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TAX MATTERS

Retirement planning isn't one-size-fits-all for business owners and professionals

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I remember when I started my first business. I was 14 and I asked my dad for \$1,000 to help get started. “A thousand dollars?” my father asked. “What do you need \$500 for? I only have \$100. Here, have \$20.” That was enough to launch the venture – which was a lawn and pool care services business. It helped to pay for university, although saving for retirement was not on my mind back then.

If you're a business owner or professional who earns more than you need to live on, you'll have to decide how to invest the rest. Should you keep the excess in your corporation to invest? Should you pay yourself additional compensation to invest personally or in your registered retirement savings plan or a tax-free savings account? Here are some key principles that should steer you in the right direction:

1. **Take salary to make catch-up RRSP contributions.** If you have RRSP contribution room available, consider paying yourself additional salary or bonuses to use up that room. This

will provide a tax deduction to your company, and result in no tax personally if you contribute the amount to your RRSP. You'll generally come out ahead this way over leaving the funds in your corporation to invest since the funds in the RRSP grow tax-sheltered. Investing in the corporation instead will generally work better only if you're focused solely on earning capital gains (and not other income).

2. **After RRSPs are maximized, use TFSAs to accumulate savings.** Once you've maximized RRSP contributions, it can make sense to pay yourself additional salary or bonuses to contribute to your TFSA. You'll accumulate TFSA contribution room each year (\$7,000 in 2025) and you can contribute up to \$102,000 in 2025 if you've never contributed before and were 18 or older back in 2008, when TFSAs were introduced. As with your RRSP,

you'll generally come out ahead paying yourself additional compensation from your company to use up TFSA room since the investments will grow tax-sheltered. Again, there could be an exception if you're investing solely for capital growth in your corporation.

- 3. Take a salary to create new RRSP contribution room – to a point.** I've mentioned that it makes sense to take additional salary or bonuses from your corporation if you have existing RRSP or TFSA contribution room. But does it make sense to take additional salary or bonuses for the purpose of creating new RRSP contribution room? The answer is: maybe. If you need the additional cash to meet your costs of living, then, yes, this can make sense. But it doesn't generally make sense to pay additional salary or bonuses to create RRSP room if you don't need the funds to live on and if you're simply going to invest most of those dollars in a non-registered account. In this case, you'll generally be better off leaving the funds in your corporation since you'll have more after-tax dollars in the company available to invest.
- 4. Take advantage of a holding company for corporate investing.** If you keep excess earnings in your operating company rather than paying these to yourself, you'd be wise to move the funds to a holding

company. The reasons? First, you won't want to expose any investments to creditors of your active business. In addition, removing the excess cash from your operating company can preserve your ability to claim the lifetime capital gains exemption on the shares of your business if they're qualified small business corporation (QSBC) shares. Excess earnings paid as dividends from an operating company to a holding company are generally tax-free to the holding company. (There's more than one way to structure this, so speak to a tax professional about it.)

- 5. Be aware that you could lose the small business deduction.** Investing excess earnings in your active operating company, or an associated holding company, could cause you to lose all or part of your active business's small business deduction (SBD). It only becomes an issue when passive income exceeds \$50,000 annually. It's not worth panicking over. It can still make sense to invest in a holding company when you've used up your RRSP and TFSA room.
- 6. Consider corporate-owned life insurance to save tax.** If you use some excess earnings in your corporation to invest in a permanent life insurance policy, you can take advantage of tax-sheltered growth inside the policy. Your life will be insured, and the corporation will own and

be beneficiary of the policy. The investment earnings inside the policy will not generally count as passive income and cause a reduction in the SBD mentioned earlier. Upon your death, the insurance proceeds will be paid to the corporation tax-free and will increase the capital dividend account of the corporation – which will allow tax-free capital dividends to be paid to your estate or heirs.

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