



Don't Forget About Your Tax Free Savings Account

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In 2011, eligible Canadians can contribute an additional \$5,000 to their Tax Free Savings Account ("TFSA"). The opportunity for savings are compounding and worth revisiting:

TFSA vs. RRSP

On the assumption that you will withdraw the funds during retirement in a year which your income is less than the year you made the contribution, there is likely a tax savings by maximizing your RRSP's prior to contributing to your TFSA. That being said, RRSP's can yield some undesirable results.

Tax-Free Savings Account

For example, when the last surviving spouse dies, the money in the RRSP or RIF is taxed as income in the taxpayer's hands on their final tax return. In some cases an individual with a working class income may have received a deduction worth 30 cents on the dollar during the years that they were making RRSP contributions. Now in the year of death, a significant portion of their RRSP or RIF could be taxed as high as 44

cents on the dollar. Under this scenario, there is a tax cost from investing in an RRSP versus a TFSA.

TFSA vs. Personal Debt

Consideration of whether to use excess funds to pay down personal debt such as a mortgage, or to contribute to a TFSA will depend on the circumstance. In particular, the investment opportunity within the TFSA versus the interest rate payable on the personal debt. For example, if the interest rate payable on the personal debt exceeds the expected return on investment within the TFSA, then this would favor paying off the debt. If liquidity is desired, a TFSA may be preferable. If liquidity is not a concern, then it may be preferable to repay the mortgage. Remember the interest you are avoiding is effectively a risk free return on your investment.

Contribution Room and Over-contributions

Unlike RRSP's, when funds are withdrawn, your contribution room is not lost, so where funds are going to be contributed, withdrawn and re-contributed with some regularity, a TFSA is likely preferable. Please don't fall into the same trap as many Canadians with respect to the rules involving withdrawal and re-contributions. Note that your

contribution room is not refreshed until January 1st of the following year.



For example, if you contributed \$10,000 to your TFSA in January 2010, withdrew it in June and re-contributed it in November you have over-contributed (subject to penalties) because your June withdrawal does not create additional contribution room until January 1, 2011.

Generally, if you are earning investment income outside of a registered plan you should consider utilizing your TFSA so the investment income is not subject to tax. While maintaining your desired asset mix, it is advisable to hold interest producing assets in your TFSA because dividends and capital gains are taxed more favorably than interest.

IMPORTANCE OF SHAREHOLDER AGREEMENTS

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Corporate Governance

There is no substitute for good corporate governance and companies of all sizes are better served by good governance practices. A shareholder's agreement is a set of ground rules that shareholders use to govern their professional relationship and behavior with respect to owning the company. A shareholder agreement can protect the expectations of the shareholders and provide some protection from future uncertainties and potentially large legal fees.

Typical Situations that Warrant Shareholder Agreements

If your business has more than one founding shareholder or has recently brought on a small number of additional shareholders as a growth strategy, you may be an ideal candidate for drafting a shareholder's agreement.

Suppose that you and the other founding 50% shareholder have an irreconcilable difference, personal or professional. Without an agreed upon method for dispute resolution, the likely default resolution mechanism is a trip to the lawyer and expensive mediation or lawsuits.

In the event where the other founding 50% shareholder of your company subsequently dies and his/her shares are assumed by the surviving spouse, that spouse now has a 50% say in the appointment of corporate directors. When the spouse's ideas run contrary to those that brought the business to its current success, conflict will likely ensue. At best, this is a situation that will cause significant stress for you, at worst the future looks good for your lawyer's billings.

When the time comes that you want to divert your energies from your business to a life changing trek up Mount Everest, your business needs clarity. It is unlikely that the other 50% shareholder will want to have to shoulder the entire responsibility of running the company and then pay you half the dividends.

These are just a small sample of potential situations that can be resolved in a manner agreeable to all shareholders, at a time when relations are good and feelings are mutual.

Clauses to Consider

The shareholder's agreement can include a multitude of clauses to deal with a multitude of potential issues between

shareholders. Some common clauses include:

- General share transfer restrictions, including rights of first refusal
- Corporate share repurchase clauses
- Dispute resolution clauses
- "Drag along" and "piggy-back" rights
- Veto rights for significant shareholdings

Next Steps

Preparing and discussing such an agreement will give you valuable insights into the compatibility of the individuals involved personal goals, objectives and propensities to take risk. It should force a close and honest evaluation of who will do what and who is committed to doing what. Even if you're not sure about certain things, there is less risk in creating an agreement now and then fixing it if necessary, i.e. revise an agreement later rather than defer having one in the first instance.

If any of these examples could apply to your corporation and you would like to explore the benefits of a shareholder agreement in more detail, we invite you to discuss this strategy with a KNV advisor.

WHAT IS
YOUR
PLAN?

2010 TAX CONSIDERATIONS

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Paying Interest on Income Splitting Loans

If you have made an income splitting loan to your spouse, a minor, or a family trust, the interest for 2010 (calculated based on the prescribed rate in effect when the loan was established) must be paid by January 30, 2011. If the interest is not paid, any investment income earned on account of the loan principal will be attributed back to you.

Tax Matters to Attend to Before the End of 2010

Supporting Distributions From a Family Trust

If it is your intention to allocate private company dividends to the beneficiaries of a family trust in 2010, KNV encourages the following practice. The Corporation pays a dividend and the cash is deposited into the family trust's bank account. Next, distributions are made by a payment from the Trust's bank account to the Beneficiaries bank account prior to the end of the year.

Utilizing Capital Losses

If you have incurred capital gains in 2010, you may want to consider selling securities with unrealized losses before the end of 2010. Any capital losses that are 'triggered' will be available to offset the capital gains. You can re-acquire the investments sold but you must wait until 30 days after the disposition; otherwise, the transaction will be considered a "superficial loss" and the capital loss will be deemed to be nil.

ARE YOU ENTITLED TO A DEDUCTION ON INTEREST YOU ARE ALREADY PAYING?

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Explore Possibilities

You may be able to access a deduction on the interest you are already paying (for example, on your mortgage) by restructuring your financial affairs. The following are examples of situations that may facilitate planning opportunities to convert interest paid on personal loans into tax deductible interest:

- Shareholder loan balance owing to you from your business
- Personal investment portfolio

Examples

Let's assume you are in the highest personal tax bracket paying tax at a rate of approxi-

mately 44%, and you were able to convert 100% of the interest paid on your personal debt into tax-deductible interest. Paying interest at a rate of 5%, you have an opportunity to save approximately \$2200 per year on every \$100,000 in debt.

Applying this theory further, say you have a mortgage of \$400,000, amortized over 25 years at a rate of 5%. In the first year you would pay approximately \$19,600 in interest and would have a potential tax savings of approximately \$8,600 if 100% of your interest was tax deductible. Over a five-year term you would pay approximately \$93,600 in interest and would have a potential tax savings of

approximately \$41,200 if 100% of your interest was tax deductible.

Next Steps

These planning opportunities pertain to debt structuring and restructuring. To date, the courts have not placed a limitation on the deduction of interest where a taxpayer rearranges his or her affairs to finance personal assets with equity and income-earning assets with debt.

Should you wish to discuss this opportunity further with us, please contact our office.



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“The great thing in this world is not so much where we stand, but rather in what direction we are moving.”
-Holmes

KNV Chartered Accountants LLP understands that in today’s complex and fast moving world how important it is to provide services that consistently assist clients in reaching their goals.

We are committed to exceeding our client’s expectations and extending our experience in the many areas of business and accounting expertise.

TOP 10 BUSINESS BOOK RECOMMENDATIONS

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Benefits of Reading Business Books

Business books are great tools for enhancing knowledge in the aspects of planning your business operations as well as developing comprehension of your overall operation in terms of human resources, marketing, customer service, financial budgeting, management and so much more. Quite often these books can be a manual, so to speak, in relation to the development of your own business and give insights to help understand many topics with different levels of complexity. Having the resource at your fingertips allows you to learn at your own speed and put it into practice on your own time. Generally, small business books are more cost/time efficient and written by authors who are experienced in similar scenarios to you at that moment or will go through in the future. Experience is sometimes the best teacher.

Recommendations

With input from the management team we have comprised the following list of business reading recommendations that may be of use and interest to you and the members of your team:

- *From Good to Great* by Jim Collins
- *The 360 Degree Leader* by John C. Maxwell
- *Freakonomics* by Stephen Dubner and Steven Levitt
- *The Five Dysfunctions of a Team* by Patrick Lencioni
- *The Millionaire Next Door* by Thomas J. Stanley and William D. Danko

- *The Wealthy Barber* by David Chilton
- *Fierce Conversations* by Susan Scott
- *The Big Short* by Michael Lewis
- *Outliers* by Malcolm Gladwell
- *The 4-Hour Workweek* by Timothy Ferriss

At KNV we are committed to staying apprised and up to date with topics and resources that assist our clients in reaching their goals.