

# IFB Summit: Prepare For Tax Changes

BY ROMANA KING

Canada can be described as a vast and diverse nation with many peaks and valleys. According to Peter Wouters, the same can be said regarding the nation's tax and estate planning legislation.

At the Independent Financial Brokers' Spring Summit, Wouters, director of tax and estate planning at Empire Life, suggested that agents be prepared for upcoming

changes to the recently updated *Bankruptcy and Insolvency Act*.

Lawyers, bankruptcy trustees and other interested parties were under the assumption that consultative talks would take place before the new legislation was passed, but that was not the case. The amendments to the *Bankruptcy and Insolvency Act* were passed and received royal assent just before the holiday

season, says Wouters, with the expected changes to take place six to 12 months from now.

The issue is that disparate rules apply to employed and self-employed individuals who run into solvency issues.

"If you were to work in a company and find yourself in financial hardship requiring you to declare bankruptcy, your retirement – through your pension – is protected," explains Wouters. "But if you were self-employed, and you placed the same amount of money into an RRSP for your retirement, that money is up for grabs if you are forced to declare bankruptcy. It's this basic unfairness that prompted the federal government to amend the act. They wanted to create some type of legislation to create equity – to level the playing field."

The problem that many trustees foresee is that the new legislation will enable people to "squirrel away" money into their RRSP before declaring insolvency.

"The argument is that anyone

**Continued on page 16**

that declares bankruptcy knows that they are in financial difficulties long before they apply for protection.”

Under the new legislation all contributions up until a year before the declaration of bankruptcy would be protected. However, at the present moment this is not the case.

The legislation received royal assent and became a statute in December 2007, but has not yet been enacted into law, explains Barry Corbin, founder of Corbin Estates Law, a Toronto-based practice specializing in estate law.

While advisors and other interested parties can expect the statute and its amendment to become law,

**Consider the amended *Bankruptcy and Insolvency Act* the equivalent of a will held by a person who is still alive – it’s just a piece of paper.**

there is the potential for another amendment that could alter the current statute, says Corbin.

While the details are still being sorted out, the current amendments, which are not officially incorporated into the *Bankruptcy and Insolvency Act*, provide protection to all RRSP contributions prior to the 12 months before the date bankruptcy is declared.

Consider the amended act the equivalent of a will held by a person who is still alive, says Corbin. It’s just a piece of paper until the person dies.

### TFSA LIMITS

Agents were also advised to consider the limitations of the Tax-Free Savings Account (TFSA), effective January 2009.

“I’m not saying I don’t want one,” says Wouters, “but I am aware of the limitations.”

When originally introduced in the February federal budget, the TFSA was being touted as a major breakthrough for low-income, affluent, self-employed and any other tax-earning individual.

This is because the annual contribution of \$5,000 and the growth on this and subsequent annual contributions are not subject to tax, says Wouters. He also points out that the funds in a TFSA – although subject to tax if withdrawn – can be used for any purpose over a person’s lifetime and, given that the TFSA is accrued annually, any withdrawal would free up contribution room (up to the \$5,000 per annum limit).

Also, this new tax-deferred investment vehicle was indexed to inflation, provided additional room (rounded to the nearest \$500), enabled a contributor to withdraw and then add that amount to the available contribution room and only taxed excess contributions at 1% tax per month.

However, Wouters points out the first and biggest limitation is that the TFSA is capped at \$5,000. Another limitation is that while the growth on the investment is protected from tax, the gains (and principal) can only be transferred to a spouse tax-free. If the TFSA is transferred to the

**A TFSA is a tax-deferment for myself, but if I’m concerned about having a tax shelter that I can pass on, I should look at other products.**

estate, another family member or another entity, that person is responsible for the taxes on the future growth within the TFSA.

“If a person does not bequest it to a spouse, the TFSA sits in the estate and will go through probate – then all the investment [future] growth is fully taxable, meaning my heirs have lost the tax shelter capacity after my demise,” he says.

While Wouters believes the TFSA is a good vehicle, he does not believe it is the panacea for clients as previously suggested.

Instead, he encourages agents to look beyond the TFSA and re-examine current life policies that provide much more flexibility, control and after-death tax protection.

For example, a special design life policy would enable parents to bequest money that maintains its tax-free status and offers the parents more control over what their children can spend the money on.

“I may create a TFSA for my children, but it’s their money, which means if I deposit \$5,000 into a TFSA in their name, they can choose to spend that money however they like,” explains Wouters. With life policies there is more control and any unused room that a parent has not used can be topped up by the child.

“A TFSA is tax-deferment for myself, but if I’m concerned about having a tax shelter that I can pass on, I should look at other products.”

### ALSO CONSIDER

Among the other highlights cited by Wouters were the recent legislative changes that affect seniors, snowbirds and non-residents – people most likely to own LIFs, LRIFs and LIRAs.

Under July 2007’s new locked-in rules, the new LIFs came into effect January 1, 2008. These new vehicles provide more flexibility in payments and allow owners time-limited opportunities to withdraw up to 25% of any amount transferred into a New LIF (this 25% withdrawal is not available on Old LIFs); it also allows owners to directly transfer money from a locked-in account (LIF) to an unlocked vehicle, such as an RRSP or RRIF (in certain situations). Applications for unlocking due to financial hardship or shortened life expectancy are still permitted.

Also, as of January 1, 2008, eligible non-residents of Canada who own locked-in accounts may apply to withdraw the money (this option is not available with non-resident purchased annuities).

Other factors to consider:

- Owners may transfer money into a LIRA or a New LIF from an Old LIF/LRIF until the end of the year they turn 71 (as long as they meet the Dec. 31, 2008, deadline).
- Owners can still purchase an annuity by age 80, but this is no longer required.
- If an owner of an Old LIF/LRIF dies, the surviving spouse (or named beneficiary) is entitled to the full amount in an unlocked lump sum.

As of January 1, 2008, spouses can transfer this full lump sum amount into their own RRSP or RRIF where permitted by federal legislation (*Income Tax Act*).

“In order to ensure maximum income payment for 2008, arrange to receive all possible income payments from the Old LIF before buying the New LIF,” explains Wouters. “Once the New LIF is purchased with a transfer, the amount paid from the New LIF drops to zero for the balance of the year.” However, Wouters adds, “the transfer must be structured so at least the minimum income payment amount required from the Old LIF is paid out.”

He also suggests that agents consider what to do when a client reaches age 55 and has less than 40% of the year’s maximum pensionable earnings under the Canada Pension Plan (\$17,960 in 2008). “The owner may transfer the entire amount directly to his or her own RRSP or RRIF rather than receiving a lump sum.”

Wouters sums up that, while recent changes are not onerous, it is necessary for advisors and agents to be aware of factors that will affect their clients – particularly the pre- and post-retirement demographic. Wouters suggests reading up on LIFs, TFSAs, increases in RESP accumulation and withdrawal period, changes to the dividend tax credit, the substantial changes in the donation of securities to private foundations, and ascertaining what is now included as qualified medical expenses, as well as examining the RDSP amendments.

“There is a lot and it’s hard to get all the facts out in a compressed period of time,” says Wouters, who presented to a packed auditorium at the IFB’s Spring Summit, held on May 27 and 28 in Toronto. But, he concedes, it’s all relevant and important information for both agents and clients. **AER**