September 2017 Newsletter

Retirement Planning for Private Corporations in the New Tax Environment

Canada's Finance Minister recently released a Consultation Paper entitled "Tax Planning Using Private Corporations". This paper outlined the government's proposals to limit the use of perceived tax loopholes in the current tax system available to private corporations. Specifically, the Finance Minister proposes to:

- Limit "income sprinkling" amongst family members of the owner of the private corporation,
- Limit "passive income" accumulation within the private corporation,
- Limit the conversion of "business income into capital gains".

Generally, these proposed new limitations will discourage the holding of corporate income within the private corporation. Essentially, these proposed limitations will result in most income from private corporations being realized as T-4 employment income at top marginal tax rates (the consultation paper reports that six Canadian jurisdictions have marginal tax rates on T-4 income in excess of 50%).

The challenge remains: How to minimize the portion of income from a private corporation payable to the owner and his family that is taxed at top marginal rates. The limits proposed by the Finance Minister will make this challenge more urgent.

Fortunately, there are two long-established tax deferral vehicles enshrined in the Income Tax Act since 1992:

- Individual Pension Plans (IPP), and
- Retirement Compensation Arrangements (RCA).

Both of these vehicles permit large tax-deductible contributions to a creditor-proof trust fund for the exclusive use of the owner and family members. Other advantages include:

- The annual contributions on behalf of IPP members over age 40 are greater than the maximum contributions to a registered retirement savings plan.
    - In many cases, significant additional tax-deductible contributions can be contributed in respect of prior service with T-4 income.

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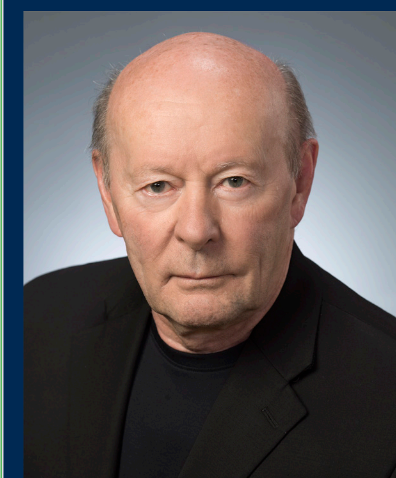

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- The maximum T-4 earnings that can be recognized in an IPP are $145,722 in 2017. However, an RCA can be established to accumulate retirement assets on salary above $145,722.
    - Contributions from a private corporation to a RCA are tax-deductible, but the investment income earned in the RCA trust is taxed at 50%. This is much less of an issue now that marginal tax rates are in excess of 50% in many jurisdictions.
    - The combination of an IPP and a RCA is a personal pension plan for the owner and his spouse that targets retirement income on all of the T-4 earnings. The two plans working in tandem will accumulate assets sufficient to target the same level of pension benefit provided by public service pension plans to federal or provincial government officials.

- All expenses of operating the plans (custodial, actuarial, administrative) and investing the assets (MER) can be paid by the private corporation as tax- deductible expenses.
- Any interest paid on money borrowed to make contributions to an IPP or RCA is deductible by the professional corporation.
- The contributions made by the private corporation to IPPs and RCAs are not subject to payroll taxes (CPP, EI, Workers Compensation).
- If investment performance is less than targeted, additional tax-deductible contributions can be made to restore the shortfall.
- If established properly, assets remaining in the IPP and RCA after the death of the owner and the spouse can be passed tax-sheltered to the next generation.
- Retirement and estate planning is easier because the IPP and RCA operating in tandem are designed to target a specific level of retirement income.

IPPs and RCAs are regulated by Canada Revenue Agency through the Income Tax Act and its Regulations. Properly established and administered, these two tax-deferral vehicles do not create any tax risk to a private corporation or its tax advisors.

The Lesniewski Moore Consulting Group is one of the largest administrators of IPPs and RCAs. Our actuaries and administrators are committed to providing the same level of service and professionalism to these personal pension plans as we would for a larger pension plan.

Mark Lesniewski	1-888-228-9024	Lindsey McKinnon
President & CEO	www.LMCGroup.ca	Regional Vice President
Calgary/Toronto		Manitoba/Saskatchewan