

Newsletter

Spring 2007

2007 PENSION INCOME SPLITTING

Author: Hugh Faloon CA, CFP, TEP, Partner, Ginsberg Gluzman Fage & Levitz, LLP, Chartered Accountants

The pension income splitting changes proposed to the Income Tax Act are the best thing that has happened to lower and middle income seniors in decades. Ontario, in their March 2007 Budget, stated they would follow the Federal pension splitting rules.



There is a tax saving if one spouse is in a lower tax bracket. The largest advantage is achieved if one spouse has minimal taxable income. For example, if one spouse has pension income of \$100,000, and the other has no pension income, the family income tax would be approximately \$30,000. If the \$100,000 pension income were split \$50,000 to each spouse (maximum split is 50%), the combined taxes would be approximately \$20,000 - resulting in a \$10,000 tax savings. The actual saving depends on the province of residence.

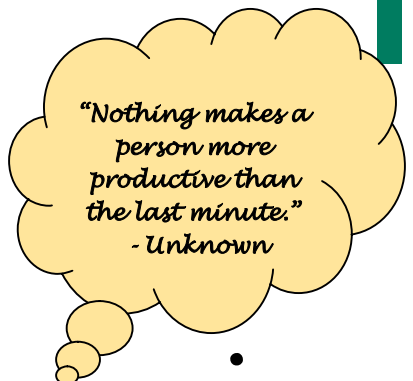
Some taxpayers have questioned whether pension income splitting would also reduce or eliminate the clawback of the Old Age Security Pension (threshold starts at \$62,144 in 2006). The March 27, 2007, draft legislation states the "split-pension amount" is to be deducted from the pensioner's net income and included in their spouse's net income. Since the clawback is based on net income, it would be a "win-win" situation if each spouse's net income is under the threshold after the pension is split. Why? You would save income tax and would not have to repay the Old Age Security Pension.

For wealthy seniors, the pension splitting will not provide a tax advantage unless their investments are held in a personal holding company or family trust, and they can control the amount of personal income they have to report on their personal tax returns.

So, when grandchildren ask their grandparents for an ice cream cone, and they say they are watching their pennies, the grandchildren can now reply, "What about the taxes you are saving from splitting your pension income?"

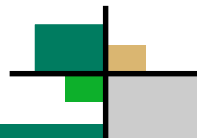
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Special points of interest:

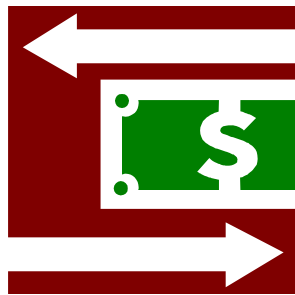
- If you missed a T3, T5, etc. slip on your 2006 personal tax return, avoid CRA penalty 163(1) - file a T1 Adjustment.
- Personal tax instalments:
 - June 15, 2007
 - September 15, 2007
 - December 15, 2007



CANADIAN PUBLIC COMPANY DIVIDENDS IN VS. OUT OF YOUR RRSP

Author: Hugh Faloon CA, CFP, TEP, Partner, Ginsberg Gluzman Fage & Levitz, LLP, Chartered Accountants

Over ten years ago, I wrote an article on investing in or out of your RRSP. With the lower tax rate on dividends from Canadian public companies (referred to in this article as “eligible dividends”), we thought it was worth discussing again.



The following observations are based on an individual having \$50,000 to invest in Canadian public companies either directly or through their RRSP. The investment earns a 5% dividend rate and no capital appreciation beyond reinvested amounts. We are also assuming the person will take the \$23,200 tax savings from the RRSP and invest it in the same investment outside the RRSP. In both cases, the net annual income from the investment is reinvested; the funds will be invested for ten years; and the funds will be spent on retirement through equal withdrawals over the next ten years.

As you all know, we do not pay income tax on the investment growth in our RRSPs until we take the money out of the RRSP. Once we do, we are taxed at our marginal rate of tax. The RRSP does not get the advantage of the lower tax rates on capital gains, eligible dividends, or non-eligible dividends.

For our example, we have assumed the individual is, now and throughout retirement, in

the highest Ontario tax bracket of 46.41% on regular income (including RRSP withdrawals), 23.2% on taxable capital gains, and the new rate of 24.64% on eligible dividends.

The main advantage of the RRSP is the deferral of income taxes, and, of course, the tax deduction for contribution to the plan. So, if you need to spend the after-tax eligible dividends or capital gains earned in your RRSP in a few years, the extra 21.77% or 23.2% tax on withdrawal could be very costly.

The results of this example are:

- The person investing \$50,000 outside their RRSP, paying the annual income taxes on eligible dividends, would be able to withdraw \$8,800 annually (after tax) from year 11 to 20 until the funds run out.
- The person investing the \$50,000 in the RRSP and investing the immediate tax savings of \$23,200 outside his RRSP would receive \$9,727 annually (after tax) from year 11 to 20 until the funds run out.

In this twenty-year 5% annual eligible dividends from investment, the RRSP combination won. If the investment were changed to provide an annual 5% capital gain and no dividends, the RRSP would still win; but, the lower tax rate gave another \$100 per year for the non-RRSP.

What you can take from this is that long-term planning using your RRSP still makes sense. However, based on the low tax rate on eligible dividends and capital gains, an RRSP can be costly if you are forced to withdraw the funds too soon. Therefore, before you make a large RRSP investment, you should discuss your future personal cash needs with your accountant.

Tax rates make a difference in required rate of return. In Ontario, a 5% interest rate is equal to a 3.556% eligible dividend; a 3.903% non-eligible dividend; and a 3.489% capital gain at the top tax rate.

FINALLY A PLEASANT SURPRISE! - EXTRA \$250,000 CAPITAL GAINS EXEMPTION

Author: Hugh Faloon CA, CFP, TEP, Partner, Ginsberg Gluzman Fage and Levitz, LLP

The March 2007 Federal Budget announced an additional \$250,000 capital gains exemption, increasing it to \$750,000. To date, the provinces have not matched the additional \$250,000; however, they usually do.



Ever since the original capital gains exemption was announced, many individuals who qualified for the exemption have either used it or have crystallized their exemption to protect it.

Crystallizations of the exemption were done out of fear that the government would either cancel the exemption (as it had cancelled the general \$100,000 exemption in 1994), or that the assets would no longer meet the test to qualify for the exemption in the future.

Again, until we get the draft legislation, we don't know of any hidden surprises. However, what does it mean? The extra \$250,000, if the provinces get on board, is worth approximately \$58,000 in tax savings.

If you have not used the \$500,000 exemption, the \$750,000 exemption would amount to approximately \$174,000 in tax savings (assuming Ontario rates), which is actually less than the original tax savings of the \$500,000 exemption, when capital gain inclusion rate was 75% and the tax rates were higher. But, who's complaining!

It is recommended that all clients meet with their accountant to discuss what they need to do to qualify for the additional \$250,000 exemption. In many cases, once the \$500,000 was used, companies may have fallen offside on meeting the required business asset test. While the new \$250,000 exemption can save \$58,000, do not forget, in many cases—either through direct share ownership or through a family trust—that \$58,000 can be multiplied by the number of family members.

Now, all we have to do is hope the Budget is passed, and that all provinces jump on board.

It is recommended that all clients meet with their accountant to discuss what they need to do to qualify for the additional \$250,000 exemption.

DOING BUSINESS IN THE U.S. – HAVE YOU CONSIDERED ALL THE ISSUES?

Authors: Andrew Shalit, CA, Tax Partner and Warren Smith, CA, TEP, Principal - Taxation Services, Segal LLP

Many entrepreneurs have plans to expand their business south of the border to a market that is much larger than the domestic Canadian market. An expansion to the U.S. market brings a host of tax issues that need to be properly addressed.

Some of the questions that need to be considered include:

1. Does the business earn active or passive income?
2. Where should you establish the business?
3. Will the business realize start-up losses?
4. How will you finance the business?
5. Will the earnings be repatriated to Canada?
6. How will a capital gain on a sale be treated?

A well thought-out corporate structure will take advantage of start-up losses, ensure income is

received in a tax-efficient manner, and could offer a tax deferral on the ultimate sale of the business.

Diving head-first into the U.S. market is fraught with potential traps for the unwary. A wise U.S. lawyer once stated that there were over 1,000 tax jurisdictions in the U.S. Proper planning can help avoid unforeseen issues.



Upcoming GGFL Community Events

- ◆ **Run For A Reason—Ottawa Hospital Race Weekend Challenge May 26, 2007**
- ◆ **Volunteers in 3rd Annual Capital Food Blitz for Food Bank—May 30, 2007**
- ◆ **Exclusive sponsor of WESTFEST STUDENT MUSIC and merchant participant at WESTFEST Festival in Westboro—June 8-10, 2007**
- ◆ **Blood Donor Drive—June 2007**

Come grow with us!

GGFL is growing nicely and is continually *seeking* enthusiastic, career-minded *accountants, at all levels*, to join our firm.

Please visit our web site – www.ggfl.ca – or contact Lisa Lawrence at lml@ggfl.ca or (613) 728-5831 x 271.

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