NAKAMUN
ADVISOR
AN INFORMATION SERVICE OF THE NAKAMUN FINANCIAL GROUP

SPRING 2013

By Garry Keiller,
The Nakamun Group,
Edmonton

FEDERAL BUDGET
HAS SOMETHING FOR EVERYONE

SHAUNA BLACKBURN-COOK
BCOM
shaunablackburn@nakamun.com

Canada is one of the few countries with a triple-A debt rating. While our debt, unlike many nations', is manageable, the priority of the 2013 Federal Budget is to eliminate the federal deficit by 2015/2016. Spending growth will increase by only 0.9 percent in 2013, the lowest rate of spending growth in 20 years.

"CANADA JOB GRANT"

A Budget priority is to encourage and support training and job creation. A new program called "Canada Job Grant" could provide $15,000 or more per person for training and skills development. The federal government will provide up to $5,000, and the hope is that the provinces and employers will match the amount.

"SUPER DONATION CREDIT"

A new, temporary "Super Donation Credit" is available to Canadians who have not claimed a charitable tax credit after 2007. Married or common-law couples are not eligible if either partner has claimed this tax credit since 2007, and only cash donations — not in-kind or property donations — qualify.

The "Super Donation Credit" provides an additional 25 percent federal tax credit on donations up to $1,000, which means 40 percent for donations of $200 or less, and 54 percent for donations over $200, up to $1,000.

MORE GST/HST EXEMPTIONS

The GST/HST exemption will be expanded to include publicly subsidized or funded personal care services to seniors and to those with disabilities requiring home care services, including bathing, feeding, and assistance with dressing and taking medication.

TARIFFS REMOVED FROM CERTAIN SPORTS EQUIPMENT

To encourage children's fitness, tariffs on certain sports and athletic equipment — excluding bicycles — imported into Canada are eliminated after March 31, 2013.

continued on page 2…

NAKAMUN GROUP
EMPLOYEE BENEFITS INC.
3263 Parsons Road, 2nd Fl.
Edmonton, AB
T6N 1B4
Phone (780) 469-6067
Fax (780) 469-6068
Toll Free 1-888-469-6068
www.nakamun.com

A MEMBER
OF THE NAKAMUN
FINANCIAL GROUP

VANCOUVER
EDMONTON
CALGARY
WINNIPEG

Independent Advisors in Retirement, Financial and Estate Planning, Employee Benefits and Corporate Insurance.

GOOD ADVICE | WELL GIVEN

…continued from page 1

HIGHER CAPITAL GAINS EXEMPTION

The Income Tax Act currently provides a lifetime capital gains exemption of up to $750,000 of capital gains realized on the sale of qualified property, a small business corporation, or farm and fishing property. The Budget proposes to raise the lifetime capital gains exemption limit on the sale of qualified property from $750,000 to $800,000, starting in the 2014 taxation year. Starting in 2015, the capital gains exemption amount will be indexed annually to inflation. The government proposes to apply this increase to all individuals, even those who have previously used the exemption.

PROPOSED ELIMINATION OF TAX LOOPHOLES

The government is focusing on eliminating tax loopholes and undue tax preferences, and cracking down on fraud.

- **Derivative Forward Agreements** — the federal government is proposing changes to prevent the use of financial arrangements involving derivatives contracts that allow for the conversion of ordinary income to capital gains. These financial arrangements have become popular with tax-conscious investors. The proposed changes, which will affect investments that promote the re-characterization of income to capital gains as a significant feature, could eliminate the advantage of these products. This measure will apply to derivative forward agreements with a duration of more than 180 days, and entered into on or after Budget Day, March 21, 2013 or with terms that extend to or beyond that date
- **"Stop International Tax Evasion Program" (SITEP)** — the government announced a new "bounty" program for Canada Revenue Agency (CRA) aimed at international tax cheats. CRA will pay up to 15 percent of the federal tax collected (not including penalties, interest, or provincial tax) to individuals who report significant international tax avoidance schemes that lead to at least $100,000 in tax assessments. Payment will be made after the taxes have been collected, and the "bounties" will be taxable
- **Changes for financial institutions** —
  - Beginning in 2015, financial firms may be required to report international electronic funds transfers of at least $10,000 to CRA, in addition to existing reporting required to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) under anti-money laundering rules
  - Possible elimination of the International Banking Centre (IBC) rules that exempt certain financial institutions from tax on income earned from non-residents through designated branches in Montreal and Vancouver
  - Credit unions may lose their preferential tax treatment with the proposed phase-out of additional deduction against certain income earned
- **"Unintended tax benefits" related to two leveraged life insurance arrangements:**
  - **10 – 8 strategies** — which involve investing in a life insurance policy and borrowing against that investment to create an annual interest-expense tax deduction for an extended period of time. If a life insurance policy or an investment account under the policy is used as security for a loan, and the interest rate on the investment account is set using the interest rate payable on the loan, or the maximum value of the investment account is set by reference to the loan, then the following income tax benefits are proposed to be denied:
    - deductibility of interest paid or payable on the loan that relates to a period after 2013
    - deductibility of a premium that is paid or payable under the policy that relates to a period after 2013
    - increase in the capital dividend account by the amount of the death benefit that becomes payable after 2013 under the policy and that is associated with the loan

In order to facilitate the termination of existing 10 – 8 arrangements before 2014, the Budget also proposes to alleviate the income tax consequences on a withdrawal from such policies when made to repay a borrowed amount under the arrangement, if the withdrawal is made on or after March 21, 2013 and before January 1, 2014

- **Leveraged insurance annuities (LIAs)** — defined by the Budget documents as "an investment product that is acquired with borrowed funds and provides fixed and guaranteed income to an investor until the death of an individual". Upon the insured individual's death, the capital invested is returned as a tax-free death benefit. Currently, these annuities allow a portion of the income earned on invested capital to be tax-free, and interest on the money used to purchase the annuity to be tax deductible, as is a portion of the invested capital. Under the proposed changes, the LIA policy will be subject to annual accrual-based taxation and will no longer qualify for a deduction on any portion of paid premiums. These changes will not apply to funds borrowed to purchase an LIA before March 21, 2013
- **Elimination of Labour-sponsored Venture Capital Corporations (LSVCC) tax credit** — in 2017. There will be no new federal registrations of LSVCCs. The tax credit will remain at 15 percent for 2013 and 2014, will drop to 10 percent for 2015, and then to 5 percent for 2016.

EXTENSION OF CRA REASSESSMENT PERIOD

The Budget proposes to extend the reassessment period to provide CRA with sufficient audit time in the following situations:

- When taxpayers participate in tax shelters where the promoter is late in filing its information return — currently, CRA has three years to reassess a return, regardless of whether the required information has been received from the promoter. That reassessment period will be extended to three years from the date when the tax shelter promoter complies with its filing requirements
- "Reportable" tax avoidance transactions — the reassessment period will be extended to three years from the time the required information return is filed

These measures will apply to tax years that end on or after March 21, 2013.

TESTAMENTARY TRUSTS

Testamentary trusts currently calculate tax using the graduated tax rates applicable to individuals, as opposed to inter vivos trusts, which pay federal taxes at the highest (29 percent) marginal rate. The government intends to review and possibly change the law to eliminate the tax benefits afforded to testamentary trusts.

SAFETY DEPOSIT BOXES

The costs of renting safety deposit boxes will no longer be tax deductible after the 2012 tax year.

HIGHER TAXES FOR NON-ELIGIBLE DIVIDENDS

The current gross-up/dividend tax credit system will be changed, resulting in higher taxes payable on non-eligible dividends.

FINANCIAL CONSUMER CODE

To better protect consumers of financial products and to ensure the necessary tools are available for consumers to make responsible financial decisions, the government proposes the development of a financial consumer code. Prior to streamlining legislation and regulations, the government will conduct consultations.

PREDATORY LENDING

The government will work with provincial authorities to ensure that predatory lending, including high-cost loans and payday lending, are effectively regulated.

ASSESSMENT OF TAX SHELTERS

Currently, CRA cannot take collection action in respect of assessed income taxes and related interest and penalties where a taxpayer has objected to the assessment of tax shelters, and in particular charitable tax shelters. Many charitable donation tax shelters have been challenged and shut down by CRA, but the process can take years in litigation, resulting in significant delays in collecting taxes from affected taxpayers. The Budget proposes to allow CRA to collect 50 percent of the disputed tax, interest, and penalties pending determination of the taxpayer's liability. This is intended to discourage participation in shady donation shelters and to ensure that the government is able to collect if it is successful in a dispute.

TFSA...

WHAT YOU DON'T KNOW COULD HURT

By Floyd Murphy, CFP, CLU, CHFC,
The Nakamun Group, Vancouver

Unlike any other government savings incentive program, the Tax Free Savings Account (TFSA), puts the onus on you to keep track of the amounts you contribute, withdraw, and replace. If you make a mistake or simply forget an amount along the way, the consequences could hurt. The TFSA rules are extremely strict and the penalties are severe.

The TFSA became available to Canadians in 2009, and as the years go by and the allowable contributions increase, the room for error expands, too, particularly if you open more than one account. If you withdraw funds from your TFSA and then replace some or all of the amount, the rules become even more complex and errors become a greater risk.

The most serious offence is to over-contribute. Even if you inadvertently contribute more than is allowed, Canada Revenue Agency (CRA) will penalize you one percent per month — that's a 12-percent-per-year penalty — on the over-contributed amount, starting from the month the deposit was made into your TFSA. By the time CRA discovers the problem, as many as 18 months could have elapsed, and if you've made more contributions in the meantime, the penalty could be significantly painful.

Since TFSA contributions are made with after-tax dollars, the only reporting to CRA is from TFSA account providers. If you have more than one TFSA account and are not keeping close track of your own transactions, the only way you will find out that you've over-contributed is the penalty bill from CRA.

THE SOLUTION

To avoid errors in TFSA contributions, withdrawals, and replacement of funds — and the resultant penalties — designate one financial advisor to coordinate all transactions. Your Nakamun Advisor is well positioned to do that for you, particularly if you already have a number of TFSA accounts at different financial institutions.

DID YOU KNOW?

Old Age Security (OAS) pension will be deferrable

Starting July 2013, those eligible for OAS pensions will be able to defer their benefits by up to five years past the age of eligibility. Until the eligibility age increases, the voluntary deferral of OAS pension will be available to individuals between the ages of 65 and 70. Check with Service Canada for details.

Employees between ages 65 and 70, receiving Canada Pension Plan (CPP) must complete the appropriate form to stop contributing

As of 2012, anyone between the ages of 65 and 70 who is still working and collecting CPP benefits, must continue to make CPP contributions, matched by the employer, unless the "Election to Stop Contributing to the Canada Pension Plan..." form is completed and provided to the Winnipeg Tax Centre and the employer. The requirement to continue making contributions remains in effect until the first day of the month following the date the form is received.

THE UNIVERSALLY DETESTED OAS CLAW BACK

By R.A. (Bob) Challis, CFP, RHU, TEP,
The Nakamun Group, Winnipeg

In our Winter 2012—2013 edition of *Nakamun Advisor*, we discussed certain financial advantages enjoyed by Canadian couples growing old together. Elements addressed included intrinsic economic values of Canada Pension Plan (CPP) and Old Age Security (OAS) benefit entitlements coupled with available personal, age, and pension tax credits. We illustrated the very real economic losses that impact the spouse who survives the other.

In addition to the loss of CPP and OAS income, and the income tax credits associated with the deceased spouse, the surviving spouse also faces the specter of having OAS income reduced by the universally detested OAS claw back calculations.

Simply put, any Canadian taxpayer whose taxable income exceeds $69,562 (2012 threshold) and who receives an OAS pension will be subject to the OAS claw back. The direct reduction in OAS benefit is 15 percent of the amount of taxable income in excess of $69,562. Once taxable income reaches $112,772 (2012) or more, the OAS benefit is completely clawed back.

WHEN ONE DIES

When one of a couple dies, the surviving spouse's income is reduced not only by the OAS formerly received by the deceased, but also by some or all of their own OAS if the claw back threshold is exceeded. Without the benefits of income splitting and double pension and age credits, the income being collected by the survivor alone is more likely to exceed the threshold than was the couple.

Example: A couple earning household taxable income of $112,772 will not lose any OAS.

If one dies, and the household's taxable income remains the same, the survivor's OAS will be clawed back 100 percent.

PLAN TO ELIMINATE OAS CLAW BACKS

Several financial planning strategies are available for higher-income households to reduce, defer, or eliminate the negative impact of the OAS claw back provisions. The common element of each of these strategies is to reduce the amount of reportable taxable income. The most common financial products designed for this purpose are:

- Prescribed Term Certain and/or Life Annuities (Joint)
- Tax Exempt Permanent Life Insurance
- Buy and Hold Equity-only Investments
- Corporate Class Investments

Less common, but perhaps even more effective techniques include:

- Testamentary Trusts
- Spousal Trusts
- Family Trusts
- Investment Corporations
- Inter-generationally owned holding companies

Each family's situation is unique, and the most advantageous solution or combination of solutions is well worth exploring. Spending time and effort now to plan around the OAS claw back can ensure the surviving spouse continues to receive full OAS benefits for life. Your Nakamun Advisor can help you identify and implement appropriate solutions.