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Business Owners are Told they are the Drivers of the Canadian Economy... *Why doesn't our tax and banking systems respect them as such?*

By: Michael Hunter

We constantly hear that small and medium-sized businesses are the engine of the Canadian Economy. Why is it then that both our Banking and Taxation systems seem to have it out for business owners? Instead of giving entrepreneurs the hand up to grow and expand their businesses, both our Banks and Revenue Canada seem to want to punish entrepreneurs. What do I mean?

Have you noticed how banks have an ever-changing formula for granting loans to businesses? I learned this 25 years ago when all it took was a small tweak in my business plan to go from banks declining my loan request to happily giving me the money I needed. Even with the strong covenants, in challenging economic times, our beloved banks still find reasons not to finance businesses. It's just part of their economic cycle, in good times they cannot wait to give away money, in challenging times, not so much!

So, what can an entrepreneur do? How can a business owner recapture control over the banking function so that they are never turned down for a loan again?

From what I gleaned from my experience as an entrepreneur and as a Financial Planner, what the banks are looking for, and something that entrepreneurs have control over is skin in the game. When we start planning to either buy an existing business or start one from scratch, there are various vehicles we can use to stockpile the capital:

- Savings Accounts and Money Markets are great, but they return little interest. Your money loses buying power to inflation. As such it is not a good place to store cash for extended periods.
- GIC's are a little better, now that rates of return have gotten back to outpacing inflation. The issue here is liquidity. Locking in capital for extended terms 3-5 years, may or may not coincide with the date you need the funds. What if an opportunity came up where you needed that cash NOW?
- Stocks and bonds have traditionally produced the greatest rates of returns, but also the biggest capital to close a deal sitting in the stock market and planned to use it in March 2020. All of a sudden you have 40% less capital.

All of these have risks associated with them, but the biggest drain on them all is Taxation! If you are stockpiling capital within a corporation in Ontario, any gains are subject to the 50% passive income tax. Every dollar of interest income from a GIC only nets you 50 cents.

So, what do business owners do with profits? If you pay yourself a salary, you could pay 53% in income tax. Keep them as retained earnings you could pay less, but then the tax on the growth is onerous. This is why I empathize with entrepreneurs. They are told they are the drivers of the Canadian Economy, but our banking system and tax system are punishing.

What is a business owner to do?

The great Albert Einstein once said, "We cannot solve our problems with the same thinking we used when we created them." As such, I would have you consider an old but revolutionary new approach to stockpiling capital.

Although they may not have called it such, The Infinite Banking Concept is a strategy that has been used by some very successful Canadian businessmen, including the late Ted Rogers and Jim Pattison.

At a high level, it is all about purchasing an asset that avoids the above issues—inflation, market volatility, and taxes--- and having a contractual right to get credit against the asset. Can you imagine a situation where the lender could not turn you down? And you set the repayment terms, not the lender!

When we think about banks' lending money, attached are normally some form of monthly payment, no matter what security is pledged. What if you could determine the repayment terms? You decide if and when you want to pay the principal and/or the interest.

So, what is this asset?
It is a specially designed, tax-exempt permanent participating life insurance contract. I say specifically designed, because, unlike the common understanding of life insurance, the contract can and should be designed to make sure you don't run out of money while you are alive, not just when you die. The benefits are that your money is inflation-protected, has no market volatility, is tax-preferred—even in a holding company, and is liquid. It is written in the contract that you have a right to borrow up to 90% of the equity in your policy. What other asset can you refinance at 90% loan to value without any qualification questions? How much easier would a business owner's life be if they had a right to credit and could not be turned down for a loan?

Case Study
I have a 35-year-old client who owns a retail business and is looking to expand. Three years ago, we started allocating $136,000 to this concept. If he died today, his family could hire someone to run the business, but we designed the policy to stockpile his retained earnings. Currently, he has accumulated over $380,000 and in two years that will rise to over $677,000! In 5 years the cash value will grow to $1.2 million, giving him more than enough capital to get a second location going!

He could contribute more later on, but even if he doesn't, at retirement age 65 he will have over $20 million in cash growing inside his Holding company not being taxed. He could enjoy a tax-free retirement income of almost $650 000 per year!

Bottom Line

This case study is a perfect example of how thinking differently and repositioning corporate assets can help entrepreneurs stockpile capital more efficiently to acquire or expand their business and plan for a tax-efficient worry-free retirement.

About the Author

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Michael is a Certified Financial Planner with the heart of an entrepreneur. His mission is to teach entrepreneurs take control of their money and create a predictable outcome, such as having reliable access to capital to either expand or acquire a new business, retire comfortably or create a legacy.

Before helping entrepreneurs plan their financial future, Michael honed his entrepreneurial skills in the hospitality industry, creatively financing multiple restaurant endeavours. He can be reached at michael@mjhfinancial.ca or 647-302-0151.