The Navigator

Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Tax Planning Checklist for the Owner-Manager

If you own an active business through a private Canadian corporation, you may find the following non-exhaustive tax-planning checklist helpful.

- Consider employing lower income earning family members and paying them a salary or bonus that is reasonable based on the services they perform for the business. This may allow you to take advantage of their lower marginal tax rate as well as create RRSP contribution room and CPP/QPP pensionable earnings for your family members.

- Speak to a tax advisor to determine if it is beneficial to pay bonuses to employees to reduce the company's taxable income down to the business limit. The federal business limit as well as the business limit for most provinces is $500,000. Active business income earned up to this limit will be taxed at a lower rate. Federally, the small business tax rate is 10% for 2018 and 9% starting in 2019. The combined federal and provincial small business tax rate ranges from approximately 12% to 22% for 2018. Active business income earned over the business limit is taxed at a higher general corporate tax rate of 15% federally. The combined federal and provincial general tax rate ranges from 26.5% to 31% for 2018.

- If your corporation and any associated corporations earns more than $50,000 of passive income in a given year, your corporation's ability to claim the small business tax rate may be affected. Where passive income is earned is in excess of $50,000 in the previous year, access to the business limit is ground down on a straight line basis by $5 for every $1 of passive income above $50,000. This may result in higher corporate taxes being paid on your corporation's active business income.

- Consider deferring the payment of employee bonuses up to 179 days after the company's year-end. Your corporation will still be able to claim a deduction for the tax year which the bonus relates to, and your employee will only have to pay taxes on the bonus in the year they receive it. This strategy helps your employee defer their tax liability.

- Consider whether paying dividends to your spouse and adult children who are shareholders of your corporation makes sense. The opportunity to

Please contact us for more information about the topics discussed in this article.

You can use corporate funds to make your RRSP contributions. The cash used to make the RRSP contribution is considered employment income to you and you will be entitled to an offsetting RRSP deduction. Income tax will not need to be withheld from the RRSP contributions, so again, tax deferral can be achieved.

split income in this manner will depend on whether the Tax on Split Income (TOSI) rules apply. If TOSI applies, the dividends paid to your family members would be subject to tax at the highest marginal tax rate, making this income splitting strategy ineffective. There are exclusions from the TOSI rules, which differ depending on the age of the family member receiving the income. The exclusions mainly rely on whether your family member is significantly involved in the business or owns a certain portion of the votes and value of the corporation's shares. These rules are complex so it is important to speak with a qualified tax advisor before implementing this strategy.

- If your company has a Refundable Dividend Tax on Hand (RDTOH) balance and you are in a low marginal tax rate, consider paying yourself a dividend up to the point where your marginal tax rate on the dividend reaches the dividend refund rate of 38⅓%. This strategy will provide you and your corporation with more cash flow overall, since the dividend refund to your corporation will be more than your personal tax on the dividend you received.

- As an alternative method of employee compensation, consider making the payments to an Employee Profit Sharing Plan (EPSP). Your corporation would receive a tax deduction for EPSP contributions and the employer EPSP contributions are taxable to the employee as employment income. No source tax deductions are required on EPSP contributions so some tax deferral can be achieved.

- You can use corporate funds to make your RRSP contributions. The cash used to make the RRSP contribution is considered employment income to you (reported on a T4 which creates future RRSP contribution room) and you will be entitled to an offsetting RRSP deduction. Income tax will not need to be withheld from the RRSP contributions, so again, tax deferral can be achieved.

- If your company is involved in research and development, then you should investigate if it is eligible to receive Scientific Research and Experimental Development (SR&ED) government tax credits for its related costs.

- Consider setting up an Individual Pension Plan (IPP) to maximize your retirement savings (beyond the level that an RRSP permits) and to lower the tax burden of the company. An IPP is a defined benefit pension plan established by a company for the owner-manager, and potentially other family members who are active in the business. IPP contributions are deductible to the corporation and the income earned in the IPP is tax-deferred since you will only pay tax on the payments you receive in retirement. In addition, IPPs are governed by provincial pension legislation and benefit from creditor protection under pension legislation.

- Consider setting up a Retirement Compensation Arrangement (RCA) to supplement your pension benefits to help you maintain your standard of living in retirement. Unlike an RRSP or IPP, there are no limits on the amount you can

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contribute to an RCA provided the contributions are reasonable (in line with your salary and service). An RCA is generally more tax-effective if you are in a lower tax bracket in retirement.

- Consider corporate-owned life insurance as a way to fund buy-sell agreements, provide cash flow in the event of disability or death of a key person and shelter surplus investment income from tax. Speak with a licensed life insurance representative for more information regarding insurance options for you.

- Determine the paid-up capital (PUC) of the shares of your corporation. The PUC of your shares represents the consideration your corporation received in return for the shares it issued to you. In some cases, your corporation can return the PUC to you tax-free as return of capital. This is a tax-effective way of withdrawing cash from your corporation. You may want to do this in the case where your corporation no longer needs the funds for its operations.

- Consider an estate freeze so that the capital gain on the future growth of the business can be deferred and recognized by the next generation. An estate freeze may also allow your family members to use their Lifetime Capital Gains Exemption (LCGE) ($848,252 for 2018, indexed annually) to shelter the capital gains arising on a future share sale from tax. For more information, please ask an RBC advisor for our article on estate freezes.

- Ensure that your company qualifies for the LCGE if you are contemplating a share sale at a future date. One of the tests to qualify is that throughout the two years before the sale more than 50% of the company's assets must have been used in an active business carried on in Canada. As such, it is important to monitor the company regularly to determine whether the shares would qualify for this exemption. In addition, at the time of sale, all or substantially all (generally at least 90%) of the assets must be used in an active business carried on in Canada. For more details on how to qualify for the LCGE, ask an RBC advisor for our article on the capital gains exemption on private shares.

There are many strategies available to you as an owner-manager to minimize your taxes. If you are interested in implementing any of the strategies discussed in this article, you should consult with a qualified tax or legal advisor.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax, or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal, and/or insurance advisor before acting on any of the information in this article.

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