



## CESTNICK

### TAX MATTERS

#### Lower your tax handicap

A couple of friends and I went golfing this week. I love the game, but don't get out as often as I'd like. With about a hundred people looking on at the first tee, my friend Gary stepped up to his ball, took a big swing, and missed. Again he addressed the ball, swung and whiffed. He tried a third time to no avail. The crowd seemed embarrassed. But not Gary. He nonchalantly turned to the crowd, smiled, and remarked: "Tough course, isn't it?"

Few things are as tough as golf. Well, trying to extract cash from your corporation without paying tax is just about as hard.

Our tax law is designed to ensure that, whenever possible, you're going to pay tax on money paid out of your company.

Today, I want to share ways to distribute cash from your corporation in a tax-free, low-tax, or tax-deferred manner.

#### Pay tax-free dividends

If a shareholder has no other source of income, he can receive up to about \$40,000 in eligible dividends from a Canadian corporation tax free in most provinces, and with minimal tax in others, thanks to the dividend tax credit.

#### Pay capital dividends

If your company has a balance in its Capital Dividend Account (CDA), tax-free dividends can be paid to the extent of that balance. You see, the CDA is a notional account that accumulates the 50-per-cent tax-free portion of net capital gains realized by the company, and also the amount of any insurance proceeds paid to the corporation (net of the adjusted cost base of the policy). Your accountant can help to determine the balance in the CDA account, and ensure the proper paperwork is filed with the Canada Revenue Agency (CRA) when paying a capital dividend.

#### Repay shareholder loans

If you have lent money to your corporation in the past, these amounts can be repaid to you tax free.

#### Extract 'paid-up capital'

You may have significant paid-up capital if, for example, you paid a substantial amount for your shares of the corporation or performed certain types of reorganizations.

Your accountant or lawyer can help determine the paid-up capital, if any, on your shares. You can extract that paid-up capital by redeeming shares, for example, but if you take more out of the company than the paid-up capital available, the excess will be taxable as a deemed dividend.

#### Borrow from the company

I always hesitate to suggest borrowing money from your own corporation due to ugly shareholder loan rules in the Income Tax Act. Basically, a loan to you could be fully taxable in your hands. There are some exceptions, however, when the loan is taken to buy a car, a home, or purchase more shares from the treasury of that same corporation.

You'll have to make sure there are reasonable repayment terms set up at the time the loan is made, and the loan must be made in your capacity as an employee, not a shareholder. In an owner-manager situation, or in a company with no arm's-length employees, this test may be difficult to meet.

#### Pay yourself rent

You may be justified in receiving rent from your company as a landlord where there is space in your home set aside for company business. You'll have to report the rents on your tax return, but may be able to claim deductions against that income (such as mortgage interest, property taxes, insurance, etc.) to result in no tax owing personally.

#### Pay a retiring allowance

Many business owners overlook the opportunity to pay themselves a retiring allowance from the business when it's time to retire. An eligible portion of that retiring allowance may be transferred to a registered retirement savings plan (RRSP) with no tax today.

## **Contribute to an IPP**

An Individual Pension Plan (IPP) is a defined benefit pension plan, generally for a single individual, that can often provide you with more retirement funds than a money purchase pension plan or an RRSP.

The company will make contributions to the IPP on your behalf and receive a tax deduction for the contributions. This is a benefit for companies that earn more than \$500,000 and are subject to relatively high levels of corporate tax.

Tim Cestnick, FCA, CPA, CFP, TEP is Managing Director of The WaterStreet Group Inc., and author of The Tax Freedom Zone and 101 Tax Secrets for Canadians 2009, among other titles.  
[tcestnick@waterstreet.ca](mailto:tcestnick@waterstreet.ca)