eastport FINANCIAL GROUP

Preserving and protecting your business's SBL (Small Business Limit)

Discussion Topic -Passive Income Rules in a small corporation in Canada.

Strategy - Tax savings and integration for small business owners **using life insurance**.

In the fall of 2017 and into the 2018 budget Canada Revenue Agency (CRA) enacted a tax policy which changed how Active Business Income is taxed in a corporation relative to the amount of Passive Income earned by the same corporation.

Some key terms to understand are:

Active Business Income (ABI) - Is income earned while doing business (sales of widgets for example).

Small Business Limit (SBL) - Is in play when a Canadian controlled private corporation, or a small business, as is commonly used has the first $500K of Active Business Income is taxed at 11.62% while any Active Business Income greater than $500K is taxed at 29.5% in Ontario. See your local province for provincial comparatives on tax rates. i.e. Nova Scotia has higher tax rates (31%) than Ontario.

Passive Income - Is investment income earned by the corporation during the year – taxed at 53.16%.

Financial Impact of the change - The Passive Income Rules state that for every $1 dollar of passive income the corporation earns in excess of $50K, their small business deduction is reduced by $5. So, if the corporation were to earn $100K of passive income in a given year, their small business deduction would be reduced to $250K.

$100,000	Passive Income	$50,000	Excess Passive Income	$500,000	Original SBD
-$50,000	Passive Income Limit	X $5	Passive Income Factor	-$250,000	Reduction in SBD
$50,000	Excess Passive Income	$250,000	Reduction in SBD	$250,000	SBD Available

This means that any Active Business Income greater than $250K up to $500K would be taxed at 29.5% rather than 11.62%. This can result in an additional tax charge of $44,700 in Ontario and $48,450 in Nova Scotia.

Options to mitigate this include -

- Publicly traded equities with a low dividend payout
- Corporate class investment funds - See link - https://www.moneysense.ca/columns/ask-moneysense/how-do-corporate-class-funds-work-and-how-can-i-find-out-more/
- Bonus cash out/don't hold retained earnings in the corporation
- Non-associated corporation, or corporate owned life insurance. Life Insurance is a solution, not the only solution.
- A combination of all of the above as a part of a strategic plan

Investing in a Permanent Insurance Strategy – Managing the Passive Income Rules

- Investing in a permanent life insurance plan is permissible by Corporations in Canada
- Typically, the owner of the company will be the insured life, and the corporation will be the owner and beneficiary of the policy.
- Permanent insurance plans will grow tax sheltered at a similar rate to most fixed income investments.
    - **The great part is that this growth does not fall into the Passive Income rules** noted above. This can reduce the corporation's overall tax bill year over year.

Provided that investing in traditional securities can add an additional layer of annual tax, consideration should be given to whether investing in a permanent insurance strategy makes sense.

In addition to the above, the owner will benefit by owning an asset which:

- Asset Accumulation - Insurance Can be drawn upon for liquidity purposes during your lifetime as a part of your integrated retirement plan.
- Tax Sheltered growth of cash
- Often the policies are vested or guaranteed as they grow
- Growth is not treated as income as it grows sheltered in the plan
- Protects the SBL (Small Business Limit)
- It is a balance sheet item on your financial statements offering strength to the balance sheet.
- Insurance offers additional creditor protection inside the corporation.
- Ensures corporate debt and NCPI (Net Cost of Pure Insurance) is tax deductible.
- Can fund a Buy Sell or other ancillary needs.
- Will pay a lump-sum benefit to the corporation at death.
- It generates 100% CDA (Capital Dividend Account) credit - https://www.advisor.ca/sun-life-retirement/tax-and-estate-planning/the-capital-dividend-account-essential-for-business-clients/
- Death Benefit can be used for estate tax funding, intergenerational transfer, philanthropic objectives, liquidity, or any combination thereof.
- Asset Accumulation; balance sheet asset, maintains financial strength of the corporation

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