Reducing taxes through your operating company

As the shareholder of an operating company, you may normally pay salary and dividends to yourself in order to provide a source of tax-efficient income. However, it may be beneficial from a tax planning perspective to bring on other family members as shareholders in order to facilitate future income splitting.

You should consider this strategy if you:

- Own shares of an operating company
- Intend to pay dividends on those shares
- Have a spouse or adult child who is in a lower tax bracket than you
- Do not intend to pay dividends to a minor child

KEY BENEFIT

- Reducing your family's overall taxes

PLANNING TIP

- Special tax considerations must also be made for investment holding company shares due to corporate attribution rules.

Please contact your Investment Advisor, accountant, tax advisor and legal counsel, as applicable, for more information.

Strategy in action

The issue: your family's tax burden

As a high-income earner, you pay your fair share of taxes. However, you can reduce your taxes through family income splitting.

The strategy: income splitting through your operating company

You can pay dividends to your spouse or adult children from your operating company and avoid immediate tax costs by implementing the following:

Step 1: Restructure the shares of your company. This step can be taken without triggering any immediate income tax. As part of this step, you will exchange your common shares for preferred shares that are redeemable and retractable for the company's current value. In other words, all the current value of the operating company will be attributable to your new special shares.

Step 2: New common shares will be issued to your spouse and/or children or to a family trust of which your spouse and/or children are beneficiaries. You may wish to have common shares issued to you as well, if you want to share in the future growth of the company. As the full value of the operating company is tied up in the preferred shares issued in Step 1, these new common shares can be issued for a nominal value.

Step 3: Dividends based on the future growth of the operating company can be paid to each common shareholder as desired. Each shareholder will pay tax on that dividend based on his or her individual tax rate.

Advantages	Considerations
■ Less tax to pay on family basis ■ If family members have no other sources of income, at least $30,000 of dividends can be paid without personal tax (amount varies by province) ■ May be opportunity to multiply capital gains exemption on eventual sale of shares[1] ■ Share future appreciation in value of shares with your family ■ Parents may maintain voting control of company if share reorganization structured correctly	■ Fees to re-structure share holdings ■ Dividends belong to shareholders ■ If business is sold in the future, common share-holders will share in the sales proceeds ■ Ensure your overall assets are sufficient to fund your future needs.

The following example shows how you can reduce your family's taxes by income splitting through your operating company. Assume that you own common shares of an operating company with a fair market value of $500,000 and an adjusted cost base of $0.

You take part in a share reorganization transaction whereby you exchange your common shares for preferred shares worth $500,000 (the current value of the company). New common shares are then issued to you, your spouse and your adult child.

The company would normally pay $90,000 in taxable dividends to you annually. It will now pay $30,000 to each shareholder, once there has been sufficient post reorganization growth in the common shares to support that amount of dividends. Your tax rate on these dividends is 31%.[2] Your spouse and adult child have no other income and can receive the entire dividend tax free.

Tax Implications

Pre Share Reorganization	You	Spouse	Adult Child	Total
Common Shares	$500,000	$0	$0	$500,000
Dividends	$ 90,000	$0	$0	$ 90,000
Tax	$ 27,900	n/a	n/a	$ 27,900

Post Share Reorganization	You	Spouse	Adult Child	Total
Preferred Shares	$500,000	$0	$0	$500,000
Dividends	$ 30,000	$30,000	$30,000	$ 90,000
Tax	$ 9,300	$0	$0	$ 9,300

Potential annual tax savings: $18,600

RESULT: You have transferred some of the tax liability on the dividends you normally would have received from your operating company to your family members. This has kept more after-tax dollars in your family.

(1) The 2007 federal budget increased the exemption to $750,000.

(2) Highest marginal rate on non-eligible dividends in Ontario. Actual rates vary by province.

As with any tax strategy, make sure you also consult with a qualified tax professional before taking action.

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