October - December 2019

Assante® WEALTH MANAGEMENT

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MONEY *matters*

HOW CAN INVESTING IN CORPORATE CLASS REDUCE YOUR TAXES?

When it comes to tax minimization, the use of corporate class mutual fund structures is a strategy that has significant benefits to individuals and to corporations.

Most mutual funds are trusts. A mutual fund trust is a single fund with a particular investment mandate. Corporate class mutual funds use a corporate structure where multiple funds with different investment objectives are held within a mutual fund corporation. This structure allows expenses and capital losses to be shared among the different funds and therefore reduce the overall taxable income of the mutual fund corporation. Therefore, capital losses incurred in one fund can be used to offset capital gains that are realized in another fund and expenses incurred by one fund can be used to offset the income generated in another fund.

Starting January 1, 2017, corporate class mutual funds, lost the benefits of tax-deferred switching among the various funds held within the corporate class structure. In the past, the capital gains that would normally be triggered when units in a fund are sold at a profit, could be deferred until the year in which the unitholder sells all his/her holdings in the corporation.

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"Corporate class mutual funds continue to offer major tax advantages compared to conventional mutual funds."

However, after the end of 2016, switches among different corporate class
mutual funds will result in capital gains or losses, and the tax treatment of switches between different corporate class mutual funds will be the same as conventional mutual funds that are structured as trusts. Despite this change in taxation, corporate class mutual funds continue to offer other major tax advantages compared to conventional mutual funds.

One of the primary benefits of corporate class funds which will continue is the ability to pool the income and expenses of all funds in the fund family. By doing so corporate class mutual funds offer the ability to minimize or defer overall taxable distributions.

The corporate class structure is particularly beneficial to income funds that tend to produce returns in the form of fully taxable interest income or for foreign equity funds that produce dividends that are ineligible for the Canadian dividend tax credit. The corporate class structure can reduce taxes by offsetting fully taxable income with unused expenses and loss carryforwards transferred from other funds in the corporate class fund family.

Since Canadian corporations can only distribute dividends and capital gains, distributions from corporate class mutual funds are only in the form of eligible Canadian dividends or realized capital gains, which are taxed at a much lower rate than regular income. In Ontario, at the top personal marginal tax bracket, interest income is taxed at 53.53%, while capital gains are taxed at 26.76% and eligible dividends are taxed at 39.34%.

The corporate class structure has many benefits for high net-worth individuals who own non-registered funds held outside registered plans such as RRSP or tax-free savings accounts. This kind of structure also provides tax advantages for small-business owners who invest their excess cash in corporate accounts owned by their operating or holding companies that are subject to high corporate taxes.

Benefits for In Trust Accounts

The corporate class structure is also of benefit to parents and grandparents who hold units of mutual funds in informal in-trust accounts for their children or grandchildren. Normally, any interest or dividends paid by a conventional fund are taxable in the hands of the parent or grandparent who contributed to these accounts, while capital gains are attributed to the child (who normally has no income and hence pays no taxes). Corporate class funds are ideal vehicles for in-trust accounts as their distributions are in the form of dividends or capital gains and hence can minimize the taxes payable.

Benefits for Retirees

The corporate class structure can also be of benefit to retirees who have set up systematic withdrawal plans and regularly withdraw funds from their non-registered portfolio to create an income stream. Retirees can not only enjoy tax efficient income earned within the corporate-class funds, but they can also realize tax efficiency on their regular withdrawals as their income stream could be set up in a way that it is considered return of capital until the adjusted cost base of the units grinds to zero and this would allow them to defer taxes and create a more tax-advantaged stream of income. This will also allow them to minimize the claw back of their Old Age Security (OAS) income.

As discussed above, corporate class mutual funds have the key benefit of accelerated compounded growth (because of reduced or eliminated distributions). However, the benefits to corporations go beyond those available to individuals.

Benefits for Corporations

Benefits of corporate class mutual funds for corporations are as follows:

- **Converting interest income to capital gains** – The corporate class structure minimizes the potential for distributions from fixed income vehicles allowing investors to 'convert' income to capital gains. For example, money market and bond funds would benefit from capital gains tax rates rather than interest income allowing you to keep more of your investments. If your corporation is in the highest tax bracket in Ontario this means that you can convert an overall 57.66% tax rate on interest income or an overall 64.23% tax on foreign income to a 30.96% tax rate on capital gains income or a 39.34% tax on eligible dividends.

- **Withdrawing trapped money from the corporation tax free** – Using the Capital Dividend Account (CDA) it is possible to minimize the taxes payable by the business owner by withdrawing from the CDA, the non-taxable portion of capital gains – money that would otherwise be trapped in the corporation.

- **Avoiding Provincial Capital Tax** – Although capital tax has been removed at the federal level, provincial capital tax may still apply. Since it is a tax on assets rather than on income, the tax impact can be substantial. Corporate Class funds qualify your corporation to be exempt from the provincial capital tax.

- **Preserving the Small Business Deduction (SBD)** – Corporate class mutual funds can reduce the

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potential impact of the new passive investment rules for investments held in Canadian Controlled Private Corporations (CCPCs) on small business deduction (DBD). Budget 2018 proposed to gradually reduce access to the small business tax rate for corporations earning “significant” passive investment income. Under the new rules if a corporation and any of its associated corporations earn more than $50,000 of passive investment income, the amount of the corporation’s income eligible for the small business tax rate will be reduced by $5 for every $1 of investment income over $50,000. A corporation’s small business limit (i.e., the limit of active business income that can be taxed at the small business tax rate and is currently $500,000) will be reduced to zero if the corporation and its associated corporations together earn $150K or more of passive investment income.

As Canadian investors remain among the most heavily taxed investors in the world, Corporate Class structures provide an efficiency that should not be overlooked.

WHEN IS THE BEST TIME TO START YOUR OLD AGE SECURITY PENSION?

If you are approaching age 65 and are still working and do not need any extra income, you may be wondering if it is a good idea to apply for your Old Age Security (OAS) payments or defer receiving your OAS payments to a later age and possibly to age 70.

In 2019, a full OAS pension is approximately $7,200 and will be indexed on a quarterly basis. Your OAS pension will be clawed back by 15% if your income exceeds a threshold. This threshold, which is indexed annually, is $77,580 in 2019. If your income exceeds $125,937 in 2019, you will lose your entire OAS benefits.

If you are still working and plan to retire later than 65, the timing of your OAS application is something you should pay attention to.

For every month that you defer receiving your OAS benefits there will be a 0.6 per cent premium increase to the base figure. This increase can extend as far as 60 months to age 70, resulting in a maximum premium of 36 per cent over and above the base rate.

It is important to note that the OAS year runs from July 1st to June 30th of the following year. The reason is that your OAS entitlement will depend on the income you reported in the previous year and given the April 30th deadline for filing personal taxes, this would give the government a sufficient window of time to ensure they can review your income in the previous calendar year and base your OAS entitlement on that.

This time frame means that your 2018 income affects your OAS entitlement from July 2019 – June 2020. Your 2019 income will affect your OAS entitlement from July 2020 to June 2021 and your 2020 income will affect your OAS entitlement from July 2021 to June 2022.

Service Canada recommends applying for your OAS benefits six months ahead of your intended start month.

Therefore, if you are turning 65 in 2019 but are planning to work until January 2022 and will have an income of over $77,580 in those years, if you apply in 2019 to have your OAS start in early 2020, potentially you will not receive any OAS pension until after June 2023, which is almost four years from now and is equivalent to almost $23,400 in foregone OAS payments and after June 2023 you will receive your base OAS payments. In this case you would be better off postponing receiving your OAS benefits for 39 months and starting to receive your OAS payments in July 2022, at which time you would be entitled to a 23.4% premium. In today’s dollars that would be over $1,684 more OAS benefits every year for the rest of your life.

While in the example above, the right decision was to postpone receiving the OAS benefits, there is not always a right or wrong answer. The decision regarding when to start your OAS benefits is in many cases a personal decision and one that has to do with your expectations with regards to your life expectancy and whether you need and want to have your benefits sooner or expect to live a long life and would rather apply later and receive more benefits for the rest of your life.

DONATE SECURITIES IN KIND AND REAP THE TAX BENEFITS

The last quarter of the year is when most of us try to make sure we have made our charitable donations before the December 31st deadline to be able to qualify for a charitable donation tax credit in 2019.

If you own stocks and bonds and other publicly listed securities with significant accrued capital gains, you should consider gifting them to a charity in your lifetime or in your will as the favourable tax treatment can shave thousands of dollars off the tax bill for your estate.

If you transfer publicly listed securities or mutual funds to a registered charity or registered private foundation, the capital gains on those securities will not be subject to tax. You will still be eligible for receiving a charitable donation tax credit based on the fair market value of the securities at the time of transfer to the charity.

If you really like those securities and would like to have them as part of your portfolio, you can always purchase them back by using the cash you had earmarked for giving to charity. By donating the securities in kind and

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using cash to purchase them back you will eliminate the capital gains on the shares that you donate and will bump up the cost base of your securities so when you sell them in the future or on your death there would be less capital gains tax payable.

If you acquire stocks with your employee stock options, you can also donate your stock options to a charity. By doing so, not only will the capital gains not be taxable, but your employment benefit that is included in your taxable income is eliminated as well.

You should note that if you acquired flow-through shares on or after March 22, 2011, a capital gain will be realized when donating them to a charity and the above rules will not apply.

TINA TEHRANCHIAN RECEIVES THE TIAW WORLD OF DIFFERENCE AWARD

Tina Tehranchian was the recipient of an award from The International Alliance for Women (TIAW) in the community category. This year nominations were received from 56 different countries and provided a vivid look at the inspiring work that women - and men - around the world are doing to support the economic empowerment of women. The recipients cover a wide range of activities on six continents.

TIAW will be presenting the awards on October 18, 2019 during a special dinner at the Royal Automobile Club of Australia in Sydney, Australia as part of the TIAW - Women Chiefs of Enterprises International (WCEI) Forum (October 17 - 18, 2019).

The International Alliance for Women is organized as a 501(c)3 foundation in the USA and connects leading women's organizations worldwide to leverage their reach and resources, creating a global community of economically empowered women.

ABOUT THE EDITOR

Tina Tehranchian MA, CFP®, CLU®, CHFC® is a Branch Manager and Senior Wealth Advisor with Assante Capital Management Ltd., one of Canada's largest wealth management firms, offering integrated financial solutions to create wealth and prosperity for you and your family. The 750 advisors serve over 300,000 Canadian families across the country and take pride in the exceptional service they offer to clients through trusted face-to-face relationships and a level of service excellence second to none. Money Matters is published as a special service for clients of Tina Tehranchian.

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