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COMMENT

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NOW THAT THE RRSP MAD DASH HAS PASSED, WHAT'S NEXT?

The first day of March marked the end of another hectic scramble for many Canadians as they did a mad dash to make their annual registered retirement savings plan (RRSP) contributions deductible in the prior year. In each of the past two years, nearly six million Canadians — almost 25 percent of Canadian taxpayers — made RRSP contributions.

Yet, once the sense of urgency has passed, it is all too easy to let the importance of saving for retirement slip out of mind until the next mad dash. This repetitive cycle may hinder individuals' ability to maximize their savings potential. Rather than benefit from a systematic savings plan, RRSP contributions become intermittent and dependent on borrowed funds or available cash flow at a point in time. Now is an ideal time to understand the savings opportunity associated with RRSP contributions and establish a plan that connects the outcome with monthly cash flow.

In general terms, an individual's annual new contribution limit for RRSP contributions is 18% of earned income from the prior year up to a maximum dollar amount, less any pension adjustment (PA) amount. The maximum annual contribution is $23,820 in 2013. The pension adjustment is an amount roughly equivalent to the value of benefits that have accrued to individuals because of their participation in a pension plan or deferred profit sharing plan, and will be calculated by the employer and reported on a T4 slip. This means an individual who participates in a registered pension plan (RPP) or deferred profit sharing plan (DPSP) can contribute less into an RRSP than those individuals who are not members of an RPP or DPSP. Individuals who do not take the opportunity to contribute their maximum available amount into an RRSP will carry forward the unused amount into future years. The accumulated unused amounts are reported on the individual's Notice of Assessment and increase the overall amount that an individual can contribute into an RRSP in any single year.

It is important to remember that the term "earned income" is defined by the income tax legislation and is generally intended to reflect amounts that arise from the performance of a service or work. As such, included in the definition of earned income are employment and self-employment earnings and rental income, less some employment and business expenses as well as rental losses. Income earned on investments does not qualify as earned income.

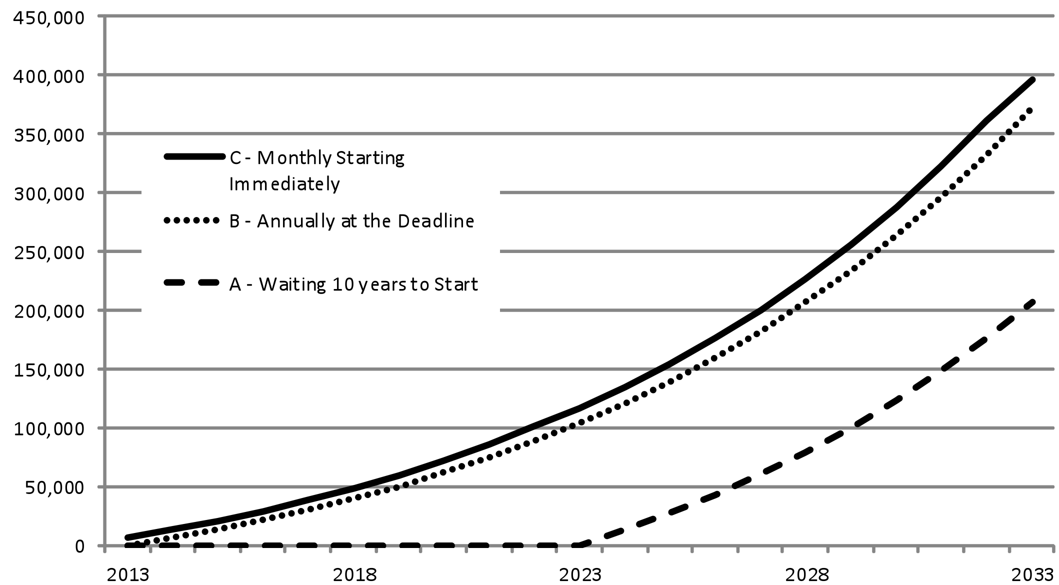
Interest paid on money borrowed to make an RRSP contribution is not deductible, which is a good reason to budget for RRSP contributions out of monthly cash flow and reduce the need to borrow.

In 2011, the average amount of new RRSP contribution room was $4,950, while $2,830 was the median amount of total RRSP contributions actually made. Nearly 23 million Canadians had room to contribute additional amounts, which collectively totalled nearly $700 billion of unused RRSP contribution room. These numbers are significant and represent a disconnect between the opportunity to methodically save for retirement and the increasing sense of worry amongst Canadians about not having sufficient savings to allow them to retire in a comfortable lifestyle. The government's tax-assisted savings program provides the opportunity for Canadians to benefit, yet only a small proportion of Canadians are taking full advantage of this opportunity.

The following chart highlights the advantage of starting early and using a systematic savings plan to accumulate retirement savings. With some planning, next year's mad dash may not be necessary.

Accumulating Registered Money for Retirement

A	Most people wait too long to start and they miss out on the opportunity for compound growth	
B	Many people wait until the deadline to contribute	
C	Some people start a systematic savings plan and like the tortoise win the race	
Example		C saves $500 per month for 20 years starting on January 1st
		B saves $6,000 per year for 20 years starting on February 28th
		A saves $12,000 per year but starts 10 years later
		4% average annual rate of return



In all cases, the individuals contributed the exact same amount of funds to their RRSP. C clearly won the race - he has almost twice as much as A and he is about 5% ahead of B.

I/R 5401.06

ENSURING PROPERTY VESTS INDEFEASIBLY

Understanding the term "vested indefeasibly," which appears in several provisions of the federal Income Tax Act, is important when a will is written or a transaction is structured. Incomplete vesting (or an incomplete transfer of property rights from one person to another) could trigger the payment of tax at an unexpected time, because a rollover that is intended to defer tax on a particular transfer may not be available.

For example, tax on capital gains and certain other associated income can be deferred when an asset is transferred directly to a spouse or common-law partner, or to a qualified spousal trust established for his or her sole benefit, provided the asset vests indefeasibly in him or her within the 36-month time period allowed under the Income Tax Act. Similarly, the tax liability on qualified farm property can be deferred when it is transferred to a child or grandchild of the individual. Either of the two transfers noted above could occur while the taxpayer is living, or arise upon the taxpayer's death.

The Income Tax Act does not define the term "vested indefeasibly;" instead, the meaning must be interpreted within the context of the particular provision where the term appears, and the wider legal definition that has been refined by the courts over the years. Generally, the term has come to mean that the new owner has an unassailable right to the ownership of the particular property, and these rights cannot be pre-empted or superseded. In the Canada Revenue Agency's view, a property vests indefeasibly in a spouse or child of the deceased when the person obtains a right to absolute ownership of that property in such a manner that the right cannot be defeated by any future event, even though that person may not be entitled to the immediate enjoyment of all the benefits arising from that right.

Where property is held in trust for the benefit of one or more persons, the property normally vests indefeasibly in the trust and not in a particular beneficiary. However, if the property is held in trust solely to carry out the terms of a will under which the ultimate and absolute ownership of that property is bequeathed to the spouse or child, and the trust arrangement is such that the individual's ownership rights cannot be defeated by any future event, and no other person has any right to an immediate or future benefit from that property or that trust, the property will be considered to vest indefeasibly in that person.

Many planning options are available for a testator to transfer qualified property to a spouse for his or her financial protection and eventually direct the transfer to the next generation. For example, a testator could bequeath the property to a qualified spousal trust and name the children as capital beneficiaries of the spousal trust. Alternatively, the testator could bequeath a life interest in the qualified property to the spouse, with the children named as ultimate owners. The children would ultimately inherit only on the death of the spouse who was entitled to receive the income.

Where shares of a company are subject to a buy-sell arrangement contained in a shareholders' agreement, the property generally cannot vest in the beneficiary. For example, if the buy-sell arrangement obligates the estate to sell the shares, the beneficiaries of the estate have no legal control over the shares and the "vest indefeasibly" provision cannot be fulfilled.

A "put-call" strategy is one planning option that has been developed to overcome the issue of vesting when an obligatory buy-sell arrangement is in place. Under the put-call strategy, the deceased bequeaths his or her shares to the surviving spouse. The bequest to the surviving spouse would occur on a rollover basis, with the spouse assuming the deceased's adjusted cost base. The surviving spouse would have a right to "put" the shares to the company for redemption or the surviving shareholders for purchase. The surviving spouse's right would be time–limited — for example, 90 days following the deceased's death. Upon the expiry of the surviving spouse's right, the company or the surviving shareholders would have a right to "call" the shares from the surviving spouse. If the redemption was funded with life insurance, the board of directors could elect capital dividend treatment on the deemed dividend arising upon the redemption of shares. Under this structure, the shares would vest indefeasibly with the surviving spouse, who then holds the legal right to put the shares to the company. The final result is that the deceased is bought out of the company with little or no income tax liability.

Failure to observe the details required in tax planning can have significant results. If indefeasible vesting is required to ensure a tax-free rollover of capital property to an intended beneficiary, then great care drafting the terms of a will or an agreement, and in structuring transactions, should be exercised to ensure compliance.

I/R 2500.07, 8001.06

UNDERSTANDING VALUE IN YOUR TAX RETURN

The federal government uses tax credits as a means to provide tax relief to some taxpayers and tax assistance to others. Introduced in 1986, the tax credit system replaced the concept of tax deductions for many items, although taxpayers often mistakenly use the terms interchangeably. In simple terms, a deduction reduces the individual's total income prior to the calculation of taxable income, while a credit is applied as a reduction to the individual's tax payable subsequent to the calculation of taxable income. A tax credit provides an equal benefit to all eligible taxpayers because it reduces the tax payable by an equal amount for all, no matter what a given person's tax rate might be. By contrast, a tax deduction tends to provide more value to those in higher tax brackets because it reduces the amount of income upon which tax is based.

Some tax credits are refundable in that they can generate a tax refund even when the individual does not otherwise owe any income tax for the year. In such a case it is important that the taxpayer file an income tax return in order to access any amount generated through a refundable credit. Rather than paying a lump sum refund, refundable tax credits are often paid by the federal or provincial government as a stream of payments at intervals throughout the subsequent year. The intention is to assist taxpayers with ongoing living expenses. Examples of streamed payments include the child tax benefit, the HST/GST tax credit and the working income tax credit.

Some tax credits are non-refundable. They can be claimed to reduce a taxpayer's tax liability, but once the individual's tax liability reaches zero there is no additional immediate direct value. However, additional indirect value may be available for some non-refundable tax credits through the opportunity to transfer unused amounts to the taxpayer's spouse, parent and/or grandparent, depending upon the credit and under specific conditions. As well, some amounts can be carried forward and claimed by the taxpayer in a future year. Planning to maximize the value of these opportunities involves calculating each family member's individual tax credits, then determining the overall income tax liability if credits can be shifted between individuals. The time value of money is also a consideration when credits can be claimed in the current period by a relative instead of carrying the credit forward to be claimed in a subsequent year.

The following is an overview of federal tax credits, with a general indication of transferability. The list is intended as a preliminary indication of credits that may be transferrable depending on the specific terms of the credit and the individual's fact situation.

Refundable Tax Credits

GST/HST tax credit	Child Tax Benefit
Medical expense supplement	Working income tax benefit
Film production credits	SR&ED refundable investment tax credit

Non-Refundable Tax Credits

Transferable to:	Spouse/Common-Law Partner	Parent	Child
Personal credit			
Married or common-law partnership status			
Wholly dependent person (equivalent to spouse credit)			
Child amount (child tax credit)	X		
In-home care of relative (caregiver credit)	X		
Dependents	X		
Additional amount (i.e., dependent)	X		
Pension credit	X		
Canada employment credit			
Adoption expense credit	X		
Public transit pass credit	X	X	
Child fitness credit	X		
Children's art tax credit	X		
First time buyer's credit	X		
Disability home purchase credit			
Volunteer firefighter tax credit			
Charitable gift tax credit	X		
Medical expense tax credit	X	X	X
Credit for mental or physical impairment (disability)	X		
Tuition credit		X	
Education credit	X	X	
Post-secondary textbook credit	X	X	
Credit for interest on student loan	X		
Credit for EI premium or CPP contribution			
Age credit	X		

One of the newer credits is the family caregiver tax credit, which can reduce taxes payable by up to $300 per year per dependant. It is available for caregivers of individuals with a mental or physical impairment when the caregiver maintains a residence where he or she and the dependent live. The maximum amount of $300 is reduced when the dependent's net income exceeds a certain threshold. The availability of this credit reflects today's changing society and is not limited to the taxpayer's dependent children. It provides tax relief to those who care for dependents including, for example, a parent or grandparent, which is becoming increasingly common. Dependents over the age of 17 must be a relative and dependent on the taxpayer because of impairment in physical or mental functions. Dependents under the age of 18 must be dependent because of prolonged and indefinite impairment in physical or mental functions, and must require more assistance than other children of the same age. If the dependent is your parent or grandparent or that of your spouse or common-law partner, he or she must have been born in 1947 or earlier (i.e., age 65 or older in 2012).

The children's arts credit provides a reduction to taxes payable up to a maximum of $75 per child for fees associated with the cost of registration or membership in programs of artistic, cultural, recreational or developmental activities for the children of the taxpayer or taxpayer's spouse/common-law partner. The credit is available for children 15 years of age or younger throughout the year. The age and amount of the credit is slightly more generous if the child qualifies for the disability tax credit. Expenses claimed for this credit cannot be claimed under other credits such as the fitness credit.

These are just two of the newer credits that taxpayers should be aware of when maximizing the value of tax credits available to them.

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