

Tax & Estate Planning for Business Owners



CIFPs 11th Annual National Conference

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May 2013

DISCLAIMER

The information provided is general in nature and is provided with the understanding that it may not be relied upon as, nor considered to be, the rendering of tax, legal, accounting or professional advice. Readers should consult with their own accountants and/or lawyers for advice on the specific circumstances before taking any action.

Agenda

- Federal Budget 2013
- Earning Income in a Corporation
- Investing for Retirement
- Actionable Items

Tax & Estate Planning
for Business Owners



PART II: EARNING INCOME IN A CORPORATION

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LIFETIME CAPITAL GAINS EXEMPTION

Current Rules:

- \$750,000 capital gains exemption on the sale of “qualified property”

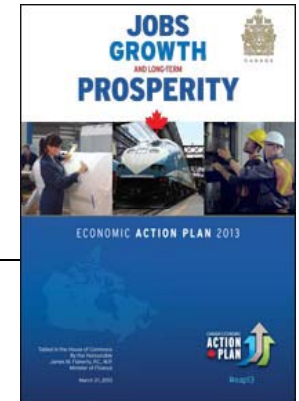
Budget 2013 Proposal:

- Increase the exemption to \$800,000 effective 2014
- Exemption will be indexed after 2014
- Federal tax savings of \$7,250 per individual
- Proper planning allows multiplication of the exemption amongst family members (spouse/partner, children)

HIRING CREDIT FOR SMALL BUSINESS

- Temporary Hiring Credit introduced in 2011; extended through 2013
- Meant to support small businesses and increase jobs
- Provides up to \$1,000 against employer's increase in 2013 EI premiums versus those paid in 2012
- To qualify, total EI premiums in 2012 must have been less than \$15,000
- Expected to impact 560,000 employers

NON-ELIGIBLE DIVIDENDS



Current Rules:

- Non-eligible dividends include dividends paid from profits taxed at the small business tax rate and;
- Corporate investment income
- Gross-up amount = $25\% / \text{DTC} = 13.33\%$

Budget 2013 Proposal:

- Reduce the gross-up to 18% and the DTC to 11%
- Effective for non-eligible dividends paid after 2013
- Will increase personal marginal tax rates on non-eligible dividends
- Impact on integration

NON-ELIGIBLE DIVIDENDS IMPACT OF NEW RULES

	2013	2014
Non-eligible Dividends	\$1,000	
Gross-up	\$250	
Taxable Dividend	\$1,250	
Federal tax (29%)	\$363	
Dividend tax credit	(\$167)	
Net federal tax	\$196	
After-tax proceeds	\$804	
Top federal marginal tax rates	19.59%	

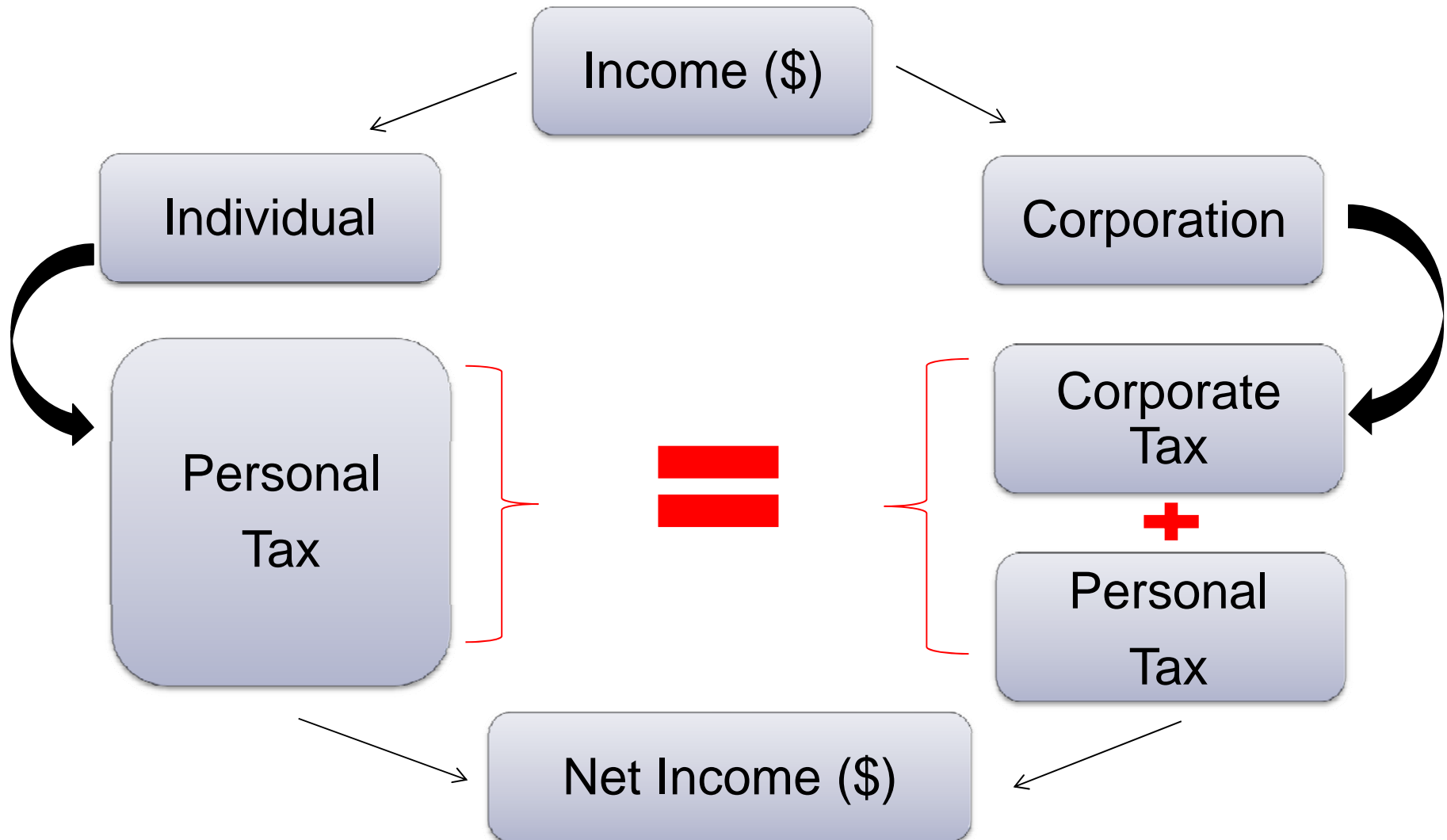
NON-ELIGIBLE DIVIDENDS IMPACT OF NEW RULES

	2013	2014
Non-eligible Dividends	\$1,000	\$1,000
Gross-up	\$250	\$180
Taxable Dividend	\$1,250	\$1,180
Federal tax (29%)	\$363	\$342
Dividend tax credit	(\$167)	(\$130)
Net federal tax	\$196	\$212
After-tax proceeds	\$804	\$788
Top federal marginal tax rates	19.59%	21.24%

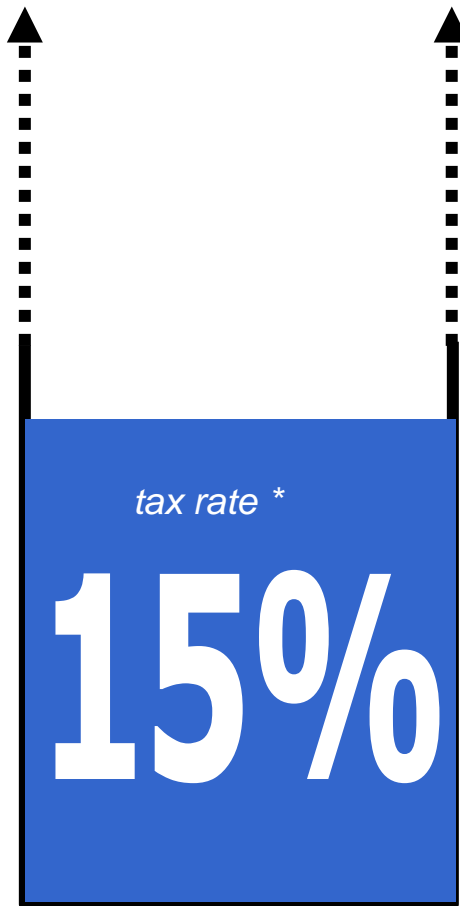
Earning Active Business Income



Integration 101



Active Business Income



- First \$500,000 (federal) of ABI:
 - Eligible for Small Business Deduction
 - Reduced tax rate on ABI vs. personal rates
 - Difference results in a tax **deferral**

* National Average – January 2013

Combined Federal and Provincial Income Tax Rates (Ontario 2013)

Small business
Income (%)

Ontario	4.5
Federal	11
Total	15.5

Combined Federal and Provincial Income Tax Rates (Ontario 2013)

	Small business Income (%)	General business Income (%)
Ontario	4.5	11.5
Federal	11	15.0
Total	15.5	26.5

TAX BENEFITS – HOLLY'S EXAMPLE

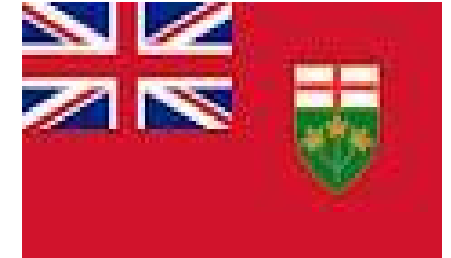
Holly owns a printing business which generates \$100,000 of business income. She does not need all of this income personally as she has other sources of income. Holly's personal marginal tax rate is 46.41%.

Question:

- What tax benefits are available if Holly chooses to incorporate her business?



Active Business Income



Ontario	2013
Active business income	\$100,000
Corporate tax	\$ 15,500
After-tax earnings*	\$ 84,500
Personal tax on dividend	\$ 27,513
Total tax	\$ 43,013
Personal tax	\$ 46,410
Deferral of tax	
Tax savings (cost)	

* Earnings paid out as an non-eligible dividend

Active Business Income



Ontario

2013

Active business income	\$100,000
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Corporate tax	\$ 15,500
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After-tax earnings*	\$ 84,500
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Personal tax on dividend	\$ 27,513
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Total tax	\$ 43,013
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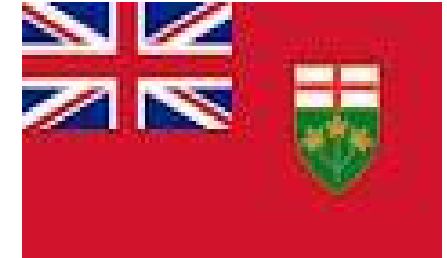
Personal tax	\$ 46,410
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Deferral of tax	\$ 30,910
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Tax savings (cost)	
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* Earnings paid out as an non-eligible dividend

Active Business Income



Ontario

2013

Active business income	\$100,000
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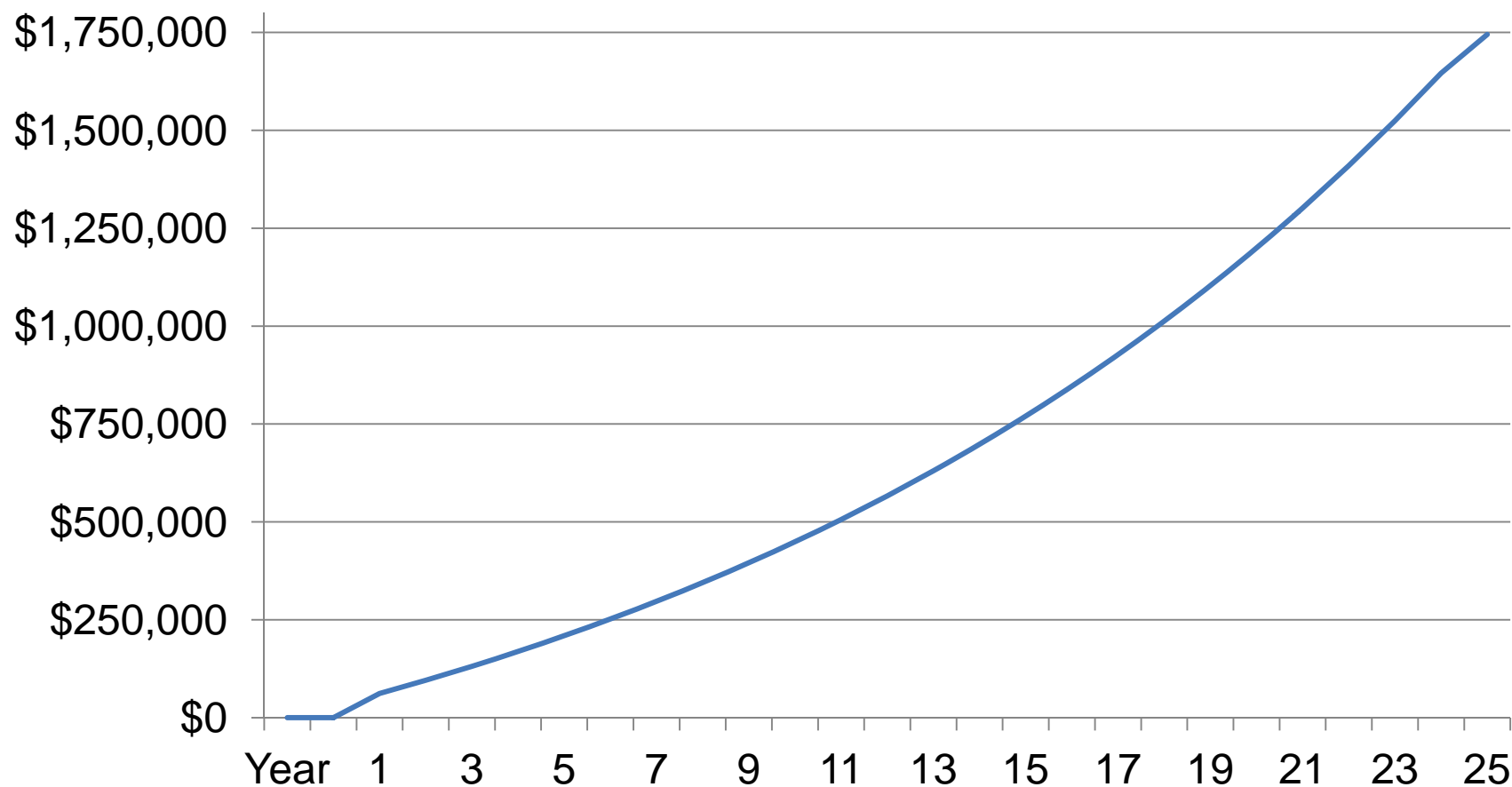
Deferral of tax	\$ 30,910
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Tax savings (cost)	\$ 3,397
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* Earnings paid out as an non-eligible dividend

Tax Deferral Advantage

An Opportunity to Rapidly Accumulate Wealth



Tax Deferral (2013): By Province

Province	Small Business Rate (A)	Personal Tax Rate (B)	Tax Deferral (B-A)
British Columbia	13.5%	43.7%	30.20%
Alberta	14.0%	39.0%	25.0%
Saskatchewan	13.0%	44.0%	31.0%
Manitoba	11.0%	46.4%	35.4%
Ontario¹	15.5%	46.4%	30.9%
Quebec	19.0%	49.9%	30.9%
New Brunswick	15.5%	43.3%	27.8%
Nova Scotia	14.5%	50.0%	35.5%
PEI	12.0%	47.4%	35.4%
Newfoundland	15.0%	42.3%	27.3%

* Rates effective as of January 1, 2013

1) Ontario tax rates ignore 2% tax increase on income in excess of \$509,000

ABI: Key Takeaways

- ABI taxed at low rates in a CCPC
- Creates an opportunity for significant tax deferral
- Allows for rapid accumulation of wealth inside a corporation



Earning Investment Income in a Corporation



Investment Income: Key Issues



- As assets accumulate in a corporation, they are invested and subject to tax at corporate rates
 - Investment tax rates > ABI rates
 - Investment tax rates > Top personal rates
 - Investment income retains its character
- High corporate taxes results in a need to be tax efficient with investment solutions

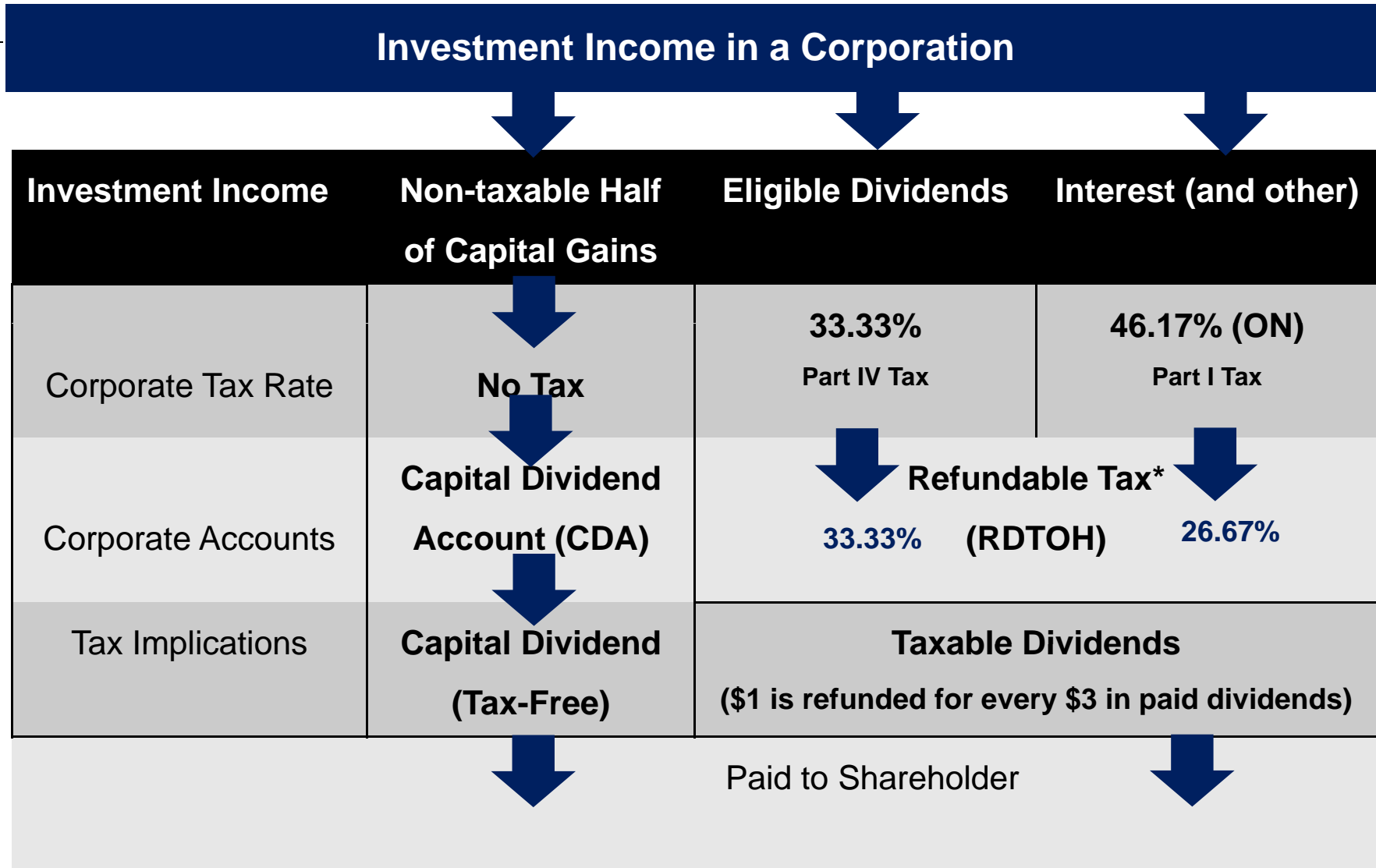
How is income taxed in a corporation?

Combined Federal and Provincial Income Tax Rates (Ontario 2013)

	Small business Income (%)	General business Income (%)	Investment Income (%)
Ontario	4.5	11.5	11.5
Federal	11	15.0	34.7
Total	15.5	26.5	46.2

Rates: January 2013

Overview of Investment Income Taxation in a Private Corporation



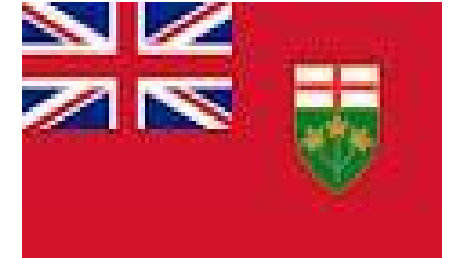
* Based on aggregate investment income

Capital Gains & the Capital Dividend Account (CDA)

- “Notional” account which tracks;
 - Non-taxable portion (50%) of capital gains
 - Other non-taxable receipts (i.e. life insurance)
- Tax-free distributions to shareholders via ‘capital dividend’

Focusing on capital gains increases the CDA!

Investment Income



Ontario ¹	2013
Interest income	\$100,000
Corporate tax	\$ 46,170
After-tax earnings*	\$ 80,497
Personal tax on dividend	\$ 26,210
Total tax	\$ 45,713
Net to Shareholder	\$ 54,287
Effective Tax Rate	45.7%

*Earnings paid out as an non-eligible dividend

•1) Ontario tax rates ignore 2% tax increase on income in excess of \$509,000

Investment Income in a Corporation (2013)

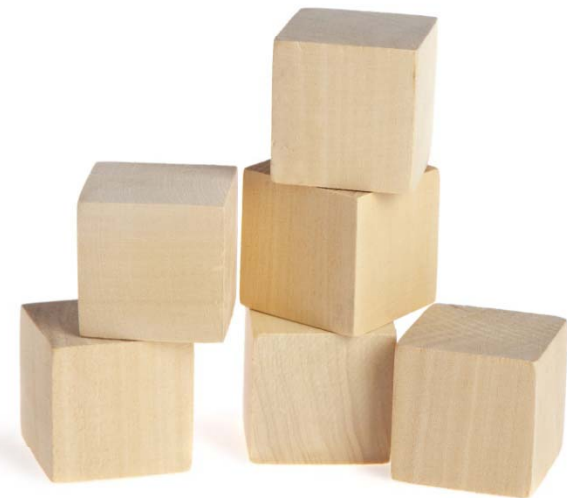
Combined Corporate / Personal Tax By Province

Province	Interest Income	Dividends	Capital Gains
British Columbia	45.6%	25.8%	22.8%
Alberta	40.7%	19.3%	20.4%
Saskatchewan	46.7%	24.8%	23.4%
Manitoba	51.3%	32.3%	25.7%
Ontario	45.7%	29.5%	22.9%
Quebec	50.8%	35.2%	25.4%
New Brunswick	43.3%	22.5%	21.7%
Nova Scotia	51.5%	36.1%	25.8%
PEI	55.3%	28.7%	27.7%
Newfoundland	45.4%	22.5%	22.7%

- Rates effective as of January 1, 2013
- Ontario excludes 2% tax increase on income in excess of \$509,000

Investment Income: Key Takeaways

- Investment income subject to high corporate taxes
- Need for
 - Tax efficiency
 - Avoidance of taxable distributions
 - Focus on capital gains



Investment Strategies for Business Owners

Consider Corporate Class Mutual Funds

- a) Minimize Tax / Maximize CDA
- b) Tax Efficient Growth
- c) Tax Efficient Rebalancing

Business Owners – Investing for Retirement



RETIREMENT PLANNING: COMPARISON OF GROWTH RRSP VS CORPORATION

Q: When saving for retirement, is investing in an RRSP or corporation more efficient?

- Sole proprietors/partners – RRSP
- Corporate shareholders – it depends on:
 - Corporate and personal tax rates
 - Cash flow needs
 - Desire for CPP benefits
 - Income-splitting opportunities

RRSP VS CORPORATION: PROS AND CONS

RRSP

- **Pros:**
 - Salary/bonus deductible to corporation
 - Contribution and growth tax-deferred
- **Cons:**
 - Salary (less RRSP contribution) fully taxable personally
 - RRSP income fully taxed on withdrawal

Corporation

- **Pros:**
 - Personal tax deferred until dividends paid
 - Dividends and capital gains taxed at preferred rates
- **Cons:**
 - Investment income taxed annually
 - No CPP benefits or income-splitting via spousal RRSPs

INVESTING FOR RETIREMENT – RRSP

Ontario

	Investing in RRSP ¹
Corporate business income	\$ 132,333 ²
Salary paid to owner	\$ 132,333
Corporate taxable income	\$ -
RRSP contribution ³	\$ 23,820
Owner's taxable salary (after RRSP contribution)	\$ 108,513
Personal tax on salary ⁴	\$ 49,916
Net cash for owner's day-to-day needs	\$ 58,597
RRSP – 15 years later ⁵	\$ 57,086
Tax on RRSP withdrawal ⁴	\$ 26,260
RRSP – Net cash to annuitant	\$ 30,826

¹ For simplicity, CPP premiums and retirement benefit not included in analysis

²Amount required to maximize RRSP contributions; ³Assumes previous year's income is same as current year

⁴For comparison purposes, top tax rate of 46% assumed

⁵RRSP contribution (\$23,820) grown at 6% per year for 15 years

INVESTING FOR RETIREMENT – CORPORATION

Ontario

	Investing in corporation
Corporate business income	\$ 132,333 ¹
Corporate tax (small business rate)	\$ 21,173
Corporate retained earnings (before dividend)	\$ 111,160
Dividend paid to shareholder	\$ 87,458 ²
Personal tax on dividend	\$ 28,861
Net cash for shareholder's day-to-day needs	\$ 58,597
Corporate retained earnings (after dividend)	\$ 23,701
Corporate retained earnings – 15 years later ³	\$ 56,802
Dividend paid to shareholder in retirement	\$ 56,802
Personal tax on dividend ⁴	\$ 15,435
Corporation – Net cash to shareholder	\$ 41,367

¹Same as previous chart for comparison purposes ²Amount required to achieve same consumption amount as RRSP chart

³Growth at 6% annually; corporate class funds, no distributions ⁴Combined corporate and personal tax rates (top rate)

RETIREMENT PLANNING: RRSP VS CORPORATION

Ontario

	RRSP	Corporation
Cash for day-to-day needs	\$58,597	\$58,597
Cash in retirement	\$30,826	\$41,367
Advantage in retirement	-	\$10,541¹

- Income subject to small business tax rate?
 - Consider investing corporately
- Income subject to general tax rate?
 - Consider maximizing RRSP; invest excess corporately
- Every situation is different; depends on business and owner

¹Based on one year's worth of contributions

¹For simplicity, CPP premiums and retirement benefit not included in analysis

Action Items For Advisors

- Understand the issues and opportunities
- Become a subject matter expert
- Identify business owner / professional clients who can benefit
- Educate COI's (i.e., accountants / lawyers) on benefits of corporate class for business owners
- Look to Mackenzie for support and solutions!

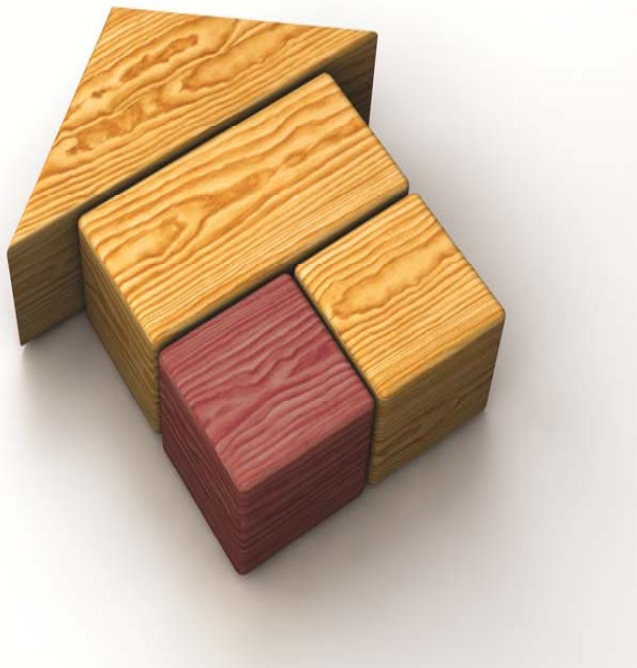
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PART 8: EARNING INCOME IN A CORPORATION

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INVESTMENTS

NEW! TAX AND ESTATE PLANNING FOR BUSINESS OWNERS KIT



- Series of brochures – 4 parts
- Investment, tax and estate planning strategies designed for business owners
- Integration reference card and Business succession checklist included
- Ideal investment options for corporate investors

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