



STRATEGY UPDATE

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Pension Splitting Opportunities for Retired Canadians by Kirk Polson



With the Royal Assent of Bill C-52, Canadians in receipt of “eligible pension income” were presented with the most significant tax planning opportunity to come their way in many years – pension “splitting”. This legislation has wide application for married or common law partners who have “eligible pension income”, regardless of their age.

There is the potential for a couple to realize significant tax savings in four areas:

- The ability to shift taxable income from one spouse to another who is in a lower tax bracket, thereby saving tax as a family unit.
- The reduction or elimination of the “clawback” (i.e. repayment) of Old Age Security (OAS) benefits. (Currently, where your 2007 net income exceeds \$63,511, you give back \$0.15 for every \$1 in excess of this, with full repayment at approximately \$102,900).
- The reduction or elimination of the “clawback” of the Age Amount Credit. (In 2006 the government announced a \$1,000 increase in the Age Credit available for Canadians who have attained age 65, from \$4,066 to \$5,066, increasing to \$5,177 in 2007. For each \$1 of income over the 2007 threshold of \$30,936, the Age Credit is reduced by \$0.15, with 100% clawed back at a net income of \$65,449).
- Both spouses can now take advantage of the \$2,000 Pension Credit whereas possibly only one may have been able to do so in the past.

Who Benefits?

Let’s take a look at who can benefit. To do this I’ll step back a bit and outline the differences between various amounts that qualify for the Pension Credit as this has a direct impact on how you can split income under the new rules.

For a number of years a non-refundable tax credit has been available for the first \$1,000 of pension income per individual. This has now been increased to \$2,000, thereby doubling the tax savings, plus giving you the opportunity to structure your affairs so that both spouses can claim the improved credit.

The income that qualifies for this credit depends on your age and is classified as either “pension income” (age 65 and over in the calendar year) or “qualified pension income” (under age 65 in the calendar year).

Canadians who are 65 and over have more potential sources of income that qualify for the pension credit, the most common a pension received from an employer pension plan. Other amounts that qualify include the following:

- Annuity payments from an RRSP or Deferred Profit Sharing Plan (DPSP).
- RRIF payments.
- The taxable portion of non-registered annuity payments, including prescribed annuities.

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For those of you under the age of 65, you are restricted to claiming "qualified pension income". This includes life annuity payments from an employer pension plan, as well as all other "pension income" amounts on the first list above as long as they are received as a consequence of the death of a spouse or common law partner. In addition, bridging benefits from a pension plan are considered life annuities and thus "qualified pension income".

Interestingly enough, life annuity payments from an employer pension plan are "qualified pension income". However, for those of you under age 65, an annuity, LIF, or LRIF from a LIRA ("locked-in retirement account"), the proceeds of which originated from an employer pension plan, does not qualify until age 65. So, if you are under age 65 and contemplating such a transfer, it will be important to take this into account in your income planning.

It's also worthwhile noting that, as in the past; OAS and CPP (Canada Pension Plan) benefits do not qualify for the Pension Credit. CPP benefits can still be "split" at source once both spouses are age 60. That is, both spouses or partners actually receive one-half of their total CPP benefits directly from the government on filing an application.

The Mechanics

To pension split, you and your spouse make a joint election on an annual basis in your income tax return. Up to 50% of eligible amounts can be allocated from the "pensioner" to the "pension transferee". This is pretty straightforward. Let's say you are 65 or over and have an employer pension of \$40,000 per annum plus RRIF income of \$10,000. Your "eligible pension income" is \$50,000 and you can choose to allocate up to 50% or \$25,000 to your spouse, regardless of his or her age.

Unlike the splitting of CPP benefits this is simply an allocation, and not a physical separation of the monthly income. The beauty of this is that you can look at your overall situation as a family unit on an annual basis and determine to what extent it is beneficial to split pension income. For example, let's say you have realized a capital gain in a particular year and your personal income is higher than usual. Assuming your spouse is in a lower tax bracket, it may make sense to allocate up to 50% of your eligible pension income to reduce your taxable income. Alternatively, this might be a good time to examine any stocks or mutual funds that you hold which have an accrued unrealized capital gain. Many Canadians are reluctant to sell "winners", thinking as we all do that "if it's gone up this much it has to go higher". Why not determine if it would make sense to trigger some accrued capital gains knowing that you have the ability to pension split when you file your 2007 income tax return.

Here are some other points that should be kept in mind:

Liability for taxes owing

As a couple you are considered jointly and severally liable for any increased taxes owing by the "pension transferee". So, if your spouse to whom you have allocated eligible pension income is not able to pay the tax owing on that additional income, you are liable on that amount (but not for other taxes owing).

Source deductions

Pension splitting will result in tax refunds. However, required deductions at source on, for example, employer pensions or RRIFs, will not be adjusted. Rather, one source has indicated that it "would appear that the taxes would be reallocated as part of the tax return filing process". This would avoid one spouse waiting for a tax refund, and the other spouse having to pay taxes.

Summary

Clearly, the new rules for pension splitting represent a terrific opportunity for married and common-law Canadians to review their income planning strategies and improve their after-tax cash flow needs. Many situations will be relatively simple, however from our discussion you can see that there will also be some scenarios where it's necessary to carefully examine both the timing and type of income required in order to take full advantage of this new opportunity to improve your cash flow.

Information contained in this article originated from a number of sources including my article in the February 2007 issue of Canadian MoneySaver magazine (www.canadianmoneysaver.ca), and "Pension Splitting: A New Planning Paradigm" (L. Koiv, Standard Life) published in the 2007, Volume 2 issue of the Conference for Advanced Life Underwriting's "Info Exchange" (www.calu.com).

AS A PROFESSIONAL....SHOULD YOU INCORPORATE?

By Allan Kalin, CFP



Incorporation can be an attractive option for professionals seeking tax saving opportunities. This article will offer some of the benefits and drawbacks of incorporation.

First things first: What is a corporation?

Simply put, it is a separate entity, separate from the individual, earning an income, paying salaries, and paying taxes...at a reduced rate.

Are you allowed to incorporate? Both the province in which one resides, as well as the regulatory body of each profession determines if a member of that profession can indeed incorporate, and what share structures can be put into place. For example in Ontario, while both doctors and dentists can arrange for family members to have shares in their corporation, accountants and lawyers are not given the same opportunity.

Incorporating offers three major benefits--tax deferral, income splitting, and tax savings—which are all related to the fact that a professional corporation pays tax at a preferential rate on active business income earned in Canada each year, up to a maximum of \$400,000.

Tax deferral on corporately retained earnings:

Professional income is active business income eligible for the small business deduction of \$400,000. As long as the money earned by the (incorporated) professional stays in the business, personal tax won't be due on the amount until it's paid out to shareholders (including the kids or spouse if allowed). Indeed, the money doesn't need to be paid out until it's advantageous to do so.

Income splitting:

As stated above, not all professions allow family members to hold non-voting shares. However, when allowed, a spouse or child over 18 years of age who is not active in the business can share a part of the professional corporation's after-tax income by receiving dividends on shares they own directly or indirectly. As dividend income is taxed less than employment income, this

strategy will provide more after-tax income for the family than if the professional personally earns all of the income.

Tax savings with cheaper non-deductibility:

Using the corporation to pay certain non-deductible expenses like insurance premiums, entertainment, and educational costs for children is beneficial since the cost of non-deductibility is less in the corporation because it pays a lower tax rate than the professional. The professional can also pay off debt faster inside the corporation, and the extra money left over which he (or she) didn't use to pay off the loan can now be used to accumulate retained earnings. Other benefits in this category can include the setting up of an Individual Pension Plan (IPP), a Retirement Compensation Arrangement (RCA) and some estate planning strategies which can significantly reduce probate taxes at death.

While the benefits of incorporation are many; what about the drawbacks. Here are a few to think about:

Start-up and annual costs are high. A lawyer is required to set up a professional corporation. In some situations, this can cost upwards of \$3,500. As well, the cost of moving existing assets into a corporation can run between \$5,000 and \$7,500.

Additional tax returns are needed, such as the T2 for corporate returns. An annual corporate financial statement must be filed which can cost up to \$2,500.

Although it is relatively easy to transfer cash into a corporation, it can be costly to move money out. The Income Tax Act allows most assets to be transferred into a newly formed corporation on a rollover basis. Removing assets can have significant income tax consequences.

So as a professional, should you incorporate? Why not sit down with your Financial Planner to review your particular situation, and if there is a consensus that incorporating your practice will indeed be beneficial, we will be happy to help you put this into place.

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Kirk Polson and Paul Bourbonniere Celebrate 10 Years of Partnership!



Congratulations to the team at Polson Bourbonniere Financial Planning Associates as they celebrate 10 years of partnership!

Kirk and Paul, the principals of PBFPA, joined forces in 1997 with a mutual objective: to build the best retirement planning firm in southern Ontario. What began with an exclusive retirement focus has now expanded to a multi-faceted wealth management approach.

With a hand-picked team of planners and a carefully selected network of strategic alliances, Kirk and Paul systematically built a best-in-class financial planning and investment advisory practice. In recruiting their team, Paul and Kirk looked for members who offered not just professional expertise, but who also shared common values and philosophies – those with a passion for helping clients achieve their financial dreams. Thanks to the combined expertise and commitment of the team, including a strong administrative infrastructure, Polson Bourbonniere clients are able to enjoy unique access to a full breadth of financial planning services.

But shared professional goals weren't all that brought Paul and Kirk together – fate was clearly at work, as well. Meeting regularly through industry associations and conferences over a fifteen year period, Paul and Kirk found that they had a lot in common. Not only did they both follow their fathers into the financial services industry, but both their dads also enjoyed long careers with Crown Life Insurance Company!

Kirk followed in his dad's footsteps, starting with Crown Life as a summer student during university. Graduating from York University in 1972, Kirk joined Crown full-time. Seven years in the Estate Planning department gave Kirk an excellent grounding in the business. His first stint in the field as a Branch Office Supervisor led to his move into personal practice. At that time, retirement planning was a largely unserved need and Kirk saw his future beckoning.

Kirk enjoyed the support of his wife, Sue, as he grew his business and the two kept extra-busy raising their three children, Cara, Terri and Derek. Cara is a new doctor, working her psychiatric residency through a rotation of Toronto hospitals; Terri makes her career in marketing as the Manager of the Calgary Home Show and Interior Design Show, and Derek is the latest member of the Polson Bourbonniere team. All three are now enjoying married life themselves, and Kirk and Sue are empty-nesters indulging their love of travel. Avid hikers, their next big trip is planned for the new year when they're headed to New Zealand.

Paul graduated from the University of Western Ontario, having specialized in Actuarial Science. Like his father, he embarked on a career in life insurance, first joining North American Life at the Toronto University management training branch. After a few years, Paul also headed into personal practice. During the 1980's, it was Paul's father who followed him – Ray Bourbonniere joined Paul's practice and continued to enjoy an active career well into his 80's.

Paul married his American Beauty, Sue Ann and was soon surrounded by ladies with the births of Jessica and Lisa. Jessica graduated from the co-op Business program at Laurier a year ago, following it up with a year in Germany. Lisa is attending university in South Carolina, on an equestrian scholarship, and is majoring in Public Relations. Time for hobbies once again with the absence of weekly horse shows, Paul rediscovered a love of running and completed his first Boston Marathon this year.

The last ten years have been full of challenge, fun and success for our two gentlemen and all signs indicate that the next ten years will provide more of the same. Ironically, although specialists in retirement planning, Paul and Kirk show no signs of wanting to hang it up. Like Paul's father before them, we see many long and successful years ahead for these two.



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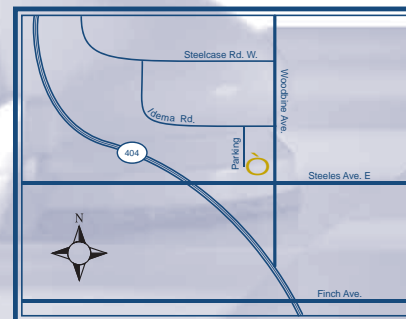
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