Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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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.

Any reference to a spouse in this article also includes a common-law partner.

Compensation

- Consider employing lower-income-earning family members and paying them a salary or bonus that's 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 registered retirement savings plan (RRSP) contribution room and Canada Pension Plan (CPP)/ Quebec Pension Plan (QPP) as pensionable earnings for your family members.
- Speak to a qualified tax advisor to determine if it's 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. Active business income earned over the business limit is taxed at a higher general corporate tax rate federally and provincially. For federal corporate tax rates and provincial corporate tax rates, ask your RBC advisor for current-year tax tables.
- 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 to which the bonus relates, 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.
- Contemplate whether paying dividends to your spouse and adult children who are shareholders of your corporation makes sense. The opportunity to 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 a qualifying corporation's shares. These rules are complex so it's important to speak with a qualified tax advisor before implementing this strategy. For more details on TOSI, please ask your RBC advisor for an article on income splitting through private corporations.

- 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.

Corporate surplus

- If your corporation and any associated corporations earn(s) 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. A detailed discussion of the association rules is beyond the scope of this article, but two corporations could be associated when one controls the other directly or indirectly or both are under common control. Where passive income earned is more than $50,000 in the previous tax year, access to the federal business limit is ground down on a straight-line basis by $5 for every $1 of passive income above $50,000. The business limit may also be impacted in some provinces. This may result in higher corporate taxes being paid on your corporation's active business income. Speak with a qualified tax advisor to see if it makes sense to manage your passive income to minimize overall after-tax income.
- If you need the corporation's surplus funds for personal use, there are many ways to withdraw those funds, each with different tax implications. Consider using the following strategies first to get funds out of a corporation tax-free before paying a taxable salary or dividend:
  - Reimburse yourself for business expenses you paid personally

As an alternative method of employee compensation, consider making the payments to an employee profit sharing plan (EPSP).

  - Repay amounts owed to you by the corporation
  - Pay a capital dividend, and
  - Reduce the amount of paid-up capital (PUC) on your shares by returning the PUC to you as tax-free return of capital. The PUC of your shares represents the consideration your corporation received in return for the shares it issued to you.

For more details on these strategies, please ask your RBC advisor for an article on withdrawing surplus from a corporation.

Retirement planning

- 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. The assets contributed to an IPP are held separate from the corporation's assets and income earned on these assets in the IPP will not affect the small business tax rate described above. In addition, IPPs are generally governed by federal or 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 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.

Succession planning

- Consider corporate-owned life or disability insurance 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 potential insurance options for you.

- Consider an estate freeze to cap the value of your assets (i.e. your shares) and transfer the future growth of your assets, and their associated tax liability to the next generation. An estate freeze may also allow your family members to use their lifetime capital gains exemption (LCGE) to shelter the capital gains arising on a future share sale from tax. The LCGE limit for 2026 is $1,275,000 and will be indexed for years after 2026. For more information, please ask your RBC advisor for an article on estate freezes.
- Ensure that your company qualifies for the LCGE if you're 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 fair market value (FMV) of the company's assets must have been used in an active business carried on primarily in Canada. In addition, at the time of sale, all or substantially all (generally at least 90%) of the FMV of the assets must be used principally in an active business carried on primarily in Canada. As such, it's important to monitor the company regularly to determine whether the shares would qualify for this exemption. For more details on how to qualify for the LCGE, ask an RBC advisor for an article on the capital gains exemption on private shares.

Consider an estate freeze to cap the value of your assets (i.e. your shares) and transfer the future growth of your assets, and their associated tax liability to the next generation.

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

This article may contain 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.

RBC Wealth Management

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