RISK AND ASSET MANAGEMENT

BENTLEY FINANCIAL

Small Business Financial Focus

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Tax Tips For Small Business Owners

If you own a small business, you work very hard for your money. You want to make sure that you have used every legal means possible to save on tax, to enhance your after-tax net income. Here are some tips to help you achieve that objective. In all examples given, make sure that you speak with a qualified professional advisor with expertise in the area. The comments given here are general guidelines only, and it is advised that you obtain current tax regulations and strategies.

Income-splitting - This is a classic way of saving on taxes. Basically, it means that you arrange your income to have it divided amongst other family members (spouse and/or children). That way, each of the individuals will be paying less taxes, because of lower marginal tax rates. The aggregate taxes paid will therefore be less than what you would pay if all the money went into your hands. Here are some examples:

Spousal RRSP - You want to try to reach the maximum of your "earned income" for RRSP calculation purposes. Rather than put the RRSP in your own name, you can put up to l00% of your RRSP annual contribution into the name of your spouse (assuming your spouse has less taxable income). You take the tax deduction from your taxable income. The advantage of this arrangement is that when the time comes to collapse the RRSP, it will be taxed in the name of your spouse, who presumably is still in a lower tax bracket and will therefore pay less tax.

Corporate shares - By splitting your shares with your spouse and children, you can reduce the amount of tax paid in aggregate because the lower the income (from dividends) the lower the marginal tax rate. For example, you could have 5l% of the shares, while your spouse and children share the remaining 49%. You can deal with the issue of control by having Class A voting shares for yourself and Class B non-voting shares for your spouse and children. You also want to have the right to buy back the shares at any time from the other shareholders at the original, or some other set share value. You also want to get professional advice if your children are minors and don't pay fair market value for their shares–their dividend income could be attributed back to the business owner for tax purposes.

Family trusts - If you set this arrangement up carefully, and there are several options, you can keep more tax-free money in the family unit. For example, if your spouse and children are holding shares in your company through the means of a family trust, and have no other family income, they could each receive up to approximately annually in dividend income totally tax-free. Sounds rather attractive doesn't it? Normally, it is structured so that you hold Class A shares (voting) in your own name, while the Class B (non-voting) shares are held in the name of a family trust. This can be set up through the assistance of your lawyer and accountant. If you own an incorporated company that intends to pay or currently pays dividends to a spouse or children who are not actively involved in your business, ask your professional accountant, make sure you receive skilled tax advance.

There are other types of creative tax benefit arrangements. For example, you could do an "estate freeze" of the shares of your existing corporation, convert them into preferred shares, and then issue new common shares with a nominal fair market value to your children. This could be with the same corporate name, or by forming a new corporation for tax purposes. Again, you will need expert advice on how to do this.

Paying family members to work in your business - If you are not already doing this, consider the benefits. You can pay family members reasonable salaries or hourly wages for actual services. No tax is paid on income up to approximately $10,000 if there is no other source of income, and those who receive the money can make RRSP and CPP/QPP contributions. You can probably think of ways to use the skills and services of your family members and pay them accordingly, in terms of comparative market rates.

Using up the $500,000 capital gains exemption - This is still available for qualifying small-business corporations. Any such change would be effective as of the date of the budget. It could therefore be a "use-it-or-lose-it" situation. Consult your professional advisors about "crystallizing" your shares to lock in the significant tax savings. For example, 90% of the assets of the business have to be used for the purpose of creating income. So you couldn't have more than l0% of the fair market value in cash, as of the day that you "crystallize" the shares.

Regards, *Steve*

Remember our motto:

Complimentary Advice. Any Time. Just Ask.