

# Income Tax Update and Year End Tax Planning

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# Topics for Discussion

- Tax Brackets – 2010 vs. 2011
- Tax Loss Selling
- Tax Effective Gifting to Charities
- Income Splitting with Family Members
- Interest Deductibility
- Extracting Tax Free Cash Using Life Insurance
- Probate Planning

# Tax Brackets and Rates – 2010

| Federal Personal Tax Brackets |                      |
|-------------------------------|----------------------|
|                               | \$0 - \$40,970       |
|                               | \$40,971 - \$81,941  |
|                               | \$81,942 - \$127,021 |
|                               | \$127,022 and over   |

| Top marginal tax rates for 2010 |        |
|---------------------------------|--------|
| Salary/wages/interest income    | 46.41% |
| Eligible dividends              | 26.57% |
| Non-eligible dividends          | 32.57% |
| Capital gains                   | 23.21% |

# Tax Brackets and Rates – 2011 (Anticipated)

| Federal Personal Tax Brackets |
|-------------------------------|
| \$0 - \$41,544                |
| \$41,545 - \$83,088           |
| \$83,089 - \$128,800          |
| \$128,801 and over            |

| Top marginal tax rates for 2011 |        |
|---------------------------------|--------|
| Salary/wages/interest income    | 46.41% |
| Eligible dividends              | 28.19% |
| Non-eligible dividends          | 32.57% |
| Capital gains                   | 23.21% |

# Tax Loss Selling



# Tax Loss Selling

Is this strategy for you?

- Have you had capital gains in the last three years?
- What tax bracket were you in?
- Do you expect to be in a higher bracket in the future?

# Tax Loss Selling - Points of Interest

## Superficial Losses

- Selling and then buying back an identical investment within 30 days will disallow the loss realized on the initial sale and add the loss to the cost base of the reinvestment

## Do you have a loss?

- A loss occurs when you sell an asset for less than you purchased it for
- Even if the value of the investment has dropped substantially, it is your original cost which matters

## For foreign securities, watch exchange rates

- Losses may be larger, smaller or may actually be a gain

# Tax Effective Gifting to Charities



# Minimize Tax While Maximizing Charitable Gift

## Tax Benefit / Background

- Previously, donations of securities with accrued gains would trigger a reduced capital gains tax but new rules enacted in 2008 allow you to support your favourite charity without triggering tax on the inherent gain
- Requires a direct donation of qualifying securities as opposed to selling securities and donating cash
- Only certain stocks, bonds, mutual funds, warrants and some derivatives qualify for this special tax treatment

# Comparison – Gifting Securities and Gifting Cash Proceeds

## Assumptions:

|  |          |
|--|----------|
| FMV of Securities                                      | \$10,000 |
| Tax Cost of Securities                                 | \$ 4,000 |
| Accumulated Gain                                       | \$ 6,000 |
| Estimated Capital Gains Tax @ 23.21%                   | \$ 1,392 |
| Top rate individual Ontario resident @ 46.41% tax rate |          |

|                             | Gifting cash proceeds from sale of securities | Gifting securities directly |
|-----------------------------|---|-----------------------------|
| Amount of Donation          | \$10,000                                      | \$10,000                    |
| Donation Tax Credit         | (\$ 4,641)                                    | (\$ 4,641)                  |
| Tax on Capital Gain         | \$ 1,392                                      | \$ 0                        |
| <b>Net Cost of Donation</b> | <b>\$ 6,751</b>                               | <b>\$ 5,359</b>             |

# Minimize Tax While Maximizing Charitable Gift Using Flow Through Securities

## Facts

- Tax deduction to individual of \$20,000
- Inherent capital gain of \$20,000 on security due to mechanism allowing full deduction of purchase price (FMV ~ \$20,000, ACB \$Nil)
- Taxable capital gain is nil if donated to registered charity (end of two year period)
- Top rate individual – Ontario resident

## Cost of Donation

|                                       |                 |
|---------------------------------------|-----------------|
| Cash Cost of Acquiring Security       | \$ 20,000       |
| Tax Savings on Flow through Deduction | ( 9,200)        |
| Tax Savings on Donation at FMV        | <u>( 9,200)</u> |
| Net Cost of Donation                  | <u>\$ 1,600</u> |

# Inter-Spousal Income Splitting Through Prescribed Rate Loan Planning



# Prescribed Rate Planning

- A prescribed rate loan plan effectively allows investment income to be earned by the lower income spouse thereby reducing the aggregate income tax paid by the family
- The higher income spouse loans the lower income spouse money for purposes of earning future investment income
- The interest on this loan needs to be at least at the prescribed rate set by the Canada Revenue Agency
- This rate is at a historical low of 1%
- The rate is set at the time the loan is made (i.e. no need to adjust rate thereafter)

# Prescribed Rate Planning

## Example

- On January 1, 2010, taxpayer loans spouse \$100,000
- Spouse invests the money and earns \$5,000 during the year
- In order to avoid attribution, interest would have to be charged at the prescribed rate for income tax purposes at the time of loan (currently 1%)
- Spouse pays taxpayer \$1,000 in interest which can be deducted as interest expense
- Taxpayer must include \$1,000 as interest income in the year
- Resulting tax savings assuming spouse is in the low tax bracket is approximately \$1,000

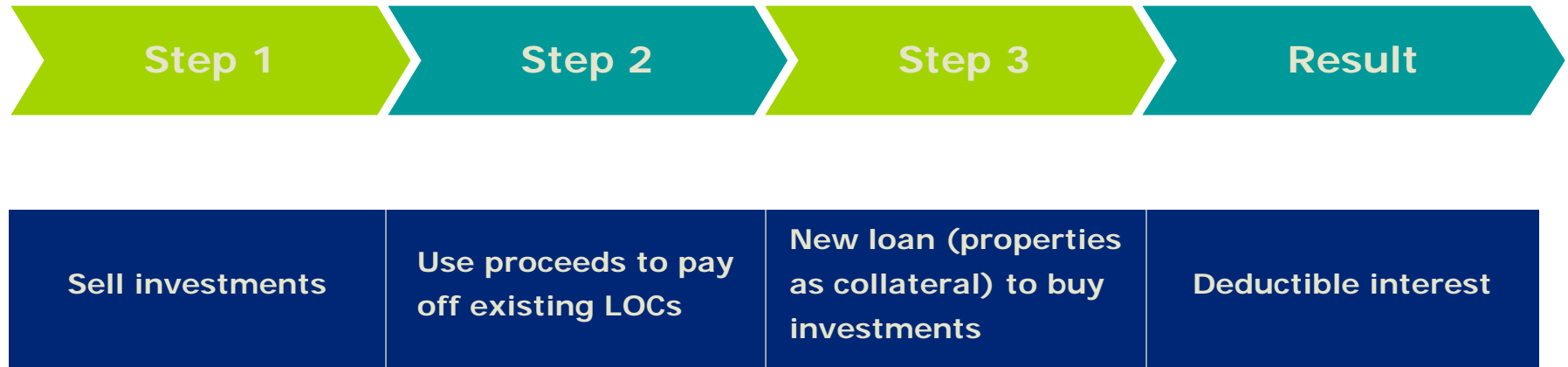
# Interest Deductibility



# Interest Deductibility

- Current: Interest paid on mortgages / lines of credit not deductible
- Plan: Save 46.41% in taxes on interest expense
- Example

# Interest Deductibility



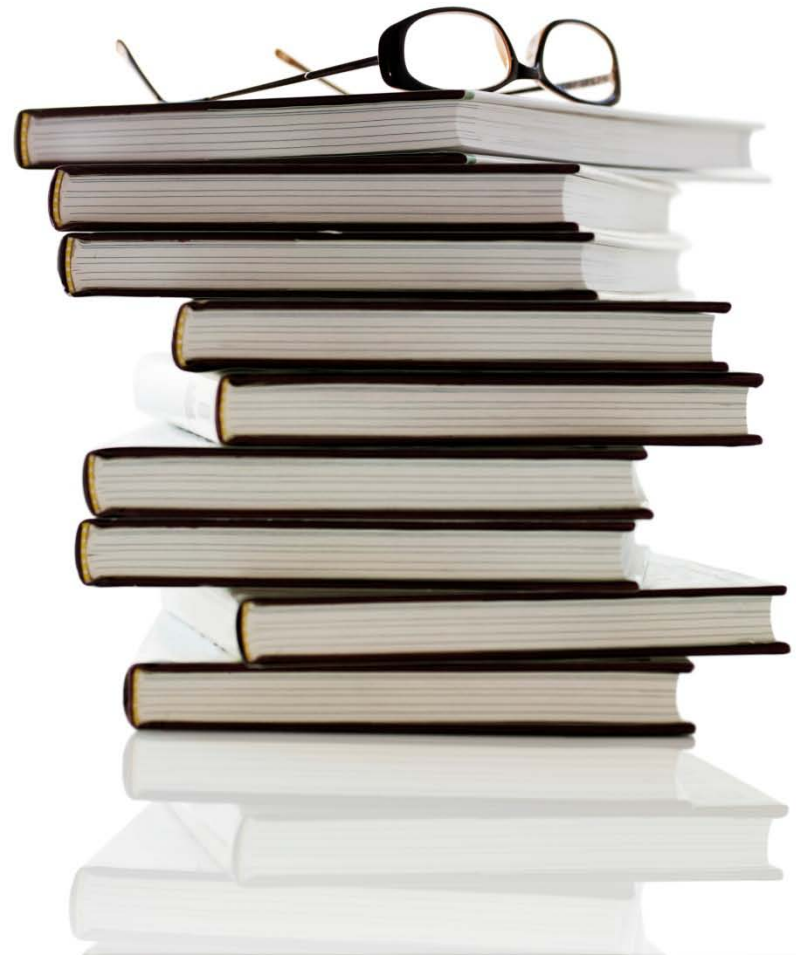
# Interest Deductibility

➤ Example: \$20,000 interest paid on LOCs

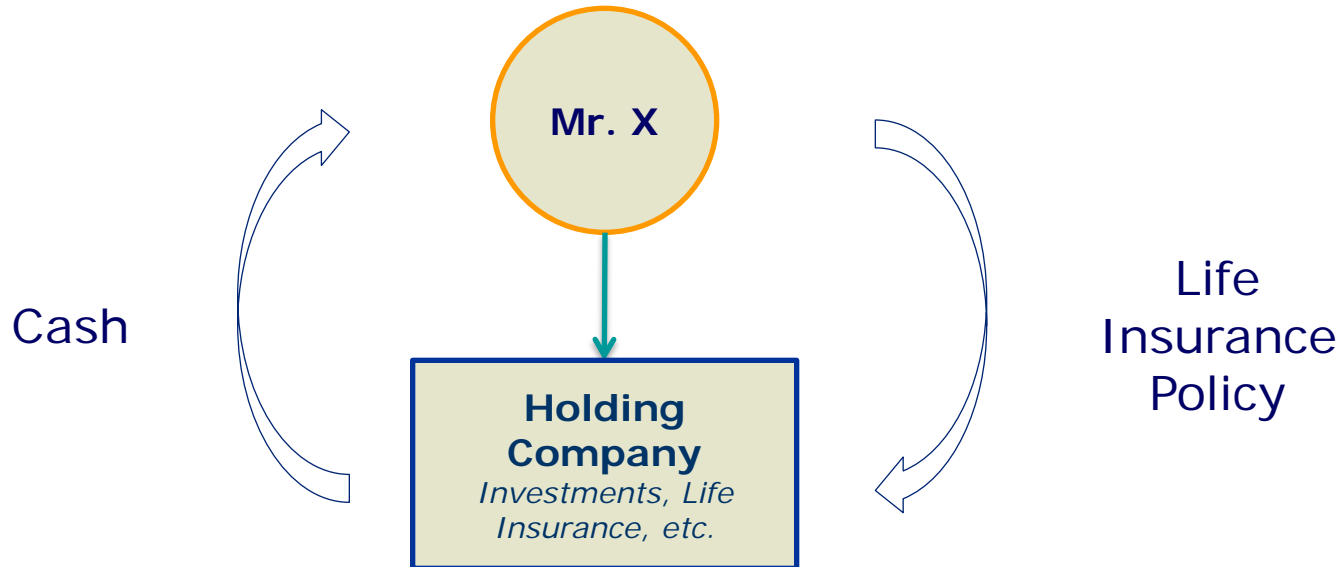
|                   | Status Quo |     | Planning |     |
|-------------------|------------|-----|----------|-----|
| Interest Expense  | \$20,000   |     | \$20,000 |     |
| Tax Savings       | \$ -       | (a) | \$ 9,282 | (b) |
| After-Tax Expense | \$20,000   |     | \$10,718 |     |

|                              |  |  |                 |  |
|------------------------------|--|--|-----------------|--|
| <b>Tax Savings (b) – (a)</b> |  |  | <b>\$ 9,282</b> |  |
|------------------------------|--|--|-----------------|--|

# Extracting Tax Free Cash Using Life Insurance



# Extracting Tax Free Cash Using Life Insurance



# Examples – Extracting Tax Free Cash Through Life Insurance

## Case 1

- Policy has \$300,000 death benefit, a fair value of \$115,000, cash surrender value of \$15,000 and tax cost of \$51,000
- Corporation pays \$115,000 for policy

## Case 2

- Policy has \$300,000 death benefit, a fair value of \$115,000, cash surrender value of \$25,000 and tax cost of \$15,000
- Corporation pays \$115,000 for policy

|        | Deemed Proceeds on Transfer | Tax Cost of Policy | Taxable Income Inclusion | Cash Extracted |
|--------|-----------------------------|--------------------|--------------------------|----------------|
| Case 1 | \$15,000                    | \$15,000           | \$ 0                     | \$115,000      |
| Case 2 | \$25,000                    | \$15,000           | \$ 10,000                | \$115,000      |

# Probate Planning



# Probate Planning

- Current: Single Will
- Plan: Multiple Wills to reduce probate fees
- Example

# Probate Planning

- In Ontario, the probate fee is approximately 1.5% of the value of the estate
- Solution: Dual Wills
  - Will #1 – cover assets that require probate
  - Will #2 – cover assets that do not require probate

# Probate Planning

➤ Example: \$5,000,000 assets not subject to probate

|                              | Status Quo |     | Planning         |     |
|------------------------------|------------|-----|------------------|-----|
| Probate Fees                 | \$ 75,000  | (a) | \$ -             | (b) |
| <b>Tax Savings (a) – (b)</b> |            |     | <b>\$ 75,000</b> |     |

# Contact Us

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