COMMENT

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FOREIGN PROPERTY HELD WITHIN DEFERRED INCOME PLANS

Up to 30 per cent of the property held within a deferred income plan can be foreign property. Deferred income plans include registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), registered pension plans (RPPs), and deferred profit sharing plans (DPSPs).

The calculation for foreign property is based on the cost of the property, not its current market value. At the end of any month, where the cost (or "book value") of foreign property exceeds 30 per cent of the cost of all property held within the plan, a penalty tax will be imposed. The monthly penalty is generally equal to one per cent of that excess amount.

Example:
Chris holds an RRSP at June 30, 2001:
(a) Total fair market value of the RRSP $125,000
(b) Total book value of the RRSP $ 85,000
(c) Foreign content permitted without penalty $ 25,500 [30% of (b)]

Chris can hold, without penalty, $25,500 of foreign property (cost of investment) within the RRSP.

Assume that Chris currently holds foreign investments costing $25,000 in the RRSP (this is within the current limit). Chris purchased an additional $13,500 of RRSP investments in September 2001, of which $6,000 is considered foreign property. The result is recast as follows:

At September 30, 2001, assuming no change in fair market value since June 30, 2001:
(d) Total fair market value of the RRSP $138,500 [(a) plus $13,500]
(e) Total book value of the RRSP $ 98,500 [(b) plus $13,500]
(f) Foreign content permitted without penalty $ 29,550 [30% of (e)]
(g) Actual foreign content held $ 31,000 [$25,000 plus $6,000]

This puts Chris in a penalty situation. At the end of each month that the foreign content component of Chris's RRSP exceeds $29,550, the penalty applies:

Foreign content amount	$31,000	
Foreign content permitted	$29,550	
Excess	$ 1,450	
Penalty	$ 14.50	[1% of $1,450]

In this case, Chris will incur a tax penalty of $14.50 at the end of each month until the foreign content percentage is realigned to meet the 30% limit.

It is important to note that the automatic reinvestment of dividends can bump the cost base of a plan's foreign content, potentially putting it offside. The penalty can be avoided by carefully monitoring the investments in the plan.

Foreign property generally includes the following: a share in a corporation other than a Canadian corporation; a mortgage on a property situated in Canada or

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elsewhere, where the mortgagor is not resident in Canada; and deposits in a bank or similar institution outside Canada, whether or not the deposit is payable in Canadian currency.

Foreign property generally does not include the following: a bond, debenture or other debt obligation issued by a resident of Canada and expressed in a foreign currency, provided the issuer remains in Canada; Government of Canada treasury bills, whether or not expressed in a currency other than Canadian dollars; and foreign currency situated in Canada.

Where the property is an interest in a mutual fund trust, a share of a mutual fund corporation, or a similar investment, then that property will not be counted as a foreign property if its own underlying investments comply with the 30 per cent limit. For investments purchased through retailers of RRSP, RRIF, and DPSP plans (such as insurance carriers and mutual fund companies), the retailer will specify whether the investments are foreign property.

The foreign property test is applied separately to each plan held by an individual. Thus, plans qualifying as Canadian property (such as guaranteed investment certificates or mutual fund interests registered as RRSPs) would not help the holder of another plan that exceeds the 30 per cent limit. However, these investments could be held in a single self-directed RRSP and count toward the total book value of the plan.

Foreign content limits do not currently apply to segregated funds. However, the Department of Finance has announced that such limits will apply in the future. The timing remains uncertain.

This 30 per cent limit may be increased for taxpayers who hold certain small business property. The Income Tax Act allows $3 of additional foreign content room for each $1 invested in a qualified small business, provided the total foreign content does not exceed 50 per cent.

Monitoring the percentage of foreign content will avoid unnecessary penalties that can reduce the profitability of a portfolio.

I/R 5401.00

TONI: A NEW CANADIAN STANDARD

TONI, which stands for "tax on income," is a new method of calculating provincial or territorial personal income tax. While Quebec has operated its own tax system for many years, the other provinces and territories have now moved away from calculating provincial income tax as a percentage of the basic federal tax. Instead, they have adopted their own systems where provincial or territorial tax is based on the taxable income calculated on the federal return.

Under the old "tax-on-tax" system, the provinces and territories were limited in setting personal income tax levels because of the direct correlation between the federal and provincial calculations. Provincial tax revenues rose or fell based on how the federal government adjusted its tax rates, tax brackets, and tax credits – unless the province or territory adjusted its tax rate or surtax in response.

With the adoption of TONI, Canada's provinces and territories acquired more autonomy in designing and implementing their own tax policies, so we can expect to see much more diversity in the federal and provincial tax systems. Although the new systems are still in their infancy, it is likely that the pace of change will speed up and the degree of complexity will increase over the next few years as the systems mature.

Provinces and territories are now free to determine:

- the number of tax brackets. For example, a province may choose more or fewer brackets than the federal government, or perhaps one bracket to effect a flat tax.

- the income thresholds for each bracket, including any indexation of those thresholds. For example, a territory could adopt the federal tax bracket thresholds initially, but either not index them for inflation or use a territorial inflation measure.
- the tax rate for each bracket. A province or territory is free, for example, to utilize a zero per cent tax for a low-income bracket.
- the design of a surtax system. While provinces and territories had this right under the tax-on-tax system, this right remains an option within the new scheme.

Provincial and territorial governments must keep the same non-refundable tax credits that already exist under the federal system; however, they are free to opt out of any indexing of non-cash credits (e.g., basic personal or spousal amounts).

For expenditure-based credits (i.e., CPP, EI, or charitable donations), the provinces and territories must at least match the federal system but can increase these credits beyond the federal amount.

The change-over to TONI from the long-standing tax-on-tax approach adds complexity. It is no longer easy to estimate the combined federal and provincial tax burden. One can no longer assume that the provincial tax is 50 per cent of the federal tax. The determination of the value of a tax deduction, tax credit, or taxation of a dividend will all be slightly more complex.

The following example has been created to depict the elements of a tax calculation under TONI. While each province and territory has its own unique tax rates, brackets, and credits, the following provincial numbers have been created for example purposes only.

Example:

(1) Taxable income:

$50,000 including $37,500 of earned income and a $10,000 cash dividend (which is grossed up to a $12,500 taxable dividend).

(2) Tax calculation:

	Federal calculation		**Provincial calculation**	
	Tax rates and brackets (2001)	Tax	Tax rates and brackets (assumed)	Tax
First tax bracket	16% ($0 – 30,754)	4,921	6% ($0 – 30,000)	1,800
Second tax bracket	22% ($30,755 – 61,509)	4,234	9% ($30,000 – 60,000)	1,800
Subtotal		$9,155		$3,600
Non-refundable tax credits	16% of $7,412	1,186	6% of $7,412	445
Dividend tax credit	13.33% of $12,500	1,667	5% of $12,500	625
Basic tax		**6,302**		**$2,530**

You will note, from the above example, that the provinces and territories have considerable room to create tax rates and brackets, as well as differentiate their tax credits. With the adoption of TONI, the provinces are opting for increased flexibility, which gives them greater independence over their own personal income tax policy and greater control over their revenue base.

I/R 7401.01

GOVERNMENT PENSION PLANS: BENEFITS AND CONTRIBUTIONS FOR 2002

Contributions and benefits under government pension plans are adjusted periodically to reflect increases in the Consumer Price Index or the average Canadian wage. The new amounts, commencing January 1, 2002, are shown in the table below. Each benefit is subject to income tax when received, with the exception of the Guaranteed Income Supplement and the Allowance. All benefits shown are paid monthly unless otherwise indicated, and are the maximum amounts.

	CPP	QPP	OAS
CPP/QPP benefits (for new beneficiaries)			
Retirement pension (at age 65)	$788.75	$788.75	
Disability pension	$956.05	$956.02	
Disabled contributor's child benefit (each child)	*$183.77	*$58.35	
Survivor's*** pension			
• under age 55	**$437.99	**$660.24	
• age 55 to 64	$437.99	$695.37	
• age 65 or over	$473.25	$473.25	
Surviving child's benefit (each child)	*$183.77	*$58.35	
Death benefit (lump sum)	$2,500.00	$2,500.00	
Combined benefits			
• survivor's*** pension and disability (under age 65)	$956.05	$1,255.04	
• survivor's*** pension and retirement (age 65 and over)	$788.75	$788.75	
Annual CPP/QPP contribution			
Self-employed (9.4%)	$3,346.40	$3,346.40	
Employee (matched by employer) (4.7%)	$1,673.20	$1,673.20	
Old Age Security (OAS)			
January to March 2002			$442.66
Guaranteed Income Supplement (GIS)			
January to March 2002			
• spouse/common-law partner receives OAS or Allowance			$342.67
• single person (or spouse/common-law partner receives neither OAS nor Allowance)			$526.08
Allowance			
January to March 2002			
• age 60 to 64, and spouse/common-law partner receives OAS and GIS			$785.33
• age 60 to 64, survivor's*** Allowance			$867.02

Notes:

* flat benefit amounts

** these amounts may vary depending on whether the survivor is under age 45, disabled, or with or without children

*** a survivor is the spouse or common-law partner of a deceased individual

I/R 3201.01 and 3201.03

Contributors to this issue of Comment:
James W. Kraft, CA, CFP, CLU, CH.F.C. and Deborah Kraft, CFP, CLU, CH.F.C.

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350 Bloor Street East, 2nd Floor, Toronto ON M4W 3W8
P:(416) 444-5251 or 1-800-563-5822 • F:(416) 444-8031
www.caifa.com • info@caifa.com

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