

YOUR MONEY

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Holding Companies' Merits

Do you own a large investment portfolio or hold shares in an operating company; earn sizeable revenue from assets held outside of a registered plan; own rental properties? If you answered yes to any of these questions, you are likely subject to high personal taxes. To minimize taxes many individuals establish holding companies - corporations that don't act as operating businesses but are generally used to hold investments.

For example, an incorporated business owner with considerable retained earnings can move them to a holding company on a tax-free basis via an inter-corporation dividend transfer. While the dividends don't grow tax-free (subject to the passive tax rate) they aren't taxed to the individual until distribution. Then, tax is based on the growth, not the original value of the retained earnings. Additionally individuals can control their own tax situation by allowing the corporation to pay tax on the growth of those assets rather than having everything taxed in their own hands.

Holding companies can provide estate planning flexibility. Although assets can be transferred to heirs without re-registration, most individuals choose to liquidate the corporation at death. Otherwise, after share transfer, the assets would have to be liquidated and distributed to the beneficiaries with the possibility of double taxation.

Assume assets are liquidated and tax is paid (e.g. capital gains) with a taxable dividend paid to beneficiaries. Complicating matters, the share value would be taxed. Let's say you start the holding company with \$1 and over time accumulate \$1,000,000.00 of assets. Your new share value is \$1,000,000.00 and your estate would face a capital

gain tax exceeding \$220,000. Typically, accountants "wind-up" the company to avoid this double taxation.

If you have a very successful operating company you will want to take retained earnings out of it to avoid losing your small business status (90% of your assets must be used to earn income in the business). If there is excess money in the operating company it can be invested in the holding company and, if necessary, can be loaned back to the operating company.

There are other possible benefits of holding companies, such as spreading income across family members through dividends, or enhanced individual retirement arrangements. Under certain circumstances, holding companies may even provide some level of creditor protection or can help to create an estate freeze, enabling accrual of the future growth of the corporation to heirs in a tax-deferred manner.

Holding companies are certainly not a tax haven but they offer excellent opportunities to qualified individuals. If you are interested in learning whether a holding company can help you or how to get the best use out of your current holding company set-up, please contact me for an analysis.

As this is such an important topic, I asked Paul Marion, Vice President Tax & Estate Planning, Canaccord Financial Services to assist in preparing this column, and I thank him for his help.

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