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Proposed Pension Income Splitting – What Does it Mean?

By **Brenda Nugent**, Vice President Corporate Planning Associates

On October 31, 2006 Finance Minister, Jim Flaherty announced changes to the taxation of income trusts as one part of Government's Tax Fairness Plan. The income trust announcement to no one's surprise garnered a great deal of media coverage and continues to remain a point of contention today. Another part of this Tax Fairness Plan is the proposal to allow spouses and common-law partners to split their pension income when calculating their taxes, which could effectively reduce the total income tax paid by the couple.

So what does the proposal mean?

If implemented the proposed splitting of pension income would allow individuals aged 65 years and older the ability to allocate up to one-half of their eligible income to their spouse or common-law partner. For those individuals under the age of 65, lifetime annuity payments from registered pension plans would qualify.

Eligible income includes payments from:

- registered pension plans (RPPs) – these are typically employer-sponsored or workplace pension plans
- registered retirement savings plans (RRSPs)
- deferred profit sharing plans
- registered retirement savings funds such as RRIFs

Payments from the following sources are not eligible for income splitting:

- benefits from public programs such as Old Age Security (OAS) and the Canada/Quebec Pension Plans (CPP and QPP)
- "top-up" schemes such as retirement compensation arrangements (RCAs) and supplemental pension plans

Unlike the assignment of CPP benefits, which allows for the income to be split and the resulting payments received by each spouse, this proposal would still see the income flow to the annuitant of the RRSP or the pension plan. The

full income and any applicable tax withheld would be claimed on their tax return. The taxpayer could then allocate a percentage to a maximum of 50% to their resident spouse or common-law partner. The ability to share pension income would be effective for the 2007 returns filed in the spring of 2008.

For a couple where one spouse receives \$100,000 of eligible pension income, the federal tax savings would be \$5,136. If the \$100,000 was claimed on one return, 15.5% tax would be paid on the first \$37,178, 22% on the next \$37,179 and 26% on the balance for a total of \$18,915. Under the proposed income splitting plan, each spouse would pay tax of 15.5% on the first \$37,178 and 22% on the balance of \$12,822 which would result in a combined tax due of \$13,779.

In addition to each spouse working through the graduated tax brackets, splitting the pension income has allowed them to double up on the non-refundable personal tax credits including the basic personal amount and pension income amount.

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The Gentle Art of Elder Care

By Julie Charles and Karen Henderson

This article appeared in the Mackenzie PROFESSIONAL™ January 2007 issue and is reprinted with the permission of Mackenzie.

Well, that mother, she got older. She got older and older and older. One day she called up her son and said, “You’d better come see me because I’m very old and sick.” So her son came to see her. When he came in the door she tried to sing the song. She sang: “I’ll love you forever, I’ll like you for always,” But she couldn’t finish because she was too old and sick.

From the children’s book *Love You Forever* by Robert Munsch, illustrated by Sheila McGraw (Firefly).

There’s a popular children’s story by Guelph-based writer Robert Munsch called *Love You Forever* that begins with a young mother rocking her new baby boy. It ends with the son rocking his sick and elderly mom before rushing off to sing to his own new baby.

This cycle-of-life tale is an unlikely bestseller: some people find it depressing and dark. Munsch’s first publisher gave it a pass, citing it as “too adult.” Those who love the *Love You* story, though, are often moved to tears. Sales have transcended every age group – the book is hugely popular in retirement communities says its writer, and there are now more than 15 million copies in print worldwide.

The passionate reaction to this simple story of growing up and getting old, and a mother too sick to sing anymore, hints at the intensity of emotion in a generation coming to terms with its mortality. The responsibility of caring for aging relatives – and coming to grips with our own sagging minds and bodies – is starting to interfere with our rose-tinted, palm-tree-lined version of baby boomer retirement.

The role of financial advisors should not be on the sidelines on this sensitive issue, says Karen Henderson, a Toronto-based consultant and educator on long-term care. She has been sounding a wake-up call for advisors to take the lead in helping clients prepare for this inevitable life challenge. Inspired by a

difficult but rewarding 14-year experience providing long-term care to a parent, Henderson founded the Long Term Care Planning Network, Canada’s only national education and resource centre for caregivers and financial professionals.

She says advisors can add value to client relationships by simply offering the facts and pointing them toward available resources – it’s not just about products like insurance. It’s easy for people to put long-term care planning on the back burner, says Henderson, unless there’s a reality check on the consequences.

“A lot of people in their 60s, or even in their 50s right now, are saying, ‘you know what, I don’t care. I want to live for the here and now, while I have my health. I want the big house and the big car’.

“Well guess what: if you go into a nursing home, you may change your mind. Because you’ll see how people live without any money and without the money to hire an advocate, and it ain’t a pretty picture,” says Henderson.

This picture remains all too vivid in Henderson’s mind. In the years during which she took care of her own aging father, who spent his last days in a long-term care facility suffering from dementia, Henderson learned about the strains – emotional and financial – endured by the elderly who depend on care. As a caregiver, Henderson knows she is one of the lucky ones: her father

Ralph, a stock broker and financial executive by profession, made sure his finances were well taken care of.

“He was around money his whole life, and knew how quickly you could lose it,” says Henderson. “And he knew, especially after having five kids, that you have to plan and you have to save. From the moment that I can remember, his message was: one, you never want to live beyond your means; and, two, you never want to be poor when you’re old.”

For most caregivers, the biggest shock is a shattered assumption that the government will take care of all major costs, says Henderson. When it comes to home care, in particular, provincial systems may limit coverage of paid assistance to just a few hours a week if a son or daughter is assessed to be available as a primary care giver.

“That comes as a rude surprise. Anything else that you want comes out of your own pocket,” says Henderson. She knows people who spend \$4,500 to \$5,000 a month on staff to assist aging parents suffering from Alzheimer’s, “and that’s not even overnight care.”

According to Statistics Canada, more than 1.7 million Canadians between the ages of 45 and 64 are responsible for the informal care of some 2.3 million seniors who have long-term disabilities or physical limitations. Caregiving also has consequences on jobs and earnings – one in five female caregivers said the need to look after a family member will be a likely reason to stop working.

A LOOMING CONCERN

Henderson’s message is starting to resonate in an industry that serves an aging demographic group. The leading edge of the boomer generation turns 61 this year, and it’s starting to show.

“We come across it all the time among our clients: everybody’s family seems to have somebody in palliative care,” say Gerry Montcalm, president of Montcalm & Associates Financial Group, an independent financial planning and group benefits expert located in Moose Creek, Ont., south of Ottawa. Montcalm heard Henderson speak at a recent advisor event in Collingwood, Ont., and her presentation struck a chord, he says.

Montcalm and his siblings have seen both parents suffer through terminal illnesses, with their father passing away in 1982, then their mother in 1999. “As her last wish, our mother asked to spend her last days at home,” he says, “so we did the 24/7 caregiving for eight or nine months.”

His brother Conrad Malcolm, a financial planning and investment/retirement planning specialist and designated Personal Financial Planner (PFP) with more than 30 years experience, says he welcomes any tools and educational resources that can help break the ice to broach the topic of long-term care.

“I feel it is a conversation that is often not accepted by clients,” says Conrad. He cites resources like Henderson’s Long Term Care Planner and other educational materials as long overdue tools.

Advisors can do their clients a great service by setting the groundwork for financial decisions that incorporate long-term care planning, says Henderson.

DELICATE SUBJECT

“The first conversation should really be between your client and his or her family. This could be the client asking his parents ‘what do you want, mom and dad, as you age?’ The greatest gift a parent can give to an adult child is to tell them what they want as they age. We shouldn’t have to guess,” says Henderson.

“The next conversation should happen between the advisor and the client. The client is now more familiar with what it’s like to care for aging parents, and has a better sense for what’s going to be down the pipe for him or her into the sixties and seventies.”

- The prevalence of chronic diseases is increasing among the elderly. In 2005, 91% of seniors reported one or more chronic health conditions as diagnosed by a health professional, compared to 87% in 2000/2001
- According to the Alzheimer Society of Canada, one in three Canadians over the age of 85 will suffer from some form of dementia
- By 2031, it’s estimated 750,000 Canadians will suffer from dementia – touching one in three families

Mark your Calendars! 2007 Tax Dates to Remember

March 1, 2007	RRSP Contribution Deadline
March 15, 2007	First Income Tax Instalment Deadline
April 30, 2007	Individual Filing Deadline
June 15, 2007	Second Tax Instalment Deadline Tax Filing Deadline for the Self-Employed
September 15, 2007	Third Tax Instalment Deadline
December 15, 2007	Fourth Tax Instalment Deadline

Corporate Wealth Management

By **Joe de Tuba**, *Managing Partner CPA Capital Corp. and Senior Vice President Corporate Planning Associates*

CPA Capital Corp. (“CPAC”) offers its services as an independent financial advisor and corporate finance specialist to Canadian owners and operators of small to medium size business. CPAC offers a continuum of corporate finance services to the client throughout its business cycle with the ultimate objective to ensure that the owner/operator achieves financial independence through sound planning techniques and intelligent investment strategies.

One may ask, “Why focus on this sector?” Let us define the size and opportunity of this sector as a compelling market niche for CPAC services.

Firstly, in Canada, there are over one million businesses that have full-time employees. Of these, 98% are small businesses with less than 100 employees. This small business sector is the driving force of Canada’s economic growth accounting for 80% of all new employment and generating approximately 43% of Canada’s economic output.

Secondly, according to a recent study there is an estimated \$1.2 trillion dollars in business assets that will be transferred to the next generation of business owners by 2010. In another study published in 2005, it is estimated that 71% of Canadian entrepreneurs are planning to retire in the next ten years with 41% planning to do so in the next five years. More than 35% of these entrepreneurs are planning to sell their business to new owners and about

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25% have no plans yet. Among those that have prepared a succession plan, the majority are considered informal and unwritten.

These statistics reveal that a significant number of small business owners and operators are not properly prepared to sell their business and as a consequence put at risk their ability to maximize value for the business and to achieve financial independence.

INTRODUCTION TO VALUE ASSESSEMENT

The first step for every potential seller is to perform a self-assessment to determine what it is they are hoping to achieve and why they are interested in selling. Knowing where you are today and where you want to go are part of the self-assessment process. Have steps been taken to maximize the value of the business? Has a business plan been created? Has a succession plan been prepared? Has a personal financial plan been completed? When these questions have been addressed, then and only then can one determine whether a sale will achieve financial independence and one's life goals.

Once the decision has been made to sell the business, one must critically examine the operations of the business to ensure that maximum value may be achieved. A buyer's approach to value is focused on the assessment of risk associated with the investment and the expectation of profits. However, determining the value of a family owned and/or owner/operator business is one of the most challenging if not most contentious aspects of the sale process. Consider that publicly traded companies operate to maximize profits to satisfy

shareholders interests, whereas privately held enterprises seek primarily to satisfy life style requirements and are typically focused on tax minimization strategies. Because the characteristics of entrepreneurs and owner/operators are independence and non-conformance with traditional practice, we, at CPAC don't always subscribe to traditional methods of arriving at price and value in small privately held businesses. It is important to realize that regardless of what product, service or entity is sold, it is ultimately the consumer who will decide the success or failure of the business. As a consequence the consumer of a smaller company's goods and services is most likely to be inordinately attached to the personality and characteristics of the previous owner. Remove him or her from that business and what the new owner inherits may not be an appropriate match in terms of today's value. Therefore the bad news for the seller is that the business may not be worth as much as initially thought. The good news is that by taking the right action, the seller can increase the value of the business.

One last thought. A message that we give to sellers who want to include future earnings as part of the value is that future earnings belong to the buyer taking the business into future events. If you want future values stay with the business, make the future happen and sell when you have reached the target value of your choice. Our message to buyers is – don't pay prices today that are based solely on future earnings. However, don't acquire a business that cannot sustain earnings into the future.

We will continue to expand our commentary on Business Value Assessment in subsequent newsletters.

CPAC offers the following services: 1. Private Placements of Debt and Equity 2. Management Buyouts 3. Financial Restructuring 4. Leveraged Buyouts 5. Mergers and Acquisitions 6. Business Value Assessments.

Pension Income Splitting

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There will be additional tax savings on the provincial side depending on the taxpayers' jurisdiction with the exception of Alberta due to the flat rate of 10%.

Under this Tax Fairness Plan, the government has also proposed changing the amount used to calculate the age credit. The change, which is retroactive to January 1, 2006, would see the amount increase by \$1,000, from \$4,066 to \$5,066. It should be noted that the tax credit claimed on this amount is phased out for incomes between \$30,270 and \$64,043 (up from \$57,377). The example above has not included a tax credit for age.

While the proposed change to age credit will benefit single or widowed seniors, the ability to split income obviously will not.

New Payment Options

CPA is pleased to announce that we are now offering a Pre-Authorized Payment plan to our clients.

This payment option will allow clients to have their payments automatically withdrawn from their bank account. Clients will no longer have to write and mail cheques to pay their invoices.

We will be mailing a letter describing this new payment service in detail in the next few weeks.

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Corporate Planning Associates
Suite 1700, 320 Bay Street
Toronto, Ontario, M5H 4A6

Tel: (416) 364-7898

Fax: (416) 364-6438

Managing Editor: Sitara de Gagne

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