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Tax Planning Checklist for the Owner-Manager

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The following represents a tax-planning checklist for individuals that 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 with 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. Among other things a shareholder agreement can help to 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; competition clauses, etc.;
- Consider employing lower income family members and pay 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;
- In certain circumstances, consider setting up an RCA or IPP to increase the retirement savings of the owner-manager and lower the tax burden of the corporation;
- Consider corporate owned life insurance as a low cost solution for funding buy-sell agreements, funding tax liabilities, key person protection, sheltering tax on surplus investment income, etc;
- 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;
- If possible, pay bonuses to employees to reduce the company's taxable income to $400,000 since the first $400,000 of small business active income is taxed at low tax rates (17% - 22%);
- 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 though 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 in a complex 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;
- 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.

Note: The above information is based on the current and proposed tax law in effect as of the date of this article. The article is for information purposes only and should not be construed as offering tax or legal advice. Individuals should consult with a qualified tax and legal advisors before taking any action based upon the information contained in this article.