Snapshots™

OWNING AND MANAGING A SMALL BUSINESS:

RETIREMENT PLANNING

AS THE OWNER OF A SOLE PROPRIETORSHIP, YOU WILL NO DOUBT HAVE YOUR HANDS FULL ESTABLISHING AND MANAGING YOUR BUSINESS. BUT IT IS ALSO IMPORTANT TO PLAN AHEAD AS YOUR BUSINESS WILL PROBABLY BE YOUR PRIMARY SOURCE OF INCOME AND ALSO THE BASIS FOR MUCH OF YOUR INCOME IN RETIREMENT.

Keeping the Business in the Family

Even if you have a family member willing and able to take over the business, you will still need to consider how to take advantage of the value of the business for providing funding for your retirement. There are two basic approaches available:

1) **Transfer the business to a child or other family member**
   There are two main issues to consider with this option. First, how will the sale be funded? In many cases a child will not have the financial ability to purchase the business outright without assuming some sort of debt. One alternative is to structure the transaction as an instalment sale whereby the payments are made over time, ideally out of company profits. The second issue is valuation – determining a price for the business. Whether you choose to transfer your business as a sale or as a gift, it is likely you will have to pay tax on what is called the 'disposition' of the assets. The amount of this tax, if any, will depend on the fair market value (FMV) of those assets. Even if you were to transfer your business assets to a family member as a gift (if that family member did not need the return of capital, for example), the transaction would still be considered a disposition at FMV and subject to any applicable taxes.

2) **Transfer the business to an arm's-length party**
   At retirement, you could also choose to sell your business assets to a non-family entity, such as a key employee or even a competitor. As with a transfer to a child or family member, you would need to consider how to fund such a sale. It is often difficult to identify potential purchasers of small businesses, so planning any transfer of business assets well in advance is strongly advised.

Personal Savings – RRSPs

While you will certainly want to consider realizing the value of your company in the future with the strategies discussed above, you should also be setting aside funds along the way. As a Sole Proprietor, you will not have access to company pension plans but can still take advantage of Registered Retirement Savings Plans (RRSPs). The amount that can be set aside in an RRSP is dependent on earned income in the previous tax year. Income earned from a Sole Proprietorship is considered income for RRSP purposes. In 2014, you can contribute the lesser of $24,270 and 18% of your 2013 earned income. The amount contributed will result in a tax deduction and the money will grow tax free in the plan until withdrawn. Although the amount eventually withdrawn will be fully taxable, you may be in a lower tax bracket in retirement resulting in tax savings. The investment options within an RRSP are very broad and there will certainly be investments that match your objectives, circumstances and risk profile. I would be pleased to discuss establishing and managing your RRSP with you.

Voluntary Retirement Savings Plan (VRSP)

Both the Federal and Provincial governments have become concerned about the amount of retirement savings of Canadians, particularly those who do not have access to traditional pension plans offered by employers. The Federal government recently introduced the Pooled Registered Pension Plan (PRPP) to provide small employers with a flexible savings alternative for employees. The Province of Quebec, as part of their 2012 budget, introduced a similar vehicle for small business owners in their province titled the Voluntary Retirement Savings Plan (VRSP). This will be a mandatory program for employers with five or more permanent employees.

While initial participation for eligible employees is required, those employees may 'opt out' if it doesn't suit their retirement plans. Employers have the option of making tax deductible contributions on behalf of their employees and any employee contributions will be a tax deduction. As registered plans, VRSPs will be subject to the usual federal restrictions on contributions (a maximum of 18% of earned income up to the statutory limits). I can provide you with more details about VRSPs.

Tax Free Savings Accounts (TFSAs)

As a Sole Proprietor, you can also establish a TSFA. TSFAs are tax-sheltered plans that are like an RRSP in reverse. Instead of receiving a tax deduction on contributions and paying full tax on withdrawal, contributions to the plan do not receive a tax deduction but any growth on the investments in the plan can be withdrawn tax free. TFSAs are particularly useful for those who have either maximized their RRSP contributions or are unable to have an RRSP due to factors such as age. The amount that can be contributed to a TSFA is limited but increases annually by approximately $5,500. As of 2015 the limit increased to $10,000, so each taxpayer will have amassed $41,000 in contribution room. I can provide you with more information on how a TSFA works.

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