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10 key decisions for business owners

Whether you're already a business owner or thinking about becoming one, the decisions you make will have far-reaching implications – not only for your business, but also for yourself and your family. Following are 10 key decisions you need to make to ensure the success of your business.

1. Choosing the best structure for your business

The structure you choose for your business has far-reaching implications – from the level of personal control you have to how much investment capital you can raise. You have three main choices:

1. Sole proprietorship

The simplest form of business structure is often a good choice for smaller enterprises. You have direct control over all key business decisions and receive all the profits. However, all your business income or loss is taxed on your personal tax return, meaning you forgo the tax advantages available to other business structures and have unlimited personal liability for the debts and obligations of your business.

2. Partnership

A partnership between two or more individuals can provide additional sources of investment capital and management expertise. With the division of authority, however, there can be potential for conflict, so it often makes sense to have a written partnership agreement covering issues such as how profits will be shared. As with sole proprietorships, all profits and losses are taxed as part of personal income, offering no special tax advantages. Legal liability depends on the type of partnership: with a general partnership, the partners share full liability jointly, but with a limited partnership, liability for limited partners extends only to the amount invested.

3. Corporation

Typically, a corporation is a more complex organization than a sole proprietorship or partnership, and involves higher costs and ongoing administrative requirements, such tax, legal and regulatory filings. Despite these drawbacks, many businesses choose a corporate structure because it enables them to raise substantial investment capital by selling shares in the business. A corporation also provides distinct tax and legal advantages. Because a corporation is a separate legal entity from its shareholders, your personal liability is limited to the shares you hold. Tax benefits include the small business deduction on active business income and the capital gains exemption on the sale of qualifying shares.

2. Reducing taxes

If you own a private Canadian corporation, you can take advantage of several tax-reducing strategies.

Personal tax strategies

- Employ lower-income family members in your corporation and pay them a reasonable salary based on the services they perform. Since they pay taxes at a lower tax rate, this reduces your family's overall tax bill.
- Establish an "estate freeze" that transfers some or all of the future growth of your business to family members. Once the freeze is in place, depending on the province, you may be able to pay more than $24,000 in tax-free dividends to your spouse and adult children annually.
- Transfer ownership of your operating company to a family trust, with your family members named as beneficiaries. When the trust sells the company, the resulting capital gains are allocated to each family member, so that they can each claim the capital gains tax exemption.

Business tax strategies

- Pay yourself a bonus to bring your active business income down to $500,000 federally (the provincial amount may vary) in order to benefit from the more favourable small business tax rate.
- Consider tax-deductible contributions to an Individual Pension Plan (IPP) or Retirement Compensation Arrangement (RCA).
- Maintain your operating company's status as a qualifying small business corporation to benefit from the capital gains tax exemption when you sell your shares.
- Pay Canadian-source dividends earned within your company to yourself. That way, you pay taxes at your lower personal rate (depending on your province of residence and your marginal tax rate) versus the flat refundable 38.3% corporate rate.
- Invest surplus assets within a tax-exempt life insurance policy to enjoy tax-deferred growth and create a tax-free death benefit for your beneficiaries.

3. What to do with surplus cash

You can use a simple "decision tree" to determine whether you should withdraw surplus cash from your business and, if so, how it should be used:

1. Consider whether there is a business need for the surplus cash any time in the foreseeable future, or an impending personal need, such as funding a family member's education or making a major purchase. If not, consider longer-term goals, like planning for retirement, maximizing your estate or protecting your assets. Retirement planning options include contributing to your Registered Retirement Savings Plan (RRSP), establishing an IPP or an RCA – all of which provide certain tax advantages.
2. Should you decide to withdraw surplus funds, consider the most tax-effective ways to do so. If you've paid business expenses personally, your corporation can pay you a tax-free reimbursement, while also receiving a tax deduction. If you've loaned personal assets to the company, these too can be paid back without tax consequences. Other ways to withdraw funds include paying yourself a dividend or paying yourself a bonus.

4. Building employee loyalty

There are several strategies to attract and retain top talent:

- Employer-sponsored savings plans including Group Registered Retirement Savings Plans (Group RRSPs) and Registered Pension Plans (RPPs). Group RRSPs work much like regular RRSPs, giving your employees the ability to make tax-deductible contributions and enjoy tax-deferred compound growth. RPPs are employer-sponsored pension plans also offering tax-deductible contributions and tax-deferred growth. There are two types of RPPs: Defined Contribution (DC) plans, which work much like RRSPs; Defined Benefit (DB) plans, on the other hand, guarantee a specific retirement benefit to the employee, calculated using formula based on earnings and years of service, which can result in a greater obligation to the employer.
- Enhanced retirement benefits, including RCAs and IPPs, which are designed for higher-income employees. An IPP is a DB plan established for one individual (and potentially that individual's spouse) that allows higher contributions compared to an RRSP. An RCA is a non-registered pension arrangement that has no set limits on contributions, provided they are "reasonable."
- Money isn't everything when it comes to rewarding your most valuable employees. Factors such as work/life balance, opportunities for growth and new challenges can all help keep your employees engaged and productive.

Planning ahead to ensure a well-funded retirement is important for anyone – but if you're a business owner, it's especially important due to the added complexities associated with your business.

5. Reducing risk

Both your personal and business assets could be subject to future creditor claims. However, there are several legitimate ways you can reduce this risk.

Protecting personal assets

- You can gift assets to family members, though this does potentially trigger taxable capital gains (unless the gift is to your spouse), and you would lose control over the gifted assets.
- Placing funds in an insurance policy or registered pension plan can safeguard them from future claims.
- You could also transfer assets to a formal trust, but again you may lose control of these assets.

Safeguarding business assets

- Avoid actions that can create the impression you are deliberately trying to put assets beyond the reach of creditors, such as transferring property below fair market value, by cash instead of cheque, without proper documentation or without a change in possession.
- Incorporate your business so that you are only personally liable to the extent of your shareholding.
- Consider transferring assets between separately incorporated businesses so that if one fails, the others are not left in a vulnerable position. Each business must be a legitimate legal entity carrying on business separately and all transfers must be properly documented and done at fair market value.
- Keep cash reserves as low as possible.

6. Dealing with the unexpected

By planning ahead, you can avoid or limit the damage of an unexpected setback or catastrophic event, whether it's a serious illness or injury, marriage breakdown or loss of a key employee.

Using insurance

Business owners commonly use insurance to protect their businesses in the event of fire, damage or theft. But insurance can protect your business in other ways. For example, it can:

- Cover business expenses if you become incapacitated
- Fund buy/sell arrangements for an orderly transfer of assets on the death, disability or illness of a partner or shareholder
- Provide financial compensation for the loss of a key employee

Minimizing the impact of marital breakdown

A marriage breakdown can have a serious impact, especially on a family business. Consider creating a family business divorce strategy that addresses issues such as business valuation and buy-out situations.

7. Retiring from your business

Planning ahead to ensure a well-funded retirement is important for anyone – but if you're a business owner, it's especially important due to the added complexities associated with your business. Following are some key things to consider:

- Will your business provide sufficient funds for your retirement? Like many business owners, your business may be your retirement nest egg. But will it be enough? It can be very difficult to predict what you'll get for your business when you sell it or arrange a buy-out. Saving for retirement outside your business (for example, through an RRSP or IPP) can reduce the risk of a shortfall.
- What's going to happen to your business? Whether you intend to pass along the business to family members, sell to a third-party or arrange a management buy-out, it's important to have an exit strategy planned early.
- Maximize tax strategies available to businesses that can help you enhance your retirement nest egg, including maintaining your small business status and establishing an estate freeze.

8. Selling your business

Many business owners who intend to sell their business often find it difficult to locate a suitable buyer willing to pay the price they want – especially on short notice. Here are some tips to help you get top dollar for your business:

- Have a valid reason to sell – but do not disclose personal information that can weaken your negotiating power.
- Don't wait until you're under pressure to sell and forced to accept a poor offer.
- Gather essential information such as financial statements, tax returns and inventory lists.
- Consider engaging experts such business brokers, legal experts, tax advisors and business valuators.
- Ask potential buyers to sign a non-disclosure agreement to protect key information from competitors.
- Keep the business going strong until you sell – letting it go into decline may affect your selling price.
- Look at tax strategies such as utilizing the capital gains tax exemption for incorporated businesses.

9. Keeping it in the family

One-quarter of business owners intend to pass on their business to a family member at some point. Unfortunately, many of these family businesses fail after the second generation due to a lack of succession planning. The following are some key components of a business succession plan:

- Take an honest look at your potential successor(s) to determine who has displayed the interest and aptitude in taking over from you.
- Get on the same page as your chosen successor. Make sure they really want to take over, then get them involved in planning the transition early.
- Get your chosen successor up to speed through training, education and mentoring. Communicate your plan to other stakeholders, such as other family members and your management team.
- Ease out of your role. Gradually give your chosen successor greater responsibility, while you scale back your duties.

10. What to do once you're retired

Often, retirement can come as a shock. You've poured your heart and soul into your business – it's who you are – and now you're expected to just stop? Here are some strategies for making the transition:

- Think about how you're going to spend your time in retirement before you do retire. Hobbies are good, but look for other meaningful activities too, such as volunteering or consulting in your area of expertise.
- Consider practical financial matters, such as ensuring your retirement income will last as long as you need it to, while providing you with the standard of living you want.
- Address how you will pass along your wealth to the next generation in the most tax-efficient way possible.

As a business owner, you have key decisions to make at each stage of your business lifecycle – from how to structure your business to how to wind it down. While you focus on taking care of your business, we can help you with the "financial business" – everything from protecting yourself from the unexpected to planning a successful retirement. Please contact us for more information.