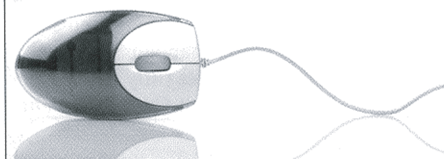
Hot tax and estate planning issues

At this summer's Canadian Institute of Financial Planners (CIFPs) conference Jamie Golombek, Managing Director, Tax and Estate Planning, CIBC Private Wealth Management, provided attendees with an update on the current hot tax and estate planning issues for investors.

Mr. Golombek started off by reviewing the key changes that were presented in the 2009 federal budget. He highlighted one change in particular that he felt was the most important of all changes introduced, because it has "the potential to literally save clients thousands, or in some cases, tens of thousands of dollars in tax" but which received the least amount of press. This change has to do with the treatment on death of an RRSP or RRIF where there is no surviving spouse, partner, or qualifying dependent child to receive a rollover of the proceeds. In that situation, the fair market value of the RRSP/RRIF is fully taxable on the terminal return.

What has changed is that the government has finally introduced legislation that will allow any post-death decreases in value to be deducted on the deceased individual's terminal return, effective with distributions made after 2008. This long-awaited change is particularly timely now, given the state of the markets over the past year. "The real issue here is what if the RRSP declines in value after death and before payout. Just imagine that someone dies in June with an RRSP worth $200,000, the market crashes by 40%, we don't pay it out until January and the value is only $120,000. You have taxable income of $200,000 on the deceased's terminal return, there's a loss of $80,000 and there's no way to claim that at all until literally a few months ago when the tax law was changed. Now that $80,000 is allowed to be deducted on the terminal tax return of the deceased, so you can reduce the income inclusion on the date of death down to $120,000. It is not a capital loss – there's been a lot of confusion on this with advisors – it's an income loss, and it's 100% tax deductible against the value of the RRSP or RRIF income inclusion on the date of death."

Jamie Golombek



Spousal Loans

Although not budget related, Mr. Golombek spent some time reviewing the benefits of using a spousal loan at the current prescribed rate of 1%. This rate, which will be in effect until at least Sept. 30, 2009, is the lowest the prescribed rate has ever been – and it can never go any lower because of the formula used to calculate the rate[1]. Because the rate at the time the loan is originally entered into can remain the same throughout the life of the loan, Mr. Golombek considers this an "amazing" opportunity to set up a long-term loan at a 1% rate. Let's say that Jack loans his wife Diane $200,000, and Diane earns $10,000 on this investment over the year. She pays $2,000 to Jack in loan interest (1% of $200,000) and pays tax on the remaining $8,000. Meanwhile, Jack pays tax on the $2,000 of loan interest. Using Ontario tax rates as an example, Mr. Golombek calculated that this couple could save over $2,000 per year by having the $8,000 investment income taxed at the lowest tax bracket rather than the highest.

However, spousal loans at the prescribed rate are not a new strategy. Many clients may already have a loan in place, set up when the prescribed rate was at 3% or 4%. Can this rate simply be adjusted to 1% going forward? Absolutely not, according to Mr. Golombek. In fact, he strongly recommended selling investments to pay off the existing loan, even if this means incurring capital gains tax. Then, start from scratch by visiting a lawyer to have a new promissory note drawn up, reflecting the current prescribed rate. In this way, clients minimize the risk of running afoul of *Canada Revenue Agency*.

Tax Free Savings Accounts

Moving on to Tax Free Savings Accounts (TFSAs), Mr. Golombek enlivened the discussion by giving attendees a quiz on calculating contribution room following a series of deposits and withdrawals. One question that many advisors got wrong is the following: A client contributes $4,000 in March 2009. In July 2009, her investment has grown to $5,000 and she withdraws the full amount. How much can she contribute in January 2010?[2] Check below to see if you got it right!

Mr. Golombek is a huge fan of TFSAs and went on to list his top five reasons why every Canadian should have one. These include:

- **Source of emergency funds**, providing liquidity and tax-free interest income, along with the ability to re-contribute;
- **Tax rate planning** – a client making under $40,000 per year is generally better off contributing to a TFSA rather than an RRSP, and contributions can be rolled into an RRSP later on if the client's taxable income increases;
- **Education planning** – while parents should take advantage of the RESP first in order to maximize the Canada Education Savings Grant, anything above $2,500 per year can be saved in a TFSA for maximum flexibility;
- **Income splitting** – a client could gift $5,000 per year to a spouse, partner, or child over age 18 with no attribution of income or capital gains;
- **Estate planning** – TFSA proceeds are completely tax-free on death. In provinces that provide for a beneficiary designation, probate taxes can be avoided as well.

So, there you have it – three top notch tax savings ideas to review with your clients in the coming months.

Lynn Biscott, CFP

1 It's based on the average 90-day Treasury bill rate, rounded up to the next full percent.

2 $11,000. This is calculated as $5,000 for 2010, plus $5,000 to replace the withdrawal made in 2009, plus $1,000 of unused contribution room for 2009.