



CESTNICK

TAX MATTERS

New tax-free savings account offers creative planning options

Jack is a good friend of mine. But he has to be the most indecisive person I know. He can never get things done, because he's always thinking about "whether it's a good decision or not."

Jack lives by the motto: "Indecision is the key to flexibility." I asked Jack whether he's going to open a tax-free savings account (TFSA) when they become available on Jan. 1. He hasn't decided yet.

Last week, I started to share some ways to use TFSAs to your advantage. Let's continue this discussion today. And by the way, I think everyone should open a TFSA. Here are eight more reasons why.

- Split income with your spouse. The attribution rules in Canadian tax law will generally prevent you from giving money to your spouse to have your spouse pay the tax on any income earned on those dollars. You can, however, give money to your spouse to contribute to his or her TFSA, with no concern about income in the TFSA being attributed back to you.

- Shelter highly taxed income. Consider holding certain investments inside a TFSA to shelter what would otherwise be highly taxed income. I'm thinking of fixed-income investments that create interest income, certain options strategies or short-selling of securities, which can give rise to regular income, or securities paying foreign dividends, which are taxed as regular income and aren't eligible for the dividend tax credit.

- Help your adult children. If you're looking to help your adult children with a major purchase (a home, for example), consider giving your child the money to contribute to his or her TFSA to allow the money to compound free of tax. Consider making this a loan to your child instead, with proper documentation, to protect the assets from a potential breakdown of your child's marriage.

- Minimize benefit clawbacks. By holding income-producing securities inside the TFSA rather than in your personal hands, income that may otherwise increase your net income and thereby reduce certain benefits (Old Age Security benefits, for example) may no longer cause a clawback of those benefits.

- Draw down TFSA assets first. When you're in retirement, consider drawing on your TFSA assets first to meet your everyday costs of living. This will allow your registered plan assets to grow a little longer before having to be withdrawn on a taxable basis.

- Smooth impact of fluctuating income. If your income will fluctuate over time, you may want to set aside money in a TFSA today, and draw down on those savings later to make a contribution to your RRSP in the year you may need a tax deduction, or to contribute to a charity in that high-income year, which will create a donation tax credit to help reduce your tax bill.

- Assist tax-loss selling. If you're thinking of selling a security that has dropped in value in order to use the resulting capital loss, but you still like the future prospects of the investment, consider selling at a loss, then contributing the proceeds to your TFSA to the extent you have contribution room. Repurchase the investment inside the TFSA. If the investment rebounds as you think it will, those gains will be sheltered from tax inside the TFSA.

- Shelter private company shares. It's possible in some cases to hold private company shares inside a registered retirement savings plan, and likewise inside a TFSA. The rules are complex, but as a general guideline, the annuitant under the plan cannot be a "connected shareholder" immediately after the time the shares are acquired by the plan.

A connected shareholder is one who owns 10 per cent or more of any class of shares. So, if your ownership is under 10 per cent, you should be fine. There's an exception to the "under-10-per-cent" limit: If you deal with the company at arm's length and the cost of your shares in the company is less than \$25,000, you may own more than 10 per cent of the shares.

But in any event, if you control the company (or you and related persons control the company), you'll be out of luck – the shares won't qualify. The rules have been

simplified here, so visit a tax pro for more information and advice on whether certain shares will qualify. Imagine, however, that you're a minority shareholder in a private company and are able to hold those shares in a TFSA; any gains on the shares would be tax-free if the company grows in value. This could be a huge win if the company's growth is significant.

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