



Chartered Accountants

255 Duncan Mill Road
Suite 402, North York,
Ontario M3B 3H9
Phone: (416) 510-8888
Fax: (416) 510-2699
Email: dcy@dcy.ca

Supersize Your Retirement Nest Eggs - For Those With A Professional Corporation

by David Chong Yen

One of the reasons for setting up a professional corporation (PC) is to save for one's retirement. Think of your PC as a supersized RRSP except that as opposed to sheltering \$20,000 per year, you can shelter up to \$500,000 per year. Hence, surplus cash should be generated from your PC. The challenge becomes, what do I do with this surplus cash, which is accumulating or has accumulated in the PC?

You may have heard from your friends, accountant, financial or insurance advisors about various life insurance products. In a nutshell, these products aim to generate returns in a tax-free environment i.e. no annual income taxes on the income generated inside the policy and your estate or a named beneficiary may receive the death benefit tax-free.

The dentist taps the funds, which have accumulated inside the policy without attracting any taxes by borrowing money from the bank using the life insurance policy as collateral; upon the dentist's death, the loan from the bank is paid off with proceeds from the life insurance policy. The interest on the loan may be tax deductible if the loan proceeds were used for investment or business purposes.

Let us see how life insurance can build up your wealth within your PC.

Sole Proprietor vs. PC

	PC	Sole Proprietor
Profit before salary	\$500,000	\$500,000
Salary / personal living expenses	(120,000)	(120,000)
Profit after salary / personal living expenses	380,000	380,000
Income taxes	(62,700)	(176,400)
Cash retained	\$317,300	\$203,600

*represents personal tax on income in excess of \$120,000

Based on the above assumptions, your PC reduces your tax bill by over \$113,700 per year, which means more cash being built up in your PC for other investment opportunities. Assuming you take

the \$113,700 savings and invest in a tax-free policy, by the end of 10 years, you may get \$1,342,546:

Year	Beginning of year	Investment	3% return	End of year
1	\$ -	\$ 113,700	\$ 3,411	\$ 117,111
2	\$ 117,111	\$ 113,700	\$ 6,924	\$ 237,735
3	\$ 237,735	\$ 113,700	\$ 10,543	\$ 361,978
4	\$ 361,978	\$ 113,700	\$ 14,270	\$ 489,949
5	\$ 489,949	\$ 113,700	\$ 18,109	\$ 621,758
6	\$ 621,758	\$ 113,700	\$ 22,064	\$ 757,522
7	\$ 757,522	\$ 113,700	\$ 26,137	\$ 897,359
8	\$ 897,359	\$ 113,700	\$ 30,332	\$ 1,041,390
9	\$ 1,041,390	\$ 113,700	\$ 34,653	\$ 1,189,743
10	\$ 1,189,743	\$ 113,700	\$ 39,103	\$ 1,342,546

Hence, this represents \$1,342,546 of cash, which would not be present if there was no PC, i.e. the tax savings from the PC was invested in a sheltered environment and grew to \$1,342,546.

From a tax saving and retirement planning perspective, life insurance sounds like a viable vehicle; however, there are other risks one needs to consider.

- If you have not utilized the \$750,000 capital gains exemption, holding a life insurance policy inside your PC may prevent you from claiming the exemption;
- Claiming the exemption on a subsequent sale of PC shares may still be possible if the life insurance is removed from the PC prior to the sale; however, this may trigger a significant personal tax bill at the same time;
- Interest rate fluctuations (on the return of the investment as well as the policy loan);.
- Changes in future income tax rates and legislation;
- Loss of its (life insurance policy) tax-free status;
- Taxable benefit may arise during one's lifetime or on death under certain circumstances;

Very often life insurance is viewed as the most economical and tax efficient vehicle for maximizing your wealth. It is rather important that you have a full understanding and obtain a full disclosure of the insurance product to make an informed choice. We also suggest that one have very little in the form of non-tax deductible debt such as a home or cottage mortgage prior to using an insurance policy to buildup your nest egg. Why? Your home or cottage mortgage bearing an interest rate of say 6.0% is actually costing you 11.0% if you are at the top tax bracket. It is hard to beat an investment which yields 11.0% with virtually no risk. Additionally, once the home is paid off, transfer it to your spouse to protect it from creditors and potential lawsuits, if you have not yet done so.

David Chong Yen, CFP, CA with an international firm background and more than twenty-four years of experience, advises healthcare professionals and owner-managers. Additional information can be obtained by phone (416) 510-8888, fax (416) 510-2699, or Email david@dcy.ca. This article is intended to present tax saving and tax planning ideas and is not intended to replace professional advice.