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## Tax Planning Checklist for the Owner-Manager

*The following represents a tax-planning checklist for individuals who have their own incorporated private Canadian active business. Due to the complexity of tax laws related to private Canadian corporations, as well as every corporation and owner manager having different facts and circumstances, it is imperative that qualified tax and/or legal advisors be consulted before taking any action based on the strategies below. Note that this is not an exhaustive list.*

- Ensure a legally binding shareholder's agreement is in place if there is more than one owner. Among other things a shareholder agreement can help ensure an orderly manner for settling shareholder disputes; can set restrictions on selling shares to third parties; can provide a framework for the purchase of the shares of a deceased shareholder; and can provide non-competition clauses.
- Consider employing lower income family members and paying them a salary that is reasonable based on the services they are performing (the salary will create RSP contribution room and generate CPP/QPP pensionable earnings).
- Consider paying dividends from corporate earnings to spouses and adult children shareholders. Canadian dividends are taxed lower than salary (however dividends will not create RSP contribution room or CPP/QPP pensionable earnings). Also, unlike salary, dividend payments do not have to be tied to the amount of services performed in the business. Dividends paid out to benefit related minor children are taxed at the highest marginal tax rate under the "kiddie tax" rules.
- Consider the pros and cons of an estate freeze so that the capital gain on the future growth of the business is deferred and attributed to the next generation, but the control of the business can remain with the parents. This may also allow for use of the \$750,000 capital gains exemption by other family members for a future share sale.
- Consider setting up an Individual Pension Plan (IPP) to increase the retirement savings of the owner-manager, beyond the level that an RSP permits, and lower the tax burden of the corporation. The IPP is a creditor protected defined benefit pension plan for the owner designed to maximize tax-sheltered retirement savings.

- Consider the pros and cons of setting up a Retirement Compensation Arrangement (RCA) to create a retirement savings vehicle that permits larger tax-deductible contributions for the employer than an IPP or an RSP allows. An RCA is generally more tax-effective if the employee is expected to be in a lower tax bracket or a non-resident of Canada in retirement. An RCA is also an effective vehicle as an employee retention tool for a key employee.
- Consider corporate owned life insurance as a low-cost solution for funding buy-sell agreements, funding tax liabilities, key person protection, and sheltering tax on surplus investment income.
- Use corporate funds to make the RSP contribution for the owner-manager. The cash used to make the RSP contribution will be considered employment income (reported on the T4 and thus will create future RSP contribution room), but the offsetting RSP deduction will avoid taxation on the increased salary.
- Speak to your tax advisor to determine if it is more beneficial to pay bonuses to employees to reduce the company's taxable income to \$500,000 (\$400,000 for B.C., Manitoba and Nova Scotia for provincial tax purposes) since amounts up to these limits of small business active income is taxed at low tax rates (approximately 12% - 19%) whereas amounts over these limits are taxed at higher corporate tax rates (approximately 29-35%). However, since these corporate tax rates are still lower than the top personal income tax rates, for some situations it is more beneficial to leave the amounts taxed in the corporation to achieve tax deferral.
- Consider deferring employee bonuses up to 179 days after the corporate year-end. The company will get a tax deduction in the current corporate tax year but does not have to pay the bonus in the current year. The employee will declare the bonus in the year of receipt, which in certain cases, may lower the tax liability for the employee on the bonus (however withholding tax will continue to apply on the bonus).
- As an alternative to large bonus payments, consider making the payments to an Employee Profit Sharing Plan (EPSP). The corporation receives a tax deduction for EPSP contributions and the EPSP employer contributions are taxable to the employee as employment income, however, no source deductions are required on EPSP contributions so some tax deferral can be achieved.
- If the corporation is involved in research and development, then the corporation should investigate if it is eligible to receive Scientific Research and Experimental Development (SR&ED) government tax credits for its related costs.
- Consider loaning corporate funds to adult children for education costs. The loan is considered taxable income to the adult child, however the tax payable on this income may be very low or even nil due to the child's basic personal, tuition and education tax credits. When the adult child repays the loan to the corporation in a future year when the adult child is working and earning income, the adult child will receive a personal tax deduction.
- Determine what the Paid-Up Capital (PUC) is on the shares. If the PUC is not nominal, an amount per share up to the PUC may be paid out to the shareholder tax-free through a series of transactions. This can assist shareholders requiring cash in a tax-effective manner. However, this tax-free pay out will reduce the ACB and PUC of the shares going forward.
- Determine what the Refundable Dividend Tax on Hand (RDTOH) is for the corporation. The RDTOH is a notional tax pool based on a percentage of the corporate tax paid on investment income. The RDTOH can be refunded to the corporation equal to \$1 RDTOH refund for every \$3 of dividends paid out of the corporation. Depending on the province and the type of dividend paid out (eligible or non-eligible), the RDTOH refund to the corporation may be greater than the personal tax paid on the dividend by the shareholder creating positive cash flow.

- To minimize net corporate tax (due to “integration”), consider paying out dividends to the shareholders in the same year that passive investment income is earned in the corporation. This is especially true for Canadian public company dividends earned in the corporation.
- If there is an impending Capital Tax liability, consider purchasing eligible investments to reduce the Capital Tax liability (investment merits and after-tax investment returns must be considered). However, many provinces are phasing out capital tax so check your provincial rules on this.
- Ensure that the corporation qualifies for the \$750,000 qualified small business exemption at all times. One of the tests to qualify is that two years before the sale more than 50% of the assets must have been used in an active Canadian business, so it is important to monitor each year whether the shares would qualify for the exemption. In addition, at the time of sale substantially all (generally at least 90%) of the assets must have been used in an active Canadian business.

If you have any questions or require clarification of any of the issues discussed in this document, do not hesitate to discuss these with your advisor.



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