

COMMENT

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Spousal RRSP Remains A Valuable Tool

A spousal registered retirement savings plan (RRSP) continues to be an important financial planning tool for couples of all ages. Even though the federal government recently introduced pension splitting for couples, spousal RRSPs can still play an important role in planning for retirement. In general, spousal RRSPs may offer greater flexibility than the new pension splitting rules.

Pension splitting is intended to allow spouses or common-law partners to lower their combined tax liability. By shifting income from one spouse to the other, the couple could take advantage of marginal tax rates and tax credit/clawback thresholds to reduce the total tax payable on their combined income.

The pension splitting rules restrict the splitting of funds to a maximum of 50 per cent of eligible income, which may not be sufficient to fully balance the couple's total income equally between them. Secondly, the new rules depend on individuals having the right type of income at certain ages. Under the pension splitting rules, qualifying income from a pension plan can be split at any age, while income accumulated in an RRSP can only be split if the annuitant is age 65 or older. This different treatment places pension-splitting restrictions on those who accumulate income through an RRSP, such as a small business owner without a pension plan or an individual whose employer opts not to have a pension plan or who utilizes an RRSP in place of a pension plan.

Income from a spousal RRSP can be withdrawn at any age, which allows a couple to retain the ability to withdraw income using a balanced approach regardless of age. This type of flexibility can be important to a

business owner or employee who does not have a pension plan where the income can be split at any age. This also means that those wishing to retire early may be better off with a spousal RRSP in order to accomplish income splitting.

For younger couples, utilizing a spousal RRSP can mean that each spouse has an RRSP and each could take advantage of the Home Buyers' Plan. In this situation, each spouse would be entitled to withdraw up to \$20,000 from his or her RRSP in respect of the purchase of a home.

Another benefit of a spousal RRSP is that the income belongs to the spouse and counts as the spouse's income. Under the pension splitting rules, it is only the tax liability that is split, not ownership of the actual income. Therefore, split income would not count as a spouse's income for credit applications or in situations where a spouse required an independent source of income. It is important to distinguish the simple tax liability aspect from other planning needs or opportunities that can be achieved with a spousal RRSP.

Lastly, spousal RRSPs can be important in financial emergencies, in that income tax can be minimized if the lower income spouse withdraws money from an RRSP. The attribution rules need to be considered, however, when such withdrawals are made (see discussion below).

The rules and planning opportunities

- Subject to age limitations, every individual who has RRSP contribution room can make the contribution to his or her own RRSP or to an RRSP where the spouse is the named annuitant (a spousal RRSP). This creates an opportunity to better plan for

retirement by minimizing the total tax liability on their combined retirement income. It should be noted that amounts eligible for rollover into an RRSP cannot be rolled into a spousal RRSP (i.e., the eligible portion of retiring allowances, lump-sum rollovers from a pension plan, etc.).

- It is important to remember that the annuitant (i.e., the contributor under a regular RRSP or the spouse of the contributor under the spousal RRSP) must be age 71 or younger by December 31st of the year for which the contribution is made. This creates a planning opportunity for individuals older than age 71 who still have RRSP contribution room, either from carry-forward room or current earned income. While such an individual can no longer contribute into a regular RRSP on behalf of himself or herself, he or she is still eligible to contribute to a spousal RRSP if the spouse meets the age criteria as the annuitant. The income tax deduction for a contribution into a spousal RRSP is claimed by the contributor, not the spouse who is annuitant/owner of the plan.
- The term spouse includes legally married spouses as well as common-law partners. Common-law partners are two individuals (either opposite or same sex) who have lived in a conjugal relationship for at least 12 months or have a child together.
- Funds withdrawn from an RRSP are subject to income tax in the hands of the annuitant/owner. Under the attribution rules, however, the funds will be taxable in the hands of the contributing spouse if a withdrawal is made from the spousal RRSP if a contribution was made in that year or in either of the two preceding years. It does not matter from which spousal RRSP the withdrawal is made, it only matters when the last contribution to a spousal RRSP was made.

The federal government's new pension splitting rules are good news for those couples that do not have time to accumulate investments in a spousal RRSP or whose retirement income will be heavily dependent on pension income, and it allows flexibility in rebalancing taxable income between spouses on a year-to-year basis in retirement. However, the new rules should not be taken as a sign that a spousal RRSP is no longer necessary; indeed, a spousal RRSP remains a unique vehicle that offers a great deal of flexibility in managing a couple's after-tax retirement income.

I/R 5401.06

Lipson At The Supreme Court

An important decision for financial planning lies ahead following the October 25, 2007, decision by the Supreme Court of Canada to grant leave to appeal in the case of *Lipson v. The Queen*. This is important because leave to appeal is only given by the court if, in the opinion of a panel of three justices, the case involves a question of public importance or if it raises an important issue of law (or a combination of law and fact) that warrants consideration by the court.

The Lipson case involved the application of general anti-avoidance rules (GAAR) to a leveraged situation.

The facts of the Lipson case are as follows:

- Mrs. Lipson borrowed \$562,500 in order to buy some shares from her husband of his company. It should be noted that the loan (dated August 31, 1994) was made because the bank knew in advance that their position would soon be secured by a mortgage against the family home. (The home purchase closed on September 1, 1994, and there was a written agreement that Mr. Lipson would use the mortgage money he got on that date to retire Mrs. Lipson's debt.)
- In reporting the sale of his shares, Mr. Lipson relied on the deeming rules of the Income Tax Act so that his proceeds of disposition equalled his adjusted cost base. This meant that the recognition of the gain was deferred and he reported no capital gain on the disposition.
- Mr. Lipson used the proceeds from the sale of his shares to complete the purchase of a family home.
- A mortgage was taken on the family home (which was registered to both of them in joint tenancy) to repay the loan that Mrs. Lipson incurred in the process of buying the shares from Mr. Lipson pursuant to his covenant to the bank.

- Since Mrs. Lipson had used borrowed funds to buy income-producing property (i.e., the company shares), the associated interest expense would ordinarily be tax deductible by her against the dividend received on the purchased shares and her other income. However, because the shares had been transferred from Mr. Lipson for less than fair market value, the attribution rules applied and he therefore reported Mrs. Lipson's investment loss (i.e., excess of interest expense over dividend income from the shares) on his own tax return.

The Lipsons had structured their affairs so that each step fit within the provisions of the Income Tax Act, their objective being to deduct the interest expense on their mortgage, and in a way that the deduction could be taken by Mr. Lipson rather than by his wife. They were assessed based on GAAR and the net investment loss claimed by Mr. Lipson was denied. The Lipsons lost their case at the Tax Court of Canada and then again at the Federal Court of Appeal.

This is an important case because the ability to apply tax-effective structuring to one's affairs is at risk. If GAAR can apply to this situation, what other similar types of situations would also be caught and what other type of similar situations would be acceptable?

Consider the situation of two neighbours, A and B. A works very hard to pay off his mortgage and then borrows against the property to invest in a portfolio of stocks and bonds. B works very hard to accumulate an investment portfolio of stocks and bonds, then sells the portfolio, pays off his mortgage and subsequently borrows against the property to invest in a new portfolio of stocks and bonds.

The interest expense on A's mortgage should be tax deductible because his economic situation changed with the addition of a mortgage and an investment portfolio. But, what about neighbour B? His picture did not change; he started with a mortgage and investment portfolio and ended with a mortgage and investment portfolio. Should this make any difference in the issue of whether his interest is deductible?

The Supreme Court's decision in the Lipson case will be important because it has the ability to impact leveraged situations where an individual has acquired a tax-exempt asset (home, life insurance policy, etc.) and sought to deduct interest expense on a new loan acquired at about the same time. Set to be heard by the Supreme Court of Canada on April 23, 2008, the potential implications from a planning perspective are significant – the last word is yet to be heard.

I/R 2121.00

Where Does Your Money Really Go?

A new year, a new outlook – sometimes this is easier said than done, especially when it comes to financial matters. Debts and expenses don't instantly disappear just because the calendar turns the page; however, for some, the new year can be an ideal time to initiate alternative behaviours to help corral that nagging feeling of defeat and begin the journey to a more relaxed financial state.

Taking a hard look at one's monthly cash flow is a good place to start – what is truly an essential expense and what is discretionary in nature? The spectrum can be pretty wide, which creates the opportunity for simple lifestyle changes that can immediately help ease the financial pressure.

Telephone, cable television, Internet and cell phones can subtly eat up a large portion of cash flow that often can be managed downward simply by looking at the

packages for each service. To achieve instant savings, consider the following.

- Basic cable television packages run about half of the cost of the gourmet packages – do you really need all of those channels?
- Internet access has become a standard service in a growing number of homes – do you need the full service high-speed package? Would a lighter-type service at a lower cost suffice?
- Telephone expenses have skyrocketed because of the many add-ons that were not available in years past – would your life really change dramatically if you did not have caller identification, an automated answering service and the variety of other optional add-ons that quickly accumulate dollar-wise on your monthly phone bill? Try eliminating the add-ons and watch the savings add up.

- Cell phones – another service that has become a lifestyle essential and that can have good merit but, similar to your home land line, do you really need all the bells and whistles? You do not have to throw away the cell phone to save money; instead, try limiting the extra features and utilizing a basic service package – what are your true needs?

Managing cash flow does not have to mean completely eliminating entertainment. Instead, easy-to-implement behaviour changes can be a comfortable way to accumulate savings that can lead to increased discretionary cash flow.

- When you visit the movie theatre, skip the food counter, which can take a bigger bite out of your cash flow than the movie itself.
- Be cautious of the growing trend toward purchasing movies on cd or in dvd format – do you really need to purchase when renting might be a more economical option? Is owning a collection of movies essential? Alternatively, if you do purchase, consider sharing movies with other family units.
- Visits to the coffee shop can add up, but the expense can be easily managed without eliminating the visits altogether. Instead of the daily morning stop at the coffee shop, consider the possibility of pouring a coffee into a travel mug at home. When meeting a friend or on your work break – keep the drink of choice simple – coffee, tea or something basic can be more cost effective than the designer drinks that add to the waistline and thin out the pocket book.
- When dining out, try ice water (via the tap) as an alternative to other pricey beverages and skip the dessert. A change to dining behaviour can be an easy adaptation that saves cash flow, yet allows you to continue dining out.

Simple changes to shopping patterns can be another source of easily attainable expense reductions.

- Buying in larger-size portions can result in lower costs, but be sure that you really are achieving the value you think. Just because the item is larger, it does not always mean savings. Be sure to do the math – is the savings worth spending the extra today? And, remember there is a cost if you buy an item and you do not use it before its shelf life expires.
- The cost of ready-made dinners adds up quickly. Consider pre-planning your menu for the week and using dinner preparation as a time for family visiting and interaction. Decide the menu in advance, pre-assign responsibility for dinner preparation to specific family members, shop for the specific ingredients, stick to the plan and enjoy the opportunity for a new family interaction. Targeted shopping can save you substantial dollars.
- Avoiding costly beverages and bottled water will help manage the expense flow. If bottled water has become a lifestyle choice, consider purchasing it by the case and taking it from home when you leave for work rather than purchasing it as a single unit at the coffee shop or variety store.

While everyone chooses to spend their money differently, a more relaxed financial state can be easily achieved through simple changes in behaviour, most of which are unlikely to turn your lifestyle upside down. Why not give some a try and enjoy the new-found cash flow?

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Contributors to this issue of Comment:

James W. Kraft, CA, MTAX, TEP, CFP, CLU, CH.F.C.

Deborah Kraft, MTAX, TEP, CFP, CLU, CH.F.C.

Published by:

CLU Institute

**390 Queens Quay West, Suite 209,
Toronto, Ontario M5V 3A2**

T: 416.444.5251 or 1.800.563.5822

F: 416.444.8031

www.cluinstitute.ca • info@cluinstitute.ca

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