Pay Less TAX

by Bob Adams *CFP, MTS*

Tax revenues are up – whether that is good or bad, this is not an article for people who like to pay tax. Tax rates have decreased but CRA has enhanced their collection processes, meaning that revenues are up.

Business owners are required to do more paperwork, thus reinforcing our unpaid work of being a “tax collector”. Clients continually ask “Why should we work harder to make more money if it is to be consistently clawed back in taxes?”

In this article, I will to outline a number of strategies one can use to “Pay Less Tax”. I owe a great deal of gratitude to the lawyers and accountants that have put these structures together. It continues to be unfortunate that so few people know what is available.

We often look at tax reduction as peeling an onion. Even though I like onions (and not taxes) they still make me cry. Peeling them is the analogy that, year by year, I use to remove layers of tax. Below are some of our methods. Please note that all strategies are not appropriate for everyone and that I have made them look simpler than they are. The average individual can reduce their personal income tax to extremely low levels, actually approaching zero, without the use of RRSP's.

Leverage: Borrowing to invest is a very common way of reducing tax. Banks will lend up to 100% for certain investment purposes. For example - $100,000 borrowed at Prime + .75% will currently produce a write off of $5,500 and a tax saving of over $2,000. The investment income can grow in a tax-deferred manner. "The Money House" is our term for how to use Mutual Funds like a rental property. A DVD on this topic can be found at http://www.tieroneplanning.ca/main/fs/financial_strategies.html

Flow Through Shares: Over twenty years ago, the government created this share structure to flow-through Development and Exploration Expenses to shareholders. The idea was to lower the risk of investing in oil and gas or mining. A $10,000 investment gives a $10,000 tax deduction and further Federal and Provincial tax credits giving an after-tax cost of approximately $4,800. After a two-year hold, the shares are sold at market value – typically in the $8,000 to $9,500 range and all with dollars that would have been given to the government. (http://www.tieroneplanning.ca/main/fs/flowthrough2.html

Family Trusts and Holding Companies: This has long been the domain of the very affluent but accounting firms are now approaching it with renewed interest. Income can be diverted from the corporation to lower tax rate family members. With the combination of holding companies and insurance (below), money can be passed, over time, from the corporation to individuals, without paying personal tax rates.

Universal Life Contracts: This is the tax shelter of the insurance industry. When properly established, money can be invested inside the plan, in any number of investment choices, and grow tax-free. There is no deduction for money going in but, if properly created, there will never be any tax on the money that is withdrawn later.

Donation Programmes: In 1996, the Department of Finance changed the charitable donation policy to allow an individual to deduct up to 75% of their income. This was not for the average Canadian, but rather for the very affluent, as the government wished them to give away land, art, artifacts, etc. Lawyers and accountants subsequently put together programmes for "average" Canadians that enable them to actually make a "positive return" by giving things away. There are now many programmes out there and it is definitely Buyer Beware. CRA hates this type of shelter.

Biomedical Flow-Through: Companies in this realm have to go through many layers of expensive testing to bring a product to market. These shelters raise money to license a product and finance stages of testing. At the end of two years, the biomedical firm must repurchase the license. There are significant tax benefits derived and shares are issued to the participants at the end of the two years.

Individual Pension Plans (IPP's): If you are an owner of a business, receive some T4 income and are over 45 years old, this programme allows you to create a special, higher pension benefit. It is an expense for the company and the owner will pay any tax at the time of the withdrawal.

Business Shelters: This buys into a specific group of operating businesses. Your full investment is returned in tax dollars while keeping the original position in the company.

Tax sheltering and deferral is a mix of art and law. If it were easy to do - more would do it. As you can see, this is just scratching the surface and the benefits can be staggering.

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