How women small business owners can fund their retirement without taking on debt

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For women entrepreneurs, borrowing money to contribute to their registered retirement savings plans (RRSPs) may not be the best option when there are other debt-free ways to fund their retirement.

That's the message from Libby Wildman, head of wealth advisory at Davis Rea Ltd. in Toronto, who has noticed in her practice that female small business owners are often borrowing from their lines of credit to contribute to their RRSPs.

"Women entrepreneurs are being driven into debt by the pressure of [contributing to their RRSPs]," she says.

The focus on contributing to RRSPs from financial institutions' annual marketing campaigns is usually suited for people who have regular salaries, but may not necessarily work for small business owners, Ms. Wildman says.

For women entrepreneurs, who are the majority owners of only 15.6 percent of Canadian small or medium enterprises with one or more employees, it's even more difficult as they struggle more than their male counterparts to get their businesses on solid footing.

For example, Ms. Wildman says that women entrepreneurs usually receive less than 3 per cent of funding available.

The COVID-19 pandemic has made that worse. According to Crunchbase, a platform that provides business information such as investments and funding, global venture funding to female-founded companies dropped 27 per cent in 2020 compared to 2019.

Given those obstacles, Ms. Wildman usually tells female entrepreneur clients not to contribute to their RRSPs when they ask if they should.

That's because there are alternatives that allow women entrepreneurs – and all small business owners, for that matter – to avoid going into debt, benefit from tax efficiencies, and still contribute to their retirement savings.

The retirement benefits from incorporating
One option is an Individual Pension Plan (IPP), set up in a corporation, says Wilmot George, vice president, tax retirement and estate planning, at CI Investments Inc. in Toronto.

"The corporation can sponsor and make contributions to the IPP for the owner," he says. "The IPP becomes the pension plan solution for that business owner in retirement."

Mr. George says that as an IPP is a registered pension plan, there will be some administrative costs associated with it and the plan would have to be registered with the Canada Revenue Agency.

But having an IPP also reduces taxes to the business because contributions to the plan are tax-deductible. The business can also contribute to make up for the years missed based on the date of incorporation. That allows the owner to catch up on contributions as the business becomes more successful.

“One of the great things about incorporation is that you accumulate active business income within your corporation,” Mr. George says. “The first $500,000 of active business income in Ontario is eligible for reduced corporate tax rates.”

It can be higher in other provinces such as Saskatchewan, where it’s the first $600,000 of active business income.

He adds that these rates are lower than personal tax rates, leaving more money in a corporation that can be used to grow the business, increasing its value, which can help fund retirement.

Megan Sutherland, investment advisor with BMO Nesbitt Burns Inc. in Calgary, says another advantage of incorporating is that it gives entrepreneurs the opportunity to access benefits such as Canada Pension Plan (CPP) credits.

“Business owners can work with an accountant to decide whether to pay themselves a salary like anyone who works for an employer, pay themselves dividends, or a combination,” she says.

Ms. Sutherland says that if a client decides to pay themselves a salary, they will accumulate CPP credits and RRSP contribution room.

With a dividend, those options aren’t available, but generally, they are paying a lesser tax rate and retaining more income that can be put toward retirement savings.

One disadvantage of incorporating is the additional cost of managing the business, Mr. George says. That includes separate tax returns and financial statements. He says that legal and accounting costs will go up, but once the business starts to become profitable, the pros can outweigh the cons.

Drawbacks of borrowing to get a tax break

Meanwhile, entrepreneurs need to be aware of the risks if they decide to borrow money to contribute to RRSPs.

Ms. Sutherland says it becomes a debt that has to be serviced on an ongoing basis.

“If we see a big correction in the market, all of a sudden that money that you borrowed [to invest] dropped to $40,000 from $50,000, for example,” she says. “Are you going to be comfortable watching the fluctuations in the market and are you able to service the debt?”

Mr. George says that borrowing to fund an RRSP also means that you can’t deduct the interest on the money borrowed.

“Anyone who is engaging in a loan would normally be doing it for the value of the RRSP deduction and tax-deferred growth going forward, as opposed to any deductibility of the interest expense on the loan,” he says.

Instead of borrowing, he says they should take advantage of dollar-cost averaging by contributing small amounts over time.

Overall, when it comes to balancing a business and retirement, Ms. Sutherland says it’s important for owners to have a financial plan and update it as they get older and the company changes.

“A lot of business owners don’t think about it until it’s time to sell the company and retire,” she adds.