Sharing the Wealth

When you own a family business it's important to structure your company to allow for income splitting and tax saving opportunities. Setting up a company can be as simple as creating one class of voting shares and one class of non-voting shares as offered by many online incorporation providers. Doing so limits and prevents you from delineating who can earn profits through dividends, when those may be earned and the amount that may be earned. It also does not allow you to create a freeze on the price of the shares if you would like to sell out your shares at a later date.

Having a lawyer incorporate your business with the financial advice of your accountant can save you money in the long run and keep more of it in your own pocket. I always recommend clients to incorporate with a share structure that keeps the possible future in mind. One class of voting common shares is generally sufficient for purposes of designating who will be responsible for operating and making decisions about the company. If more than one family member is involved in the business or you have a spouse and/or children (regardless of their involvement), it is best to create a number of classes of preferred dividend bearing shares (**"Preferred Shares"**).

The ability to split the profit from your company among various members of your family allows you to legally reduce your total taxes payable to the Canada Revenue Agency. Small Ontario incorporated businesses earning less than $10 million are taxed at a lower rate than large businesses and personal income earned through employment. Despite however many members of your family work in the business, they do not necessarily need to earn employment income from the business. Instead, they can be issued dividends from the after-tax dollars earned by the company, which will be taxed at a substantially lower rate than employment income, with the first forty thousand being tax free.

Any member of your family can own Preferred Shares in your company, without impacting how it is run on a day-to-day basis. By setting up various classes of Preferred Shares, you can own one class, your spouse can own another and each of your offspring can hold their own class. Assuming the company derived a profit and depending on the profit amount, the company can declare dividends to all of the classes of Preferred Shares or to just one class. If your spouse is not employed or has a lower income, the company can issue dividends to his class of Preferred Shares only and pay your spouse. Essentially, the company can pay out dividends to the shareholders who will incur the least amount of taxes, keeping more money in your pocket.

I also like to create a class of special shares, which will allow an estate freeze on the sale of voting shares sometime in the future. Through a number of mechanisms, the existing shareholder can sell or have his voting shares redeemed by the company and receive special shares in exchange. The value of the special shares is "frozen" at the value of the sold shares. The successor purchases common shares in the company, which have no value and allows future growth in the company to accrue to the successor's common shares and not those sold or redeemed by the previous owner.

By creating an estate freeze scenario, the owner will not trigger immediate capital gains on the transfer of his shares and also locks in the value of the capital gains payable once the special shares are redeemed. The owner can still maintain voting control over the company until all of the special shares are eventually redeemed which may allow for a smooth transition to the successors and creates incentive for the new owners to grow the business. Because the value of the company remains with the owner once the freeze has been triggered, the successors can only gain from any increase in the value of the business and have an incentive to continually grow and not let the business flounder.

When incorporating your business and considering how you would like it to contribute to your family's wealth, it is wise to talk to a lawyer and an accountant about the best structure for tax saving and income-splitting purposes. You should treat your company in the same manner as you would a child, planning and saving for her future and figuring out the best way to share the wealth among all of your loved ones. You can use a cookie-cutter incorporator, but in doing so, you may give away more of your profits than you intended and have less to pass on to your successors. For incorporating and other family business needs, contact your Chief Loophole Advisor at moira@wallacelaw.ca.