The Institute for Advanced Financial Education

COMMENT

Edition 285 – 2014

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CPP Retirement Benefit: It's All in the Timing

The Canada Pension Plan (CPP) provides a number of benefits, the most significant of which is the retirement pension that forms an integral part of most Canadians' financial plans for retirement. The Quebec Pension Plan (QPP) provides parallel benefits for Quebec residents. Every contributor to these government-sponsored pension plans will eventually need to make important decisions about when to begin receiving these valuable benefits.

The standard age for beginning CPP retirement pension payments is the month following an individual's 65th birthday. The amount of CPP retirement pension payable is based on how much and how long the person has contributed to CPP.

Individuals can begin to receive a CPP retirement pension as early as the month following their 60th birthday. This is treated as an early pension, and the entitlement is based on a projected entitlement at the normal retirement date reduced by a factor. The reduction factor is being increased slowly from 0.5 to 0.6 per cent per month from 2012 to 2016. This means the annual pension will be reduced by 36 per cent (i.e., 60 months times 0.6 per cent per month) for pensions starting in 2016, so that the net pension payable would be 64 per cent of what would otherwise have been receivable at age 65. The amount by which the normal pension is reduced is the cost of receiving the pension earlier, and needs to be weighed against the trade-off of receiving the CPP benefit for a longer period of time (up to 60 months longer).

When individuals elect to begin their CPP retirement pension before age 65 but continue to work, these individuals and their employers are required to make CPP contributions. Individuals who are self-employed must make both the employer and employee's mandatory contributions. The contributions are mandatory until the individual reaches age 65.

When individuals elect to begin their CPP retirement pension and continue to work beyond age 65, they can decide if they want to contribute to CPP. Employers are obligated to deduct the employee's CPP contribution and make the employer's contribution unless the employee elects not to contribute. In order to stop or re-start CPP contributions, an individual must file a special form — CPT30 - Election to Stop Contributing to the CPP, or Revocation of a Prior Election — with their employer(s) and the Canada Revenue Agency. The individual can change their contribution status only once each year.

CPP contributions made while individuals are receiving CPP retirement benefits will create a Post-Retirement Benefit (PRB). The amount of PRB will depend on earnings, amount of CPP contributions during the previous year, and age as of the effective date of the PRB. The maximum PRB for one year of contributions will be 1/40 of the maximum CPP retirement pension. The PRB will be automatically added to the CPP retirement benefit beginning in the following January, payable for life. This allows individuals to receive the regular CPP inflation adjustment plus a PRB amount each January.

Individuals can delay the receipt of their CPP retirement pension until age 70. Delaying a CPP retirement pension will increase the individual's pension entitlement. The delayed pension entitlement will be based on the individual's projected entitlement at the normal retirement date plus a factor of 0.7 per cent for every month the pension is delayed. This means the increase factor could be as high as 42 per cent (i.e., 60 months times 0.7 per cent) if the pension is delayed until age 70.

Individuals who delay the start of their CPP retirement pension and continue to work after age 65 must continue contributing to CPP, and their employer is obligated to make the employer's contribution.

Individuals can share their CPP retirement pension with their spouse or common-law partner. To do so, they must be receiving their pension, or be eligible to receive it, and be living with their spouse or common-law partner. The portion of their pension that can be shared is based on the number of months they lived together during their joint contributory period. Each individual will be taxed on the amounts actually received, which may result in tax savings.

The Canada Pension Plan is an important aspect of many retirement plans, and it is important to understand the flexibility associated with the beginning of benefits. Both the

Quebec government and the federal government maintain excellent websites that are designed to provide answers to typical questions about Canada/Quebec Pension Plans.

I/R 3201.01

Eligible Capital Property Under Review

The 2014 Federal Budget proposed to conduct a public consultation of the income tax rules with respect to eligible capital property, with a view to "leveling the playing field" with other types of property. Among other changes, the proposed rules will impact taxpayers that sell the assets of their business when some of the sale proceeds are allocated to goodwill.

Eligible capital property is capital property other than tangible capital property or intangible capital property with a definite life. Examples include incorporation costs, customer lists, and goodwill resulting from the purchase of another company's assets.

Current Regime

For income tax purposes, eligible capital property is grouped into a single pool called cumulative eligible capital (CEC). When a taxpayer acquires a CEC property from an arm's-length person, three-quarters of the purchase price is added to the CEC pool. When a taxpayer disposes of a CEC property, three-quarters of the proceeds of disposition is subtracted from the pool.

The depreciation or amortization of the CEC pool is called the cumulative eligible capital amount (CECA), and it is a maximum of seven per cent of the positive balance as at the year-end of the taxpayer (prorated for a short fiscal year). It should be noted that a taxpayer may choose to claim less than the seven per cent maximum in any year. The amount of CECA claimed is subtracted from the CEC pool balance at the end of the year.

To the extent the CEC pool has a negative balance at the year-end of the taxpayer, income tax consequences arise. The portion of the negative balance equal to the cumulative CECA claimed over the years will be reported as a recaptured amount and treated as active business income. Two-third of any excess negative value is brought into income as active business income.

For example, assume a corporation purchased a client list in June 2013 and sold it 18 months later in December 2014 for $200,000.

	CEC Balance
Opening Balance	0
Year 1:	
Purchase Price: $100,000 original cost Addition to CEC pool (3/4 x $100,000)	+ 75,000
CECA claim in first year 7% of 75,000	- 5,250
	= 69,750
Year 2:	
Sale of client list: $200,000 proceeds Deduction from CEC pool (3/4 x $200,000)	- 150,000
	= (80,250)

RESULT — $80,250 negative balance in the CEC pool

Tax Consequence:

- $5,250 amount of CECA previously claimed is re-captured and taxed as business income (leaving a $75,000 negative balance of CEC pool)
- $50,000 taxed as business income (2/3 x 75,000 remaining negative balance in CEC pool)
- $50,000 credit to capital dividend account (2/3 of 75,000)

Proposal

The 2014 federal budget proposes to make the CEC system similar to that of the Capital Cost Allowance system. For example, the proposals provide that 100 per cent of expenditures would be added to the pool to be amortized, 100 per cent of the proceeds of disposition would be used in the calculation, and that gains on disposition would be an account of capital and not active business income. The most significant change would arise when a business sells its assets; the sale of goodwill would be taxed as a capital gain. This means the income reported will be passive or investment income and subject to the higher corporate taxes, a portion of which are refundable under provisions of the Income Tax Act.

For example, consider a business owner who has an offer to buy the assets of the company. As per the agreement, $10 million of the sale proceeds will be allocated to goodwill. Under the current regime this means the buyer can add three-quarters of the $10 million cost to its CEC pool, and the seller has to subtract three-quarters of the $10 million proceeds from its CEC pool. This example looks only at the goodwill portion of the agreement, and uses the 2014 federal tax rates combined with the provincial rates for PEI.

	Current Rules	Proposed Rules
Corporate Level		
Business income (2/3 of negative CEC balance)	$5,000,000	
Taxable capital gain (2/3 of negative CEC balance)		$5,000,000
Corporate taxes (31.0%, 50.67%)	1,550,000	2,533,333
Refundable portion (26.67%)	n/a	1,333,333
CDA credit (2/3 of negative CEC balance)	5,000,000	5,000,000
Cash position of company	$8,450,000	$7,466,667
Shareholder Level		
Capital dividend	$5,000,000	$5,000,000
Taxable dividend	3,450,000	3,666,667
Personal taxes (28.71%, 38.74%)	990,495	1,420,467
Cash position of shareholder	$7,459,505	$7,246,200

This example highlights two issues. First, under the proposed approach, the business owner's cash position is about $213,000 worse than under the current regime. Second and more importantly, the business owner has lost almost $1,000,000 of tax deferral. In the above example the taxpayer could choose to leave the taxable dividend in the corporation, which would defer the tax on the taxable dividend.

Understanding the proposed changes will help business owners assess the potential impact on their wealth transfer plan.

I/R 7401.00

The Changing Face of Canadian Society

A recent Statistics Canada publication was the impetus for a look at a few insights into contemporary Canada.

Canada's population now sits at 35.1 million, which represents an increase of 11 per cent over the 10-year period between 2003 and 2013. Every province has shared in this growth, some more than others: Alberta takes the lead at 26.5 percent; British Columbia, Saskatchewan and Ontario grew in the 10 to 11 per cent range; Quebec and Manitoba had growth of just under nine per cent; at the low end are Nova Scotia and New Brunswick, both with population growth of under one per cent. The cities of Edmonton and Calgary outpaced their peers, with growth of approximately 25 and 30 per cent, respectively, for the 10-year period ending in 2012.

There was a downward trend in the birth rate, with a decline of nearly 16 per cent during the 10-year period between 1992 and 2002; however, there was a substantial recovery in the subsequent 10 years, with nearly 384,000 births in 2012, just two per cent shy of the number 20 years earlier. We're seeing a steady shift in the age at which women are choosing to have families, with a clear trend toward waiting much longer to have children. The number of births among 20-somethings decreased by nearly 28 per cent while births to women in their thirties increased by 31 per cent between 1991 and 2011.

About 66 per cent of adults are in a married or common-law relationship, with about 28 per cent of them having been married before.

From a health perspective, about one-fifth of Canadians smoke, with the split between males and females at 23 and 17.5 per cent respectively. This is a fairly substantial segment of society. However, to counter this, about 55 per cent of individuals indicate they are physically active during leisure time, and about 40 per cent consume fruit and vegetables at least five times a day.

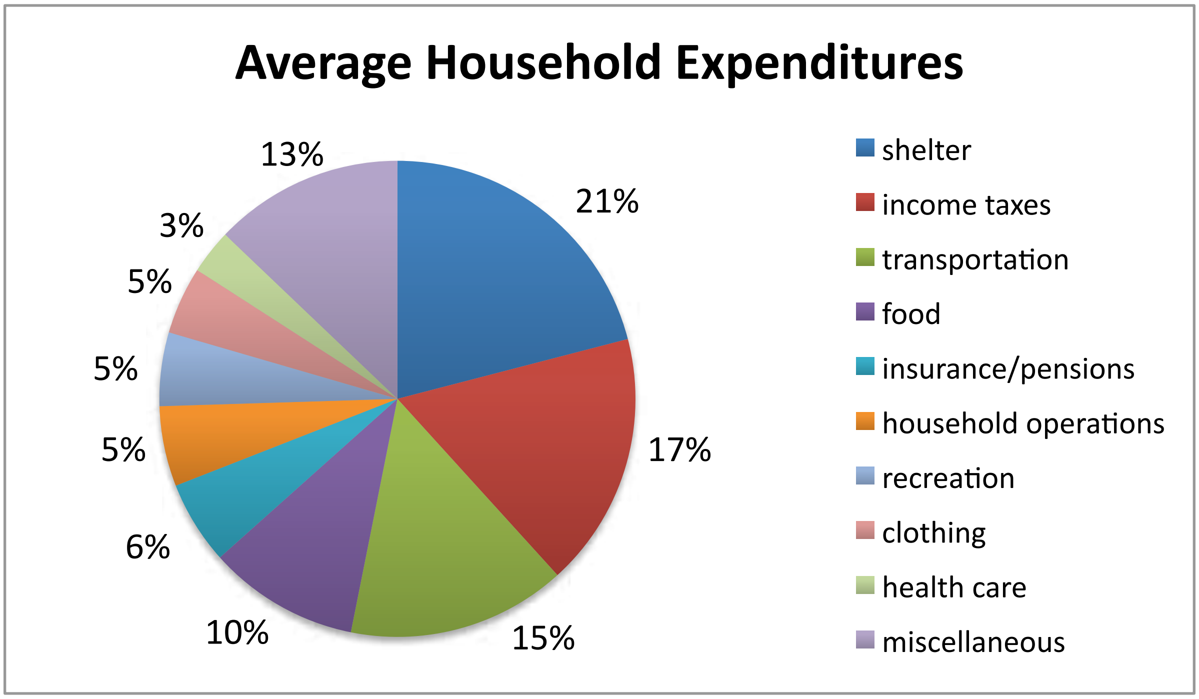
There has been a dramatic increase in life expectancy for Canadians over the 70-year period between 1941 and 2011. In 1941, life expectancy at birth was 66.3 for females and 63 for males. There has been a steady upward trend, with life expectancy rising to 83.6 for females and 79.3 for males in the period ending in 2011. The gap between males and females has widened, and now sits at an extra 4.3 years for females relative to males in 2011 compared with a difference of 3.3 years 70 years earlier.

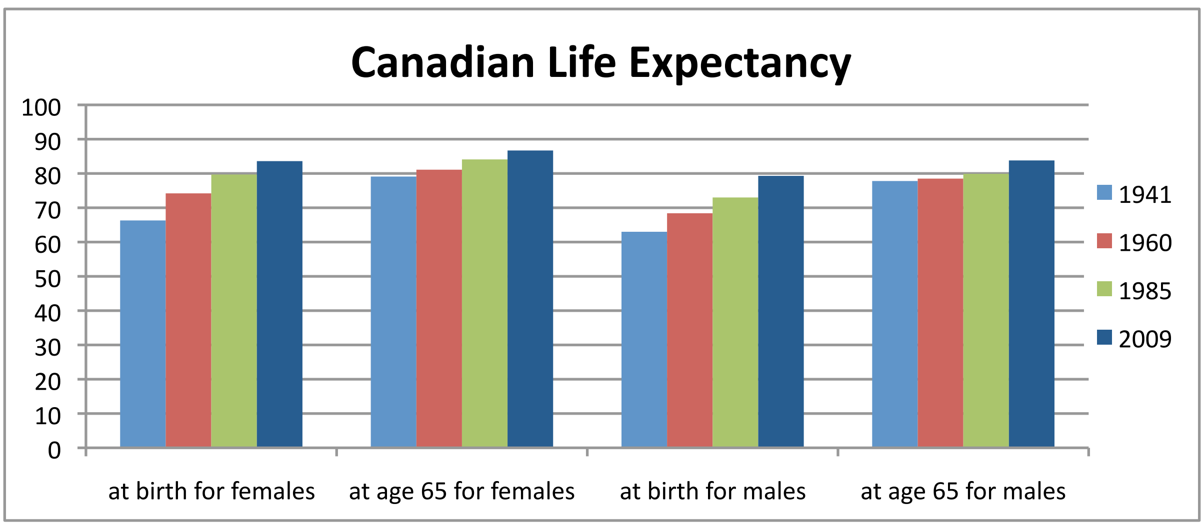
Economically, median inflation-adjusted after-tax income has increased by 25 percent between 1991 and 2011, and now sits at $68,000. There are some very significant variances worthy of comment. The annual income for unattached elderly females and males is $23,000 and $27,800 respectively, compared with elderly families at $49,300.

About 66 per cent of Canadians own their dwelling, while 35 per cent rent. Of those who own, 31 per cent are mortgage-free. On average, Canadians spend about 21 per cent of their income on shelter, 15 per cent on transportation, 5.6 per cent on personal insurance payments and pension contributions, and five per cent on recreation.

Canadians are quite happy, with 92 per cent indicating they are either satisfied or very satisfied with their life overall. There was no differential between males and females.

I/R 6851.00





Data Source: Statistics Canada

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Publication Agreement # 40069004

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