TAXES 101

PK WEALTH

Different types of taxes

Income taxes

Canadian taxation is based on your residency and runs from January 1st to December 31st. You are required to include income earned both inside and outside of Canada. Income is taxed at a progressive rate per your income bracket, & you are taxed at both the federal & provincial levels.

Sales taxes

The federal government's Goods and Services Tax (GST) and provincial governments' Provincial Sales Tax (PST) are both applied to the majority of goods and services consumed in Canada. In some provinces, the GST and PST are combined to form a Harmonized Sales Tax (HST). In other provinces, there is no PST.

Corporate taxes

Corporate taxes are levied at the federal & provincial levels. This tax rate varies by the type and size of the corporation, & also its province of operation.

Property taxes

Property tax is a tax on an asset. If you own a home in Canada, you will need to pay property tax on it. It covers several services including water, snow removal, garbage collection, policing, and fire protection.

Different tax strategies

Charitable giving

Charitable donations & gifts provide tax credits which are directly applied against taxes payable to reduce the tax bill. The federal tax credit is 15 per cent of the first $200 of charitable gifts, 29 per cent of gifts in excess of $200 and 33 per cent of gifts if your taxable income is in excess of $200,000. In most provinces, the combined rate will be at least 40 per cent to 50 per cent of the gifts for donors. The maximum amount of charitable contributions that can be claimed in any one year (except on the terminal tax return) is limited to 75 per cent of net income in most provinces, while contributions may be carried forward for up to five years.

Registered accounts

TFSA (tax free account): all investment growth (income, interest, capital gains, dividends) earned in this account is tax free money. Annual contribution limit in 2024 for TFSA = $7,000. Unused contribution room is carried forward in future years.

RRSP (tax deferred account): When you contribute to your RRSP account, you can deduct that contribution from your income for the year. Annual contribution limit in 2024 for RRSP = lesser of 18% of your income & limit of $31,560. Unused contribution room is carried forward in future years. Investment growth in RRSP is taxed only on withdrawal from account.

Contributions to RESP (Registered Education Savings Plans)& RDSP (Registered Disability Savings Plans) are not tax-deductible, though the investment growth within the plan is tax-sheltered. RESP is a tax-efficient way to save for your child's education.

Income splitting

Strategy to reduce a taxpayer's overall tax bill by allocating income to lower-income family members. Loans to family members or trust can be given at the government prescribed rate, and the family members (or trust) can use this loan to invest. The growth in investment over the prescribed rate will be taxed to lower income family member. Another income splitting strategy is splitting the pension income amongst spouses.

Homebuyer plan

You may withdraw up to $35,000 from your registered retirement savings plan (RRSP) tax-free to buy your first home. Budget 2024 proposes to increase the HBP withdrawal limit from $35,000 to $60,000. This limit would apply to withdrawals made after April 16, 2024. Funds withdrawn under the HBP must be repaid to their RRSP over a 15-year period. At least 1/15 of your withdrawal must be repaid to your RRSP each year.

Tax deductions

Tax deductions are amounts you subtract from your total income, making your taxable income lower. This means you'd be charged taxes on a smaller amount of income. Examples are: self employed business expenses, medical expenses, & vehicle expenses incurred for employment.

Tax credits

Tax credits are amounts that directly reduce the tax you pay on your taxable income. Some are refundable and some aren't. Examples are: GST/HST credits, disability tax credit, first home buyer's tax credit.

Lifetime capital gains deduction

An eligible individual is entitled to a cumulative lifetime capital gains exemption (LCGE) on net gains realized on the disposition of qualified property: qualified farm of fishing property (QFFP), qualified small business corporation shares (QSBCS), qualified farm property (QFP), or qualified fishing property (QXP) you may be eligible for the LCGE. The total of your capital gains deductions limit = $485,595 (one half of the $971,190 LCGE for 2023).

Life insurance

The death benefit is generally paid out income tax free. Permanent life insurance builds up cash value over time as you pay premiums. The total cash value accumulates on a tax-deferred basis. Money borrowed or taken from the cash value of a life insurance policy is not subject to taxes up to the "cost basis" – the amount paid into the policy through premiums.

Your assets can generate a significant tax bill at death. An estate preservation strategy involves taking out a life insurance policy that will provide a large tax-free lump sum that will cover the costs of the estate's tax bill. Because the insurance payout goes directly to your beneficiary, it bypasses your estate and avoids any possible probate fees.

Corporate owned life insurance

Corporate tax rates are lower than personal rates, and so premiums are paid for with cheaper, after-tax corporate dollars. Growth in the insurance policy is tax deferred, so it won't add to the corporation's passive investment income. The capital dividend account (CDA) can be used to pay out the life insurance proceeds to shareholders as a tax-free capital dividend. The CDA is a net balance of Capital gains and losses.

Holding company

Having a hold company which owns the operating company allows to defer taxes & reduce taxes with income splitting. Excess cash and investments can be flown up to the holding company as a dividend without attracting any tax. Shareholders of holding companies can optimize tax liability through income splitting. You can distribute dividends to family members who are in lower tax brackets, reducing the overall tax burden.The following tax strategies can also be setup with a holding company: estate freeze, small business deduction, lifetime capital gains exemption.

Shareholder loans

You can loan money to your company by way of a shareholder loan or borrow money from your corporation through the shareholder loan. Loans from your company to you must be given at the government prescribed rate (5% in 2024). The loan must be paid back to your company before the end of the following fiscal year to avoid taxation. This is a way for entrepreneurs to access money in their business at a low interest rate.

Capital gains stripping

Capital gains surplus stripping refers to tax strategies that let you distribute cash from your corporation as a capital gain instead of pulling the cash out as dividends, which are more highly tax. It is accomplished by structuring a transaction that operates as a sale of shares of your professional corporation, thus converting the money received for the sale of those shares into a capital gain. The way this works is that the existing corporation is amended to create new share classes and a new corporation is created . Then, the existing corporation can undergo a special transaction that creates new shares which are then sold to new corporation, the proceeds of which can be used to offset existing shareholder loans or paid in cash to the shareholder. In both cases the income is characterized as a capital gain since the shares that were sold are considered capital property.

Capital dividend account

The capital dividend account (CDA) is a special corporate tax account that gives shareholders designated capital dividends, tax-free. When a company receives a capital gain, the non-taxable portion of the gain is added to the CDA, increasing its balance. This allows the CCPC to declare a tax-free capital dividend for its Canadian resident shareholders. CDA includes: The proceeds of a life insurance policy received by the corporation in excess of the Adjusted Cost Basis (ACB) of the policy.

Small business deduction

The small business rates are the applicable rates after deducting the small business deduction (SBD), which is available to Canadian-controlled private corporations (CCPCs). The small business rate is available on active business income up to the amount of the Business Limit. The federal business limit of $500,000 begins to be reduced when a CCPC's taxable capital reaches $10 million, and is eliminated when taxable capital reaches $15 million. The average Canada small business rate = 12% vs. average Canada corporate tax rate = 27%.

Passive investment income in business

Private corporations subject to the small business tax rate face a higher tax bill if their annual passive investment income exceeds $50,000. Any amount of passive income earned above that rate reduces access to the small business preferential tax rate, and the preferential rate is eliminated completely when passive investment income exceeds $150,000. Passive investment income is comprised of interest income and eligible dividends plus 50% of capital gains.

Individual pension plan

An IPP is a defined benefit pension plan for one person. With an IPP, only the employer contributes to the plan for the employee. If you own a medical professional corporation, your corporation (as the employer) would make the contributions for you (as the employee).An IPP provides a way to save taxes because the corporation can make tax-deductible contributions and the employee (you) can benefit from tax-deferred growth inside the plan. It also provides a guaranteed retirement income. Compared with a registered retirement savings plan (RRSP), the IPP has a greater contribution limit that increases with age.

Refundable dividends tax on hand

The federal government levies a tax on any investment income earned by a corporation. This includes interest income, capital gains income and most income from property. The tax goes into the company's RDTOH account with CRA and is refunded to the corporation when it pays a taxable dividend. The amount that is added to the RDTOH is roughly 26% of any aggregate investment income + 33% on dividends received from eligible Canadian corporations. For every $3 in taxable dividends that are paid to shareholders, the company is refunded $1 from its RDTOH.

Trusts

Transferring assets into a trust may offer many benefits over direct gifts, including: • Control over the timing and amount of distributions to beneficiaries • Lower tax bills for the family, which may be achieved through income splitting or charitable gift planning. • Reduced probate fees • Maintaining privacy for your estate since a trust agreement is not subject to a public probate process. A disposition of trust assets is deemed to occur every 21 years which results in taxes on the accrued capital gain. To create a trust, a settlor transfers assets to a trustee who manages the assets on behalf of the "beneficiary".

Estate freeze

An estate freeze is a tax planning strategy where a business owner locks in the current value of their estate to minimize future taxes on capital gains. An estate freeze is implemented by exchanging property that is likely to grow in value (e.g. common shares of your business) for property with no growth potential (e.g. fixed-value preferred shares of your business). Estate freezes generally makes sense only when there is an expectation that the corporation will grow in value, resulting in capital gains, and where there is a clear successor or next generation of owners. It is also beneficial if you own an operating company that has grown to a size where you would use all of your lifetime capital gains exemption (LCGE) on the disposition of the shares of the corporation. You may also have a spouse and/or children who have not used their LCGEs and you expect your business to grow significantly in the future.