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Your Guide to Tax-Saving Strategies

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TAXSTRATEGY

Minimize your retirement tax with these...

Clawback strategies

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In the August issue of The TaxLetter ("Adding up the clawbacks"), I discussed the importance of having the right type of income when you retire.

In this article I will go into detail about the various strategies on how to do that.

The strategies to deal with clawbacks are only limited by your imagination. For example:

The right investments

Plan to have the right type of investments that provide the right type of income.

This includes growth investments (that generally have deferred growth and capital gains), dividend investments and interest-bearing investments.

Choose the best plan

Invest in RRSPs or TFSA's, depending on which is better for

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you based on your bracket before and after retirement.

Use a combination of plans

Have a combination of RRSP, TFSA and non-registered investments so that you can plan each year exactly how much income to take from each pool of investments.

Keep contributing

Contribute to your RRSP after age 65.

Use corporate class funds

Use investments, such as corporate class mutual funds (see "A class act," on page five), to convert interest or dividend income into dividends or capital gains, or defer taxable income with return of capital.

Withdraw every few years

Withdraw a large amount from your RRSP or corporation every few years, so that you avoid clawbacks in between. (This strategy takes some cre-

activity to figure out how large a withdrawal you should make – and how often – to receive the optimal tax savings.)

Borrow to invest

Use aggressive strategies such as borrowing to invest or investing in tax shelters to take advantage of the deductions.

Borrowing to invest is generally too risky for most seniors, but can be a very effective strategy for seniors in the clawback tax brackets.

Pension split creatively

Use pension splitting creatively to adjust the income of spouses to avoid clawbacks.

The effect of clawbacks may be even higher for you in the future. There is a trend in government to clawback many benefit programs, and my expectation is that the number and effect of these initiatives is likely to increase.

It is important to note that each clawback has a noble objective. And, these programs are not aware of each other, so it is entirely possible that you may end up in a marginal tax (plus clawbacks) bracket greater than 100 per cent.

Other considerations:

Note that the incomes in the tables on the following page are taxable incomes, which are different amounts of cash with different income types.

For example, if you have no

other income other than Old Age Security (OAS) and qualify for maximum GIS of \$8,868, the entire amount is clawed back with \$12,852 of dividends, \$17,736 of interest income, or \$35,472 of capital gains.

These tax rates apply to taxable income and to tax deductions, but not to tax credits. Tax credits are based on a fixed rate which is generally based on the lowest tax bracket: about 20 per cent. Many people do not understand this difference between tax deductions and tax credits.

All these tax brackets are usually indexed with inflation each year. When planning for your retirement income, you need to estimate what it will be in future dollars and what the tax brackets will be at that time.

Note that changes to legislation can happen at any time, so future tax brackets will not definitely be what we project.

Our general expectation is that tax brackets are more likely to creep up, given the shortage of money our government is expected to have in the future while providing for the retirement and medical costs of retired Baby Boomers.

For people under 65 planning for their future, it is quite possible that tax brackets will be higher than shown in the tables.

It is common for many accountants to ignore the OAS clawback; if their client makes a lot of money, why should they worry about \$6,500 of OAS?

However, OAS may not be insignificant. The average Canadian lives 22 years after age

65, and will receive \$143,000 OAS during this time (plus inflation).

Seeing the OAS clawback as a tax bracket is a much more practical viewpoint. You may be able to plan around the clawback, just like you can plan to be in lower tax brackets.

Plan for the long term

Effective long term tax plan-

ning involves minimizing your tax over your entire life. It requires understanding your tax bracket both when you are working and after you retire. While it is widely believed that seniors are taxed at low income tax rates, when you add up all the clawbacks it is clear that for most seniors this is a myth. The highest-taxed Canadians are seniors making less than

Taxable Income		Under Age 65				Clawbacks				Over Age 65			
		Marginal Tax Rates				Tax Rates with Clawbacks							
From	To	Pension, RRSP & Interest	Capital Gains	Eligible Dividends	* Non Eligible Dividends	GIS	Age	OAS	GST	Pension, RRSP & Interest	Capital Gains	Eligible Dividends	* Non Eligible Dividends
\$ -	\$ 8,438	0%	0%	0%	0%	50%				✗ 50%	✓ 25%	✗ 69%	✗ 63%
\$ 8,439	\$ 10,822	0%	0%	0%	0%	50%				↓ 48%	✓ 24%	✗ 66%	✗ 60%
\$ 10,823	\$ 13,702	0%	0%	0%	2%	50%				↓ 48%	✓ 24%	✗ 66%	✗ 62%
\$ 13,703	\$ 15,289	0%	0%	-4%	3%	50%				↓ 48%	✓ 24%	✗ 62%	✗ 63%
\$ 15,290	\$ 17,542	0%	0%	-4%	3%	50%				✗ 50%	✓ 25%	✗ 65%	✗ 66%
\$ 17,543	\$ 18,000	25%	13%	-4%	3%	50%				✗ 75%	↓ 38%	✓ 65%	✗ 66%
\$ 18,001	\$ 23,052	20%	10%	-2%	3%	50%				✗ 70%	↓ 35%	✗ 67%	✗ 65%
\$ 23,053	\$ 33,883	20%	10%	-2%	3%					✓ 20%	✓ 10%	✓ -2%	✓ 3%
\$ 33,884	\$ 39,020	20%	10%	-2%	3%	3%				↓ 28%	✓ 14%	✓ 9%	✓ 13%
\$ 39,021	\$ 42,707	24%	12%	4%	8%	3%		5%		↓ 32%	✓ 16%	✓ 15%	✓ 18%
\$ 42,708	\$ 68,718	31%	16%	13%	17%	3%				↓ 34%	✓ 17%	✓ 18%	✓ 20%
\$ 68,719	\$ 69,562	33%	16%	14%	18%	2%				↓ 35%	✓ 18%	✓ 17%	✓ 21%
\$ 69,563	\$ 78,043	33%	16%	14%	18%	2%	15%			✗ 50%	✓ 25%	✓ 38%	✓ 39%
\$ 78,044	\$ 78,684	35%	18%	18%	21%	2%	15%			✗ 53%	↓ 26%	↓ 41%	↓ 42%
\$ 78,685	\$ 80,962	35%	18%	18%	21%		15%			✗ 50%	✓ 25%	↓ 38%	↓ 40%
\$ 80,963	\$ 85,414	39%	20%	20%	24%		15%			✗ 54%	↓ 27%	↓ 41%	↓ 43%
\$ 85,415	\$ 113,160	43%	22%	25%	29%			15%		✗ 58%	↓ 29%	↓ 46%	↓ 48%
\$ 113,161	\$ 132,406	43%	22%	25%	29%					↓ 43%	✓ 22%	✓ 25%	✓ 29%
\$ 132,407	and over	46%	23%	30%	33%					↓ 46%	✓ 23%	↓ 30%	↓ 33%

* Note: if the dividends come from your corporation you will also have paid approximately 15% income tax in the corporation

✗ High tax rate
↓ Medium tax rate
✓ Low tax rate

Taxable Income per spouse		Under Age 65				Clawbacks				Over Age 65			
		Marginal Tax Rates				Tax Rates with Clawbacks							
From	To	Pension, RRSP & Interest	Capital Gains	Eligible Dividends	* Non Eligible Dividends	GIS	Age	OAS	GST	Pension, RRSP & Interest	Capital Gains	Eligible Dividends	* Non Eligible Dividends
\$ -	\$ 10,822	0%	0%	0%	0%	50%				✗ 50%	✓ 25%	✗ 69%	✗ 63%
\$ 10,823	\$ 13,702	0%	0%	0%	2%	50%				✗ 50%	✓ 25%	✗ 69%	✗ 65%
\$ 13,703	\$ 16,942	0%	0%	-4%	3%	50%				✗ 50%	✓ 25%	✗ 65%	✗ 66%
\$ 16,942	\$ 17,459	0%	0%	-4%	3%	50%				✗ 55%	↓ 28%	✗ 72%	✗ 72%
\$ 17,460	\$ 17,542	0%	0%	-4%	3%					✓ 5%	✓ 3%	✓ 3%	✓ 10%
\$ 17,543	\$ 18,000	25%	13%	-4%	3%					↓ 30%	✓ 15%	✓ 3%	✓ 10%
\$ 18,001	\$ 22,142	20%	10%	-2%	3%					✓ 5%	✓ 13%	✓ 5%	✓ 9%
\$ 22,143	\$ 33,883	20%	10%	-2%	3%					✓ 20%	✓ 10%	✓ -2%	✓ 3%
\$ 33,884	\$ 39,020	20%	10%	-2%	3%	3%				↓ 23%	✓ 12%	✓ 2%	✓ 7%
\$ 39,021	\$ 42,707	24%	12%	4%	8%	3%				↓ 27%	✓ 14%	✓ 8%	✓ 12%
\$ 42,708	\$ 68,718	31%	16%	13%	17%	3%				↓ 34%	✓ 17%	✓ 18%	✓ 20%
\$ 68,719	\$ 69,562	33%	16%	14%	18%	2%				↓ 35%	✓ 18%	✓ 17%	✓ 21%
\$ 69,563	\$ 78,043	33%	16%	14%	18%	2%	15%			✗ 50%	✓ 25%	↓ 38%	✓ 39%
\$ 78,044	\$ 78,684	35%	18%	18%	21%	2%	15%			✗ 53%	↓ 26%	↓ 41%	↓ 42%
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\$ 85,415	\$ 113,160	43%	22%	25%	29%			15%		✗ 58%	↓ 29%	↓ 46%	↓ 48%
\$ 113,161	\$ 132,406	43%	22%	25%	29%					↓ 43%	✓ 22%	✓ 25%	✓ 29%
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* Note: if the dividends come from your corporation you will also have paid approximately 15% income tax in the corporation

✗ High tax rate
↓ Medium tax rate
✓ Low tax rate

\$23,000 per year – not people making millions each year.

Many benefits for seniors (and some for non-seniors) are clawed back based on taxable income. The four main benefit clawbacks are GIS, age credit, GST and OAS. Since they apply to everyone in certain tax brackets, these clawbacks are most accurately viewed as a tax.

There are a wide variety of tax planning issues related to tax brackets before and after retirement, and a wide variety of strategies to deal with the high taxes many seniors face resulting from benefit clawbacks.

This article is a broad introduction to a large topic. In future articles, I will discuss specific issues here in more detail. □

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