

Fall 2004 issue

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Tax Planning Through Income Splitting

Income splitting with other family members continues to be an effective long-term tax planning strategy. The following are various examples that can be used to structure a taxpayer's affairs so that income can be shifted to family members in lower income tax brackets.

Loan to family member

Generally, where one spouse lends money to the other spouse (or another family member) for investment purposes at little or no interest, any income realized will be attributed back to the lending spouse and taxed accordingly. However, where an interest rate is at least equal to the lesser of the going market rate and the Canada Revenue Agency ("CRA") prescribed rate (currently 3%) at the time the loan is made, the resulting income is taxed in the hands of the borrowing spouse.

If a higher income spouse lends to the lower income spouse and charges the prescribed rate throughout the period in which the loan is outstanding, all income and capital gains, net of the interest paid, is taxed in the hands of the lower income spouse. The lending spouse would only include the prescribed interest in income.

The current prescribed rate is locked in as long as the loan is in place. As a result, where interest rates begin to rise, significant tax savings will accumulate.

Transfers to minor children

Where a parent owns assets with a low value but expects significant appreciation in the future, transferring these assets to his/her children or a trust for the children should be considered.

Any subsequent capital gain realized, unlike other sources of income, does not attribute back to the parent even where the children are not the age of majority.

Spousal Retirement Savings Plan ("RRSP")

For income tax purposes, you are allowed to contribute to a spousal RRSP and deduct the amount of the contribution in computing your income. The deduction for the contribution is limited to your regular RRSP deduction limit for the year and it reduces the amount that you can contribute to your own RRSP. A contribution to your spouse's RRSP can be beneficial from a tax perspective for the following reasons:

First, a spousal RRSP contribution allows you to split income with your spouse, since the RRSP withdrawals will be included in your spouse's income rather than your income. This income tax treatment will lead to tax savings if your spouse is in a lower tax bracket than you in the year in which the funds are withdrawn from the RRSP. In this regard, it is important to remember that the funds must remain inside your spouse's RRSP until after the end of the 2nd calendar year following the year

in which the contribution is made. Otherwise, the withdrawal will be included in your income and the potential tax savings from the income splitting will be lost.

Second, if you are older than your spouse, the funds contributed to your spouse's RRSP can grow free of tax for a longer period of time. This is because an RRSP must mature and be "collapsed" by the end of the year in which the annuitant of the RRSP turns 69. Thus, for example, if you are currently 65 years old and your spouse is 60, a contribution to your spouse's RRSP in this year will have five extra years to earn tax deferred income in the RRSP as compared to a contribution to your own RRSP.

Furthermore, if you are over 69 years old and you continue to have "earned income", you can contribute to your spouse's RRSP until the end of the year in which your spouse turns 69, even though your own RRSP will have matured by then. "Earned income" for these purposes includes employment and business income, royalty income, net rental income from real estate, and disability pension income under the Canada Pension Plan ("CPP") or Quebec Pension Plan.

Registered Education Savings Plans ("RESP")

RESP's can help build an education fund for children by allowing them to earn investment income in a tax deferred environment.

Unlike RRSP contributions, contributions to an RESP are not tax deductible. The tax advantage of an RESP is that the investment income in the plan accumulates tax free and, when the child withdraws the funds, the income received from the RESP will be taxable to the child in the year of receipt. As a student, the child will probably not have much other income and will be eligible for the tuition and education credits, and therefore pays little or no income tax. The distribution of income from the RESP is fully taxable, even if the accumulated investment income was dividends or capital gains, which are normally taxed at a lower rate.

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CPP Income Splitting

Under provisions of the CPP Act, it is possible to split a portion of a CPP annuity with a spouse. This is attractive where the person who has the right to receive the payments is in a higher tax bracket than the spouse.

Under income tax rules, the CPP payments received by the lower income spouse are not subject to attribution. In addition, where the higher

income spouse is receiving Old Age Security ("OAS"), his/her lowered income may now reduce or eliminate the OAS subject to claw back.



To learn more about income splitting and other tax strategies, please contact Enzo Morini of the W&P Tax Group: (416) 969-8166 ext. 244.

Biggest Hiring Mistakes Companies Make (Part 1 of 3)

Finding the right individual, especially for a key role is worth the extra time and money it takes to seek out the best person. Even though we all believe we have the patience, we often rush to fill a position and do not spend the required time to complete the hire satisfactorily.

Here are some of the biggest mistakes companies make when hiring:

1. Having a Clerk to do a Manager's job

If you let a clerk do your screening and you do not get your hiring manager involved early in the process, top candidates will quickly smell bureaucracy and disappear.

The best candidates are in demand. Recruiters will find them and present them to organizations that appear serious about hiring. For candidates, the hiring process itself demonstrates key things about the organization including its efficiency and professionalism.

2. Not delivering value to the candidate

You are not just filling a job. You are asking an individual to make a life-altering decision for themselves and their family.

Immediately have the individual meet the hiring manager. Give them a tour of the office and/or facilities. Show them what their surroundings will be like. Show, explain or demonstrate your products or services. Demonstrate what they will get out of the relationship.

One of my candidates' reported his best experience with a potential suitor was his impression sitting in the reception area. Every individual that walked by said hello or good morning and many asked if he needed assistance or if they could get him coffee. It gave him a positive sense of community and the likelihood of a friendly workplace.

3. Long decision process

The longer you take to make up your mind, the more likely it is that you will lose the best and most talented candidates.

It is important to follow a process and screen individuals appropriately, ...but if you then sit on the decision for weeks, you will scare

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TAX TIP "Ownership of U.S. Residential Property"

Canadians considering the purchase of a U.S. residential property for personal or rental purposes should be made aware of the exposure to U.S. estate tax.

U.S. situs assets, such as real estate, held by an estate may be exposed to U.S. estate tax. The U.S. estate tax rate varies from 18% to 45% based on the fair market value (not capital gain) of the U.S. estate on date of death.

Non-residents of the U.S. are allowed a credit of US \$13,000, effectively exempting U.S. situs estates of US \$60,000 or less. The Canada-U.S. Treaty increases the applicable amount for residents and citizens of Canada from the US \$13,000 allowed under U.S. law. However, the credit must be pro-rated by the ratio of the fair market value of the individual's U.S. situs assets over the worldwide estate.

The use of a single purpose Canadian corporation to own U.S. real estate has been a popular strategy in avoiding U.S. estate tax. In addition, the Canada Revenue Agency ("CRA") has administratively ignored the application of any taxable benefit to a shareholder for the use of U.S. real estate held by a single purpose corporation. However, the CRA has recently announced that this policy with respect to single purpose corporations is no longer applicable for purchases subsequent to May 24, 2004. As a result, a taxable benefit to a shareholder may be imposed where a Canadian single purpose corporation owns a U.S. residence.

Consequently, Canadians considering the purchase of U.S. residential property may want to consider other alternatives including: joint ownership with several family members, the use of a Canadian partnership, or a Canadian discretionary trust in order to minimize U.S. estate tax exposure.

TAX TIP deals with a wide variety of issues and the information is general in nature.

As each person's circumstances are unique, readers are urged to consult W&P prior to acting on the basis of material in this Tax Tip.

If you have any questions regarding the content of this or any other Tax Tips, please contact the W&P Tax Group.

off your best candidates, or they will ultimately refuse the offer and put you back to square one.

Set a timeline, get your stakeholders committed to it as a priority and stick as close to that as possible. Treat your hiring process the same way you would a delivery schedule or the management of any critical project. If it is late, your reputation suffers in the marketplace.

4. Incomplete or superficial reference checks

In the rush to get an offer to a qualified individual, companies often only conduct cursory reference checks, or do them after offers are made and signed.

A better practice is to do at least one in depth reference check before the offer is made, and then have the final offer contingent on satisfactory completion of the others. Always try to get a current peer, subordinate or manager of the individual you wish to hire. Do not be comfortable with the “he’s a great guy, we hate to lose him” line. Ask in depth ques-

tions about how the individual manages stress, how they operate in crisis situations, and their mentoring and coaching style. Ask the reference to provide specific examples to back up their comments. Make sure the check is conducted by an experienced professional who is not afraid to ask in depth questions to the reference.



Arnie Teolis is a Partner with the JSG Group, a Professional Management and Executive Recruiting firm specializing in Management and Executive search. They have been successfully finding key individuals for their clients for over 25 years. For more information contact Arnie at (905) 294-0043 or arnie@jsggroup.com. You can visit them at www.jsggroup.com.

Individual Pension Plans

What is an Individual Pension Plan (IPP)? It has been called “an RRSP on steroids”, “a turbo-charged RRSP” and “the wealthy person’s answer to an RRSP”.

If your RRSP investments have not performed as expected, or you haven’t been diligent about making the maximum annual RRSP contributions, or you would like to have as much of your assets as possible protected from creditors – an IPP may be the answer. IPPs offer the best tax and retirement savings solution for owners or executives who are at least 40 years of age and have a minimum T4 income of \$100,000.

The four main reasons why IPPs are far superior to RRSPs are: 1) all fees and contributions are a tax-deductible expense to your corporation (and tax-free to the employee); 2) they have significantly higher contribution limits, resulting in much larger retirement savings; 3) all monies in the IPP are protected from both corporate and personal creditors regardless of the investments within the IPP; and 4) the IPP guarantees you a specific level of income at retirement; no more wondering about how much you will have finally accumulated for your retirement.

In order to fund this guarantee of retirement benefits, the investments within the IPP must earn an annual rate of return of 7.5%. If your investments do not achieve a 7.5% return, your corporation is required to make a “top-up” contribution to compensate for the shortfall (tax-deductible to the corporation of course). With an RRSP, should your investments not perform as well as expected, or should the market be in an extended decline just prior to your retirement, your pool of retirement savings may not be as large as expected. This will not occur with an IPP.

If there are several family members receiving T4 income from the same corporation there are additional estate planning benefits. Where two spouses are employed, it often makes sense to set up a joint IPP, thereby minimizing administrative costs (only one spouse requires \$100,000 of T4 income). In instances where there are two generations receiving T4 income you could also have a joint IPP. With an RRSP/RRIF, there is a

deemed disposition of assets upon the death of the last surviving parent and income tax is then payable. With a joint IPP between generations there is significant tax deferral since there is no tax payable on the IPP assets at the time of death of the last surviving parent.

One other advantage of IPPs, in many cases, is that past service contributions dating back to 1991 can be made on your behalf. For example, a 50 year-old earning \$100,000 from the same corporation since 1991, would have a past service allowance up to \$260,000 and a 60 year-old with the same circumstances would have up to \$313,800.

Annual IPP contributions are based on age and salary level. For example, for a salary of \$100,000, the 2005 contribution for a 45 year-old is about \$20,300 and, for a 60 year-old is around \$27,000. These contributions increase by 7.5% annually.

Since each IPP is tailor-made for the specific individual, there may very well be other advantages to having an IPP. Using an IPP as part of an executive benefit package may help attract or retain top executives in your company.

Should circumstances change and the need arises to “wind up” the IPP, there are several alternatives. Prior to age 69, the IPP assets can be transferred to a locked-in RRSP, or, if income is desired, to a Life Income Fund (LIF). After retirement, the assets may remain in the IPP or transferred to an annuity or Locked-In Retirement Income Fund (LRIF).

It is important that you deal with an investment advisor and actuary who have expertise in IPPs due to the specialized knowledge required, in addition to your accountant. The IPP takes a minimal amount of your time and none of your staff’s, since the ongoing administration is carried out by the actuarial firm and investment advisor.

To summarize, the Individual Pension Plan may be of great benefit to those looking to take money out of their corporation without paying current tax and build a substantially larger retirement fund whose assets are protected from creditors.

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Childhood Cancer Foundation Candlelighters Canada

There are 10,000 children with cancer in Canada today and 1,400 new cases will be diagnosed this year. Cancer kills more of our children than the next five major diseases combined.

The Childhood Cancer Foundation Candlelighters Canada is the only national charitable organization dedicated entirely to the fight against pediatric cancers. Founded in 1987, the Foundation delivers a broad strategic agenda of support programs for children and their families, advocates for progressive public policies that affect Canada's health-care, child well being and family care programs, and funds a range of childhood cancer research initiatives.

The Foundation has been an important source of comfort and material support for Canada's families that must deal with a child's cancer journey. From its special resource kit designed for families at the time of first diagnosis, to its bursary program directed at childhood cancer survivors embarking on post-secondary education, to its benevolent fund designed to help families struggling with the financial challenge of final arrangements for their departed child, the Foundation is there to help.

New Strategies for Changing Times

In 2004, the Foundation undertakes some important new directions with the implementation of its Creating The Future Strategic Plan. This strategy will drive a significant investment in a re-built, information rich, interactive Web site, as well as a streamlining of the Foundation's support programs.

A fundamental component of the strategy will see the Foundation exploit its unique agreement with the Canadian Council of Pediatric Hematology/Oncology Directors. This alliance with all 17 Canadian centres with a childhood cancer treatment and research facility, will see renewed investment in a truly pan-Canadian pediatric cancer research network. Such a Canada-wide program will help ensure that only the very best proposals are chosen for funding, and should see more Canadian kids able to participate in clinical trials. Improved treatments and, ultimately, a 100 per cent cure rate, are the anticipated results.

Gold Ribbon Gala

Another component of Creating The Future will see implementation of a more vigorous fund development and national branding program.

One aspect of this will be the Foundation's first-ever Gold Ribbon Gala, slated for this November 10th at the downtown Toronto Hilton. Several hundred Foundation supporters and business leaders will join survivors and their families for an entertaining, information-packed, and compelling evening. In many ways the Gala signals a future bright with promise for the Foundation and its noble challenge to help beat childhood cancer.

The Childhood Cancer Foundation Candlelighters Canada is a non-profit organization dedicated to supporting children with cancer and their families. For further information, please visit their website at www.candlelighters.ca.

W&P Newsbits

Partner, Carlo De Pellegrin became a "Nonno" for the first time. Congratulations go to Carlo and Sonia on the birth of the first De Pellegrin grandchild. Carlo's daughter, Tania and her husband Chris are the proud parents of baby girl, Ava Isabella who was born on July 5, 2004. Could "Nonno-hood" be softening Carlo up a bit? "Not a chance," says Carlo "I think I need to be on my toes, now more than ever!"

Welcome back Suzi!

Suzi Monastero has returned to work as a part-time bookkeeper after being home for a year with her baby daughter Samantha. Suzi is available to assist our client's with all aspects of their bookkeeping requirements. Please contact one of our Partners if you could use Suzi's help.

Be the best that you can be...

- Shanon Hawkshaw is now a fully qualified Chartered Accountant (CA) after passing the Uniform Evaluation (UFE) last year and meeting her practical experience requirements.
- Simon Sham also received his CA designation as well as his Certified Public Accountant (CPA) designation.

Congratulations, Shanon and Simon!

NOTICE

Williams & Partners distributes tax tips on a regular basis via email to our clients. If you wish to be on our email distribution list for tax tips, please contact Wendy Pettey at (416) 969-8166, ext. 229, or by email to wendy.pettey@williamsandpartners.com.

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