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Why Tax Planning?

Many Canadians do not give much thought to how they can reduce their taxes until it's time to file their tax returns. By then, many tax saving opportunities for the year may be lost. I have seen this in my practice through new clients who often say tax guy never talked to them about how to lower tax bill through tax planning. Many people dump their tax documents on the tax preparer's desk and hope for the best. This is a recipe for disaster.

Understanding the impact that taxes have on financial well-being is essential, especially for a self-employed. Take time to plan for the current year and make adjustments to create positive momentum. The income tax system is constantly changing and there are always new laws and provisions in the tax system which illustrate the importance of planning.

Taking control of taxes and saving tax dollars is what tax planning is all about. Some of the biggest savings associated with tax planning can come from ideas that are very simple.

Like many other aspects of our financial life, through knowledge and understanding can come clarity and improvement. Take control of your taxes. Remember that taxes are the single largest recurring expense that most of us will have throughout our lifetime. The tax system is quite complicated, so talk with your Financial Advisor or tax preparer about helping you plan accordingly.

Is tax planning really necessary? If you are super wealthy and very generous to the taxing authorities, then the answer is no. For the rest of us, it might be a smart idea. In general, the more money we make the greater the importance of tax planning. Each dollar we earned above a tax bracket will put us into the next higher tax bracket. This is known as marginal tax rate.

Correct tax planning mandates precise actions with meticulous consideration among a wide spectrum of financial knowledge (tax, financial planning, real estate, and so on). Look for an accounting firm with such resources because your decision today will greatly impact your wealth tomorrow, either positively or negatively.

What do all of these business owners have in common? Good tax planning. Here are some year-end tax strategies for business owners.

1. Review your compensation mix
As we approach year-end, consider the optimal mix of salary and dividends for 2019. There's no best answer here for everyone, but you should consider your personal marginal tax rate and that of your business, registered retirement savings plan (RRSP) contribution room and provincial health or payroll taxes.
As a general rule, if you don't need the cash and your company has a lower tax rate than you, consider leaving the cash in the corporation.

2. Pay salaries to family members
If a family member has provided services to your business, consider paying them reasonable salaries or bonuses.

Watch for TOSI (Tax On Split Income). The TOSI rules apply to most income sources, including interest on a debt, dividends and capital gains. Keep in mind, salaries and wages have always been subject to a reasonableness test. A tax deduction will not be allowed in the business for amounts paid in excess of a reasonable amount, but will still be fully taxable to the recipient, resulting in double taxation.

Revenue Agency (CRA) has no problems with you paying family members as a tax-saving strategy so long as you meet two key conditions:

You must be able to show that your family members actually did the work

The wages must be "reasonable in the circumstances"

3. Pay tax-free amounts where possible
If you own a corporation, there may be ways to withdraw funds from your company on a tax-efficient basis.

4. Manage your shareholder loans carefully.
If you've lent money to your company, consider whether it makes sense to charge interest on those loans. This may be the case where the company needs deductions to keep its taxable income below the small business threshold in order to keep its tax rate down.
And if you've borrowed money from your corporation, consider repaying those amounts to avoid paying personal tax on those loan amounts (in some cases it can make sense to borrow money to repay these loans).

5. Take steps to protect your business assets
If you own assets, such as real estate or intellectual property, that you use in your business, consider separating that ownership from your business operations by placing those assets in a holding company to protect them from creditors of the business. Also, if you have excess cash in your corporation, consider paying those amounts as dividends to a holding company and then lending the funds back on a secured basis if needed in the business operations. This will give your holding company a claim on the assets of the business, protecting those assets from third parties.

6. Time the purchase and sale of capital assets
Finally, if you're purchasing capital assets, consider doing so, and putting those assets to use, before your business year-end to begin claiming capital cost allowance (CCA) sooner. If you're selling capital assets, consider delaying the sale until after your year-end to claim CCA for one additional year.

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