Progress

Article: Less is More

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To take more control of your taxes, you must deduct, divide, and defer. Most homeowners wouldn't tolerate a house that was leaking thousands of dollars' worth of heat each year, and yet too many business owners still allow their operations to leak money every year in the form of tax dollars.

That's unfortunate, according to David Jones, the senior financial advisor with Assante Capital Management Ltd., because in most cases they're in a very good position to plug those leaks.

"There are a number of things that business owners and professionals can do to take on more control of the taxes they are paying," says Jones. "It varies on an individual basis, of course, but there are some basic things that every business owner should look at, such as income splitting, financing non-deductibles, and the way they compensate themselves."

You could call them the "three Ds": deduct, divide, and defer. By taking every deduction you're entitled to, dividing your income among family members, and deferring any income you don't have to pay tax on right away, you can create an efficient strategy to minimize the taxes you're paying.

For businesspeople and other professionals, exercising control over taxes usually begins with incorporation. Start by asking one simple question: How big am I? "If you run a small business and you need everything you're bringing in to pay your own salary, then you don't have anything you really need to shelter," says Jones. "In that case, maybe incorporation isn't the best idea." For those fortunate enough to have money left over after living expenses are paid, incorporation offers one huge tax advantage: the ability to control your income—to defer it and the taxes on it—until a time that might be more advantageous, or to split it with your spouse or children.

Daren Baxter is a lawyer, a tax expert, and a partner at McInnes Cooper in Halifax. He says that paying yourself a salary from a corporation provides a small saving over earning that money directly, but when you do the math it

only works out to about 2 %. "That 2% savings isn't enough to compel a businessperson to incorporate," he says. "But there's another tax advantage to incorporation that's huge–we don't have to pay personal tax on that income until we access it. And we can choose when we access it."

> "One size never fits all when it comes to mitigating taxes… "

An unincorporated businessperson or a professional earning more than $150,000 has to pay about 50% of his or her income in taxes. But corporations only pay around 15.5% tax on the first $350,000 in income. "That means a corporation is earning 85-cent dollars as opposed to 50-cent dollars for the unincorporated," says Baxter.

Paying yourself a salary is just one way of using the money earned by a corporation. Dividends can often be a more effective way of getting money into the corporation owner's pocket–a one-two strategy that can allow you to keep your salary at a level well below the $150,000 maximum tax bracket while maximizing your RRSP and CPP contribution potential. A spouse with no income can earn up to $30,000 worth of dividends tax free. And leaving the money within the corporation, enjoying its low corporate tax rate, may be the best strategy of all.

Baxter uses the example of a young dentist buying a practice. If she borrows money as an individual, she's paying for that business with 50-cent dollars. But as a corporation she can set up her business and grow it using 85-cent dollars. When it becomes time to retire in a few decades, she'll have built a valuable business asset while racking up huge tax savings. "With the capital gains exemption, you can sell up to $800,000 of your corporate shares tax free when it comes time to sell the business," says Baxter. If you have a spouse and two children who also have shares, that's $3.2 million in tax-free capital gains.

> "You need to find a experienced financial advisor or tax accountant–someone who understands your situation and someone you trust."

It's a complicated process, but Baxter offers a caveat. "One size never fits all when it comes to mitigating taxes," he says. "Everyone's situation is unique, and pretty much everyone needs to seek professional advice if they're going to maximize their tax savings. You need to find a experienced financial advisor or tax accountant–someone who understands your situation and someone you trust."

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