TAX TALK

The keys to allocating shares in your company

Your spouse may be in for a rude awakening if proper care isn't taken when allocating shares

One of the most misunderstood questions about incorporating is, who owns the trucking business?

I'm not talking about what you call yourself on your business card or who controls the day-to-day operations.

The issue is how you allocate shares when you set up your corporation, especially when your spouse is involved. It's a decision you need to take seriously. Because let me tell you, the government sure does.

I know an owner/operator who asked a lawyer to incorporate his business for him. The lawyer gave the owner/operator one share and his wife one share for no reason other than that's just the way the lawyer handled all his clients. The wife had a full-time job and played no active role in the company.

Fast-forward a few years. The owner/operator's wife gets laid off by her employer. She submits an application for Employment Insurance benefits.

When you file an EI claim, Service Canada will review the total earnings you've been paid in the last 26 weeks ending with your last day of work. Included in this total is any income you receive as an officer of a corporation.

So the government reviewed the claim and saw that the laid-off spouse was a shareholder and officer of a corporation. Because she owned 50% of the company, the spouse was deemed to be self-employed. Service Canada clawed back her percentage of the corporation's weekly earnings from her benefits.

Service Canada sees plenty of scams where a corporation earns income while the owner/operator does not and files an EI claim. In this case, the wife hadn't taken a dime from the business. Yet Service Canada attached a portion of the company's earnings to her overall income and reduced her EI benefits.

I've written before about the dangers of cookie-cutter solutions, and the carelessness of this lawyer who slammed together a corporation without asking any questions really hurt this couple financially.

I don't know if the owner/operator got the corporation cheaper, but whatever money they may have saved was lost when Service Canada stripped away part of the wife's EI income. (This owner/operator and his wife happened to be incorporated, but the same thing could happen in a sole proprietorship or partnership).

Shares with care

A corporation is collectively owned by its shareholders. Many owner/operators hold 100% of the shares – they don't have any other partners or investors, just themselves. Others issue shares to their spouse because he or she is employed by the business in some way or otherwise contributes to its success. Others still give shares

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to a spouse purely as part of a tax strategy – they want to lower their individual tax obligation by splitting income. Each of these is a valid approach depending on your situation and priorities.

If you're concerned about a Service Canada clawback yet want to preserve the potential tax benefits of income splitting, consider this strategy:

When we set up corporations where the spouse has no active role in the business, we'll give the owner/operator 1,000 shares and the spouse only 10.

Her 1% share ownership is such a small percentage that her exposure to Service Canada is minimal. Yet she's still entitled to dividends at any time.

Another approach is to issue different types of shares. Typically, common shares truly own and control the company and special shares are issued to investors.

You could own the common shares and your spouse would own the special shares. Dividends are issued on a per-share basis and each share type can receive a different amount. So why would you want you and your spouse to own the same type of share and the same amount and receive the same dividend?

For instance, your 1,000 common shares at $5 per means a $5,000 dividend in your pocket and tax return while $2,000 per share for 10 special shares means a $20,000 dividend to your spouse. There are other important things to consider when allocating shares to a spouse.

What if you divorce or one of you dies? The shares in the company have value. Would you or your spouse be able to buy the remaining shares?

Are you trying to hide something? That's what Canada Revenue Agency, Service Canada, and your spouse's divorce attorney will ask if your company is flush with cash but your personal income is low.

How many times have you heard owner/operators telling you that their wives own the business even though they have nothing to do with running it?

Typically, they do this to hide income or assets from an ex-spouse or collection agency.

When you set up your business, you have to be concerned with what's best for today and tomorrow. If your spouse is a vital part of the operation, maybe he or she should own half? If you're only doing it for tax planning, then you need to talk to your accountant or business advisor about the range of possibilities. ☐

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