

COMMENT

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Low Interest Environment Creates Planning Opportunity

Worldwide economic conditions have had a pervasive impact on Canadians as a whole with the negative consequences constantly profiled through the media. In these trying times, it can be difficult to find bright lights, but an opportunity for income splitting lies within the current very low interest rate environment.

The Income Tax Act uses several interest rates throughout its provisions in order to calculate late charges, give interest credits, measure reasonableness or charge taxable benefits.

All of the interest rates referenced in the Income Tax Act share the same base interest rate, referred to as the prescribed interest rate. The prescribed interest rate is established each calendar quarter as the average rate (rounded to the next-higher whole percentage if the average is not a whole percentage) charged on 90-day Government of Canada Treasury Bills issued during the first month of the preceding quarter. Therefore, the prescribed rate is established at a time that is between two and five months before the relevant date.

On March 4, 2009, the Canada Revenue Agency (CRA) announced the prescribed rate applicable for the next quarter. For the second quarter of 2009, the prescribed interest rate will be one per cent.

The following chart details the prescribed interest rate over the last four years.

	1st Q	2nd Q	3rd Q	4th Q
2009	2%	1%		
2008	4%	4%	3%	3%
2007	5%	5%	5%	5%
2006	3%	4%	4%	5%

The rates in 2009 are at an all-time low and present planning opportunities that are even more attractive than in recent years.

The prescribed rate is used to determine whether or not an income-splitting arrangement between spouses is allowed under the Income Tax Act. Normally, one cannot transfer investment income to one's spouse for income tax purposes merely by transferring investments (or the funds to purchase them) to him or her, or by lending funds or investments to a spouse. However, one spouse can lend the other spouse capital to invest and the attribution rules will not apply to tax the income in the first spouse's hands provided the interest rate charged on the borrowed funds is at least the prescribed rate in effect when the loan was incurred and the interest amount owing is paid by no later than the 30th day following the end of the calendar year in each and every year the arrangement exists. (Note that the prescribed rate used to determine attribution is set at the time of the loan or transfer and will not change even if the prescribed rates change after that time.) Income splitting between

spouses could provide a financial benefit to the couple by lowering the overall tax liability within the family unit if the investment income exceeds the interest rate the transferee spouse pays on the loan. The loan agreement between the spouses should be documented in writing.

Other benefits also arise from the low interest rate environment.

The rate for the deemed interest on employee and shareholder loans is the prescribed rate noted above plus two per cent (i.e., in the second quarter of 2009, the rate will be three per cent).

The rate for overdue income tax payments, insufficient instalments, unremitted source deductions and unpaid penalties is the prescribed interest rate noted above plus four per cent. It should be noted that the interest paid in these cases is not tax-deductible.

If the federal government owes an amount to a taxpayer, the interest rate is the prescribed rate noted above plus two per cent. Note, however, that interest paid by the government is taxable to the receiving individual or company.

The prescribed interest rate can change every quarter and now may be the time to establish an income splitting arrangement between spouses at one per cent. While the rate may fall to a lower level, it is hard to imagine enough of a drop to make waiting worthwhile.

I/R 1101.00; 2500.13

Insuring Your Children

Putting life insurance policies in place on the lives of children can make a lot of financial sense for many families. The insurance protection can help provide coverage of funeral and burial costs (which can be a large burden for young families) and may also allow parents to take needed time off work to deal with the terrible adjustment period after the loss of a child. A juvenile policy is also valuable in ensuring that the children will have a certain level of insurance protection as they grow older, especially in the event that they later develop health concerns that make it difficult to obtain coverage at a reasonable cost or at any cost. In this regard, guaranteed insurability options under the policy may even allow the child to obtain additional coverage in the future without evidence of insurability.

In addition to the insurance protection provided by such policies, parents may want to use an insurance policy as a cash accumulation vehicle (which can provide a cash-value buildup for emergencies or other future uses, such as collateral for a loan), with the intention

of eventually passing this wealth on to the next generation.

The usual practice is to have the parent own the policy on the child's life and later transfer the policy to the child when the parent feels the child is ready to assume ownership of the policy and its related funding obligations.

The Income Tax Act allows a tax-free rollover of a life insurance policy (other than an annuity contract) from a parent to a child where a child is the life insured under the policy. If the rollover is not available, then the transfer of the policy can result in a taxable policy gain equal to the cash surrender value of the contract minus the policy's adjusted cost basis. The rollover is an important provision that allows a significant amount of flexibility but also carries some traps for the unwary.

- One of the opportunities available is that a grandparent can own and fund the life insurance policy and later transfer it to his or her grandchild.

- One of the traps in the provision is that the child has to be the only person insured under the policy. In the Canada Revenue Agency's opinion, multi-life coverage does not qualify for the tax-free rollover treatment.

While the above-noted strategy of the parent buying the policy and later transferring it to the child will work in many scenarios, this plan can be fraught with many issues depending on the unfolding circumstances of the family.

For example, if the parent passes away before transferring the policy to the child, access to the rollover provision could be lost because that provision does not allow for the tax-free transfer from the parent to the estate at death, and then eventually from the estate to the child. Planning could overcome this issue by naming the child as the successor owner under the contract, provided the child is of legal age and will be inclined to maintain the policy rather than cash it in. When a child is named as successor owner in this fashion, the parent is deemed to have transferred the policy at death to the child. However, the successor owner strategy will not work until the child has reached an age at which he or she is legally entitled to assume ownership and control of the policy on his or her own.

Even though the Income Tax Act provides for a tax-free rollover of the policy from parent to child, consideration should be given to the use of a trust to hold the policy, as owner, from the original time of purchase. The strategy of using a trust has several advantages, provided that the structure of the trust document is arranged appropriately. First, the trust can hold the policy as long as reasonable in the circumstances because the insurance policy is not subject to the deemed disposition of trust assets every 21 years. Second, the trust can hold the policy well beyond the life expectancy of a parent or grandparent, removing the issue of interim ownership. Third, under current tax law, the trust may be able to transfer the policy to the child (who would be the beneficiary of the trust) on a rollover basis when the time is right. Lastly, the trustee(s) could access

the values within the insurance policy for the benefit of the child and the child could be the recipient of an income allocation if any arises when the cash value of the policy is accessed. It is important to note, though, that such trusts require careful drafting by a legal professional, and consultation with a tax professional, to ensure that the trust's terms will allow the rollover to the child when the policy is transferred.

Juvenile policies are excellent tools that allow parents to help in lowering their children's long-term financial risk.

I/R 4200.00

Government Pension Plans: Benefits And Contributions For 2009

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, 2009, 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)	\$908.75	\$908.75	
Disability pension	\$1,105.99	\$1,105.99	
Disabled contributor's child benefit (each child)	*\$213.99	*\$67.95	
Survivor's*** pension			
• under age 65	**\$506.38	**\$765.18	
• age 65 or over	\$545.25	\$545.25	
Surviving child's benefit (each child)	*\$213.99	*\$67.95	
Death benefit (lump sum)	\$2,500.00	\$2,500.00	
Combined benefits			
• survivor's*** pension and disability (under age 65)	\$1,105.99	n/a	
• survivor's*** pension and retirement (age 65 and over)	\$908.75	\$908.75	
Annual CPP/QPP contribution			
Self-employed (9.9%)	\$4,237.20	\$4,237.20	
Employee (matched by employer) (4.95%)	\$2,118.60	\$2,118.60	
Old Age Security (OAS)			
January to March 2009			\$516.96
Guaranteed Income Supplement (GIS)			
January to March 2009			
• spouse/common-law partner receives OAS or Allowance			\$430.90
• single person (or spouse/common-law partner receives neither OAS nor Allowance)			\$652.51
Allowance			
January to March 2009			
• age 60 to 64 and spouse/common-law partner receives OAS and GIS			\$947.86
• age 60 to 64, survivor's*** Allowance			\$1,050.68
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

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