the government every three months to help determine short-term government of Canada T-bill rates. Once you make the loan, that prescribed rate does not change, a benefit of a low-interest rate environment.

The borrower can invest the money with income earned above the prescribed rate taxed in the hands of the lower-income spouse. The interest must be paid each year to the lender by January 30th of the following year; good record keeping is essential.

Tax-efficient estate planning

In many situations, the least expensive and most tax-effective method to preserve the future ownership of your company is to use life insurance or other insurance instruments. Life insurance is a reliable estate planning tool that enjoys unique tax treatment in Canada because life insurance proceeds flow tax-free to beneficiaries and bypass probate. People buy life insurance because it is more cost effective and tax-friendly than other options, and can be used to pay future tax liabilities (for pennies on the dollar) or help lower current taxes.

Post-mortem planning

When an individual owns shares in a private corporation, post-mortem planning can reduce or eliminate the double taxation that can result from the deemed disposition of the shares at death as well as the tax liability on the final distribution of the assets out of the corporation. What's needed is competent post-mortem planning by professionals who can help reduce the impact of this double taxation by using corporate-owned life insurance. This will help your estate keep more of the business that you worked so hard to build.

Seek professional help

This was just a sampler of the tax-saving ideas available to business owners. We hear from many people who are very wealthy but don't consider themselves as such. Is their modesty a Canadian thing?

Too many people continue to dole out unnecessary taxes because they don't know about available legitimate strategies to keep more of their money for family and favourite charities.

Contact us to determine how these and other strategies can help you, or to get a second opinion on your current planning.

The best way to get financial peace of mind starts with advice from an impartial and experienced team that includes your accountant, lawyer and a Certified Financial Planner or Trust & Estate Practitioner. ❐

Mark Halpern is a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and one of Canada's top life insurance advisors. He is CEO of WEALTHinsurance.com® and illnessPROTECTION.com®, with special expertise for business owners, entrepreneurs, medical professionals, high-net worth individuals and their families.
He can be reached at 416-364-2929, toll-free at 1-866-566-2001 or mark@WEALTHinsurance.com
Visit WEALTHinsurance.com
Get your FREE Estate Planning Toolkit at www.WEALTHinsurance.com/toolkits.html
The expanded toolkit now includes:
Estate Directory
Estate Planning Checklist
Executor Duties Checklist
Business Owners Planning Guide
Visit www.MarkHalpernBlog.com and sign up for free updates

© Copyright 2016 by MPL Communications Inc., Reproduced by permission of *The TaxLetter*, 133 Richmond St. W., Toronto, ON M5H 3M8