

TAX ALERT



TAX ALERT is a commentary on topics of current interest – usually topics relating to recent changes in tax law, new CRA administrative practices or current interpretations arising from tax cases. Professional advice should be obtained before acting on any of this information. *ed.9/06*

PRIVATE COMPANIES – RETIREMENT COMPENSATION ARRANGEMENTS

If a private company wishes to reduce corporate income to the Small Business Limit, an owner-manager may wish to consider using a Retirement Compensation Arrangement (RCA) rather than a salary or bonus.

An RCA is really a non-registered pension plan for the owner-manager. Contributions are determined by the level of pension income to be provided to the owner-manager, and must be reasonable to be deductible. An actuarial calculation is required to support contributions. A payment to an RCA is subject to a 50% refundable tax. This tax is refunded when funds are distributed from the RCA and the distribution is taxable to the owner-manager.

An RCA has many advantages:

- ◆ Funds in the RCA are considered to be held in trust and cannot be seized by creditors of the owner-manager or the company
- ◆ RCA contributions are not subject to Employer Health Tax (nor is the later distribution by the RCA).
- ◆ The refundable tax of the RCA can be used as collateral security for a loan, increasing the capital available to the employer company.
- ◆ If the owner manager is in a lower tax bracket at retirement, income tax savings will arise when distributions are made by the RCA.
- ◆ RCA payments can be spread over a number of years (compared to a bonus being taxable all in one year).
- ◆ Payments to RCA beneficiaries can be allocated between family members with a lot of flexibility to provide income splitting advantages- providing family members are working in the business.
- ◆ If retirement is planned outside of Canada, amounts received from the RCA by a non-resident will be taxed at significantly lower tax rates than a resident of Canada.
- ◆ A properly structured RCA can ensure its funds are not subject to probate fees.
- ◆ RCA's have significant flexibility for estate planning in terms of allocation of payments to survivors.
- ◆ An RCA can be started at any age.

An RCA could also be considered upon the sale of a company's assets to take advantage of tax deferrals and Employer Health tax savings. They are equally beneficial vehicle to park income (otherwise subject to high rates of current tax), which can be distributed late when tax rates are lower.

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