



FALL 2011 NEWSLETTER

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Top Ten Tax-Saving Tips for Individuals

Ed Militzer, CA, Principal KNV Chartered Accountants LLP

To minimize the amount you spend on personal income tax and to undertake planning in keeping with your personal, investing, and estate planning objectives, consider tax planning strategies that make sense in your own situation. Rather than waiting until 2012, take some time now to plan and implement a few simple tax planning techniques which could result in a pleasant surprise in the form of a tax refund when you go to file your 2011 tax return.

1. **RRSP** - RRSPs allow you to save for retirement and give you a break at tax time. Any income you earn in a registered retirement savings plan (RRSP) is exempt from tax as long as the funds remain in the plan. Contributions made in 2011 or within 60 days after year end are tax deductible so long as you do not exceed your RRSP Contribution Room. The 2011 RRSP limit is reported on your 2010 personal Notice of Assessment issued by Canada Revenue Agency (2011 RRSP maximum of \$22,450). If you turn 71 in 2011, you must wind-up your RRSP and then talk to your investment advisor regarding alternatives to draw the income out over time using a tax deferred plan like a RRIF.

2. **TFSA** - As long as you stay within your contribution room

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limit, you will not pay tax on any income you earn from investments in your tax-free savings account (TFSA). Again, your 2011 TFSA limit is reported on your 2010 personal Notice of Assessment issued by Canada Revenue Agency.

Beware, if you are contributing and withdrawing from your TFSA in the same year, although your TFSA balance may not exceed the \$5,000 contribution limit for the year, this may still result in a TFSA over-contribution and penalty tax. This is because any withdrawals from your TFSA do not increase your TFSA limit until the following calendar year.

3. **US Citizens** – From a Canadian tax perspective, plans such as RESPs and TFSA's are tax deferred. These plans are not generally recognized as tax deferred vehicles in the US so, as a US citizen these plans may attract taxation, significant separate US tax filings and thus may be less desirable to a US citizen. As a planning point, if you are a US citizen and haven't been up to date on your US tax filings the IRS Offshore Voluntary Disclosure Initiative gives filers until August 31 2011 to get up to date on past US filings and mitigate penalties.
4. **Loans to family member** – Enhance your after tax return on non-registered investments by lending money to a family member in a lower tax bracket. So long as interest on the loan is charged at or above CRA's prescribed interest rate at the time the loan is made (1% for loans made in the July 1 to September 30, 2011 period) the family member will be able to earn the investment yield over and above the interest paid and have it taxed at their lower marginal rates. The loan document must be bonafide, bearing the appropriate rate of interest. To avoid the attribution rules, interest must be paid annually to you (the lender) by January 30 of the following year. The interest income (at 1% in our example) will be taxable to the lender and may be tax deductible as a carrying charge to the payor. For many, it makes sense to take advantage of CRA's low prescribed rate of 1% (a historic low) and lock-in the benefit of these once in a lifetime low interest rates.
5. **Interest Deductibility** -- It is understood that interest paid on a home mortgage and a loan for the personal use of an automobile are not normally deductible. However, reasonable interest paid on loans used to earn business or investment income may be tax deductible. So, if have a choice, try to repay your "non-deductible" debt while leaving the debt on which interest is deductible outstanding. To determine whether the loan was taken out for an eligible business purpose, CRA looks at a "direct tracing" concept. For example, a cheque written on your line of credit to acquire publically traded bank shares would be an "eligible purpose" paving the way for an interest deduction.

To facilitate tracing and to provide a better record of deductible interest paid each year (should CRA request it) consider obtaining a

step or tiered mortgage that allows for a number of different borrowings (one or two of which could be for an eligible purpose). Compared to unsecured loans, the interest rate that you pay the financial institution will be lower as the loan(s) will be secured by a mortgage on Canadian Real Estate.

6. **New Home Buyers Credit** - The ability to claim the 15% Home Renovation Tax (HRTC) credit ended on January 31, 2010. However, there are still various incentives available for new home buyers. Two notable examples are the ability to withdraw funds from an RRSP under the Home Buyers Plan and the New Home Buyer's Tax Credit. In terms of the New Home Buyer's Tax Credit, a buyer who acquires a qualifying home after January 27, 2009, may be eligible for a credit calculated as \$5,000 multiplied by the Federal rate of 15% (the lowest marginal tax rate for 2010 and 2011), resulting in a non-refundable credit of \$750. If you are purchasing the home jointly, you will need to share the credit. The individual buying the home must be a first-time home buyer (unless you are disabled), meaning that neither the individual nor the individual's spouse or common-law partner owned and lived in another home in the year of purchase or in any of the four preceding years. A home purchased by an individual is a qualifying home if it is currently eligible for the home buyers' plan (See Canada Revenue Agency Guide RC4135 for further information) and the individual or the individual's spouse or common-law partner intends to occupy it as his or her principal residence no later than one year after its acquisition.
7. **Pension income splitting** -- Income splitting is planning that results in income from a highly taxed person to have income shifted or split with someone (usually a spouse) in a lower tax bracket. Have you retired and now receive a company pension?

You can split up to 50% of eligible pension income with your spouse or common-law partner to reduce the overall taxes you pay. This may be accomplished by making a pension splitting designation in your tax return. Canada Pension Plan (CPP) pension benefits are not eligible for this designation. However, if there is an income splitting advantage, it may be possible to split CPP entitlement with your spouse as noted in the link below.

<http://www.servicecanada.gc.ca/eng/isp/pub/factsheets/credit.shtml>

8. **Estate planning** – Consider appropriate planning to facilitate the transfer of assets to the next generation now or on your passing while minimizing income tax, probate fees associated with the transfer. Moving assets to the next generation doesn't mean that you need to give up control over the assets or business decisions. Meeting various estate planning objectives including maintaining control may be achieved through an "estate freeze", family trust and/or alter-ego trust. There a number of tax and non-tax issues to consider so, make sure you obtain advice from your legal

counsel and tax advisor before moving forward with your plan.

9. **Review your family trust** – If you have a family trust, review your trust arrangements to make sure the Trust's documentation is up-to-date and that any transactions or trust allocations have been properly documented. Consider steps possible to save tax for the year.

10. **Universal Child Care Benefit (UCCB)** - Make sure you have applied for and are receiving the Universal Child Care Benefit (UCCB). The benefit is \$100 per month (up to \$1,200 annually) for each child under six years of age. It is paid separately from the Canada Child Tax Benefit and is taxable in the hands of the lower income spouse or common law partner. The funds can be invested in an "in-trust" account for the child such that the income and capital gains will not be attributed to the parent. The income earned on these funds will be taxed in the child's hands with the first \$10,527 of income being sheltered by the 2011 Federal Basic Personal amount

Leasing Your Capital Infrastructure

Alicia Jobb, CA KNV Chartered Accountants LLP

In the past, leasing capital infrastructure was often less favorable than financing because lease rates were often higher and you usually couldn't lease to own. Most banks now offer leasing as an alternative to conventional financing and lease rates are often comparable to finance rates. Leasing capital infrastructure for your business can offer the following advantages compared to financing: the ability to lease 100% of the asset with no down payment; the terms can be structured to allow more flexibility than financing which can help with asset obsolescence management; and an accelerated tax deduction, as a purchased asset may take up to 20 years to be amortized for tax purposes but lease payments are fully deductible in the period made and a lease term will likely be only 5 to 10 years. We recommend that you discuss leasing and financing options with your financier and KNV representative to discuss the alternatives before your next asset purchase.

Cash Flow Management – Staying in Control

Author: Wade Paulhus, CA KNV Chartered Accountants LLP

One of the biggest mistakes leading to the failure of a business is not managing cash properly. This is especially true in the early stages of the business. Most companies don't see positive cash flow until at least the third year of operations.

The key is to understand the difference between profit and cash flow. The statement of income could show positive results; however, a disproportionate increase and decrease in accounts receivable and accounts payable respectively could mean cash is being absorbed. Here are some tips to manage the inflows and outflows of cash:

General

- Prepare monthly cash reconciliations. Rarely will the balance of cash in the books equal what is shown on the bank statement. Use the balance on the books to analyze your cash flow since this will include outstanding withdrawals and deposits.
- Create an annual budget, refer back to it on a regular basis and compare actual results to the budgeted figures.
- If possible, delay taking a salary. Not only will this allow for funds to be reinvested into the company but it also shows investors that you are committed to the future growth of the business.

Cash inflows

- Invoice your customers immediately after shipment of goods or rendering of services. Late invoicing suggests to your customer that you are not in a hurry to collect.
- Outline payment terms on each invoice and statement.
- Obtain credit applications for larger and repeat customers.
- Require COD payment for poor credit and one-time customers.
- Enforce late payment penalties. On the other side, consider a 1-2% discount for payment within 10 days of invoicing customer.
- Consider allowing customers to pay by credit card or electronic funds transfer.
- Negotiate longer term contracts to include collection of partial payments through out the term, rather than at the conclusion of the contract.

Cash outflows

- Initially, ensure you pay your vendors as soon as possible to establish a good credit rating with them. After a number of payments, request for longer payment terms.
- Keep your overhead to a minimum.
- Establish a line of credit with the bank, even if not required immediately.
- Establish good internal controls over the handling of cash.
- For capital expenditures, consider leasing instead of purchasing (see article 'Leasing Your Capital Infrastructure').

Remember “Cash is King”, know how much cash there is in the business at all times and know what inflows and outflows are expected.

Watch for a future article on where to look for financing and what to do in a cash crisis.

Competitive Compensation

**Lindsay Thorpe, BBA, CHRP Human Resource Advisor
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Competitive compensation is strategic compensation; the two phrases

go hand-in-hand. Strategic pay emphasizes paying employees for their competencies and results rather than solely for their job responsibilities.

With regards to base pay, a company that is in a financial position to offer higher wages to attract and retain the best candidates will adopt a 'lead' strategy. However, for those companies that cannot adopt this strategy a 'matching or lagging' market strategy can still be effective if the position offers other perks such as incentive plans, benefits or perquisites such as recognition.

Incentive plans such as profit or gain-sharing plans can be especially beneficial to align strategic organizational goals with employee performance. Gain-sharing plans in particular are useful in engaging employees by implementing their suggested solutions that will increase productivity or reduce labour costs. When there are improvements from these suggestions, a portion of the company profit is shared with the team. Long-term incentives such as company equity or a share of company profit when there is a long-term target are especially beneficial for key employees. Such incentives are important in retaining top talent and giving them an opportunity to benefit from the discretionary effort they put into the company.

Money isn't everything when it comes to compensation. Non-monetary employee recognition can also be extremely strategic. It takes 5-8% of pay to have an impact on behaviour with a cash reward and only 4% when a non-cash form such as recognition or modest gifts is used. A presentation process with meaningful non-monetary rewards achieves several goals – saying thank-you, encouraging good workers and encouraging good behavior.

Sourced documents available upon request.

The Insured Annuity—An Often Overlooked Tax Efficient Investment Strategy for Seniors

David Wang, CA, Manager KNV Chartered Accountants LLP

What is an insured annuity?

The insured annuity involves two separate financial products: a prescribed life annuity and a life insurance policy.

A prescribed life annuity provides annuity income for life. The cash flow includes both the principal (non-taxable) and interest component (taxable). Because the taxable portion is lower than the interest income earned by a GIC, the annuity stream is taxed at a lower effective tax rate.

A term-to-100 life insurance policy guarantees the return of the principal at death. Insurance premium payments continue until age 100 when the premiums normally cease while the insurance coverage continues.

An insured annuity is not CDIC insured, rather security is provided by a government-regulated entity called Assuris. Potential investors

should understand how Assuris provides security to insurance-related investments so as to be comfortable that an insured annuity is indeed “low risk.”

Who is it for?

Not all investors are willing to take more risk for a higher yield on their investment portfolios. For investors whose portfolios include conservative investments such as GICs and bonds, moving the money into an insured annuity may be a good way to increase after-tax cash flow without increasing risk.

Because an insured annuity is a lifetime investment, it is generally more appropriate for those individuals who are age 65 or over and not averse to long-term planning strategies. To be insurable, the individual must be in good health and pass a basic physical examination.

How does it work?

A prescribed life annuity typically generates more after-tax cash flow than can be obtained from a conventional GIC due to its preferred tax treatment. See chart for an illustration:

	Insured GIC (4%)	Annuity
Total invested	\$ 100,000	\$ 100,000
Annual income	\$ 4,000	\$ 8,000
Taxable portion	\$ 4,000	\$ 2,000
Tax @ 40%	\$ 1,600	\$ 800
After-tax cash flow	\$ 2,400	\$ 7,200
Cost of life insurance	\$ 0	\$ 4,000
Net Cash Flow	\$ 2,400	\$ 3,200

What are the pros and cons of an insured annuity?

Pros:

The investor can receive more net cash flow with the insured annuity, particularly for those in higher tax brackets.

The death benefits are tax free to beneficiaries.

The investor can potentially avoid probate costs when death benefits from the life insurance bypass his or her estate and go directly to the beneficiaries.

Cons:

The annuity capital is locked in for life, so once the insured annuity is implemented it cannot be undone. For that reason, it is generally advisable to restrict one’s investment in this strategy to a maximum of 30 per cent of available capital.

The purchasing power of annuity income may be vulnerable to inflation. If interest rates rise, the strategy will become less attractive.

Insured annuities are not for everyone, but seniors in higher tax brackets may want to consider them as a method to increase their after-tax income on a low-risk basis. Speak to your advisor before

making any definitive decisions.

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