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Sixteen ways to beat the taxman

Sick of paying so much income tax? Are you losing out on some fat deductions? Here we review 16 tax-saving manoeuvres — from the tried-and-true to the decidedly risky — that help you keep your cash where it belongs

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In 1917, Canadians paid income taxes for the first time, and we've been trying to avoid them ever since. Consider the following dichotomy: Whereas tax "evasion," involving the falsification of your tax statement, is illegal and will land you in hot water with the Canada Revenue Agency (CRA), tax "avoidance" is seen as common sense and the rightful duty of every taxpayer.

On the following pages, you'll find 16 tax manoeuvres - beginning with the mundane (RRSPs) and ending with the most aggressive (charity flips). The information comes from our panel of experts, which includes Robert Korne, a tax lawyer at Montreal-based BCF LLP; Robert Kliaman, a Toronto-based chartered accountant; and Russell Todd, a financial planner living in Calgary. For each strategy, we describe who can benefit, how it works and your chances of being reassessed. Your job? Figure out what level of risk-tolerance you're comfortable with and watch your tax bill shrink before your eyes.

RRSPs

WHO CAN USE IT? Just about anyone - but they're most useful for employees in high tax brackets.

HOW DOES IT WORK? The run-of-the-mill registered retirement savings plan (RRSP) is still the most common tax-reduction mechanism. Annual contributions - limited to 18% of your last year's income up to \$19,000 (depending on your pension) - are fully deductible. Better yet, your investments grow tax-deferred until they're withdrawn (by age 71, at the latest). Typically, retirees earn less annual income, so their RRSP withdrawals are taxed at a lower rate. This year's deadline is Feb. 29, but unused contribution room can be carried forward.

RISK OF REASSESSMENT: Practically nil.

RESPs

WHO CAN USE IT? Parents, relatives and friends of young children.

HOW DOES IT WORK? Registered education savings plans are usually thought of as a way to fund your kids' post-secondary education, but the personal savings can be significant - even if your kids don't go to college or university. Family and friends can contribute up to \$50,000 for each child, either upfront or in annual instalments. There's no tax refund, but growth within the RESP is tax-deferred for up to 26 years. If the kids use the funds, they'll get a federal top-up grant worth 20% of the contributions (up to \$7,200). If not, parents benefit from the tax-deferral.

RISK OF REASSESSMENT: Very low.

INDIVIDUAL PENSION PLANS (IPPs)

WHO CAN USE IT? Small-business owners nearing retirement, ideally earning over \$100,000 annually.

HOW DOES IT WORK? "These are similar to RRSPs, but there's more bang for the buck," says Korne. Instead of funding personal saving plans, small business owners can set up defined-benefit pension plans for themselves within their own companies. These plans are funded by the company based on actuarial calculations, and those contributions are deducted from corporate profit. Pros: The contribution limits are much higher than RRSPs, and they're protected from creditor litigation. Con: Funds cannot be withdrawn until retirement.

RISK OF REASSESSMENT: Unlikely, but you'll need a tax expert to help you set one up.

INSURANCE COMBOS

WHO CAN USE IT? High-net-worth seniors who want to leave an estate to their heirs.

HOW DOES IT WORK? By combining various insurance products, financial planners have discovered a way to achieve guaranteed returns that exceed those coming from fixed-income investments. One popular combination is called a "back-to-back." Seniors use their nest egg to buy an annuity that provides a fixed stream of income for life. Part of that income is then used to pay the premiums on a life insurance policy payable to your kids, which replaces most of the money used to buy the annuity. After taxes, the return is generally much better than bonds.

RISK OF REASSESSMENT: Low, but rules must be followed carefully. "The CRA doesn't like these," says Korne.

IMMIGRANT TRUSTS

WHO CAN USE IT? New immigrants with high net worth.

HOW DOES IT WORK? If your wealthy uncle Rupert is planning to immigrate from a low-tax jurisdiction, such as the Barbados or Cayman Islands, to the frigid climes of Canada, be sure that you inform him that income he previously earned can be placed in a trust set up outside Canada, where it is entitled to grow tax-free offshore for up to five years. Once the grace period expires, the money can be withdrawn from the trust totally free of Canadian taxes. The dodge is perfectly legitimate, although you'll need a professional to help set it up.

RISK OF REASSESSMENT: Low. "These trusts are specifically provided for in the tax laws," says Korne.

FLOW-THROUGH SHARES

WHO CAN USE IT? Investors with spare cash who are looking for deductions.

HOW DOES IT WORK? In order to stimulate investment in certain sectors - generally real estate and resource exploration - governments offer big tax incentives. In the case of "flow-through shares," start-up ventures approved by the CRA distribute (or "flow") their development costs to shareholders, who can then deduct them from other income. Besides the immediate tax break, investors also enjoy the possibility of investment growth. Be cautious, however, when investing in flow-through shares bundled within tax shelters, as these tend to be riskier.

RISK OF REASSESSMENT? Low to moderate, but your tax savings could be undermined by a poor investment.

HIRING YOUR KIDS

WHO CAN USE IT? Anybody with a business and a child.

HOW DOES IT WORK? Here's a tried and tested way of reducing your family's income tax bill. If you own a business - whether incorporated or not - you can hire your children (or lower-earning spouse) to do some of the work. The business gets to deduct the cost of labour and your children will likely pay little to no tax on that income. Bonus: If your kids are using their salary to pay for college or university, their tuition tax credit will help offset any taxable earnings. Just be sure that the jobs are real and that the salary you pay them is reasonable.

RISK OF REASSESSMENT: Low to moderate. "If you go overboard, the CRA may reject it," says Korne.

INCOME SPLITTING

WHO CAN USE IT? Spouses with a wide income disparity.

HOW DOES IT WORK? Canadian couples can't file joint income-tax statements, but by putting investment income in the lower-earning spouse's name, a couple can reduce their overall tax bill. A spousal loan is arranged in which the lower-earning spouse borrows from the higher-earning one - at a "prescribed rate," currently 4% - to buy investments. The loan interest is deducted from the lower-earning spouse's income, and added to the income of the higher-earning spouse. Spouses can also trade an equal value of home equity for investments.

RISK OF REASSESSMENT: Low to moderate. Be sure to keep all the documentation.

FAMILY TRUSTS

WHO CAN USE IT? Nearly anyone, but particularly useful for parents with kids in university.

HOW DOES IT WORK? Family trusts - legal entities where funds are set aside for beneficiaries - are becoming a popular tax-avoidance technique. There are many ways to use these, but one more aggressive tactic involves putting a small business that you own into a trust. The business's after-tax profit is distributed as a dividend to the trust, which pays the dividends out to beneficiaries - typically, the spouse or adult children who are in a low tax bracket. Bottom line: Each beneficiary could earn \$34,500 (in Ontario) without paying income taxes.

RISK OF REASSESSMENT: Moderate. Risk increases as the company makes more aggressive deductions.

SINGLETON SHUFFLE

WHO CAN USE IT? Anyone with a mortgage and non-registered investments.

HOW DOES IT WORK? Named after John Singleton, the Vancouver tax lawyer whose court victory made it legal, the Singleton Shuffle is a nifty way to convert non-deductible mortgage interest into 100% deductible investment interest. Step one: Use your non-registered investments to pay off your mortgage. Step two: Borrow against your home to buy non-registered investments. Like magic, your mortgage payments have been transformed into a tax write-off. Before moving ahead, though, consider pitfalls like capital gains taxes or early payment penalties.

RISK OF REASSESSMENT: Moderate. The CRA is challenging this strategy but isn't expected to be successful.

SELLING THE FARM

WHO CAN USE IT? Shareholders of Canadian farms or small businesses.

HOW DOES IT WORK? Most Canadians never to get a chance to use their \$750,000 lifetime capital gains exemption on the sale of shares in a farm or small business, but for those who do, the savings can be huge. Not that the CRA will make it easy. "Anyone who thinks they can earn \$750,000 tax-free without scrutiny is living in a dream world," says Kliaman. Meeting the criteria for what qualifies as a small business can be difficult. Ninety per cent of the company's assets must be involved in operations (not investments), and shares must be sold to an unrelated party.

RISK OF REASSESSMENT: Moderate.

INCORPORATE YOURSELF

WHO CAN USE IT? Individuals who contract out services to multiple clients.

HOW DOES IT WORK? First, have a lawyer incorporate an entity on your behalf. Then register with the CRA and get any required business licenses. Finally, open a bank account in the corporation's name ... and you're off to the races. The tax advantage of incorporation lies in the fact that your company can deduct expenses that, as an individual, you would have a hard time legitimizing - things like health-care costs, life insurance and personal vehicles. Another benefit is the ability to split income between family members who work for the business.

RISK OF REASSESSMENT: Moderate to high. The CRA monitors personal service corporations carefully.

RESEARCH TAX CREDIT

WHO CAN USE IT? Private corporations engaged in experimental development.

HOW DOES IT WORK: There are major tax incentives available to companies that can prove they are carrying out experimental research that will lead to the commercialization of a product. Up to 35% of associated costs - including salaries, materials, machinery and equipment leases - may be refunded by the federal government. The remainder can be deducted from future profits earned by the company. The rules around the research credit are very complex, though, so you'll need to work with a tax professional with a science background.

RISK OF REASSESSMENT: Moderate to high. Every application is reviewed and audits are commonplace.

OFFSHORE TAX HAVENS

WHO CAN USE IT? Most useful for Canadians working abroad.

HOW DOES IT WORK? In the world of tax planning, moving to a haven like the Cayman Islands is considered extreme. But if you have few domestic ties and can easily work abroad, it's one way to not only dodge taxes - you can dodge the whole tax administration. You really do have to sever all your ties, though. That includes selling real estate, closing bank accounts and transferring investments. There may also be an upfront tax hit on departure, based on "deemed disposition" rules. You'll need a pro to pull this one off with minimal pain.

RISK OF REASSESSMENT: High, especially if you still have ties to Canada, such as a spouse and kids.

TAX SHELTERS

WHO CAN USE IT? High-income earners with an appetite for risk.

HOW DOES IT WORK? Tax shelters use various techniques, focus-ing on everything from film production to real estate to charitable giving. Usually, there's an underlying business or group of businesses that are losing money and re-quire investment. A partnership is created to raise funds and distribute tax deductions to investors. These deductions are typically worth more than the investment - paid for by the shelter with some cash along with significant loans (often in the form of a promissory note). Rule of thumb: If it sounds too good to be true, it probably is.

RISK OF REASSESSMENT: High. "A questionable strategy," says Korne. "Get professional tax advice first."

CHARITY FLIPS

WHO CAN USE IT? People who like to be audited.

HOW DOES IT WORK? The idea is simple enough. You find a dupe to sell you a valuable object for practically nothing, then have it appraised to determine its market value. If the object is worth at least three times more than what you paid for it, you donate it to charity and receive a deduction greater than its original price. If the appraisal is genuine, the deduction is legal, but these schemes are currently under review, and those involving artwork have already been shut down. "It may be only a matter of time before your deduction is reversed," says Todd.

RISK OF REASSESSMENT: Extremely high.

[Reassessed: Classic Canadian tax schemes that were too good to be true](#)

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