
NEW INCOME SPLITTING OPPORTUNITY

The federal government buried some good news in its announcement with respect to income trusts. Accompanying the proposals to tax income trusts was a new provision for income splitting for pensioners. This provision creates a new tax saving opportunity.

Income splitting is the ability to take one taxpayer's income and have another taxpayer report it and pay the associated income tax liability. The benefit of income splitting is being able to lower the overall tax liability of the family unit, thereby increasing the after-tax cash flow available for lifestyle expenditures. Since the choice to split income is left to the discretion of the taxpayer, it's a strategy that can only benefit the taxpayer.

The proposal will allow a Canadian resident taxpayer to allocate up to one-half of eligible pension income to his/her spouse (or common-law partner).

Eligible income that will qualify for income splitting is the same income that qualifies for the pension income credit:

- if you are 65 or older, eligible income includes lifetime annuity payments under a registered pension plan (RPP) or registered retirement savings

plan (RRSP); the taxable portion of a prescribed annuity; and payments from a registered retirement income fund (RRIF);

- if you are under age 65, eligible income includes only lifetime annuity payments under a RPP and certain other payments received as a consequence of the death of a spouse.

This means that pension income splitting will generally be limited to people age 65 and older as well as pensioners under pension plans.

"Common-law" partner is a defined term that means a person who cohabits with the taxpayer in a conjugal relationship and has done so for a continuous period of at least one year. The one-year timeframe need not be met if the common-law partner is the parent of a child of the taxpayer.

In terms of tax savings, the following chart highlights the after-tax cash flow advantage of income splitting.

One conclusion that can be derived from the following table is that there is a more significant advantage to income splitting the wider the disparity of income between the spouses.

	Before		After		Advantage
	Him	Her	Him	Her	
A Income	70,000	zero	35,000	35,000	
Taxes	14,573		5,016	5,016	4,541
As a %					31%
B Income	60,000	10,000	35,000	35,000	
Taxes	12,987	zero	5,016	5,016	2,955
As a %					23%
C Income	50,000	20,000	35,000	35,000	
Taxes	10,421	1,359	5,016	5,016	1,748
As a %					15%

Taxes payable based on an Ontario couple over the age of 65.

The government has offered seniors a significant opportunity to lower their taxes and increase their after-tax income through the utilization of this income splitting provision. Seniors and their advisors will have to be prepared to complete the appropriate paperwork to effect the strategy. In addition, be aware of strategies that can generate eligible pension income that can qualify for this new income splitting proposal.

These proposals were introduced to improve the fairness of taxation among retired couples with similar combined incomes. Fairness should also involve adjustments to the clawbacks of the age amount and of old age security payments. The government's announcement is, however, silent on whether the income allocation will be made before or after the calculation of these clawbacks.

I/R 2500.13

COMMON DISASTER

Death through a common disaster can be devastating for everyone involved – the loss of two people at once emotionally affects family, friends and associates. A common disaster can also be a test of any financial plan and therefore should be addressed as part of the planning process.

Without proper planning:

- estate settlement costs could double if one estate has to be settled first and then paid into the second estate, which would then have to be settled subsequently;
- beneficiaries could be disinherited if one estate was paid into the second estate and the second estate did not have the same alternative beneficiaries as the first.

Beneficiary designations

In general, the beneficiary receives the proceeds of a life insurance policy

upon the death of the life insured. Where there is no named beneficiary, or the named beneficiary has predeceased the life insured and there is no alternative beneficiary designated, the insurance proceeds would be paid to the owner of the contract. If the owner is the deceased person, the proceeds will be paid to his or her estate.

The Insurance Act provides that in situations where it is impossible to determine whether the beneficiary or the insured died first, the beneficiary is presumed to have died first. In these situations, the insurance proceeds would be paid to the alternative beneficiary, and failing an alternative beneficiary, the insurance proceeds would be paid to the owner of the life insurance contract.

It should be noted that if the courts can determine who passed away first, then the above provision of the Insurance Act will not apply and the general rule outlined in

the first paragraph above will dictate the flow of the life insurance proceeds.

One solution is to consider naming alternative beneficiaries for life insurance proceeds. The alternative beneficiary would be entitled to the life insurance proceeds should the first beneficiary predecease the life insured. If the alternative beneficiaries are minors, as is often the case, the beneficiary designation may appoint trustees to hold the proceeds on the children's behalf. Such a designation can be made in a separate declaration containing detailed trust provisions.

Will planning

Most provinces have survivorship legislation, which provides rules where two or more persons die at the same time or in circumstances rendering it uncertain as to which of them died first. Ontario, for example, states that each person's property will be disposed of as if he or she had survived the other. This means each estate would be settled onto the ultimate beneficiaries. This is very important because each spouse may have different secondary beneficiaries of his or her estate.

However, where it can be determined who passed away first, that individual's estate would be settled before the second individual's estate. This means that the first estate could be settled onto the

longer surviving spouse and his or her estate would then be settled onto the second spouse's ultimate beneficiaries. In such a situation, the estate settlement cost could be doubled and the alternative beneficiaries of one spouse may be disinherited if the other spouse had different alternative beneficiaries.

One solution is to add a common disaster clause to both wills. Such a clause would state that the beneficiary must survive the testator by 30 days in order to benefit from the estate. If the surviving spouse did not survive the 30-day period provided for in the common disaster clause, then the estate would be distributed to the first testator's alternative beneficiaries. It should be noted that such a clause does not contain the words "common disaster." The clause would apply to a death from any cause within the 30-day period.

Intestacy

A common disaster in an intestacy situation would mean that the provincial survivorship legislation would dictate how the estates would be settled. The solution is to prevent an intestacy by ensuring that the spouses each have an up-to-date valid will.

Planning has to consider many different potential risks. The risk of a common disaster should not be compounded by poor planning.

I/R 1200.00

UNIVERSAL CHILD CARE BENEFIT

The Universal Child Care Benefit (UCCB) came into effect on July 1, 2006. Beginning on July 20, 2006, eligible parents with children under the age of six began receiving \$100 per month per child. The recipient parent has unrestricted use of the money; it can be used to buy day care or babysitting services, food, clothing, etc. The government has put no restrictions on the use of the funds. Instead, the intention is to ensure that every family with young children

has resources available to help them in whatever way they choose.

Application

To be eligible to receive the UCCB, a person must meet all of the following criteria.

- The individual must live with the child and the child must be under the age of six. The benefit is payable until the month after that in which the child reaches his or her sixth birthday.

- The individual must be the person primarily responsible for the care and upbringing of the child. If there is a female parent who lives with the child, this parent will be considered to be this person. However, the person could be the father, grandparent or guardian. It should be noted that the recipient is not necessarily the person who is taxable on the benefit amount received.
- The individual must be a resident of Canada.
- The individual or spouse or common-law partner must be either a citizen of Canada, a permanent resident of Canada, a protected person (defined term) or a temporary resident of Canada for at least 18 months with a valid permit in the 19th month.

Eligibility

In most cases, the Canada Revenue Agency (CRA) already has the information needed to process payment of the UCCB and it uses this information to begin the payments. The CRA's information comes from the annual income tax return where parents would apply for the Canada

Child Tax Benefit (CCTB). Even if the family income was too high to collect the CCTB, the CRA will be able to use the information to pay the UCCB.

If an eligible individual has not yet received the first UCCB cheques, which should have been mailed in July 2006, then CRA form RC66 should be submitted.

As with most government benefits, the funds can be deposited directly into the parent's bank account rather than having a cheque mailed monthly. This improves security, convenience and reliability.

Taxation

The UCCB is taxable. Where the recipient is single, that person is taxable on the receipt. In married or common-law relationships, the person with the lower income must report the UCCB benefit.

The UCCB is part of a package of programs delivered to parents through the income tax system. Other programs include the child care deduction, child disability benefit, child tax benefit and the Goods and Service Tax (GST) credit.

I/R 3201.00

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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
350 Bloor Street East, 2nd Floor,
Toronto, Ontario M4W 3W8
T: 416.444.5251 or 1.800.563.5822
F: 416.444.8031

www.cluinstitute.ca • info@cluinstitute.ca

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Publication Agreement # 40069004