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LLP

FOUNDATIONS

IDEAS & TECHNIQUES TO BUILD YOUR SUCCESS

INDEX

the future of
your RRSP.....1-2

health insurance
premiums.....3-4

up close and personal.....3

dates and deadlines4

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The primary purpose of
Foundations is to provide you, our
clients and friends, with timely
and useful advice and information
on a tri-annual basis (December,
June and September). In the
months ahead, we will be
bringing you helpful tips for
saving taxes, growing your
business, managing and investing
your money wisely and planning
for your financial future.



CHARTERED ACCOUNTANTS
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the future of your RRSP

Many Canadian taxpayers have been able to build substantial RRSP's that will one day supplement their pensions and other sources of retirement income.

Since the inception of this strategic retirement savings program, the RRSP has become an attractive investment for many taxpayers. An RRSP offers the contributor both immediate and long-term benefits:

- a reduction of personal income tax for the year in which the contribution is made
- the security of knowing that these savings will help finance your future retirement but can also be accessed in the event of an emergency
- the deferral of taxes on the income and capital gains on the RRSP investments that accrue within the plan, and
- substantial savings in taxes if your income (and marginal tax rate) is lower at the time you make withdrawals for your retirement.

withdrawals from RRSPs

Generally, you can withdraw funds from an RRSP at any time and the tax consequences are very straightforward – the amount of your withdrawal is fully taxable in that taxation year. As these savings are for your retirement, withdrawals should only be made in the case of an emergency or in a year in

which your income is particularly low. It is very important to get tax advice before you consider withdrawing RRSP funds prior to the maturing of your plan.

However, the lifespan of the RRSP does not continue beyond the year in which you turn age 69. In that year, the RRSP is said to have matured. That is, you must terminate your RRSP in the year in which you reach age 69.

You do have options for winding up the RRSP. Besides a lump sum withdrawal (which would be subject to tax in that year), you can purchase a life annuity or fixed term annuity and pay taxes as the payments are received. However, annuities lack flexibility and the rates of return may not be competitive with other investments. Your other alternative is to transfer the funds on a tax-free basis to a Registered Retirement Income Fund (RRIF). Note that if you do not select one of these options by the end of the year in which you turn 69, the RRSP is automatically deregistered. For tax purposes, this deregistration is treated as if it is a lump sum withdrawal so a high portion of the funds would be taxed at the maximum tax rate.

continued on next page

the future of your RRSP continued from page 1

registered retirement income fund (RRIF)

A RRIF is managed in much the same manner as an RRSP; however, deductible contributions cannot be made to a RRIF. For this reason, there is usually no advantage to establishing a RRIF prior to age 69.

Once inside the RRIF, the assets can be managed by the trustee of the plan according to the taxpayer's directions. The wide range of qualifying investments that can be acquired in a RRIF may make it possible to achieve a better rate of return than those available through the purchase of annuities.

The RRIF offers some degree of flexibility as there is no maximum to the amount that you can withdraw in a year. However, it is important to note that you must withdraw a minimum from your RRIF each year. The *Income Tax Act* sets out the percentage of the fair market value of the RRIF assets that must be withdrawn (and are subject to tax) each year, beginning in the year following the year that the RRIF is established. If the RRIF is established at age 69, the percentage starts at 4.76% and increases until it reaches 20% at age 94. At age 94, it stays at the 20% level until such time that you die.

what happens on death?

Whether you currently have an RRSP or have transferred your funds to a RRIF, make sure you designate a beneficiary. Amounts received by your spouse or financially dependent children will be taxable in their hands; however, the tax on the receipt of these amounts may be eligible for deferral if they transfer the funds to an RRSP or annuity. If you do not designate a beneficiary, your estate will be taxable on the fair market value of your plan at the time of your death unless your legal representative jointly elects with the spouse/partner or financially

dependent child to transfer the amount to him or her in which case it would be taxable in his or her hands.

You also need to revisit your assignment of beneficiaries periodically to reflect changes in your life such as separation or divorce, the birth of a child, or the death of a beneficiary.

an example

Let's look at an example. A taxpayer who was in the top tax bracket began making annual RRSP contributions of \$10,000 on January 1, 1983.

Throughout the years 1983 to 2002, he received a 6% return on his RRSP investments. By January 1, 2002, the RRSP vehicle had allowed him to defer almost \$100,000 in income taxes while his RRSP portfolio grew to an aggregate principal and interest value of \$367,855.

In 2002, he reached age 69 and as the RRSP must be terminated before December 31st of the year in which you reach 69, he transferred the funds to a RRIF. Unfortunately he met an early demise in 2003.

Taking into account the additional interest of \$22,071 that his investments would earn in 2002, the value of the RRIF at December 31, 2002 would be \$389,926. The RRIF would have provided a minimum payment of \$18,560 for 2003. If this payment had been made, the remaining balance of the RRIF would be \$371,366. The tax on this remaining amount, depending on the tax jurisdiction, would be approximately 45% of the RRIF face value, or \$167,115. (The lowest tax rate is in Alberta and the highest in Newfoundland.)

How could he have protected his estate from this substantial tax liability on death?

RRIF transfers on death

When a RRIF annuitant dies, the spouse or common-law partner can become the annuitant of the RRIF on a tax-free basis. There is also a rollover if the RRIF assets are left to a financially dependent child or grandchild. In essence, the beneficiary may defer taxes on the amount by transferring it to an issuer to buy an annuity that provides payments until the child reaches the age of 18. Of course, any payments received from the plan or annuity are subject to tax in the hands of the beneficiary. Also of note is that for children and grandchildren that are financially dependent by reason of a mental or physical infirmity, the amount can also be transferred to an RRSP or other eligible annuities regardless of their age. In this case, you should also consider the impact of the annuity on any social assistance that the dependent receives.

If the assets are left to any other beneficiary, the fair market value of the assets will have to be added to the deceased taxpayer's income in the year of death. This could result in a very large tax liability. In some instances, the taxpayer will purchase a life insurance policy to provide the funds to pay this tax liability at death.

consult your professional advisors

Be sure to consult with your contact at Scott, Rankin & Gardiner Chartered Accountants and your lawyer before making decisions about your estate planning or signing documents. Your professional advisors can help you plan for your retirement years secure in the knowledge that you have addressed the tax liability issues to better provide for your beneficiaries.

health insurance premiums

Self-employed individuals, whether partners or sole proprietors, are generally allowed to deduct health and dental premiums paid to a private health service plan (PHSP) subject to certain limits and conditions. The deduction extends to premiums that you pay on behalf of your spouse or common-law partner and member of your household.

The private health coverage must be paid or payable under a contract to an insurance company, a trust company, a person or partnership in the business of administering PHSP's, a tax-exempt trade union of which you or the majority of your employees are members, or to a tax-exempt business organization or tax-exempt professional organization of which you are a member.

To claim the PHSP deduction, you must be actively engaged in the business on a regular and continuous basis either directly or as a member of the partnership and:

- Your net income from self-employment for the current or previous taxation year is more than 50% of your total income, or
- Your income from sources other than self-employment is \$10,000 or less for the current or previous taxation year.

maximum deduction for you and members of your household

The premiums can be paid to insure yourself, your spouse or common-law partner and any members of your household. If you have no arm's length employees, the allowable deduction is a maximum of \$1,500 each for the self-employed person, your spouse or common-law partner, and any household member who is 18 years of age or older at the start of the period when they were insured. For each household member who is under the age of 18, the deduction is limited to a maximum of \$750.

These deductions are also affected by the number of days the person was insured. For example, although the annual limit is \$1,500 for a self-employed person, if you were insured for about half of the year, your deduction limit would be approximately \$750.

You cannot claim a deduction for PHSP premiums of another person deducted the amount or if you or anyone else claimed the premiums as a medical expense.

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up close and personal . . .

with Caine Ruckstuhl

Caine Ruckstuhl is the newest member of our ACCPAC division SRGG Solutions Inc. Caine joined SRGG Solutions Inc. in November 2002 as our Manager of Business Development. Caine is responsible for all sales, marketing and customer service activities.

Caine has a Bachelor's of Law Degree from Carleton University and gained much of his experience working as a business owner, financial advisor and personal trainer.

"From the very first time I stepped foot into the office of SR&G, I was impressed. The quality of the people

and attention to detail truly made me feel special. My decision to join the SR&G team was easy. Six months have passed and I continue to be impressed by the partners and staff. Employees are happy and customers continue to receive excellent service."

Caine and his wife Dora, are recently married and have just moved into their new home in Kanata. Caine is a member of Toastmasters International and CSAE Canadian Society of Association Executives. In his spare time, you will find Caine busy helping around the house, enjoying a good book or staying fit at Goodlife Fitness.

health insurance premiums continued from page 3

if you have employees

In calculating your maximum PHSP deduction, you must also take into consideration whether you had employees and whether you provided OHSP insurance coverage for them for all or part of the year.

If you have one or more arm's length employees and at least 50% of the persons in your business are qualified employees, the limit on the deduction is based on the lowest cost of equivalent coverage available for each of your qualified employees. Generally, a qualified employee is an arm's length, full-time employee who is not related to you, had worked at least three months, and is not carrying on the business with you, for example, as your partner.

Let's say that you have one arm's length employee for whom you paid 60% of his or

her health coverage premium. To provide yourself with equivalent health coverage, you paid a premium of \$1,800. The maximum deduction that you can claim on your personal income tax return is \$1,080 ($\$1,800 \times 60\% = \$1,080$).

Similarly, there are formula-based limitations on your deduction if you insure some of your employees but less than 50% of all the arm's length employees in your business.

If you had full-time employees throughout 2002 and you did not provide this coverage, you cannot claim your PHSP premiums as a deduction from your self-employment income. In this instance, you may be able to include the premiums as a deduction from your self-employment income. In this instance, you may be able to include the premiums in the calculation of your non-

refundable medical expense tax-credit. This tax credit is based on a formula of 16% times your total expenses over the lesser of \$1,728 and 3% of your income for the year.

extended coverage

While our public healthcare system provides access to medical services across the country, private health insurance provides coverage where the government plan ends. If you do not currently have extended coverage for dental, vision, pharmaceutical and other medical services not covered by our public healthcare system, the availability of the deduction for PHSP premiums may make this protection more affordable than you realize. Talk to your contact at Scott, Rankin & Gardiner Chartered Accountants and your insurance broker to ensure you find the plan that will best meet your needs.

dates and deadlines

corporations

- Taxes are due either two or three months after the year end depending on the type of corporation and / or the nature of the income.
- Interest on taxes is calculated from earlier dates depending on the company's requirement to make instalments and type(s) of income.

personal

- Persons with self employment income and their spouses have until June 15, 2003 to file their income tax return. However, if any tax balance is owing, it is due April 30, 2003 and is subject to interest.
- Income tax instalments for 2003 are due on the 15th of each of March, June, September and December.

- March 1, 2004 will be the last day for contributing to an RRSP to claim as a contribution on your 2003 tax return.

GST

- Due dates for GST returns vary depending on whether you are required to file monthly, quarterly or annually.



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