



CESTNICK

TAX MATTERS

Retirement planning for business owners can take different forms

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The first job I ever had was cleaning toilets. My boss took me aside one day and asked: “What are your thoughts on nepotism in the workplace?” “You know, Dad, that’s a really good question,” I replied. “And Dad, I’ve decided that I don’t want to clean toilets all my life. I’ve been reading some self-help books and I know the secret to financial success,” I explained. “And what’s that?,” he asked. “I’m going to write a self-help book,” I said.

I did write a self-help tax-planning book a few years later. My father? He continued running his business without me – until he retired. Building on my conversation last week, I want to share four things my father did as a business owner to create a secure retirement financially.

1. Set up an individual pension plan. An individual pension plan (IPP) is a registered pension plan for one person, as opposed to a plan covering all employees. An IPP can create a predictable income in retirement. You can generally contribute more to an IPP – once you’ve reached about 40 – than to

a registered retirement savings plan (RRSP) since the IPP contributions are based on the actuarially calculated defined benefit the IPP will pay each year. You can start collecting pension benefits as early as 55 and can split those benefits with your spouse by reporting up to half of the pension income on your spouse’s tax return. Income earned inside an IPP, unlike passive income earned directly by your corporation, will not reduce the small business deduction available to your company. Be sure to understand the administrative costs to set up and maintain the IPP, but if your business is consistently profitable each year and could use the tax deduction from IPP contributions, an IPP can make good sense.

2. Make tax-free corporate withdrawals. Once you’re retired, you’ll very likely still have a corporation in your life. Whether you sell your active business and the funds are paid into your holding company, or the corporation carrying on your active business simply stops operating and becomes a holding company with cash and investments accumulated over time, you’ll be looking

to make withdrawals from your company in retirement. Tax-free withdrawals are always best. You can do this by having your company repay loans that you previously made to it. These shareholder loans are common if, for example, you transfer investments or other assets to your company as part of an estate freeze or other tax planning. You can also pay yourself tax-free dividends out of the capital dividend account of the company if it had previously realized capital gains on the sale of assets or had received life insurance proceeds in the past.

3. Pay yourself dividends. As a retired business owner with a corporation, you have the option of paying yourself dividends each year. If you had no other source of income, you could pay yourself a meaningful level of dividends and pay little or no income tax thanks to the dividend tax credit. The actual amount of low- or no-tax dividends will depend on whether the dividends are “eligible” or “non-eligible” (I won’t get into the difference today). In the case of eligible dividends, you can expect to pay little or no tax on about \$70,000 annually, but the result varies by province. As for ineligible dividends, the tax-free level of dividends is about \$30,000, depending on your province. Here’s another idea: Consider paying twice the level of dividends to yourself every other year, and nothing in the years in between. Doing this will allow you to avoid regular tax instalments because you can base your instalments on last year’s income, or your expected income in the current year (you’ll always be able to base your instalments on a year when you had little or no income).

4. Consider the use of life insurance. A permanent life insurance policy can be used to accumulate investments on a tax-sheltered basis. You can access these investments in retirement by making direct withdrawals from the policy, which are often taxable as regular income, or you can borrow from the bank using the policy as collateral and use the loan proceeds to meet cash needs in retirement. The bank loan would then be paid off upon your death when the insurance pays out tax-free. Visit a tax professional to talk about this loan idea since you’ll want to structure it properly (you’ll be using a corporate asset as collateral on a personal loan). You might also use insurance to fund a buy-sell agreement between you and another shareholder (the surviving shareholder uses insurance proceeds to buy the shares from the estate of the deceased shareholder).

The bottom line? Start thinking about your retirement income today.

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