THE CANADIAN BUSINESS JOURNAL

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A small business can be a powerful engine for creating wealth. Small businesses are also the biggest creator of jobs in Canada. According to Statistics Canada's Key Small Business Statistics survey "Small businesses account for more than 98 percent of all firms in Canada and proportionally play a large role in net job creation, creating 77.7 percent of all private jobs from 2002 to 2012"*.

ACCORDING TO THE Canadian Federation of Independent Business (CFIB), close to 50% of business owners plan on exiting their business in the next five years with more than 75% planning to exit within the next 10 years.** This provides a great opportunity for effective tax planning and charitable gift planning strategies for business owners.

Our tax rules provide a favourable tax rate for Canadian Controlled Private Corporations (CCPC). The first $500,000 of income of a Canadian-controlled Private Corporation (CCPC) enjoys a very low federal small business tax of 10.5%. The small business rate is available on active business income up to the amount of the Business Limit. The federal business limit of $500,000 begins to be reduced when a CCPC's taxable capital reaches $10 million, and is eliminated when taxable capital reaches $15 million.

In 2016, CCPCs that are eligible for the small business deduction pay the following combined federal and provincial (Ontario) tax rates on different types of income***:

General Rate	26.50%
Small Business (to $500,000)	15.00%
Investment	50.17%

When money is withdrawn from the corporation, it will be taxed at the top marginal tax bracket of the owner, depending on the amount of income he/she declares in that year. If the owner's net income is over $220,000 in Ontario, and the amount that is withdrawn from the corporation is in the form of salary, the income would be taxed at 53.53%. If it is withdrawn in the form of non-eligible dividends then it would be taxed at 45.3%.

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Locked-up Capital in Holding Companies

The cash inside an operating company can be transferred to a holding company using inter corporate dividends, on a tax free basis. Business owners set up holding companies mainly either to protect themselves from claims of creditors or as a retirement strategy to set up an investment portfolio inside the corporation without having to withdraw any funds and then to withdraw the funds as dividends during retirement.

While the low tax rate for small businesses helps spur growth in the business sector and helps the business owners accumulate wealth, this wealth creates complexity.

The biggest dilemma for most business owners is how to extract the funds in their corporations and holding companies without paying personal taxes at very high rates, due to those funds being taxed as personal income upon extraction from the company. There can be substantial reduction in the value of a company upon withdrawal of the funds. For example, assuming a 45% tax rate, a holding company with a value of $3,000,000, is actually only worth $1,650,000 after tax.

Therefore, it is understandable that business owners are always looking for tax effective methods of extracting their locked up capital from their corporations.

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Charitable Giving Considerations

When a corporation makes a charitable gift, the corporation receives a tax deduction, which reduces its income and will therefore reduce the taxes it has to pay. When a charitable gift is made personally, it results in a charitable donation tax credit which will reduce tax that was otherwise payable. Both on a personal level and corporate level, the limit on the amount of the charitable donation that may be claimed in a given year is 75% of net income and if the credit or deduction is not used, it can be carried forward for 5 years. Also, capital gains are eliminated for both personal and corporate gifts of public securities when the gift is made in kind.

A big difference between personal and corporate donations is that in the year of death, for an individual, the limit is 100% of net income and any excess can be carried back one year.

Giving Though a Private Corp

Private corporations have a notional account called the capital dividend account (CDA). The CDA creates a unique financial planning opportunity for business owners when it comes to philanthropic tax planning and makes charitable giving through a corporation extremely attractive.

The CDA does not appear on the corporation's balance sheet and is a notional account that keeps track of the amounts that are eligible to be flowed to a shareholder on a tax free basis, and is a cumulative total that is often recorded in the notes to the financial statements. The CDA is a very important notional account as it allows a shareholder to withdraw funds on a tax free basis from the corporation.

When a publicly traded security is sold by a corporation, 50% of the capital gain is taxable as income. The remaining 50% is not taxable and is credited to the CDA account.

When publicly traded securities with accrued gains are donated to a charity in kind, the CDA is credited with the non-taxable portion of the capital gain. Since donation of securities in kind to a charity eliminates 100% of the capital gain, 100% of the capital gain will be credited to the CDA account in this case. Therefore, by donating securities in kind to a charity, the entire capital gain can be withdrawn on a tax free basis from the CDA account.

While the decision with regards to making a charitable gift is a personal decision and is based on the philanthropic intentions of the donor, the decision as to whether to make a gift personally or through a corporation often hinges on the tax benefits. Therefore, the ability to extract money on a tax free basis from a corporation through the CDA, is a major consideration for shareholders as to where the source of the charitable gift should be.

The proceeds of a corporately owned life insurance policy also flow through the CDA account and can be paid to the shareholders on a tax free basis after deduction of the adjusted cost base of the policy.

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The use of life insurance together with donation of securities in kind can allow business owners to multiply the results of their giving and minimize their estate tax liability. The upcoming changes to Insurance rules in 2017, will reduce the maximum premiums and/or deposits permitted in an exempt policy and therefore will reduce the possibility of accumulating funds on a tax sheltered basis in a corporately owned policy. Therefore now is a good time for business owners to review and update their retirement and charitable giving strategies. **CBJ**

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