



CASE #5

- A potential buyer offers to buy all of the shares of the business and the owner wants to sell.
- Owner discovers that for years the company has bonused down to the small business tax rate level and invested the retained earnings in bonds.
- Over the years the interest on the retained earnings has grown to be in excess of 10% of the annual income of the company.
- The owner's accountant points out the 90/10 rule. If more than 10% of the total income from passive assets (such as retained earnings) the business will fail to be a Qualifying Small Business Corporation and the owner and his wife will not be able to claim the \$500,000 lifetime capital gains exemption.
- The business owner and accountant looking at transferring the money to an holding company but realize that investment income in that holding company will be taxed at the highest corporate rate and when the money is eventually paid to him in dividends he will have to pay tax.

Solution

- An RCA is established
- The actuarial certificate will allow for all of the retained earnings to be contributed to the plan with he and his wife as beneficiaries.
- The corporation makes the contribution and is thus purified.
- The sale goes forward and the couple receives the first million in proceeds free of taxation.
- The remaining proceeds are taxed as capital gains.

