



Strategies & Tax Update

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Fedder, Gurau & Staniewski
chartered accountants

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The new Tax Free
Savings Account

Professional Corporation 2008 update

Personal Income Tax Information must be
submitted by April 15, 2008 to ensure
completion by April 30th filing deadline.

2008 Federal Budget Highlights

The major personal benefit that was announced in Jim Flaherty's Budget last week was the introduction of the Tax Free Savings Account (TFSA) concept. Commencing in 2009 this vehicle will provide Canadians with an opportunity to save money on a tax-free basis. These savings will always be accessible and as long as the guidelines are followed both the savings and the income earned by these savings will not attract tax when withdrawn.

To be eligible for this TFSA an individual must be at least 18 years old and have a SIN when they open an account and be a resident of Canada. There is no limit on the number of plans that an individual can have. The only limitation is the amount of the annual contribution.

The annual limit that an individual can contribute is \$5000. This amount is scheduled to be indexed each year after 2009. As well the contribution room is cumulative, meaning that if you do not contribute the maximum \$5000 in a year the unused

contribution is added to the following year's \$5000. For example if in 2009 an individual contributes \$3000, then in 2010 they would be eligible to contribute \$7000. Also unlike RRSP's, if an individual withdraws money from their TFSA then this withdrawal amount is added to the contribution limit, giving the individual the opportunity to refresh the account when funds become available. Important to note is this withdrawal did not create any tax liability.

As stated above the withdrawal from a TFSA is not taxable. The other side of this equation is that any contribution is not deductible. As the money coming out is not considered income it will not have any affect on an individual's eligibility for tax credits (the age credit, GST tax credit and Ontario Property Tax Credit), income based benefits (guaranteed income supplement) and the clawback of Old Age Security benefits.

You will be able to invest in most qualified instruments that are available for RRSP's. An exception

will be that one cannot invest in a non-arms length entity. An individual can borrow funds to put into the TFSA but the interest will not be deductible. Another difference from RRSP's is that the TFSA can be used as collateral for a loan. One spouse can give money to the other spouse's account and not be subject to attribution of the income earned. If there is a marriage breakdown, funds can be transferred between accounts without penalty. On death the account can either be paid into the Estate, without a tax liability, or can be transferred to the surviving spouse. If the individual becomes a non-resident they can hold their account, continue to earn income on a tax free basis but will be ineligible to make contributions or accumulate room.

The decision on whether to contribute to a RRSP or TFSA will depend on the expected tax rate at the time of withdrawal. If your tax rate at the time of withdrawal is expected to be lower than it is at the time of the contribution then it appears that the RRSP will be the

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better decision. If the tax rate is expected to be higher at the time of withdrawal then the TFSA route will be the better decision. As with all tax motivated programs there will be significant analysis undertaken before the 2009 implementation date. Stay tuned.

Professional Corporations

Save by Deferring Tax

Starting in 2008, the corporate income tax rate has been decreased to 16.5% on taxable income less than \$400000. If you can keep funds in the corporation it is the best way to build wealth in addition to an RRSP.

Salary for Maximum RRSPs

The RRSP contribution for the 2008 income tax year is \$20000. In order to maximize these contributions you need to pay a salary of at least \$112000 for the year. This will also provide maximum CPP contributions each year.

Income Split With Dividends

Wages paid out to family members require job descriptions to justify the wages that are paid. This means that there are limitations on the wages that can be paid depending on the business operations. Dividends can be paid to individuals who own shares of the corporation. A dividend in the

amount of \$35000 can be paid out with no personal income tax. If a spouse has no income and a dividend in the amount of \$120000 is paid to the spouse, there is a tax savings of \$17500 versus paying the dividend to the doctor. If the spouse has employment income of \$30000, a dividend of \$80000 can be paid and there will be a tax savings of \$8100 versus paying the doctor paying tax on the income.

Salary versus Dividend

If the doctor is paying income tax at the high marginal tax rate should additional salaries be paid or dividends if funds are required personally? An additional \$10000 salary would cost \$4660 of income tax. A \$10000 dividend would cost \$4280 of income tax. There would be a tax savings of \$380 by paying a dividend versus a salary. Therefore, it is most advantageous to pay a salary for maximum RRSP contributions and any additional funds required are to be paid by dividend.

Income over \$400000

Any corporation that earns net active business income over \$400000 is subject to pay income tax at a higher rate. The corporate tax rate is 38.1 %. When the funds are paid out of the corporation to the shareholder the total income tax is 53%. This is significantly higher than the highest personal income tax rate of 46%. Therefore, there is no advantage to pay income tax on income over \$400000 in the corporation.

Investment Income

When funds are used to purchase investments in the corporation, the investment income is taxed at the following rates:

Interest income - 48.67%
Dividend income - 33.33%
Capital gains - 24.33%

One-half of the capital gains can be paid out of the corporation tax-free. If a dividend is paid out the 33.33% corporate tax is refunded and personal tax is payable of 21.25%. There is a savings of 12.08%.

Important Dates

*Personal Tax Installments
Due March 15, 2008
Due June 15, 2008*

*Corporate Tax
Balance due 3 months after fiscal
yearend.*

*Personal Income Tax filing deadline
April 30, 2008. To ensure return is
completed by the deadline kindly
submit all information to us by April
15th.*

Referrals

*We would like to take the
opportunity to thank our clients who
value our service and have
recommended our firm to others.
We thank you for contributing to the
success of our firm.*

Partners

Victor Staniewski, CA
Irving Gurau, CA