



Planning Points

Employees Profit Sharing Plans

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How do you get paid?

As an incorporated professional or business owner you may have asked: which is more tax efficient, salary or dividends? The answer was probably: “it depends.”

A salary qualifies as earned income to increase RRSP contribution room but salary is subject to withholding taxes including Canada Pension Plan (CPP) deductions. On the other hand, dividends avoid CPP but do not qualify for RRSP contribution.

Why not get the best of both? An Employees Profit Sharing Plan (EPSP) can be used to allocate profits from a corporation to the owners without the need to remit CPP, yet the payments also qualify for RRSP contributions.

What is an EPSP?

EPSPs have been around for many years. However, the steady increase in CPP and the recent restrictions on family trusts have renewed the interest in the unique opportunities of the EPSP.

An EPSP is an arrangement that allows a business to pay some of its profits to selected employees. The business contributes the profit to a trust. The trust then divides the profit among the selected employees. The business's contributions are deductible as an expense. The selected employees pay tax on the income allocated to them.

No CPP Premiums

Contributions from the business to the EPSP are not subject to withholding amounts such as CPP. CPP premiums amount to more than \$3,000 per year. These premiums have increased dramatically in the past few years.

RRSP Eligible

The payments from the EPSP to the employees qualify as earned income for the purpose of creating RRSP contribution room or carry-forward.

Who must be included in the EPSP?

There is no requirement that all employees be included in the EPSP.

The decision is up to you. Most business owners will include themselves and their employee spouses.

How much profit should I contribute?

The Income Tax Act requires that contributions to the EPSP be computed by reference to profits. The business must make payments according to a formula based on profits. This usually means a percentage or share of the business profit. When there are profits, there must be a contribution.

However, Canada Customs and Revenue Agency (CCRA) is flexible if the EPSP is filed with them. They simply require that the business contribute at least 1% of profit or \$100 per selected employee.

The amount that your business contributes each year above this minimum can be adjusted to your circumstances.

How does the EPSP work?

- You decide which employees to include in the EPSP, probably you and your spouse.
- You select trustees. The best selection would include an independent person.
- You will have the ability to fire and replace the trustee.
- The EPSP will set up a bank account and be registered.
- Profits from the business are contributed to the EPSP. The contributions are deductible.
- The EPSP pays the contributions to you and your spouse as selected employees. You will pay installment tax on your respective amounts.
- (The EPSP is not required to file annual tax returns.)
- The amounts allocated to you are summarized and reported each year on a T4PS & summary form.

The Benefit?

You and your spouse will have income that qualifies for RRSP contributions without paying CPP premiums.

Warning!

Every person's circumstances are unique. This information is not legal advice. Do not take any action, or decide to not take any action, based on this information. Let an experienced professional help you.