# Corporations and Passive Income

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# Agenda

- Review of Passive Income Rules

  *Jiashu Zheng, CPA, CA ~ MAC LLP*

- Planning Strategy 1: Structuring an Investment Portfolio

  *Brian Durno, CFP, CFA ~ IAIC*

- Planning Strategy 2: Individual Pension Plans

  *Gord Hardie, CFP, CIM, FCSI ~ IAIC*

- Planning Strategy 3: Corporately Owned Life Insurance

  *Oliver Lee, B.Math ~ IALIA*

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# Review of Passive Income Rules

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## What Is the Small Business Limit (SBL)

- Reduced rate of tax on the first $500,000 of active business income
  - Available for Canadian Controlled Private Corporations (CCPCs)
  - 12.5% tax rate on the first $500,000 of active business income
  - 26.5% tax rate on active business income above the small business limit

## Reduction of the Small Business Limit

- Taxable capital of one company or group of companies exceeds $10 million
  - The SBL is ground down from $500,000 to nil as the taxable capital increases from $10 million to $15 million.
  - 10% reduction of $500,000 for taxable capital in excess of $10 million
- Passive income of one company or a group of companies exceeds $50,000
  - As passive income of the company or group goes from $50,000 to $150,000, there will be a grind down in the SBL from $500,000 to nil
  - No changes for companies or groups below $50,000
- The SBL will be the lowest figure obtained after applying the two grind calculations



## What is Considered Passive Income?

- Taxable capital gains (excludes taxable capital gain realized on sale of active business assets)
- Dividends from non-connected corporations (investment dividends)
- Interest Income
- Rental income other than rent that is ancillary to the business operation
- Taxable amounts in respect of life insurance policy (i.e. savings in a life insurance policy that is not an exempt policy)
- Excludes losses carried over from other tax years

## Considerations

- There is no change to the way that investment income is being taxed
- For a company or group of companies with no active business income, these new rules will have no affect
- If there is a group of associated companies, then the investment income in one company could now affect the SBL in the active company or companies.





## Strategy 1: Structuring an Investment Portfolio

Brian Durno CFP, CFA
Advising Representative

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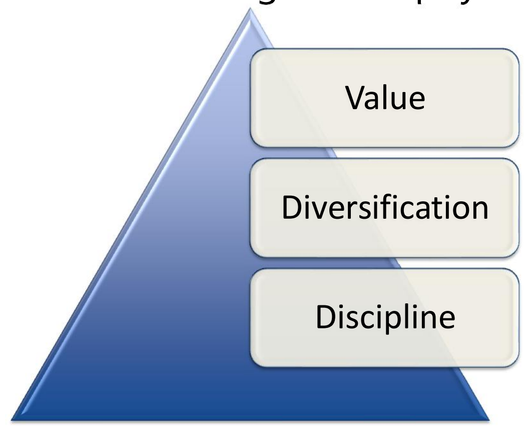
# Core Principals of IAIC Investing Philosophy



# Value Investing

- Focus is both top down and bottom up

## Environment

- Industry fundamentals
- Competition
- Regulatory issues
- Cost structures

## Financials

- Earning(P/E)
- Growth
- Cash flow
- Book value
- Earnings quality
- Leverage
- Dividends
- Relative values



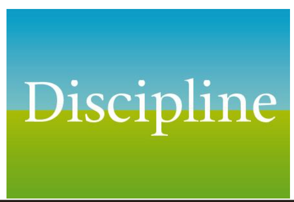


# Diversification

- Balanced across asset classes
- Diversified across global markets and economic sectors
- Client's customized Investment Policy Statement defines asset allocation and diversification plan

# Discipline

- Rigorous valuation analysis of Core Pick and Watch lists
- Buy up to price discipline
- Regular industry analysis
- Quarterly rebalancing to IPS ranges








# Passive Income Rule

- Integration with Accountant and Financial Planner ensures optimal choices to minimize the impact of this threat
- Custom portfolio design provides advantages to mitigate impact of rule
- Individual holdings better than blunt instrument of pools/mutual funds
- Capital gains? Lower yielding investments?

Vision. Focus. Balance.

# Strategy 2: Individual Pension Plan(IPP)

Gord Hardie CFP, CIM, FCSI
Vice President, Financial Planning

Independent Accountants' Investment Counsel Inc.
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## What is an IPP?

- Alternative to saving in an RRSP
- Plans that are specifically designed for business owners of corporations and incorporated professionals
- A defined benefit pension plan that is set up for one individual
- Can bring significant tax advantages, and gives more flexibility in how much you can save for retirement

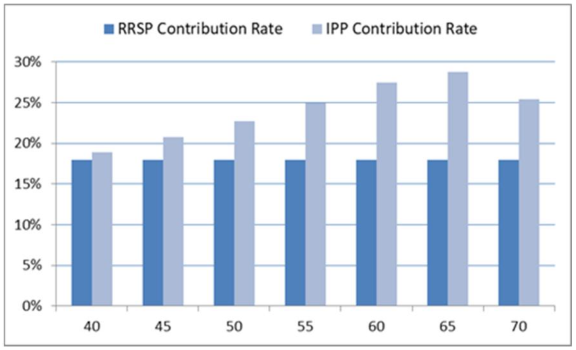
# How does an IPP work?

- Similar to an RRSP, an investment account is established to accumulate assets over time to fund retirement
- Greater annual contribution limits than RRSPs
- Unlike an RRSP, amounts are locked in and may be used only for retirement purposes
- T4 income is required to be able to contribute
- All contributions and earnings are creditor proof
- Typically need to be in 40s or 50s and draw a salary of $100,000 or more



# Contribution room benefits

- Contribution advantage as a percentage of income increases with age:



## Potential Tax advantages of IPPs

- All set up and ongoing fees for the plan are deductible expenses for the company
- Contributions are deductible expenses for the company
- Investment fees charged to the IPP can be reimbursed by the company as deductible expenses
- Pension legislation requires a pension to earn 7.5% annually
  - allows companies to make tax deductible top ups to achieve this performance threshold



## IPP Planning Considerations

- If the operating company continues beyond your retirement, you can draw an annual pension
- The IPP can be wound down and transferred to a Life Income Fund (LIF)
  - Assets are locked in, and subject to annual maximum payouts in retirement
- Limited flexibility in payment amounts once plan is set up
- Pension income from IPP can be split with an eligible spouse
- Past service contributions to the plan may be possible but proceeds must first come from personal RRSP assets, and use of unused contribution room before company contributions are allowed.

PLANNING

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# Strategy 3: Corporately Owned Life Insurance

Oliver Lee, B.Math
Vice President, Life Insurance and Living Benefits

IALIA
Independent Accountants' Life Insurance Agency Inc.

IALIA

# How life insurance works

- Tax deferral of growth within life insurance
  - Not a tax deduction
- Tax free payout
  - Most and possibly all of the death benefit can be paid out of the corporation tax free
- Costs
  - Insurance, management fees
- Access to cash value limitations
  - Costs, limits, taxation
- Cash value and Death Benefit
  - Can't have both

| | | | |
|---|---|---|---|
| Cash Value | 1 | 54 | 22,000 |
| | 7 | 60 | 199,000 |
| | 17 | 70 | 640,000 |
| | 27 | 80 | 1,260,000 |
| | 37 | 90 | 1,861,000 |
| | 47 | 100 | 2,739,000 |
| Death Benefit | 1 | 54 | 821,000 |
| | 7 | 60 | 1,164,000 |
| | 17 | 70 | 1,472,000 |
| | 27 | 80 | 1,823,000 |
| | 37 | 90 | 2,248,000 |
| | 47 | 100 | 2,739,000 |
| Pre-Tax Returns | 1 | 54 | 3319.3% |
| | 7 | 60 | 65.6% |
| | 17 | 70 | 18.9% |
| | 27 | 80 | 12.6% |
| | 37 | 90 | 10.1% |
| | 47 | 100 | 8.8% |

# If your goal is to fund your retirement

- If you don't need the life insurance, there are more efficient ways to get more income
  - Less cost, 100% access to investments
  - UNLESS you want to be more aggressive when it comes to tax planning
- If you do receive an illustration
  - Use an appropriate rate of growth in the life insurance
  - It will compare to a non-insurance solution – make sure it's comparable to how you would normally invest




# If your goal is to transfer wealth

- Could be good strategy as a large portion can be paid out tax free
  - Excess profits would be either taxed as dividends or capitals gains
- Can multiply the amount given
  - Usually $1 of premium can buy much more  death benefit
- Health and financial qualification
  - If you don't have the wealth or health, you may not be able to purchase life insurance

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