



Financial Planning for Business Owners

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At the beginning of my career in the financial planning industry during the early 1990s, I was very fortunate to meet one of Canada's most successful self-made businessmen.

He was in his late 50s and had much more life experience than me. He told me that the majority of the investment advisors he met over the course of his career did not have the foggiest idea how to make money that lasted, nor did they understand what successful business people were looking for when they sought out professional financial advice.

He told me that when he took a risk he got paid for his risk. He could buy a piece of property for a marginal amount, get it rezoned for a shopping plaza and then get franchisees to sign letters of intent to lease for five years or more when the property was developed. Once this was done he would go off to the bank and borrow on the future revenue that would be generated from these highly profitable leases to develop his properties and create a residual income.

He knew that he could take his own money and make 100 times the amount with 1/10th the risk that any stock broker could offer him. He was right. Business owners are not looking for financial advisors to give them the life they want by making a killing in the stock market; these people have been able to create the life they want by themselves.

Successful business people want their financial advisors to show them ways to keep their wealth. In essence, successful people want their financial advisors to provide them with financial, tax, succession, and estate planning solutions.

Business owners are different from the rest of Canadians. If for no other reason, the Income Tax Act favors people who work for themselves. There are numerous advantages available to those who own their own business, who take the risk and have the creativity and fortitude to do something on their own. These people are compensated for it.

If you are a self-employed individual or a business owner you might consider discussing some of these tax-saving ideas with your financial advisors to help keep the taxman out of your pockets. (Note: If you find these tax strategies of interest and desire more information, I will be expanding on them over the next few months in *Canadian MoneySaver*.)

Hire Family Members

If you employ family members in your business, prepare a written job description for each individual and pay them a reasonable salary and bonus for services rendered. For example, Canadians who earn less than \$8,148 for 2005 qualify for the personal tax exemption resulting in them paying no provincial or federal taxes. Family members earning up to \$33,375 will have, in Ontario, a combined federal and provincial marginal tax rate of 22%.

Pay Dividends

If you have an incorporated business and your spouse and children are shareholders, you may pay a dividend to them. If your family members have no other income and are in the lower marginal tax brackets, their dividend income will be taxed at a very low rate. When an individual earns regular income up to \$33,375, they will pay a combined provincial and federal tax rate of 22% in Ontario. If this same individual were to earn this money as dividend income rather than as regular income, they would pay taxes of only 12% on their money. By adopting this strategy there would be a further tax reduction of 10%.

Making Mortgage Interest Tax Deductible

If you have an incorporated business and have a mortgage on your home and happen to have excess capital in your business' bank account, consider writing a cheque from the company to yourself, depleting this capital balance. Use this money to reduce or eliminate your home mortgage. Ask the bank for a personal investment/business loan and invest the money back into your business. This strategy converts the non-tax deductible mortgage interest into a tax-deductible interest on a business or investment loan. An added plus is that it can help protect your money from creditors.

Incorporate

If you are self-employed and have not yet incorporated your business, consider it. This could result in tax savings and/or a tax deferral because corporations are taxed at 18.62% on the first \$300,000 of taxable income in the

2005 calendar year compared with the top combined personal federal and provincial tax rates in Ontario of 46.41%. This strategy only works if money is retained within the business or the business owner decides they are going to take money out of their company for themselves and family by paying dividends. If you need all the extra money generated from your business for living expenses, then the business may not earn a sufficient amount of profit to justify the extra money that will be involved in the legal set-up fees and on-going tax advice and corporate tax return filings needed to create the incorporated business.

Maximize Retirement Savings

As an unincorporated person, you may contribute the maximum amount permitted each year to a Registered Retirement Savings Plan (RRSP). However, if you are employed by your incorporated business and are earning a high income, consider creating a “super RRSP” in the form of an Individual Pension Plan (IPP) or a Retirement Compensation Arrangement (RCA). Contributions to these two vehicles may exceed the maximum allowable RRSP limits, are fully deductible by your company and are a non-taxable benefit for yourself. All the increase in the total value of assets is tax-deferred until withdrawal. IPPs and RCAs offer significant amounts of additional tax-deferred income to be set aside for your retirement.

(Note: Before implementing this strategy, it is important to seek the professional advice of an expert to perform a cost analysis to make sure that this is the best approach for your particular corporate and personal situation.)

For example, a 45-year-old MacDonald’s franchisee who has worked for their incorporated business since 1991 and has averaged a T4 income of over \$100,000 per year and plans to “max-out” their IPP contribution room (using a yearly rate of return of 7.5%) will accumulate \$4,800,101 in registered retirement assets. Opting for this tax solution, this individual would have a registered retirement yearly benefit at age 69 of \$362,819.

In comparison, if this same individual only utilizes their RRSP option from 45 to age 69, he/she would only accumulate \$3,310,822 in registered retirement tax-sheltered assets (using the same 7.5% compounded interest rate). This amount of RRSP assets on an annual basis would generate from age 69 and beyond \$250,251 of retirement income.

The decision is clear; this particular MacDonald’s franchisee who implements both the IPP and RRSP tax solutions (as part of their retirement plan) would have an additional \$1,489,279 of tax-sheltered assets in their registered retirement plan and have an additional \$112,568 in annual retirement income.

Create a Health Spending Account

If you have an incorporated business, consider creating a personal Health and Welfare Trust (HWT). A HWT is a bank account whose deposits are spent exclusively on health care expenses. By having an HWT, you may convert health care expenses into 100% business deductions and a non-taxable benefit for yourself. You determine both the amount of the annual contribution and how the benefit dollars are spent. Best of all, unlike traditional medical and dental plans, any unused funds remain in the account for your future needs.

Imagine an incorporated lawyer in Ontario who earns \$100,000 of net income this year, who incurs \$10,000 worth of medical and dental expenses. This lawyer must withdraw \$18,416 in pre-tax income from their company to pay their current medical expenses. By using a Health and Welfare Trust, their company would pay only \$11,000.00, which would then be 100% tax deductible from their business and a non-taxable benefit for themselves. Their company would experience an overall savings of \$7,416.

The Corporate Retirement Income Maximizer

The Corporate Retirement Income Maximizer provides tax-sheltered growth within the company. Use a corporate-owned life insurance contract which creates cash values. Access these funds personally during your lifetime by collateralizing loans from a bank. Borrow funds annually to increase your retirement cash flow. Use appropriate documentation and guarantee fees to avoid a personal benefit. The bank loan is paid automatically at your death using a portion of the policy proceeds while a credit to the Capital Dividend Account (CDA) is created equal to the full policy proceeds.

Successful business people in this world look for and build networks of experts to help them achieve their life and financial dreams. So, it is highly recommended that before you implement any of these tax-saving strategies to first sit down with an expert who will advise you on your best options. The key to managing your future is to plan for it.

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