

COMMENT

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Taxation Of Dividends

Changes to the federal Income Tax Act in 2006 introduced “eligible dividends” to re-level the playing field that was severely tilted by income trusts. Income trusts were designed to pay out business profits on a pre-tax basis to investors without any corporate taxation reducing the return. The investor would claim the income distributed and pay income taxes at his or her marginal rate, which generally resulted in an overall lower level of taxation and an overall greater level of after-tax income.

The introduction of eligible dividends changed the dividend gross-up and credit system in a manner designed to make the investor indifferent as to how he or she received the return on investment (i.e., directly via an income trust or indirectly via dividends).

The dividend gross-up and credit system is designed to recognize the amount of corporate tax already paid on the corporate income being distributed as a dividend and gives the shareholder a credit for the corporate tax paid. However, over time, the gross-up and credit system goes out of balance with respect to the level of corporate taxation.

Eligible dividends were introduced to level the playing field in public company investing, but the playing field is being dramatically altered with the planned reduction of corporate income tax rates over the next four years.

As corporate tax rates are reduced, the dividend gross-up for eligible dividends and accompanying dividend tax credit will also have to be reduced to maintain a balance in the system. The following table lists key information about planned changes to federal corporate income tax rates and the gross-up and related dividend tax credit on eligible dividends.

	2008	2009	2010	2011	2012
Top federal corporate tax rate on active business income above the small business deduction limit	19%	19%	18%	16.5%	15%
Dividend gross-up on eligible dividends	45%	45%	44%	41%	38%
Federal dividend tax credit:					
• proportion of the gross-up amount	11/18	11/18	10/17	13/23	6/11
• percentage of the base dividend	27.50%	27.50%	25.88%	23.17%	20.73%
• percentage of the grossed up dividend	18.97%	18.97%	17.97%	16.44%	15.02%
Effective top federal rate on eligible dividends	14.55%	14.55%	15.88%	17.72%	19.29%

The table highlights the federal government’s planned decrease in corporate tax rates and its adjustments to the gross-up and dividend credit systems. However, the last line of the chart highlights the fact that personal taxation on eligible dividends is projected to increase over time. In addition to the federal figures in the table noted above, the provincial tax authorities will also be making adjustments to their dividend tax credit systems.

The bottom line is that the eligible dividend system will remain in a state of flux and that regular adjustments are needed to meet the purpose of the gross-up and dividend tax credit mechanism.

I/R 7401.00

Planning Considerations For Students

Every year, parents across the country send their children off to university and college in search of higher education. Sometimes the student will be far away from home, sometimes the student may be close to home but living separately and sometimes the student will live at home while attending school locally.

Whenever a student heads off to school, there is a wide range of things to consider. The following is a checklist of some of the more common financial concerns impacting post-secondary students:

Property and Casualty Insurance

Does your home insurance coverage extend to your child's school residence or other housing arrangement? Does your home insurance cover the student's possessions as well as damage to a neighbour's property caused by negligence or perhaps an inadvertent mishap? Have you discussed this with your insurance broker or insurance company with details specific to your set of circumstances?

Health & Dental Coverage

Does your group benefit plan at work cover your child? Do you have to contact your human resource area to update or inform them that you have an over-age dependant who is attending school on a full-time basis? If you have coverage, does your child want to opt out of the school plan? If you have coverage and the student also takes coverage under a school plan, there is the ability to co-ordinate benefits under the two plans – have you provided the student with the information needed when visiting the dentist and/or pharmacist?

Car Insurance

If your child drives a car while at school, has his or her risk changed? Should you have a discussion with your broker to ensure that you have complete and full disclosure of the student's situation?

Moving Expenses

Will your student's moving expenses be tax deductible? If so, take the time to gather the receipts now so that you will be able to find them at tax filing time.

Tuition, Education and Textbook Tax Credits

Students may be eligible to claim the tuition, education and textbook tax credits. These amounts can be claimed by the student in the year of study and unclaimed amounts may be carried over to another year or transferred to a parent or grandparent. Ensure your child knows about these credits and sets aside the appropriate documentation for tax time.

Access to Cash

Does your child have sufficient cash reserves to carry him or her through the full school year? Parents often feel a tap on the shoulder for additional money throughout the year. An option that can make it easy to assist the student financially is a joint bank account with one or both of the parents. A parent might have sufficient rating at the bank such that when he or she makes a deposit into the joint account, the bank will not impose any holds on the funds. This can allow the student to access the funds without delay and without incurring extra charges.

Establishing a Credit History

Does your child have a credit card? If not, it can be wise for the child to apply for a student credit card as it will start the process of building a credit history. With a credit card in hand, responsibility for making the regular payments becomes important to maintaining a good credit rating. Do you need to monitor that the bill gets paid on time, at least until you are confident that this task is well in hand? It is important to ensure that your child's bills are paid on time because of the potential interest and late charges as well as the detrimental effect on the student's credit record.

☑ Financial Responsibility

Will your child be liable for utilities at his or her place of residence? Similar to a credit card, you need to determine if monitoring the necessary payments may be helpful initially to ensure good financial responsibility.

Some, or all, of the above list may apply to your student's situation and it is important to determine which of the issues you feel needs to be addressed. Once you have considered the issues and your priorities, it is relatively easy to help get your student off on a good financial footing and aid in their financial education.

I/R 2300.00

Refund Of Premiums

The Canada Revenue Agency (CRA) was asked to comment on the income tax consequences of a return of premium rider on a life insurance policy. The particular policy under analysis had two benefits: first, a life insurance component that would pay a benefit upon the death of the life insured and, second, a return of premiums if death had not occurred during the term of the life insurance policy contract.

It should be noted that this opinion from the CRA was in respect of a life insurance policy. At the time of writing, the Canada Revenue Agency still does not have an official position on the refund of premiums of a critical illness policy.

I/R 7401.00, 4400.00

It was the CRA's view that the benefit received at the end of the policy duration would be considered proceeds of disposition. The policyholder would have to recognize a policy gain to the extent that the proceeds of disposition exceed his or her adjusted cost basis in the contract.

A Look At Canadian Spending And Income Patterns

The old adage, that death and taxes are the only certainties in life, continues to hold true for many Canadians as Statistics Canada has reported that Canadian households spent on average 21 per cent of their budget in 2007 on personal taxes. The three other necessities in life – shelter, transportation and food – accounted for an additional 20 per cent, 13 per cent and 10 per cent respectively (based on a survey of more than 21,000 households).

Charitable donations in 2007 totalled \$8.6 billion, with 5.7 million tax filers having made donations. The median donation was \$250.

When looking at family budgets and undertaking financial planning exercises, it is important to ensure an adequate reflection of true spending needs – historical patterns are not always good indicators of the future.

I/R 6851.00

Looking at Canadian spending patterns in 2007, it is interesting to note obvious changes through time. For example, 71 per cent of Canadian households reported owning a cellphone with an average annual household cost of \$770. Sixty-one per cent of households indicated they had a high-speed Internet connection, while only nine per cent had a dial-up connection. Household spending on Internet connections averaged \$430.

The median contribution to an RRSP in 2007 was \$2,780, with 6.3 million tax filers making some type of RRSP contribution for a total value of \$34.1 billion.



There's an **EVOLUTION** of public expectations underway. Increasing consumer demands on the financial services industry and the need for improved financial literacy among the public suggest we're coming to a point of convergence.

At the same time, we're seeing signs of a **REVOLUTION** in regulation. Distribution models are changing and momentum is growing for a single securities regulator. The result will be new roles, responsibilities and regulations for advisors and other intermediaries.

**Who will benefit from these changes?
Who will lose out?**

Find out November 26, 2009.

Early bird pricing starts November 2	Breakfast & Lunch
\$200 + GST members \$250 + GST non-members Regular pricing in effect Nov. 3-25 \$250 + GST members \$295 + GST non-members	

The Future of Financial Services Distribution in Canada

An Advocis Symposium

Speakers include:

Donald A. Stewart, CEO, Sun Life Financial Inc. & Chair, Task Force on Financial Literacy on the importance of financial literacy in Canada.

Larry Ritchie, Executive Vice President and Senior Policy Advisor, Transition Office, Canadian Securities Regulator on moving towards a national securities regulator.

The Hon. John Wilkinson, Ontario Minister of Revenue, on Ontario's comprehensive tax package.

Paul Mahon, President & Chief Operating Officer, Canada, Great-West Life / London Life / Canada Life, on the impact of global trends on Canadian financial service providers.

To register or find out more, visit www.advocis.ca/ARAsymposium.

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