The Morneau Escape Hatch 3 in 1©:

The Morneau Escape Hatch 3 in 1© is an effective way to use alternative moves to get around the CRA's new rules that have removed former exit strategies for private business owners.

For many business owners the first move they have considered in the past was selling the shares or assets. Most owners would rather sell shares and they rarely get them sold for a price they feel is fair price. However even after they settle the sales process, they still must face CRA's tax gauntlet.

The small business exemption for capital gains on sale of shares is a mute point in many cases because owners rarely sell if reports by business brokers are any indication. They want to sell but they rarely complete a transaction because of lack of trust and perceived lack of fairness on value by the buyer. One brokerage insider told us that only 1 in 50 listings ever actually gets sold. This used to be about 1 in 24, but the number of unsold businesses is rising because so many baby boomers are looking for an exit all at the same time.

One business owner told us there is no point in selling assets that generate an annual ROA of 20% or more. "Where else are you going to get a return of 20%" he said. All of this makes sense but what about income and liquidity for the retiring baby boomer shareholder?

If there is understandably scant interest selling an asset base that generates 20%, liquidity must come sooner or later and in the end is forced upon the shareholder at death by CRA –

***CRA just wants its tax due on capital gains*.**

CRA will be content with just their capitals gains tax, provided there is not a large pile of cash on the balance sheet which nulls the cap gains exemption on disposition of shares because of the 90/10 rules on cash in a corporation.

An easy way to facilitate this payment is to use a corporate owned life insurance. Need a million in cap gains tax? You can buy that from a Lifeco for about $300,000 and premiums paid will accrue as cash on the balance sheet as life insurance cash value. In brief, whatever you pay in premiums stays on the balance sheet as cash and does not get in the way of the 90/10 rules.

So much for liquidity. What about income and the dividend strategy?

In past years, CRA allowed dividends from a corporation to be split with a spouse for a lower taxable income. This is now only allowed in extremely rarefied situations where paid up capital and other conditions have been in place for many years and well documented from day one.

However, dividends have the following tax hurdles:

1. Dividends are an after-tax allocation of profit. Which means before they can be paid to shareholders the source corporation has to pay tax to CRA first and then the fully taxable dividend is received into the hands of shareholders as a…
2. non-eligible dividend which gets a mandatory and artificial "gross up" of the value so that CRA can get yet even more tax from the shareholder. In the end the "grossed up" dividend is taxed

at the recipient's marginal rate of tax. So, there is no joy nor any discernible advantages in this move when looking at the ***net after-tax impact to the personal holdings*** of the shareholder.

3. In the event the dividend is paid to a Holdco and reinvested, CRA taxes the reinvested profits at slightly more than 50%. When the dividend is paid from the Holdco the tax is applied as in hurdle #2. In that, there are no discernible advantages on a net after-tax impact to the personal holdings of the shareholder.
4. In most cases the dividend income will not be allowed to be split with a spouse.

In Brief, tax is paid to CRA when a dividend is created and when it is paid to the recipient (on a personal basis) who most of the time is not allowed to split the income with a spouse.

Wouldn't it be much better to ***expense cash off a balance sheet rather than pay it as a taxable profit***? Doing this would let you skate by Tax Hurdle #1.

Wouldn't it be better to ***keep it all cash payments from the corporation 100% tax sheltered and creditor proof*** for the rest of your life? Doing this would let you skate by Tax Hurdle #3.

Wouldn't it be better to ***split income with a spouse taking advantage of lower marginal tax rates***? This would allow your tax-sheltered account to last much longer maybe even twice as long at the same income level.

There is one instrument that archives this level of tax efficiency: it is called an Individual Pension Plan (IPP) or a Personal Pension Plan (PPP) and is approved by CRA under the Pension Legislation as a personal pension plan for business owners and self-employed professionals such as dentists, physicians, lawyers and accountants.

IPP/PPP address all the above concerns ***and*** allow the business owner to deduct the fees charged by financial services firms to manage and invest your funds.

In testing we have done, the income from an PPP/IPP over a lifetime (based on actuarial projections) will easily be **double** that for the same amount of cash sent to a Holdco as dividends and then used as income at retirement.

In summary, the PPP/IPP work so well because cash is expensed, tax sheltered in a beneficiary's own trust and income can be split with a spouse.

The Morneau Escape Hatch 3 in 1© is VERY effective.

Our firm specializes in this type of restructuring. Call to see our Case Study.

Article Courtesy: John Lindsay, ProfitExits.Ca, MacDonald Management

Sources: CRA, TaxTips.com, TaxPlanningGuide.ca, Advisor.ca