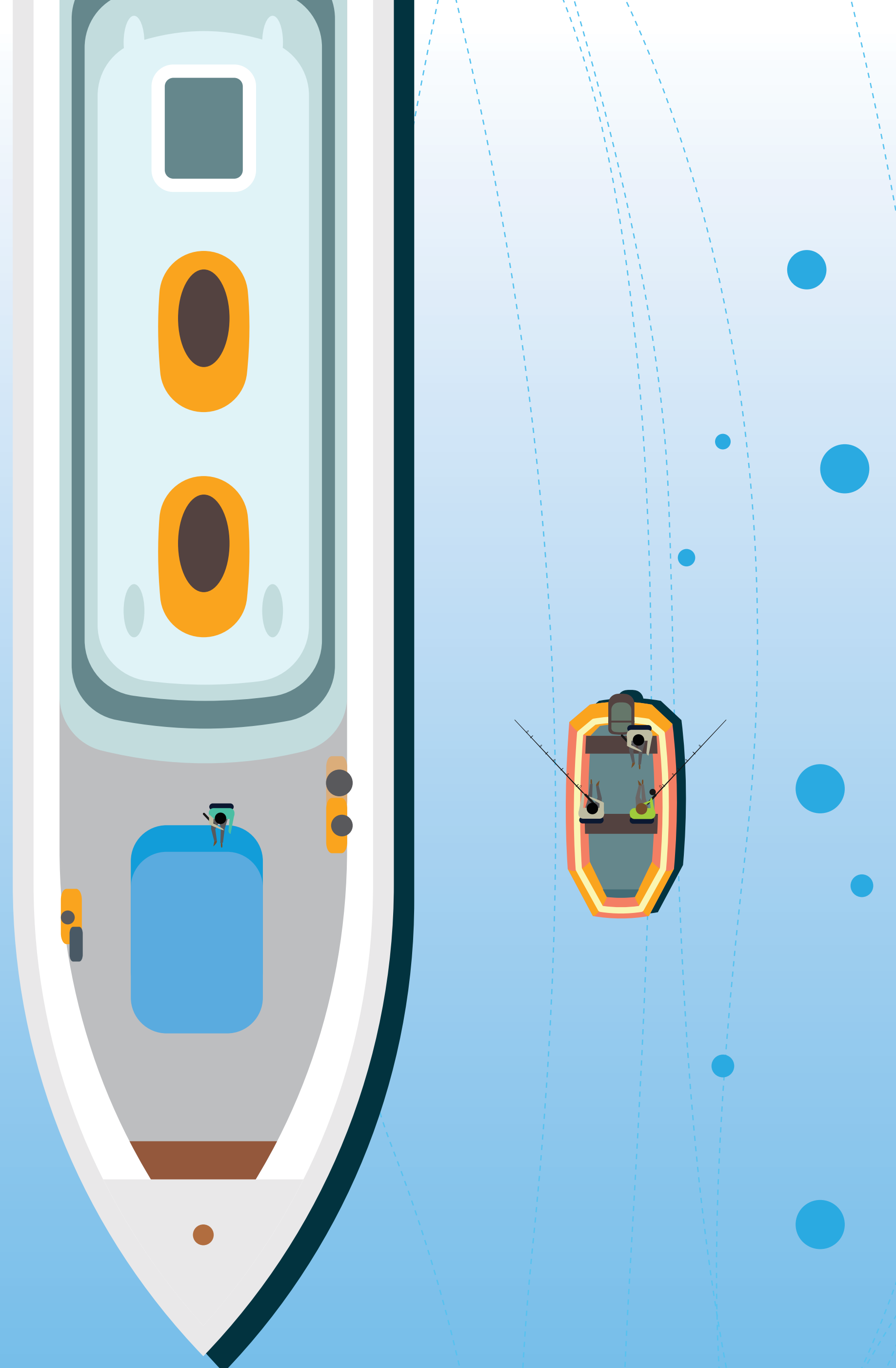
BUSINESS VANCOUVER
2018



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How to retire

THIS WILL HURT: NEW TOSI RULES AND YOUR RETIREMENT

CINDY DAVID | Starting January 1 you will not be able to split income with your spouse or adult children unless they are significantly involved in the business

> **If you draw $150,000 per year from your corporation, and could split the income with your spouse, you would pay a combined total of $30,670 in taxes. Under the new regime, if the whole amount is attributable to a sole owner, then you would pay a total of $44,023 in taxes**

On July 18, 2017, the Department of Finance released a 60-plus-page paper entitled *Tax Planning Using Private Corporations*. This is further to concerns by Finance in the 2017 budget that high-income Canadians were using private corporations to obtain tax advantages that are not available to other Canadians.

This article will specifically address the tax on split income (TOSI) rules and how they will affect retirement income.

The premise of this article assumes that the details of the proposals related to income sprinkling by the Department of Finance released on December 13 are implemented.

What you can expect: Starting January 1, 2018, and all future taxation years, you will not be able to pay dividends to your adult children or spouse unless they are significantly involved in the business. If you are found to be in breach of this rule, Canada Revenue Agency will apply the highest marginal tax rate on any payment made to your children or spouse, whether you deem it to be salary or a dividend. An exception is made for spouses but not until they reach age 65. For clarity, they have indicated that a substantial labour contribution means generally an average of at least 20 hours per week during the year, or any of five previous years. And then there is an ownership exclusion on top of all of this that excludes any adult (over age 25) who owns shares equal to 10 per cent or more; earns less than 90 per cent of income from providing services; is not a professional corporation, and does not have income derived directly or indirectly from another related business.

All of this comes down to three major issues:

- they want to limit your ability to split income with non-active family members;
- they recognize a contribution to the business and will not punish you from a tax perspective for rewarding that contribution; and
- they recognize the importance of income splitting with your spouse in retirement, just like your local MP can with income from his or her defined benefit pension plan.

CHILDREN ■ There is no more splitting income with children who don't meet the exclusion definitions.

What have you lost? In the past, you could carve out close to $40,000 per year to your adult children with no or little tax. Now, if they don't qualify, that same $40,000 will cost $19,080 in tax. For most clients, this ends or is tapered when children graduate, get jobs and become financially self-sustaining.

SPOUSE ■ There is no more splitting income with spouse, until age 65.

This is going to hurt. If you draw $150,000 per year from your corporation, and could split the income with your spouse, you would pay a combined total of $30,670 in taxes, or 20.45 per cent average tax. Under the new regime, if the whole amount is attributable to a sole owner, then you would pay a total of $44,023 in taxes, or 29.35 per cent average tax.

The net effect is that if you have to pay more in tax on retirement income, it requires more savings to meet the same spending needs.

To the extent income splitting was with children to pay for post-secondary education, either a higher amount will need to be to be paid out of the corporation to fund the same expenses on an after-tax basis or the business owner will need to personally fund a greater portion of those expenses with after-tax income. Either way, there will be less available for investment and retirement income.

A business owner may want to consider registered education savings plans, tax-free savings accounts and other income-splitting strategies, such as prescribed rate loans to avoid both the attribution and TOSI rules. This can reduce the after-tax costs of funding post-secondary education, and in turn preserve more capital for investment/retirement purposes. However, these strategies will often require extracting money from the business, which carries an additional tax cost. Also, to make some of these strategies worthwhile you need to pay out larger amounts from the corporation (versus trickling out dividends).

To the extent that income splitting is with a spouse, the spouse will receive less on an after-tax basis. This will reduce the amount available to the spouse for investment purposes and for retirement income. Alternatively the business owner will not pay out those dividends and the spouse's investment capital will be reduced even more. Business owners may find it more advantageous from a tax perspective to pay out reasonable salaries rather than dividends to themselves and family members involved in the business. This will create registered retirement savings plan contribution room.

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