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COMMENT

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INSURANCE TRUST

Sometimes in creating an estate plan the topic of an insurance trust arises. But, what is really meant by an insurance trust? What objectives does such a trust accomplish? How is such a trust taxed?

The most common definition of an insurance trust is a trust established by a testator's will and funded from a life insurance policy on the life of the testator.

- The testator's will, or a separate trust declaration, would include all of the instructions necessary for the establishment of a trust. The "three certainties" that prove the existence of a trust must be present: (1) certainty as to intent to establish a trust; (2) certainty as to subject matter (i.e., the property to be placed in the trust); and (3) certainty of objects (i.e., the beneficiaries of the trust). Also included would be the names of the trustees who are to be responsible for carrying out the provisions of the trust. If these provisions are included in the individual's will, clear wording should be used to distinguish the insurance trust from other trusts established in the will. This will ensure that the trust does not form part of the estate for probate and creditor protection purposes, as discussed below.

- The testator would name the trustees of the insurance trust and, in their capacity as trustees, designate them as beneficiaries of the life insurance policy on his/her life. Upon the death of the life insured, the proceeds of life insurance would be paid to the trustees for the trust. The beneficiary designation is extremely important because there must be full co-ordination between the trust document and the life insurance policy.

The primary reason for using an insurance trust is to control the distribution of insurance monies, whether to a spouse, adult children or minor children. A trust gives the testator the ability to give the trustee the insurance money to manage; to give certain investment powers; and to control the long-term distribution of the trust funds whether over time to the named beneficiary or to a remainder beneficiary after the interest of an income beneficiary has expired.

A secondary reason for such a strategy is that insurance monies are paid by way of a beneficiary designation to the trust and do not pass through the estate. This provides creditor protection and ensures the avoidance of probate fees levied by several provinces. In addition, if the trust was created through a separate trust deed rather than the will, this ensures the privacy of the testator because the insurance money is not passed through the probated estate and its public documentation.

From a tax point of view, the insurance trust will be a testamentary trust (as contrasted with an inter vivos trust). This means that trust will be taxed at graduated marginal rates as opposed to the top marginal tax rate. The insurance trust is a testamentary trust because the trust is settled upon the death of the testator (i.e., the trust cannot have been settled during the insured

person's lifetime). This would be the case even if the testator drafted a trust deed during lifetime and funded the trust from the proceeds of a life insurance policy at the time of death.

An insurance trust could be the ideal strategy to use life insurance to create capital for beneficiaries where the need for long-term control is still present. It is also a good solution for supporting minor children.

I/R 8001.04

TRANSIT PASS TAX CREDIT

In its 2006 budget, the federal government introduced a tax credit for public transit passes. This credit became available as of July 1, 2006, which means that it can be claimed when taxpayers file their tax returns for 2006.

The tax credit is part of the government's plan to discourage automobile commutes and reduce inner city traffic congestion and the resulting harmful emissions.

Similar to other tax credits, the new transit pass tax credit is non-refundable and is based on 15.25 per cent (2006 lowest federal tax rate, increasing to 15.5 per cent for 2007) of the cost of transit passes.

The transit pass has to be for a period of at least one month. Weekly passes or 10-pay passes are not eligible for the credit.

The transit pass can be for any service, such as buses, commuter trains, subways or local ferries.

In order to support a claim for the new transit pass credit, taxpayers should keep the expired transit pass. The transit pass should clearly indicate that it is for a period of one month (or longer), the dates for which the pass is valid, the name of the transit authority, the amount paid and the identity of the rider. If the expired transit pass does not contain all of this information, the taxpayer should keep any receipts for the purchase of such passes.

The taxpayer can claim the new transit pass credit for him or herself; as well, the taxpayer can claim the credit for his/her spouse or common-law partner and any children who are under the age of 19.

It should be noted that the transit pass credit is available for 2006 but only for expenses incurred for transit travel from July 1st to Dec. 31st of that year. It will not matter when the transit pass was purchased, only that it was for travel between those dates.

As in anything new, the taxpayer and his/her planner must collect and keep enough information to support a claim.

I/R 7401.00

CHILDREN'S FITNESS TAX CREDIT

In recognition of several research and media reports, the federal government wants to encourage parents to keep their children active. To achieve this policy objective, the federal government is using the tax system to provide encouragement by way of a non-refundable tax credit that, in essence, refunds a portion of the expense of qualifying children's programs.

The federal government introduced this new children's fitness tax credit as of January 1, 2007. While an individual taxpayer will not receive any benefit from this new credit until filing a 2007 income tax return, understanding the credit and careful planning during 2007 will help to set the stage to ensure an opportunity for potential tax relief is not inadvertently missed.

Similar to other credits, the federal government (and provincial governments that opt to match the federal government's provisions) will offer a new tax credit equal to the lowest tax bracket rate (15.5 per cent in 2007) times the eligible expense up to a prescribed maximum. In this case, the maximum prescribed amount will be $500 paid for qualifying activities in respect of each qualifying child.

The Canada Revenue Agency (CRA) is working with organizations that provide physical fitness programs to determine which programs have sufficient physical activity to be eligible for the tax credit. The CRA's recent news release described the type of program that would qualify as follows:

An ongoing, supervised program, suitable for children, in which substantially all of the activities undertaken include a significant amount of physical activity that contributes to cardio-respiratory endurance, plus one or more of: (1) muscular strength, (2) muscular endurance, (3) flexibility or (4) balance.

To be eligible, the child must be less than age 16 at any time in the year. This means that in the year that the child turns 17, expenses will still qualify for the tax credit. In the year the child turns age 18, however, the child will no longer qualify.

If the program fee includes accommodation, travel, food or beverage costs, then the provider must deduct those amounts in calculating the fee that qualifies for the tax credit.

If the program is for a family, then the portion relating to the child will be eligible for the tax credit.

Lastly, the amounts must be paid in 2007 to be claimed for the 2007 tax credit. If a program was paid for in 2006 but only began in 2007, no portion of the expense will qualify for the tax credit.

In order to claim this new credit, the parents should gather together the necessary receipts, which should contain all of the following information:

- the organization's name and address;
- the name of the program or activity;
- the total amount paid and the amount that is eligible;
- the full name of the payer (usually the parent);
- the name of the child participating as well as the year of birth; and
- an authorized signature for manual receipts.

The children's fitness tax credit is a brand-new credit that is still being defined. It is incumbent on the parent to keep track of receipts, program details and any other material that may be needed to substantiate a claim. Information about how to claim the tax credit will be included in the *General Income Tax and Benefit Guide* – 2007.

I/R 7401.00

MEDICAL EXPENSE TAX CREDIT

Medical expenses can create a valuable tax credit that might be lost unless care is taken to observe and carefully track the medical expenditures.

The claim for medical expenses takes the form of a tax credit. The credit is equal to the lowest tax bracket rate (15.25 per cent in 2006 and 15.5 per cent in 2007), multiplied by the sum of all of the medical expenses paid during any 12-month period ending in the tax year, but only to the extent that such amount exceeds the lesser of $1,813 and three per cent of the individual's net income. It should be noted that the federal government and most of the provincial governments calculate the tax credit separately and deduct it from taxes owing.

Example:

Net income	$60,000
Medical expenses	$2,200
Lesser of $1,813 and 3% of net income	1,800
Excess of medical expenses	$400
Federal and provincial tax credits at lowest tax bracket rate (assumed 20%)	$80

The medical expenses must be in relation to the taxpayer, the taxpayer's spouse or common-law partner or a child of the taxpayer (or a child of the taxpayer's spouse or common-law partner) who is under the age of 18 at the end of the taxation year and dependent upon the taxpayer for support. This allows one spouse to claim the medical expenses of the entire family and therefore maximize the value of the medical expense tax credit.

As noted in the first example, the claim for medical expenses is for any 12-month period ending in the taxation year. This allows taxpayers an opportunity to maximize their claims by grouping any medical expenses incurred within that period.

Example:

Medical expenses paid in June 2005	$1,500
Medical expenses paid in Dec. 2005	100
Medical expenses paid in May 2006	200
Medical expenses paid in Nov. 2006	1,000

In the previous example, the taxpayer should claim medical expenses paid in the 12-month period ended May 2006, which would allow the $1,500 medical expense paid in June 2005 to be claimed on the 2006 tax return. The remaining $1,000 amount from November 2006 remains available for use the following year depending upon the 12-month period selected at that time (which would be chosen with the objective of maximizing the total amount claimed).

The medical expenses eligible for the tax credit claim can be increased by the medical expenses of an older dependent child, grandchild, parent or grandparent. Dependency is based on the individual's need for support from the taxpayer. The inclusion is the lesser of $10,000 and the dependant's medical expenses in excess of three per cent of that dependant's net income (to a maximum of $1,813).

In a recent letter, the Canada Revenue Agency confirmed that when four adult siblings each paid $15,000 towards the nursing care of their mother, each of the siblings could claim $10,000 in his or her claim for a tax credit

The Income Tax Act contains a long list of eligible medical expenses and includes amounts paid to a medical practitioner, dentist or nurse or a public or licensed private hospital. In addition, amounts paid for one full-time attendant or other amounts paid for care at a group home or nursing facility may be eligible expenses. The complete list is very long and should be referenced to identify more obscure items that are eligible for the tax credit claim.

Every facet of tax planning requires attention to the details and the claim for medical expenses is no exception. The credit saves tax dollars and this allows an individual to recover some of the expenses incurred for medical treatment.

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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, Ste. 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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