THE SMALLBIZ BUILDER

September 2021 PADGETT BUSINESS SERVICES® Vol. 19, No. 9

This Month:

- Income Splitting Using Prescribed Rate Loans
- Business Investment Losses
- Should You Incorporate Your Business?

Income Splitting Using Prescribed Rate Loans

Income splitting is a term used to describe a method of shifting income from a higher income earner to a lower income earner. In the case of spouses, it is possible to achieve income splitting using a "prescribed rate loan". The loan needs to be properly documented in a loan agreement. The lower income spouse borrows the funds and invests them. For tax purposes, it is important that the loan carries interest at the prescribed rate, which has been maintained at 1% for the third calendar quarter ending September 30th, 2021. The lower income spouse needs to pay the interest on the loan annually to the higher income spouse, no later than January 30th. If this deadline is missed, even once, the loan becomes "offside" and for tax purposes, all the investment income would be taxed in the hands of the higher income spouse. Therefore, it is important to keep proof that the interest payments were made.

This strategy will only work if there are funds available to invest outside of tax-deferred plans like RRSPs or a TFSA. Also, the tax advantage will depend on two things: (1) the difference in tax rates between the higher and lower income spouse, and (2) the rate of return on the capital invested.

Padgett Business Services
109 Cree Road, Sherwood Park, AB T8E 3X9
Telephone 780-464-6441
admin@padgetttsherwood.ca
Www.padgettsherwood.ca

Business Investment Losses

A loss on an investment in a company you own or made in another person's small business can qualify for some advantageous tax rules to help ease the impact on your finances. Whether the investment was in shares or a loan to a small business it may qualify for a full deduction against your personal income.

Typically, only half of an investment loss would be deducted and only against investment capital gains. The ability to deduct these business investment losses against any type of personal income can reduce income taxes for the year by a substantial amount. It's important that the nature of the investment be properly analyzed to ensure it meets the criteria. Many small businesses will meet the criteria.

Furthermore, if the loss exceeds your income for the year, it is possible to carryback the loss against income you earned in the three previous years or carry them forward to apply against future income.

The Canada Revenue Agency will typically ask for some documents to support your claim. If this unfortunate situation has impacted you, consult with your Padgett advisor to make sure that you can at least minimize your income taxes. Your Padgett advisor can also help you determine if the loss can be claimed even though the investment still exists, but the likelihood of recovery is very low.

Should You Incorporate Your Business?

If you own a business, you may have wondered if you should incorporate. Historically the income tax system in Canada has benefited incorporated Canadian small businesses. Although the income and deduction calculations are almost identical to an unincorporated business, the major differences are in the corporate taxation structure and tax planning opportunities. When developing the tax plan for your business, you and your advisor should look for opportunities in the following areas:

- Income splitting with family members;
- Tax deferral to the future;
- Estate planning for you and your family;
- Utilization of the capital gains exemption; and
- Planning your retirement, including disposing of your business.

Since personal and corporate tax as well as family law issues can make this issue complex, please contact our office to discuss your situation.