

RRSPS ARE IMPORTANT

It has become a well-known fact that RRSPs can play an important role in an individual's financial affairs. These registered savings vehicles not only provide for a welcome tax deduction but, more importantly, they are a significant conduit for retirement savings.

But, do we really know if the average Canadian is doing enough for his or her retirement? The Canada Revenue Agency (CRA) has recently released statistical information from the 2003 taxation year, and it is interesting to analyze how well Canadians are doing with respect to RRSP contributions.

One fascinating piece of information is the distribution of Canadians who contribute to an RRSP by income bracket:

From the table below, it should be noted that a significant proportion of RRSP contributors have total incomes between \$20,000 and \$60,000. This seems to indicate that tax savings is not the motivating factor

An alternative way to view the data is by the age of the contributor:

From the following table, it appears that individuals are still waiting too long to contribute to an RRSP. Over 50 per cent of the RRSP contributors are age 45 or older. By starting younger, individuals benefit significantly from the power of compounding. The encouraging news is there is a reasonable pro-

Less than age 24	2%
Between ages 25 and 34	15%
Between ages 35 and 44	27%
Between ages 45 and 54	31%
Between ages 55 and 64	21%
Over age 64	4%

portion of younger people contributing to RRSPs, but it could be much higher.

Total Income	Portion of total RRSP contributors
More than \$80,000 of income	15%
Between \$60,000 and \$80,000 of income	16%
Between \$40,000 and \$60,000 of income	29%
Between \$20,000 and \$40,000 of income	31%
Less than \$20,000 of income	9%

behind RRSP contributions, because the taxpayers in this group are not in the highest marginal tax bracket. (Remember that taxpayers only realize savings at their marginal tax rate.)

The information above is based solely on RRSP statistics and does not include those Canadians who save for their retirement through a pension plan.

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CORPORATELY VERSUS PERSONALLY OWNED INSURANCE

Choosing the most appropriate owner for a life insurance policy is not always an easy decision because there can be a lot of considerations to take into account. The issue becomes more complicated for owners of private companies because they have a choice between personal and corporate ownership.

Life insurance premiums are not generally deductible for tax purposes and, therefore, must be paid with after-tax cash flow. Since corporations generally have a lower tax bracket than the shareholders, the lower after-tax premium cost is often a reason that corporate ownership of life insurance is considered.

If the policy is owned personally, the individual can name any beneficiary and the beneficiary will receive the life insurance proceeds. If the individual's corporation owns and is the beneficiary of the policy, the corporation would receive the life insurance proceeds. An amount equal to the life insurance proceeds less the adjusted cost basis of the policy will be credited to the corporation's capital dividend account (CDA). Amounts can be paid out of the corporation's CDA balance to its shareholders tax-free and an amount equal to the adjusted cost basis of the policy could be paid out as a taxable dividend.

First, the purpose of the insurance must be identified. Is it cash for the family, liquidity for the corporation or funding for a buy-sell agreement? Keeping this in mind, the following are some of the major considerations that should be reviewed initially and periodically over time with respect to who should be the owner of a life insurance policy. (Remember, though, that a transfer from one owner to another may result in a taxable disposition and employee/shareholder benefits.)

Creditor shelter — Protection from claims of creditors is available to the policyholder if there is a named beneficiary from a prescribed class. For individually owned life insurance, this means a spouse, child or parent. A corporate owner can name the same individuals as beneficiaries, but they cannot qualify as beneficiaries from the prescribed class because a corporation cannot have a blood relationship with anyone. However, where creditor protection is a concern in a corporate setting, consider having the policy owned in

a company that does not carry on an active business (i.e., a holding company). This generally results in improved creditor protection.

CDA planning — Post-mortem tax planning can be enhanced if there is a CDA credit in the company formerly owned by the deceased individual. Redemption strategies create deemed dividends and all or part of these deemed dividends could be elected as a tax-free capital dividend. Plus, if the redemption strategy is completed within the first taxation year of the estate, the resulting capital loss (after taking into account the stop-loss rules) can be carried back to the terminal tax return. The net effect can be lower overall taxation of the deceased and his or her surviving family.

Administration — If life insurance policies are part of a buy-sell arrangement, there is a control advantage in having the company own the policies. If the policies are corporate-owned, the involved shareholders could inspect the records to ensure that the premiums are paid and the life insurance policies are in force. If the life insurance policies are personally owned, the shareholders have to trust each other to ensure that the policies (and thus the buy-sell funding) are in force and in good standing, although ownership by a trustee on behalf of the shareholders can alleviate that problem. In addition, if there are several shareholders, personal ownership (each shareholder owning a policy on each of the others) can result in a large number of policies. Corporate ownership of one policy on each life would be much simpler.

Cost of the premium — As noted above, the primary advantage of corporate-owned life insurance is that the economic cost is lower with the premium paid by the corporation.

premium amount	\$1,000
tax bracket of the corporation (i.e., the rate for first level of active business income)	20%
top marginal tax bracket of the shareholder	45%

If the insurance is owned personally, the shareholder will have to pay the insurance premium personally:

bonus required by the shareholder	\$1,818
tax cost of shareholder on bonus (i.e., 45%)	818
after-tax position of the shareholder	\$1,000
required premium for the life insurance	1,000
net cash flow of the individual	zero
bonus paid by the corporation	\$1,818
tax savings released by the corporation (i.e., 20% bracket)	364
after-tax cost to the corporation to pay the bonus	1,454

Control — Long-term control of the life insurance policy may be jeopardized if it is corporately owned. If the shareholder wants to sell the corporation, the life insurance policy would also be sold as part of the corporation. While the shareholder could remove the life

insurance policy prior to sale, this would be a disposition by the corporation and a taxable benefit to the shareholder. This could be avoided if the life insurance policy were owned by a holding company; however, the shareholder may not be able to benefit from the capital gains exemption on the sale of the company.

Capital gains exemption — The shares of a qualified small business corporation are eligible for the capital gains exemption. One of the criteria is that the value of passive assets has to be less than 10 per cent of the fair market value of all of the assets. A life insurance policy is considered a passive asset, so any significant cash value buildup could cause the corporation to lose its eligibility for the capital gains exemption.

Probate planning — Corporate-owned life insurance might inflate the value of the corporation for probate purposes in the same fashion as naming the estate as the beneficiary of a personally owned policy.

The structure of ownership for a life insurance policy can dramatically improve the situation or open up a new set of problems and issues. Professional advice is required to contemplate all of the issues and develop the best strategy in each situation.

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LEAVING CANADA

Many individuals emigrate from Canada to take up residence in another country. The reasons for leaving could be many, such as tax planning, a change of employment, marriage or retirement. No matter what the reason, one of the expected outcomes may be leaving the Canadian tax net behind. However, doing so is much more difficult than simply departing Canada.

The courts have developed guidelines to assist the Canada Revenue Agency (CRA) in determining when an individual has left Canada and is no longer taxable on worldwide income in Canada. While the outcome of one test will sometimes be determinative, other times it will be the preponderance of several outcomes that will settle the matter. The following are some key factors:

1. Check to see if there is a tax treaty with the new country of residence. If there is a treaty, then the individual may be able to rely on the residency

provisions of the treaty (generally found in article 4) to determine residency. If the “tiebreaker” tests under the treaty indicate that the individual is a resident of the other country, then that same individual cannot be a resident of Canada.

2. The individual’s home could be a determinant. The individual should have a home in the new country. It is not critical to give up the Canadian home entirely, but that Canadian home should not be available to the individual. One method to ensure unavailability is to rent out the Canadian home.
3. The individual’s intentions will be important. If an individual’s departure plan also includes a plan to return, the CRA may consider that the individual did not intend to leave permanently and will continue to tax that individual in Canada on worldwide income.

4. Family will be important. It's not only important where you live, but where your spouse and dependant children will reside. If an individual leaves his or her family behind, the general interpretation is that the departure is not a permanent one.
5. Sever as many Canadian ties as possible. Items like Canadian bank accounts, credit cards, driver's licences, memberships, phone numbers and mailing addresses should be discontinued. If an individual really intends to depart from Canada and begin a new life abroad, discontinuing the majority of these items should cause little inconvenience, while demonstrating a sense of permanency.
6. The continued ownership of an automobile in Canada could send the wrong message to the CRA. The individual should take the car abroad or sell it. Keeping the car for occasional use while visiting Canada generally does not support the premise that an individual intends to sever all ties with Canada.
7. The individual should establish as many ties in the foreign country as possible. Items listed in paragraph 5 above should be set up as soon as possible. If these are established as the Canadian ties are severed, the individual will be clearly demonstrating his or her intentions.
8. Provincial medical and hospitalization insurance will need to be cancelled once necessary coverage has been established in the new jurisdiction. This type of coverage is only available to residents of a particular province and if the individual maintains coverage, or continues to utilize this type of coverage, he or she is clearly admitting continuing residency of that province.
9. In the year of departure, the Canadian tax return should reflect part-year residency and any capital gains triggered upon emigration. Following the year of departure, it is important to discontinue filing a Canadian tax return (unless one is required because of ongoing Canadian-source income) and to file a tax return in the new country of residence.
10. After an individual has left Canada, it is quite acceptable to visit; however, the frequency, length and purpose of visits to Canada will be considered by the CRA in determining if Canadian residency has been terminated. Too much visiting could be construed as never intending to leave Canada. While there are no hard and fast rules, a rule of thumb suggests that visiting should be limited to less-than-30-day stays and 60-day maximums per year for the first three years.

No situation can be "perfect" from an income tax point of view. The above is a compilation of the issues that the CRA, and in some cases the courts, consider in these situations.

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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
350 Bloor Street East, 2nd Floor,
Toronto, Ontario M4W 3W8
T: 416.444.5251 or 1.800.563.5822
F: 416.444.8031
www.cluinstitute.ca • info@cluinstitute.ca

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