FINANCIAL PLANNING FOR DENTISTRY PROFESSIONALS

Jack Courtney, B.A., LL.B., CFP, TEP
Vice-President – Private Client Planning
Tax planning progression of a dental practice

Starting Out
- Debt repayment
- Incorporation
  - Why
  - When
- Options and Restrictions

Growth
- Compensation
- Income splitting
- Enhancing tax deferral
- Liability/creditor protection
- Preserving capital gains exemption?
- Other planning

Succession/Retirement/Estate
- Sale of a practice
  - Assets v shares
- Retirement income
  - Longevity
  - Tax efficiency
- Wealth transfer
Starting Out
Employee v Independent Contractor

• One of the most litigated issues!
• Why so important?
  – Tort law
    • vicarious liability of employers for actions of employees
  – *Income Tax Act* status
    • ability of service provider to deduct expenses
    • Personal Service Business rules
  – Canada Pension Plan & Employment Insurance
    • Eligibility and liability for contributions
Is the person in a business on his or her own account?

Two part test

• **Intention** – as expressed by the contract between the parties and the manner in which they treat the relationship in their tax filings

• **Do objective facts support intention?**

  …*the legal status of independent contractor or of employee is not determined solely on the basis of the parties declaration as to their intent. That determination must also be grounded in verifiable objective reality*” – 1392644 Ontario Inc. O/A Connor Homes, 2013 FCA 85
Objective Tests

- **Control** – the payer determines what work should be done, how it is to be done and provides training. In a business relationship the independent contractor works independently and has discretion to accept or refuse work.

- **Tools** – contractors generally supply their own instruments, computers and any other items needed to perform their duties.

- **Subcontractors** – ability to hire assistants and subcontract.

- **Risk of loss and opportunity for Profit**

- **Integration** – are the payer’s activities integrated with the worker’s “business” and is the worker integrated into the payer’s activities.
Crushing tax rates

- Corporate tax rate (depending on province) – 38% to 44%
  - Loss of small business deduction & general rate reduction
- Combined corporate and personal tax - 50-65%
  - after payment of dividends to shareholder

Loss of all deductions other than salary and benefits paid to incorporated employee
Cash Damming

Tax and Cash Management Strategy
- For the sole proprietor/independent contractor (not incorporated)
- High business expenses and significant personal debt
- Conversion of personal debt into business debt on which interest is fully deductible.

Tax Rulings
- Consistent with Supreme Court of Canada reasoning on debt swap transactions (Singleton Case).
- CRA has commented favourably in IT-533.
Cash Damming - Example

Cash Damming does not impact gross business revenue or pre-tax profitability. It also does not increase the level of indebtedness or cash flow obligations.

Assumptions (annual)

- Business Revenue $300,000
- Business Expenses $125,000
- Profit $175,000
- Taxes $75,000
- Personal Expenses $100,000

$175,000
Normal Cash Flow

Business revenue $300k

Business Chequing account $300k ($25k mth)

Business Expenses $125k
Taxes $75k
Personal Expenses $100k

Business Chequing account

Loan payments
$1,500 month

Personal Chequing

Personal Debt $250,000
Cash Damming - New Cash Flow

Step 1: Direct all cash flow to personal use
Step 2: Use a LOC or AIO to fund business expenses

Business Chequing account $300k ($25k mth)

New LOC or AIO $250,000

$10,400/month

Business Expenses $125k

$10,400/month

Personal Chequing

Taxes $75k

$25,000/month

Personal Expenses $100k

Loan payments

$1,500/mth + $10,400/mth

Non Deductible Debt $250,000
Cash Damming – examples of expenses

Eligible Business Expenses

• Employee salaries
• Rent / taxes
• Cost of supplies and inventory
• Meals / entertainment*
• Vehicle expenses*
• Compound deductible interest

* Although only 50% of these costs are deductible for income tax purposes, 100% of the cost is considered a business expense.

Non-eligible Expenses

• Income taxes
• Owner draws
Forms of Professional Business

• **Sole proprietorship**
  – Simplicity
  – Losses can offset other sources of income

• **Partnership**
  – Managing partner control
  – Very flexible allocation of profits and expenses
  – Shared liability unless LLP

• **Corporation**
  – Tax planning advantages
  – More costly to establish and maintain
#1 Reason to Incorporate

**Tax deferral**

Top personal tax rate  
43.3%

Corporate rate on first $500,000 of “active business income” eligible for small business deduction  
(14.0%)

**Tax deferral**  
29.3%

*2015 Newfoundland Tax Rates*
Other tax reasons to incorporate

- **Income splitting with family**
  - **Dividends** – spouse or adult children
    - Salary – Must be reasonable for services performed
    - Kiddie Tax – children under 18
    - Corporate Attribution – can complicate (but not prevent) income splitting with spouse

- **Use of capital gains exemption on share sale**
  - More commonly used by dentists than other professions
  - Some provinces there is *trade-off* - tax deferred investing versus capital gains exemption
When to Incorporate?

- Will you retain earnings inside the corporation to:
  - pay down business debt
  - buy equipment and expand operations
  - invest more for retirement
  - pay insurance premiums

- Income splitting
  - May justify cost of incorporation
Provinces have jurisdiction to regulate professions

- Typically only professions that have a self-governing body or association are allowed to incorporate
  - Dental hygienists have self-governing status in some provinces

- All provinces allow dentists to incorporate

- Provincial rules relating to share ownership differ
  - Restrictions on share ownership and organizational can affect tax planning opportunities.
Common Conditions on Dentistry Corporations

- **Name of Corporation** – *must usually:*
  - include Surname of one or more of the professional shareholders
  - indicate the profession practiced
  - include the word “Professional Corporation”

- **Restriction on Business Activities** – *usually restricted to:*
  - practice of profession
  - Activities ancillary to professional practice
  - Investment of *surplus funds*

- **Shareholders** – *typical that:*
  - voting shares must be owned by members of the profession
  - Many provinces impose further restrictions
Costs of Incorporation

Tax advice
- Valuation of business being transferred to corporation
- Appropriate income tax elections

Legal work
- Articles of incorporation
- Share registry
- Share subscription
- By-laws
- Minutes of annual directors meetings and resolutions (dividend declarations)
Annual Costs

Provincial Corporation’s Office Filing fees
- For initial incorporation
- Annual information returns

Accounting work – preparation of annual
- financial statements
- T2 tax return
- T4 and/or T5 slips
Mechanics of Incorporation

Professional

Preferred Shares
- $90,000 redemption value
- ACB = nominal

Business Assets
- FMV = $100,000
- ACB/UCC = $10,000

Shareholder loan
- $10,000
  (= ACB/UCC of assets)

Voting Common Shares
- FMV = initially nominal
- ACB = nominal

Spouse & Adult children

Non-Voting Common Shares
- FMV = initially nominal
- ACB = nominal
  or

Participating Preferred
- (Dividends payable at discretion of directors)
- Redemption value = $100
- PUC = ACB = $100

Professional Corp.

Tax deferred transfer of business assets to Professional Corp. in exchange for loan and shares of Professional Corp.
(Section 85 of the Income Tax Act)
Rollover or transfer of goodwill at FMV?

- Rollover defers taxes
- Top personal tax rates on capital gains lower than non-eligible dividends

Mary Brown - goodwill at time of incorporation equals $100,000
$225,000 of pre-tax income will be required for personal consumption in first year of incorporation.
On transfer of goodwill – elects proceeds of disposition of $42,500
Tax savings in first year of 9.9% or $4,949

<table>
<thead>
<tr>
<th></th>
<th>Salary &gt; $175,000</th>
<th>Capital Gain</th>
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<tbody>
<tr>
<td>Corp Income</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Salary</td>
<td>(50,000)</td>
<td></td>
</tr>
<tr>
<td>Corp Tax</td>
<td>Nil</td>
<td>(7,500)</td>
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<tr>
<td>Salary/repayment</td>
<td>$50,000</td>
<td>$42,500</td>
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<td>Tax on salary</td>
<td>(21,650)</td>
<td>Nil</td>
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<tr>
<td>Tax paid on gain</td>
<td>Nil</td>
<td>(9,201)</td>
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<tr>
<td>Net Cash</td>
<td>$28,350</td>
<td>$33,299</td>
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</table>
What is the Optimal Corporate Structure?
# Restrictions on Incorporation of Dentists

<table>
<thead>
<tr>
<th></th>
<th>BC</th>
<th>Alta</th>
<th>Sask</th>
<th>Man</th>
<th>Ont</th>
<th>Que</th>
<th>NB</th>
<th>NS</th>
<th>PEI</th>
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<td>Holding Companies</td>
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<td>X</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>X</td>
</tr>
</tbody>
</table>
Should I plan for use of capital gains exemption?

- $813,600 lifetime per shareholder (indexed)
  - or for every beneficiary of a discretionary family trust

\[\text{= $185,600 tax savings per shareholder} \]
\[\text{(46.4% marginal tax rate)} \]

- Is a sale of shares probable?
- Must be a “small business corporation”
  - 90% or more of the fair market value of the corporation’s assets are any combination of:
    1) assets used in an active business; or
    2) shares or debt of another small business corporation
The Trade-off

Capital Gains Exemption

VS.

Tax Deferred Savings

Unless provincial rules allow for share ownership by holding companies
Quantifying Value of Tax Deferral

Bonus Paid to Preserve Capital Gains Exemption

Before tax income $100,000
Tax @ 46.4% (46,400)
Funds available for investment $ 53,600

Investment Funds Retained in Corporation

Before tax income $100,000
Tax @ 15.5% ( 15,500)
Funds available for investment $84,500

$30,900 more to invest each year
## Power of Tax Deferral

<table>
<thead>
<tr>
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<th>Corporation</th>
<th>Individual</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual contribution</strong></td>
<td>$84,500</td>
<td>$53,600</td>
<td>$30,900</td>
</tr>
<tr>
<td><strong>Gross Value @10 yrs</strong></td>
<td>$1,180,603</td>
<td>$748,880</td>
<td>$431,723</td>
</tr>
<tr>
<td><strong>Gross Value @20 yrs</strong></td>
<td>$3,294,885</td>
<td>$2,090,010</td>
<td>$1,204,875</td>
</tr>
</tbody>
</table>

6% deferred growth
# Power of Tax Deferral – After Tax

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<th>Individual</th>
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<tbody>
<tr>
<td><strong>Annual contribution</strong></td>
<td>$ 84,500</td>
<td>$ 53,600</td>
<td>$ 30,900</td>
</tr>
<tr>
<td><strong>After-tax value @ 10 yrs</strong></td>
<td>$ 827,528</td>
<td>$ 699,491</td>
<td>$ 128,037</td>
</tr>
<tr>
<td><strong>After-tax value @ 20 yrs</strong></td>
<td>$ 2,372,119</td>
<td>$1,853,832</td>
<td>$ 518,287</td>
</tr>
</tbody>
</table>

*46.4% personal tax rate*
Where Holdco Permitted

Professional

- Preferred Shares
  - $90,000 redemption value
  - ACB = nominal

- Voting Common Shares
  - FMV = initially nominal
  - ACB = nominal

Shareholder loan
- $10,000
  (= ACB/UCC of assets)

Professional & Spouse

Holding Corp.

- Participating Preferred Shares

Spouse & Adult children

- Non-Voting Common Shares
  - FMV = initially nominal
  - ACB = nominal

  or

- Participating Preferred
  (Dividends payable at discretion of directors)
  - Redemption value = $100
  - PUC = ACB = $100

- Dividends paid to Holdco to preserves capital gains exemption on common shares
- Creditor protection dependant on professional’s ownership interest in Holdco
Trust Permitted

Professional

Voting Preferred Shares
$90,000 redemption value
ACB = nominal

Shareholder loan
$10,000
(= ACB/UCC of assets)

Non-Voting Common Shares
FMV = initially nominal
ACB = nominal

Family Trust

Beneficiaries
Professional Spouse Children

Professional & Spouse

Holding Corp.

Professional Corp.

Participating Preferred Shares

Capital gains exemption can be multiplied among entire family
No Trust or Corporation Allowed?

Professional

- Preferred Shares
  - $90,000 redemption value
  - ACB = nominal

- Voting Common Shares
  - FMV = initially nominal
  - ACB = nominal

Shareholder loan
$10,000
(= ACB/UCC of assets)

Spouse

- Non-Voting Common Shares
  - FMV = initially nominal
  - ACB = nominal

Series of loans - creditor proof growth on retained earnings

Professional Corp. will still lose status as Small Business Corporation
Growth

Tax Efficient Compensation and Retirement Savings
Salary vs. Dividend Compensation – Common Questions

1. Are there any rules of thumb?
   • When is salary preferable to dividends?
   • When are dividends clearly preferable to salary?

2. Should companies bonus down to the SBD limit?
   • Should private corporations pay enough salary (even if not needed by the business owner) to reduce corporate income below the small business deduction limit?

3. Should individuals receive enough salary to maximize registered savings?
   • This question can also be phrased as “Should I take all my compensation as dividends?”
   • Do these questions depend on corporate profitability and tax rates?
   • What is the impact on Canada Pension Plan benefits?

4. Are there considerations that may outweigh tax?
**Compensation Basics**

**Salary (including bonus)**
- Deductible expense to company (reduces corporate income)
- CPP premiums (both employer & employee)
- Payroll taxes in some provinces depending on size of payroll
- Creates RRSP contribution room
- Needed to establish an Individual Pension Plan (IPP)

**Dividends**
- Paid out of after-tax profits
- Personal tax treatment depends on tax rate paid by company
- Higher corporate tax results in lower personal tax
  - Eligible v. non-eligible dividends
Integration of Corporate & Personal Tax

• With perfect integration, individuals should be tax indifferent between:
  • Carrying on business through a corporation, or as a sole proprietor, or member of a partnership;
  • Earning investment income personally or through a corporation.

Integration is not perfect!
Taxation of Salary vs. Dividends
(General Tax Rates – Corporate Income > SBD limit)

<table>
<thead>
<tr>
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<th>Salary</th>
<th>Impact of Incorporation</th>
<th>Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>$ 100,000</td>
<td></td>
<td>$ 100,000</td>
</tr>
<tr>
<td>Corporate Tax - General Rate</td>
<td>$ 43,300</td>
<td>Tax Deferral: $14.3k</td>
<td>$ 29,000</td>
</tr>
<tr>
<td>Corp. Inc. to Distribute or Invest</td>
<td></td>
<td>or 14.3%</td>
<td>$ 71,000</td>
</tr>
<tr>
<td>Personal Tax</td>
<td>$ 43,300</td>
<td>Tax Cost: $8.1k</td>
<td>$ 48,581</td>
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<tr>
<td>Net Personal Income After-tax</td>
<td>$ 56,700</td>
<td></td>
<td>$ 48,581</td>
</tr>
<tr>
<td>Total Corp. &amp; Personal Tax</td>
<td>$ 43,300</td>
<td></td>
<td>$ 51,419</td>
</tr>
<tr>
<td>Total Corp. &amp; Personal Tax Rate</td>
<td>43.3%</td>
<td></td>
<td>51.4%</td>
</tr>
</tbody>
</table>

* Reflects highest Federal & Newfoundland tax rates in effect as of July 1/15.
<table>
<thead>
<tr>
<th>Province</th>
<th>Top Personal Rate</th>
<th>General Rate</th>
<th>Tax Deferral</th>
<th>Tax Savings (Cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BC</td>
<td>45.80%</td>
<td>26.0%</td>
<td>19.8%</td>
<td>(1.4%)</td>
</tr>
<tr>
<td>Alberta</td>
<td>40.25%</td>
<td>27.0%</td>
<td>13.3%</td>
<td>(2.1%)</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>44.00%</td>
<td>27.0%</td>
<td>17.0%</td>
<td>(1.1%)</td>
</tr>
<tr>
<td>Manitoba</td>
<td>46.40%</td>
<td>27.0%</td>
<td>19.4%</td>
<td>(4.2%)</td>
</tr>
<tr>
<td>Ontario</td>
<td>49.53%</td>
<td>26.5%</td>
<td>23.0%</td>
<td>(1.8%)</td>
</tr>
<tr>
<td>Quebec</td>
<td>49.97%</td>
<td>26.9%</td>
<td>23.1%</td>
<td>(2.7%)</td>
</tr>
<tr>
<td>NB</td>
<td>54.75%</td>
<td>27.0%</td>
<td>27.8%</td>
<td>(0.2%)</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>50.00%</td>
<td>31.0%</td>
<td>19.0%</td>
<td>(5.9%)</td>
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<tr>
<td>PEI</td>
<td>47.37%</td>
<td>31.0%</td>
<td>16.4%</td>
<td>(3.4%)</td>
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<tr>
<td>Nfld</td>
<td>43.30%</td>
<td>29.0%</td>
<td>14.3%</td>
<td>(8.1%)</td>
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</tbody>
</table>

* Tax rates in effect as at July 1, 2015.
Time Value of Money Question:

- Personal tax can be deferred by delaying dividend distributions.
- *How long would it take for investment of deferred taxes to recoup the tax cost?*

Answer depends on three factors:

1. The amount of tax deferral.
2. The tax cost of leaving money in the corporation.
3. The expected rate of return on investment.
Corporation’s with profit in excess of $500,000 - Investment time horizon influences decision to bonus down to SBD limit

- Active income taxed in corporation at the **General rate**
- Deferred tax invested to produce a 3% after-tax return
  - Combined corporate and personal tax at top personal rates

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<tbody>
<tr>
<td>Deferred Tax</td>
<td>19.8</td>
<td>13.3</td>
<td>17.0</td>
<td>19.4</td>
<td>23.0</td>
<td>23.1</td>
<td>27.8</td>
<td>19.0</td>
<td>16.4</td>
<td>14.3</td>
</tr>
<tr>
<td>Tax cost</td>
<td>(1.4)</td>
<td>(2.1 )</td>
<td>(1.1 )</td>
<td>(4.2 )</td>
<td>(1.8 )</td>
<td>(2.7 )</td>
<td>(0.2 )</td>
<td>(5.9 )</td>
<td>(3.4 )</td>
<td>(8.1 )</td>
</tr>
<tr>
<td># of Years to breakeven</td>
<td>2.31</td>
<td>4.96</td>
<td>2.12</td>
<td>6.63</td>
<td>2.55</td>
<td>3.74</td>
<td>0.24</td>
<td>9.15</td>
<td>6.37</td>
<td>15.2</td>
</tr>
</tbody>
</table>

- **New Brunswick** – almost no tax cost – no reason to bonus down
- **B.C., Saskatchewan, Ontario, & Quebec** – breakeven time relatively short (2 to 4 years)
- **Alberta, Manitoba, P.E.I., Nova Scotia & Newfoundland** – breakeven time 5 years or longer
## Taxation of Salary vs. Dividends

### (Small Business Tax Rates)

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<td>$ 43,300</td>
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<td>$ 86,000</td>
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<td>Personal Tax</td>
<td>$ 43,300</td>
<td>Tax Savings: $0.7k</td>
<td>$ 28,600</td>
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<tr>
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<td>or 29.3%</td>
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<td></td>
<td>42.6%</td>
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</table>

- **Result of imperfect integration**

- Reflects highest Federal & Newfoundland tax rates in effect as of July 1/15.

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*Investors Group*
## Tax Deferral/Savings (Cost) – 2015 – SBD Rate

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<td>13.0%</td>
<td>31.0%</td>
<td>0.6</td>
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<tr>
<td>Manitoba</td>
<td>46.40%</td>
<td>11.0%</td>
<td>35.4%</td>
<td>(0.9)</td>
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<td>Ontario</td>
<td>49.53%</td>
<td>15.5%</td>
<td>34.0%</td>
<td>0.1</td>
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<td>47.37%</td>
<td>15.5%</td>
<td>31.9%</td>
<td>(0.9)</td>
</tr>
<tr>
<td>Nfld</td>
<td>43.30%</td>
<td>14.0%</td>
<td>29.3%</td>
<td>0.7</td>
</tr>
</tbody>
</table>

* Tax rates in effect as at July 1, 2015.
Corporate Income Taxed at **Small Business Rates** – How Many Years to Breakeven?

- How many years are required to recoup the tax cost for a corporation taxed at small business rates:
- Assuming deferred taxes are invested to produce a 3% after-tax return?

<table>
<thead>
<tr>
<th>Provinces with Tax Savings</th>
<th>Provinces with Tax (Cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SK</td>
<td>ON</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Tax Deferral (%)</td>
<td>31.0</td>
</tr>
<tr>
<td>Tax Savings / (Cost) (%)</td>
<td>0.6</td>
</tr>
<tr>
<td># Years to Breakeven</td>
<td>-</td>
</tr>
</tbody>
</table>

* Assumes 2015 highest marginal tax rates in each jurisdiction.

- For nearly half the provinces there is no tax cost for active business income taxed at small business rates; for provinces where there are costs the breakeven time horizons are small.
- **Opportunities exist to take advantage of the tax deferred within a corporation.**

Which compensation strategy is better for small business owners, Salary or Dividends?
Quebec

- Starting January 1, 2017
- Must employ more than 3 full-time employees to be eligible for Small Business Deduction
Which compensation strategy is better for small business owners, Salary or Dividends?

• Should business owners take all their compensation as dividends?
  or
• Should business owners receive enough salary to maximize registered savings?

• Corporate profitability and the tax rate on active business income are major factors.

• Analysis must consider the costs and benefits associated with the Canada Pension Plan (CPP) and Old Age Security (OAS) in retirement.

• Our example will assume all profit qualifies for small business rates
Salary vs. Dividends – Assumptions
(Corporate Income Less Than $500,000, Based in Ontario)

• Current age of the individual is 45 years old
• Pensionable earnings for CPP:
  • Zero from age 18 to 24
  • Years maximum pensionable earnings (YMPE) age 25 to 45
• Will work until age 65
• Plan for retirement income to age 90
• Annual after-tax RRIF income of ~$42,000 accumulated to date – received during retirement
Salary vs. Dividends – Assumptions
(Corporate Income Less Than $500,000, Based in Ontario)

• **Salary/RRSP Strategy**
  - Salary of $138,500 (in 2015 dollars) paid until age 65 to maximize RRSPs
  - Contributes $24,930 each year to RRSPs until retirement
  - YMPE continues to age 65

• **Dividend/Corporate Investing Strategy**
  - Dividends paid until age 65 to provide the same after-tax spending power as $138,500 of salary
  - No further pensionable earnings
  - $26,842 invested each year inside corporation until retirement
Salary vs. Dividends – With Corporate Class Investment Returns (Corporate Income Less Than $500,000, Based in Ontario)

- Which strategy results in greater retirement savings & income, if RRSPs & corporate investments earn a 3% annual (real) rate of return?

<table>
<thead>
<tr>
<th>($)</th>
<th>Salary</th>
<th>Dividend</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Business Income</td>
<td>140,980</td>
<td>140,980</td>
<td></td>
</tr>
<tr>
<td>Salary Paid to Business Owner</td>
<td>(138,500)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>CPP Contributions</td>
<td>(2,480)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Corporate Tax</td>
<td>-</td>
<td>(19,032)</td>
<td></td>
</tr>
<tr>
<td>Dividend Paid to Business Owner</td>
<td>-</td>
<td>(95,106)</td>
<td></td>
</tr>
<tr>
<td>Retained Earnings (Available for Corporate Investment)</td>
<td>-</td>
<td>26,842</td>
<td></td>
</tr>
<tr>
<td>Personal Income</td>
<td>138,500</td>
<td>95,106</td>
<td></td>
</tr>
<tr>
<td>RRSP Contributions</td>
<td>(24,930)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>CPP Contributions</td>
<td>(2,480)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Personal Tax</td>
<td>(32,484)</td>
<td>(16,500)</td>
<td></td>
</tr>
<tr>
<td><strong>Net Personal Income (Available for Consumption)</strong></td>
<td><strong>78,606</strong></td>
<td><strong>78,606</strong></td>
<td></td>
</tr>
<tr>
<td>RRSP / Corp. Savings at Ret. (Accumulated Over 20 Yrs)</td>
<td>669,878</td>
<td>713,537</td>
<td>43,658</td>
</tr>
<tr>
<td>a) Lump Sum Withdrawal (After-Tax) - at Retirement</td>
<td>374,151</td>
<td>492,782</td>
<td>118,631</td>
</tr>
<tr>
<td>b) Annual Income Stream Over 25 Yrs</td>
<td>78,838</td>
<td>83,627</td>
<td>4,789</td>
</tr>
</tbody>
</table>

x 20 years
The Nature of Your Investment Returns Matters!

- The type of investment selected for corporate investing can dramatically impact the results of a retirement savings plan.

<table>
<thead>
<tr>
<th>Corporate Class</th>
<th>Interest Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Income</td>
<td>0.00%</td>
</tr>
<tr>
<td>Realized Capital Gains</td>
<td>0.45%</td>
</tr>
<tr>
<td>Deferred Growth</td>
<td>2.55%</td>
</tr>
<tr>
<td>Total</td>
<td>3.00%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Pre-tax (Real*) Rate of Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Class</td>
<td>Interest Income</td>
</tr>
<tr>
<td>Interest Income</td>
<td>0.00%</td>
</tr>
<tr>
<td>Realized Capital Gains</td>
<td>0.00%</td>
</tr>
<tr>
<td>Deferred Growth</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total</td>
<td>3.00%</td>
</tr>
</tbody>
</table>

* Real = after inflation
### Corporate Class Investment Returns

<table>
<thead>
<tr>
<th></th>
<th>Salary</th>
<th>Dividend</th>
<th>Difference</th>
</tr>
</thead>
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<td>4,789</td>
</tr>
</tbody>
</table>

### Interest Income Investment Returns

<table>
<thead>
<tr>
<th></th>
<th>Salary</th>
<th>Dividend</th>
<th>Difference</th>
</tr>
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<td>626,071</td>
<td>(43,808)</td>
</tr>
<tr>
<td>a) Lump Sum Withdrawal (After-Tax) - at Retirement</td>
<td>374,151</td>
<td>440,430</td>
<td>66,279</td>
</tr>
<tr>
<td>b) Annual Income Stream Over 25 Yrs</td>
<td>78,838</td>
<td>78,170</td>
<td>(668)</td>
</tr>
</tbody>
</table>

- Assumes savings earn a 3% annual (real) rate of return
Salary vs. Dividends – Highlights

Three primary factors impact the benefits of the Dividend & Corporate Investing strategy:

1. The age at which the individual switches to the strategy.
2. The province in which the individual resides.
3. Nature of investment returns
   • deferred growth v current Income
### Average Retirement Income (After-tax) by Province (Including Other RRIF, CPP, & OAS Income)

#### Assuming Corporate Class Investment Returns

<table>
<thead>
<tr>
<th>Province</th>
<th>Salary</th>
<th>Dividend</th>
<th>Dividend vs. Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Columbia</td>
<td>80,611</td>
<td>83,908</td>
<td>3,297</td>
</tr>
<tr>
<td>Alberta</td>
<td>79,976</td>
<td>83,009</td>
<td>3,034</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>77,420</td>
<td>82,792</td>
<td>5,372</td>
</tr>
<tr>
<td>Manitoba</td>
<td>74,676</td>
<td>77,706</td>
<td>3,031</td>
</tr>
<tr>
<td><strong>Ontario</strong></td>
<td><strong>78,838</strong></td>
<td><strong>83,627</strong></td>
<td><strong>4,789</strong></td>
</tr>
<tr>
<td>Quebec</td>
<td>73,253</td>
<td>75,834</td>
<td>2,581</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>75,274</td>
<td>79,519</td>
<td>4,245</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>74,212</td>
<td>83,561</td>
<td>9,348</td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>74,429</td>
<td>76,704</td>
<td>2,275</td>
</tr>
<tr>
<td>Newfoundland</td>
<td>77,371</td>
<td>82,755</td>
<td>5,384</td>
</tr>
</tbody>
</table>

- Assumes savings earn a 3% annual (real) rate of return
Average Retirement Income (After-tax) by Province (Including Other RRIF, CPP, & OAS Income)

### Assuming Interest Income Investment Returns

<table>
<thead>
<tr>
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<th>Salary</th>
<th>Dividend</th>
<th>Dividend vs. Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Columbia</td>
<td>80,611</td>
<td>78,587</td>
<td>$2,025 (2.5%)</td>
</tr>
<tr>
<td>Alberta</td>
<td>79,976</td>
<td>78,380</td>
<td>$1,596 (2.0%)</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>77,420</td>
<td>77,518</td>
<td>98 (0.1%)</td>
</tr>
<tr>
<td>Manitoba</td>
<td>74,676</td>
<td>72,112</td>
<td>$2,564 (3.4%)</td>
</tr>
<tr>
<td><strong>Ontario</strong></td>
<td>78,838</td>
<td>78,170</td>
<td>$668 (0.8%)</td>
</tr>
<tr>
<td>Quebec</td>
<td>73,253</td>
<td>70,868</td>
<td>$2,385 (3.3%)</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>75,274</td>
<td>74,226</td>
<td>$1,048 (1.4%)</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>74,212</td>
<td>77,083</td>
<td>2,871 3.9%</td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>74,429</td>
<td>71,435</td>
<td>$2,994 (4.0%)</td>
</tr>
<tr>
<td>Newfoundland</td>
<td>77,371</td>
<td>77,377</td>
<td>6 (0.0%)</td>
</tr>
</tbody>
</table>

- Assumes savings earn a 3% annual (real) rate of return
Summary

When money **not needed** for personal consumption:

- Reconsider traditional advice to **bonus down** to Small Business Deduction limit
  - It may make sense to retain high tax rate income
  - Depends on province, time horizon and expected after-tax rate of return
  - Usually more tax efficient to pay life insurance premiums with after-tax corporate dollars

- More tax efficient to invest inside corporation
- Consider **creditor protection**
  - Can a holding company be used as part of a creditor proofing strategy?
Salary is preferable to dividends
• Salary reduces current overall tax payable
• Salary, registered savings & CPP benefits can create greater retirement income than dividend compensation & corporate investing. Consider:
  • **Guaranteed Income Funds** for enhanced creditor protection in registered & personally owned non-registered investments
  • Maximizing registered savings & creditor protection with an *Individual Pension Plan* (IPP)

It may be preferable to take all compensation as dividends
• Depends on province and choice of non-reg investments
• Dividends & corporate investing have the potential to create greater retirement income than salary, registered savings and CPP benefit.

But... there are a variety of reasons why clients and their accountants may still want to pay salary to maximize RRSP savings!
Before switching from Salary to only Dividends

Consider:

- Desire for fixed income investments
- Creditor protection
- Personal retirement tax rate
- Possible reduction in CPP survivor benefits
- Loss of CPP disability benefits
- T4 income may be needed to qualify for benefits under group disability plans
- Cost of maintaining a corporation in retirement
- Will corporate money be treated as retirement savings?
- Tax rates are always changing
TFSA v Corporate Investing

• Do I draw money out of Corporation to make TFSA contribution?
Growth

Other Planning Objectives
Purchase Real Estate

- Practice is successful and looking to purchase/build new premises
- Incorporate separate company to purchase building
- Rental agreement in place for use of space between corporations
- Rent will be payable from Dentist Inc. to Realco
Purchase of Real Estate for Practice

What type of income does Realco earn?

Realco

Income Inclusion

Building

Rental Payment

Use of Building

Dentist Inc.

Bill Julie

50 voting Common
50 non-voting Common

Julie Bill

50 voting Common
50 non-voting Common

What type of income does Realco earn?
I Want to Buy a vacation property!

- Excess cash or investments inside corporation
Vacation property - Alt #1: Corporate Ownership

- What if professional corporation purchases vacation property?
- Usually not a good option
- **Taxable shareholder benefit**
  - CRA could calculate benefit based on the amount of time the property was available to the professional/family (not on actual use)
- No corresponding deduction – *double taxation*
- Exception - property can be rented for most of the year
Alt #2 – Loan to professional from corporation

Shareholder loan rules

– Full income inclusion for value of loan
  • Result is *double tax*
  • Unless loan repaid within one year from the end of the corporation’s fiscal year end in which the loan was made
Vacation Property - Alt #3 – Increase Salary/dividend

• Additional personal tax
• But - personal tax can be reduced if capital gains can be triggered on corporate owned investments!
  – Half of capital gain credit to capital dividend account (CDA) – allows for payment of tax free capital dividend
Corporate Cash vs. Capital gain

Assume Two Options:
- **Cash = $100,000**
- **Investment with FMV = $100,000 & ACB = $50,000**
- **Corporate tax rate (investment income) = 48.7%**
- **Personal tax rate on non-eligible dividends = 33.33%**

Pay Dividend out of Cash
- **Zero Corporate Tax**
- **Personal Tax = $33,333**
- **Net After-tax = $66,666**

Trigger Capital
- **Capital Gain = $50,000**
- **Tax on Capital Gain = $11,975**
  - Combined corporate & personal tax rate of 47.9% on taxable gain
- **Personal tax on capital = $16,650**
  - non-eligible dividend
- **Net after-tax = $71,375**

At top personal tax rates, triggering gains on corporate investments can reduce total tax cost of distributions.
Funding Children’s Education

For children under 18 years

• Kiddy tax rules effectively prohibit income splitting through payment of dividends (exception where child disabled or parent dies)

• Related strategies no longer available as a result of legislated changes

• Capital gains splitting available on after tax personal dollars gifted or loaned interest free loan to a trust for the child
Funding Children’s Education

Corporate Investing v RESP (Registered Education Savings Plan)

• Do I withdraw money from corporation to fund RESP contribution
  or
• Do I invest within my corporation and structure corporation to pay dividends to children once they have reached the age of 18?
  o Does tax deferral and efficiency outweigh 20% government grant

• Corporate Investing should produce better result!
  o Generally more money invested – 32% more at top Nfld. tax rates
  o More tax efficient income to student
  o Tax efficiency can be enhanced through Corporate Class investment funds
Assisting children with personal cash – Max RESP then consider Investment Trust

- Principal of loan to be repaid to Dentist
- Capital gains taxes in hands of children
- Interest and dividends attributable to Dentist

Trust

Dentist

Trustees Dentist

Beneficiaries Children

Investments realizing capital gains

Interest free loan to trust
Selling a practice – tax implications
Selling Business

- **Seller**: wants to sell shares
- **Buyer**: wants to buy assets

**Why sell shares:**
1. LCGE
2. Avoid recapture

**Why purchase assets:**
1. Limit Liability
2. Stepped up basis

How to manage this disconnect?

Dentist  Spouse

**Dental Practice**

Inventory/Equipment/Goodwill

Potential Buyer
<table>
<thead>
<tr>
<th>Assets</th>
<th>Book Value</th>
<th>Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and accounts receivable</td>
<td>$250,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$900,000</td>
<td>$570,000</td>
</tr>
<tr>
<td>Accumulated depreciation – equip.</td>
<td>-500,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>Goodwill</td>
<td>$0</td>
<td>$1,150,000</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$650,000</td>
<td>$1,970,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Book Value</th>
<th>Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>$20,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Shareholders Loan</td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>$120,000</td>
<td>$120,000</td>
</tr>
</tbody>
</table>

Shareholders equity
- Capital Stock                | $100       | $1,850,000   |
- Retained Earnings            | $529,900   | $530,000     |
| **Total Shareholder Equity**  | $530,000   |              |

Total Liabilities and Shareholder Equity $650,000
## Share Sale

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Due to Shareholders</td>
<td>$ 100,000</td>
</tr>
<tr>
<td>Proceeds of Share Sale</td>
<td>1,850,000</td>
</tr>
<tr>
<td>Less: ACB</td>
<td>(100)</td>
</tr>
<tr>
<td>Capital gains exemption (dentist)</td>
<td>(813,600)</td>
</tr>
<tr>
<td>Capital gains exemption (spouse)</td>
<td>(813,600)</td>
</tr>
<tr>
<td>Capital gain</td>
<td>222,700</td>
</tr>
<tr>
<td>Taxable gain</td>
<td>111,350</td>
</tr>
<tr>
<td>Personal tax on gain</td>
<td>50,998</td>
</tr>
<tr>
<td><strong>Net After-tax</strong></td>
<td><strong>$1,899,002</strong></td>
</tr>
</tbody>
</table>

Less than 3% of value lost to tax

Assumes 2015 top B.C. personal tax rate of 45.8%
## Asset Sale - Corporate Tax - 2015 B.C. tax rates

<table>
<thead>
<tr>
<th></th>
<th>Original Cost</th>
<th>Tax Cost</th>
<th>FMV</th>
<th>Income</th>
<th>Capital Dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>900,000</td>
<td>400,000</td>
<td>570,000</td>
<td>170,000</td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td></td>
<td></td>
<td></td>
<td>1,150,000</td>
<td>575,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>900,000</td>
<td>400,000</td>
<td>1,970,000</td>
<td>745,000</td>
<td>575,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td></td>
<td></td>
<td>-20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Due to Shareholder</td>
<td></td>
<td></td>
<td>-100,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Assets minus Liabilities</strong></td>
<td></td>
<td></td>
<td>1,850,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Tax Payable on $750K</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First $500K -13.5%</td>
<td></td>
<td></td>
<td>67,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Rate – 26%</td>
<td></td>
<td></td>
<td>63,700</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Taxes Payable</strong></td>
<td></td>
<td></td>
<td>131,200</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Available to distribute</strong></td>
<td></td>
<td></td>
<td>1,718,800</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Asset Sale - After-tax Cash to Shareholders

<table>
<thead>
<tr>
<th>Corporate Distribution to Shareholders</th>
<th>Amount</th>
<th>Tax Rate</th>
<th>Estimated Tax</th>
<th>After-tax Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Dividend</td>
<td>575,000</td>
<td>-</td>
<td>-</td>
<td>575,000</td>
</tr>
<tr>
<td>Paid-up Capital</td>
<td>100</td>
<td>-</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Future eligible dividend</td>
<td>176,400</td>
<td>28.68%</td>
<td>50,592</td>
<td>125,808</td>
</tr>
<tr>
<td>Future non-eligible dividend</td>
<td>967,300</td>
<td>37.98%</td>
<td>367,381</td>
<td>599,919</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,718,800</td>
<td></td>
<td>417,973</td>
<td>1,300,827</td>
</tr>
</tbody>
</table>

**Repayment of loan**

- **Amount:** 100,000

**After-tax cash**

- **Total:** 1,400,827

*Almost 30% of value lost to tax*

Assumes 2015 top B.C. personal tax rates
Selling practice: asset vs. share

- Practice is worth approximately $1,850,000

After-tax cash subject to negotiation

Asset Sale → Share Sale

$1.4M

$1.9M

$500,000

After-tax cash to Seller
Geransky Planning – using exemption on asset sale

- Tax can be significantly reduced by use of lifetime gains exemptions
  - In this example with 2 lifetime exemptions, tax is limited to corporate taxes payable on asset sale
- No downside to purchaser (other than more complicated)
  - Costs of Newco and additional transactions typically born by seller
  - Does not inherit liabilities and gets stepped up ACB

After-tax cash to Seller

Asset Sale $1.82M

After-tax cash subject to negotiation

$80,000

Share Sale $1.9M

After-tax cash to Seller

Share Sale $1.9M

After-tax cash subject to negotiation

$80,000

Asset Sale $1.82M
Retirement Planning
“Am I going to be OK?”
Opportunity Cost

Estimated effective interest rate on total deposits

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>3.35%</td>
</tr>
<tr>
<td>2013</td>
<td>1.17%</td>
</tr>
</tbody>
</table>

Deposit balances, in billions of dollars

- **$574** in Jun 2007
- **$940** in Jun 2013

The inflation rate in Canada was recorded at 2.30 percent in May of 2014.

Source: Insight Advisory Service, January 2014, Exhibit 3. Excludes market-linked GICs
Factors Affecting Retirement Income

- Withdrawal duration
- Inflation
- Rate of Withdrawal
- Sequence of Investment Returns
- Asset allocation
Life Expectancy

- Male currently aged 65, has a...
  - 50% chance of living until age 83.
  - 25% chance of living until age 89.

- Female currently aged 65, has a...
  - 50% chance of living until age 86.
  - 25% chance of living until age 92.

- Couple both currently aged 65, have a...
  - 50% chance at least one will live past age 90.
  - 25% chance at least one will live past age 94.

Source: Canadian Institute of Actuaries, UP-94 Projected to 2015
Minimized Taxes

= Reduced Draw

= Increased Sustainability
Tax Opportunities

• **Tax Free Savings Accounts** - Tax free income
The 2015 federal budget proposes to increase the annual TFSA dollar limit from $5,500 to $10,000, retroactive to January 1, 2015

• Assumptions:
  • Person is age 50 in 2015
  • Contributes to the TFSA for 25 years
  • No TFSA redemptions made
  • Annual rate of return is 5.0%
Tax Opportunities

- **Tax Free Savings Accounts** - Tax free income
- **Corporate Class Investments** - Tax deferral
- **T-series Investments** - Tax deferred cash flow
  - Suitable for personally owned non-registered portfolios
The Corporate Class Advantage

- Rebalance without immediate tax liability
- Tax-deferred compound growth
- T Series - tax efficient cash flow through the return of capital

Tax planning benefits throughout the lifecycle of your investments.
Tax Opportunities

- **Tax Free Savings Accounts** - Tax free income
- **Corporate Class Investments** - Tax deferral
- **T-series Investments** - Tax deferred cash flow
- **Real Property (Fund)** - Tax deferred cash flow
- **Non-Registered Annuities**
  - Payments only partially taxable
  - Pension Income Credit
  - Pension Income Splitting
- **Guaranteed Income Funds**
  - Life Income Benefit options
Accumulation Phase

- Time works for you
- Volatility has little impact

Distribution Phase

- Time works against you
- Volatility can work against you

Retirement Age

Retirement Risks

- Longevity risk
- Inflation risk
- Market risk
- Healthcare risk

Time

Wealth
Sequence of Returns

The same overall returns can deliver different consequences
The complexities of multiple income sources

• Understanding your sources of income is critically important:

  **Personal savings:**
  - RRSP/RRIF
  - TFSA
  - Non-registered investments
  - Corporate investments

  **Government:**
  - CPP
  - QPP
  - OAS
  - Etc...

  **Other:**
  - Part-time employment
  - Home equity
  - Etc...

  **Employer sponsored:**
  - Employer pension plan
  - Group RRSP
  - Deferred profit sharing
  - Individual Pension Plans
Retirement Income Planning Process

- Calculate retirement income
- Estimate retirement expenses
- Determine income sustainability
- Determine income gaps
- Calculate withdrawal
- Suggest appropriate product and planning alternatives
- Monitor and adjust plan regularly
A Thorough Analysis – models the “What Ifs”

The following graph provides a summary of the accumulation and/or depletion of your assets linked to your retirement goal.
A Thorough Analysis – instills confidence
Allows you to plan for the future
The Estate Freeze

Original Cost
= $0

Freeze Value = $1.5M

Future Value

Value of Preference Shares
Taxed on the death of shareholder, redemption or sale

Value of Common Shares
Taxed on death of new shareholder and/or beneficiary, redemption or sale
Estate Freeze – Potential Benefits

• Income Splitting with adult children and grandchildren
• **Capital Appreciation to Next Generation**
• Creditor Protection – claims against beneficiaries
• Possible avoidance of marital property claims against a beneficiary
• Avoidance of Wills Variation Act Claims (British Columbia)
• Reduction of Probate Fees
• **CONTROL**
Estate Planning

Retired Professional

$1.5 million common shares*
ACB = $100
PUC = $100

Investment Corporation

- The value is attributable to the investment of retained earnings from a former active professional practice.
- Objective – reduce taxes on death
Investment Corporation

Trust

Common Shares

Retired Professional

$1.5 million preferred shares
ACB = $100
PUC = $100

Settlor
Relative or friend
Gift

Trustees
• Retired Professional
• One other

Beneficiaries
• Retired Professional
• children
• grandchildren

Issued at a nominal cost
Financing from bank

Future growth in value of investment corporation accrues to common shares
Reduction of Taxes on Death

• **Will the next generation trigger the tax?**
  — Do they want the cash?
  — Will they sell the investments, wind-up Investment Co?
  — Insurance may be a more tax efficient alternative
Reduction of Taxes on Death

• Can the investments be distributed to separate investment corporations for each beneficiary on a tax deferred basis?
  – May be possible if Investment Co holds only mutual funds and stock
  – Real estate is more problematic to divide both practically and from a tax perspective

• Tax on preferred shares
  – Serial redemption
  – Insurance
    • Provides liquidity
    • Can reduce overall tax bill!
Tax Benefits of Corporate owned Life Insurance

• **Tax deferral**
  – premiums paid out of lower taxed corporate dollars
  – a vehicle for tax sheltered investing

• **Tax savings**
  – Proceeds received by corporation tax free.
  – Proceeds in excess of policy ACB credit capital dividend account
    • Tax free payment to estate
    • **Insurance can actually reduce tax exposure on death of last spouse**

• **Cash value provides retirement safety net**
CUSTOMIZED SOLUTIONS

- Tax-efficient options
- Integrated banking
- Tax & estate planning
- Philanthropic planning
- Your goals & concerns
- Insurance planning
- Preferred pricing
- Managed asset investment programs
- Brokerage services