Minden Gross LLP

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TOPICS:

INCOME SPLITTING 101: *Prescribed* Rate Loan Planning

With tax rates as high as they are in Canada, it's no wonder that people continue to search for ways to reduce their tax bill. Prescribed rate loan planning is a simple and effective strategy that allows high-income earners to split income with their family members who earn little or no income, including spouses, children, grandchildren, and even minor nephews and nieces. The strategy involves a loan of money or assets by the high-income earning individual directly to one or more family members facing lower tax rates or, more commonly, to a trust established for the benefit of such family members. Where in-kind property is transferred, consideration must be given to the taxes that may arise on the transfer. To avoid the application of the attribution rules (that cause all of the income earned by the loaned property to be taxed in the high-income earner's hands), the loan must bear interest of at least the "prescribed rate," a rate set by the government every three months determined with reference to short-term government of Canada T-bill rates.

Once the loan is made, the borrower – whether the family member(s) or a trust on behalf of such family members - can invest the funds, and any income earned in excess of the prescribed rate can be taxed in the hands of such family members. The tax-saving opportunity lies in the spread between the prescribed rate and the rate at which the invested funds earn income. In fact, once the loan is made, it can bear interest at the prescribed rate, set at the time of the loan, forever and as interest rates rise (and with it, the prescribed rate), so too should the spread and, the tax savings.

The tax impact of this strategy is best explained through an example.

A couple, both paying taxes at the top marginal tax rate, has three young children (with no other income), each of whom attends private school, summer camp, and participates in a number of extra-curricular activities. The annual expenses for each child in this regard totals $10,000 and the parents have been funding these expenses with income they earn on their investments, the fair market value of which is assumed to be $1 million.

If the couple is earning 5% on its $1 million investments annually, they will be paying anywhere from roughly $12,500 to $25,000 of tax on their $50,000 of investment income, depending on the type of income they are earning (e.g., capital gains, dividends, interest, rent, etc.). If this income was used to pay for their children's expenses, they could be left with as much as $7,500 after-tax for other purposes or they might have to dip into their other income to come up with the $5,000 shortfall for their children's expenses.

If prescribed rate planning is used instead, $10,000 (1% of $1 million) of income would be taxed in the couple's hands, resulting in taxes in the range of $2,500 to $5,000, while $40,000 of income would be taxed in the children's hands, resulting in anywhere from no taxes to roughly $1,500 in taxes (so long as the "kiddie tax" does not apply to any of the children while they are minors - which will depend on the nature of the investments). As a family unit, they will enjoy annual savings in the range of $10,000 to $18,500.

All of the income taxed in the children's hands must be paid to, or applied for the benefit of, the children. Since children's costs don't typically start and end with private school, summer camp, and extra-curricular activities, the excess (i.e., extra $10,000 taxed in the children's hands) could be used to pay for other expenses like the children's portion of family trips, clothing and even groceries. (Strict record keeping is highly advisable.) Alternatively, the couple doesn't have to loan the entire $1 million; however, any income earned on the portion that is not loaned will, of course, be subject to tax in the couples' hands at the highest marginal tax rates.

In order for the strategy to work, it is imperative that the prescribed rate of interest actually be paid in each year to the lender by January 30th of the following year. If that interest payment is missed even once, the benefits of the planning will be undermined forever. Conversely, there may be instances where attribution is desired (i.e., if the investments go bad), in which case missing an interest payment could cause one to purposely fall into the attribution rules. In addition, there will be some ongoing administration where a trust is used, including, among other things, the filing of tax returns and resolutions documenting the allocation and payment of income to the trust's beneficiaries in each year.

Any future loans can only be made at the prescribed rate at the time of the loan so proper record keeping is critical in order to ensure that the appropriate amount of interest is being paid to the lender in each year.

Finally, it is critical that US tax consequences be considered when implementing a prescribed

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A *Whole* New World

Time to Revisit Your Will (and Trust) Planning

IN 2013, THE DEPARTMENT OF FINANCE PROPOSED TO ELIMINATE MOST TAX BENEFITS that have traditionally been available to certain trusts formed on the death of an individual (in this article referred to as "Testamentary Trusts") so that Testamentary Trusts, which include an individual's estate, as well as trusts created under the terms of an individual's will for his or her spouse and/or other persons, would be taxed in a manner similar to trusts that are not Testamentary Trusts.

Notwithstanding much critical commentary, the 2014 budget announced plans to implement the proposals. By December 16, 2014, *Bill C-43, Economic Action Plan 2014 Act, No. 2,* was enacted as the law of the land, though its application in connection with Testamentary Trusts will be delayed until 2016.

As bad as the original proposals were thought to be, the final legislation not only implemented the proposals but went far beyond their original scope in ways that will broadly and generally negatively impact traditional will planning as well as planning involving so-called "life time trusts" (these are self-benefit trusts, alter ego trusts and joint partner trusts, but are not ordinary discretionary family trusts typically set-up for an estate freeze or other planning).

Although there is no way to adequately address the legislative changes in this article, some of the more critical changes impacting Testamentary Trusts are highlighted below:

1. the income of a Testamentary Trust that is a spousal trust in the year of death of the beneficiary spouse will be deemed to be the income of the deceased beneficiary spouse and not the spousal trust. This rule may result in significant inequitable consequences in situations where the deceased beneficiary spouse's heirs (who effectively end up paying the tax) are different from the residuary

beneficiaries of the spousal trust (who will receive the assets of the spousal trust);

2. access to many traditional tax saving testamentary tax planning practices will only be available to a "graduated rate estate" ("GRE"). Only estates of deceased persons that meet certain criteria can qualify as GREs and GREs can only last to the first 36 months of a qualifying estate. Other Testamentary Trusts, such as spousal, family or insurance trusts formed under a decedent's will will not qualify as GREs, though certain trusts formed under a will for the benefit of disabled persons will, with limitations, be able to qualify as GREs; and

3. the ability of a Testamentary Trust to enjoy the annual savings that come from being taxed at graduated tax rates (about $23,000 on the first $135,000 of income earned in Ontario in 2014) will only be available to GREs, which, as noted above, can only exist for the first 36 months of a qualifying estate.

Another significant problem with Bill C-43 is that it was enacted without provisions that would "grandfather" situations where wills can no longer be changed, for example, because the maker of the will is dead or incapacitated. Consequently, in these situations it may not be possible to take any steps to address the legislative changes, which could give rise to adverse tax results and, in some situations, potentially lead to unnecessary litigation.

We are here to help. To identify how this legislation may impact your estate and succession plans, you should consider reviewing your wills (particularly if they contain spousal trusts) with your tax and/or estate advisors before Bill C-43 comes into effect on January 1, 2016. Also, since the changes enacted in Bill C-43 will impact lifetime trust planning, if you have employed such trusts in your planning you should meet with your advisors to review whether those trusts will continue to meet your planning needs.

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rate plan where one or more of the borrowers or the beneficiaries of a trust are US citizens, US residents or US green card holders. The tax implications in this regard may be far-reaching and the importance of considering them cannot be understated.

With the prescribed interest rate at a historically low rate of 1%, now is the ideal time to implement a prescribed rate loan if you haven't already done so. And even if you have, consideration should be given to repaying any prescribed rate loans in full and putting a new loan into place at the 1% prescribed rate, taking into account the taxes that may be owing upon the liquidation of the assets required to repay the loan.

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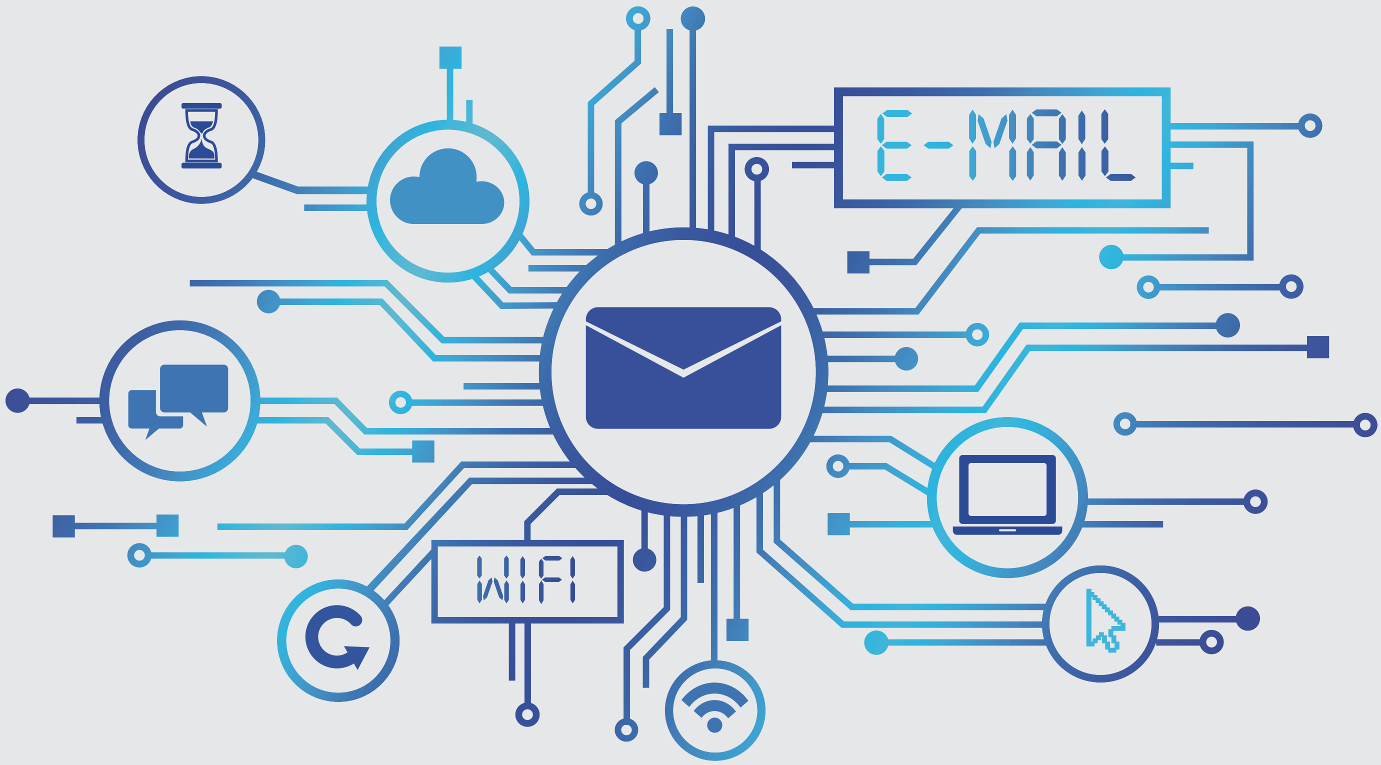

CASL: Not Just About Spam

(It's Also Software)

On January 15, 2015, the provisions of Canada's Anti-Spam Legislation ("CASL") related to the installation of computer programs came into force. Companies that are directly or indirectly in the software/app business should take note. Generally, going forward, installing or directing (or aiding, inducing or procuring) the installation of a computer program (or updates/upgrades) on the computer system of another person without that person's prior consent will be a violation of CASL.

Violating CASL should not be taken lightly – CASL provides for administrative penalties of up to $1 million per violation for individuals and $10 million per violation for corporations. As a result, companies should consider reviewing and making updates to their software license agreements and terms of use documents in order to ensure that they are compliant with CASL.

CASL doesn't apply to all software installations. CASL only applies to the installation of a computer program if the subject computer system is located in Canada at the time of installation or if the person installing or causing the program to be installed is in Canada at the time of the installation (or direction of the installation). As well, CASL only prohibits installation of a computer program on the computer system of another person. Computer programs installed on a computer system by an owner or authorized user of the computer system (a "User") would not be restricted by CASL so long as the computer program performs functions that the User would reasonably expect. As an example, firmware installed by a manufacturer at the time of device production would not be governed by CASL as the computer system would be owned by the manufacturer at such time (similarly, CASL wouldn't restrict the installation of computer programs by businesses on owned devices that are used by their employees). CASL does, however, restrict the installation of unexpected or secondary concealed functions whether or not a User installs the software. This restriction demonstrates one of the driving purposes of the legislation – limiting the spread of malware and spyware.

If CASL does apply, the User's consent must be obtained prior to installation. CASL's consent request requirements for software mirror CASL's consent request requirements for sending commercial electronic messages. A request for consent must clearly and simply state: the purpose of the consent; who's seeking consent and their full contact information; that consent can be withdrawn; and a general description of the functions and purpose of the computer program to be installed. Fresh consent isn't required to install an update or upgrade if it was expressly consented to when the computer program was first installed, if the User is entitled to receive the update or upgrade under the initial consent, and if the update or upgrade is installed in accordance with the terms of the initial consent.

There are certain situations where consent to the installation of a computer program is implied. Consent is implied where a bug fix or patch is installed as a reactive or proactive step taken to correct a failure in the operation of a computer system or a program installed on it, so long as the installation is solely for that corrective purpose and is consistent with consumer expectations. As well, consent is implied where a computer program is only executable using another computer program, the installation of which was previously consented to. It must, however, be reasonable to believe from the User's conduct that that the User consents to the program's installation. For example, it wouldn't be reasonable to believe that a User consents to the installation of cookies if that User configured his/her browser to refuse cookies.

If a computer program is intended to perform certain functions that are contrary to the reasonable expectations of a user, additional prescribed information must also be clearly and prominently described and brought to the attention of the User. Some of these functions include: collecting personal information stored on a computer system, interfering with the User's control of the computer system, and changing or interfering with settings, preferences or commands on the computer system without the knowledge of the User. In certain circumstances, CASL also requires the provision of assistance to Users in removing or disabling computer programs.

There is a limited transitional period for CASL's provisions relating to the installation of computer programs. If a computer program was installed before January 15, 2015, the User's consent to the installation of an update or upgrade to the program is implied until the earlier of January 15, 2018 and the date that the person withdraws their implied consent. The installation of computer programs after January 15, 2015 (as well as the installation of updates or upgrades to such programs) will, however, have to comply with CASL.

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Firm News

New Partner - **Rachel Moses**

Minden Gross LLP is pleased to announce the admission to partnership of Rachel Moses. Rachel is a litigator whose practice focuses primarily on banking and commercial litigation. She also litigates in corporate and real estate matters.

Professional Notes

Congratulations to **Christina Kobi**, who was appointed as a CREW Network Foundation Champion Director. Christina will promote the CREW Network Foundation's fundraising efforts by supporting donations, chapter fundraising and implementing local Career Outreach programs.

Congratulations to **Brian Levett**, who is a ranked lawyer in the 2014/2015 *Lexpert Leading Canadian Lawyers in Global Mining*.

The *2015 Lexpert/ALM Guide to the Leading 500 Lawyers in Canada* continues to recognize **Stephen Posen** and **Stephen Messinger** as the country's top practitioners in Property Leasing.

Catherine Francis was quoted in *The Globe and Mail* article "For Michael Wekerle, an old friendship becomes a $1.3-million feud" on January 22, 2014.

Eric Hoffstein was the co-chair of the Federated Press' 2nd Elderly Client Course on January 22-23, 2015, and spoke on the topic of "Financial Abuse of the Elderly". He presented "Who needs a will? You do." at the Princess Margaret Hospital Patient & Family Education Program on November 25, 2014. Eric spoke on "Trustee Liability Issues - Enforceability of Exculpatory Clauses" and provided an "Estate Litigation Update" and **Michael Goldberg** spoke on "Powers to Add and Remove Beneficiaries - Tax Considerations" at the 17th Annual Estates and Trusts Summit on November 3 and 4, 2014.

Samantha Prasad published her monthly articles in *The TaxLetter*, including "RRSP tax plan" in January 2015, and three articles in The Fund Library, including "The Grinch who stole your tax break" in December 2014.

David Ullmann was quoted in *The Globe and Mail* article "Target tries to soften blow with unprecedented employee fund" on January 15, 2015. David and **Adam Perzow** published "Five Important Things to Know If Your Retail Tenant is Insolvent" in January 2015. David and **Ryan Fenton** published "Court of Appeal Sounds Death Knell for Dominance of Hourly Rate Billing in Insolvencies" in the OBA *Insolvency Newsletter* and "Favicons: A "Brand" New Kind of Trademark" in December 2014.

Michael Goldberg published "A Whole New World – Time For Your Clients to Revisit Their Will (And Trust) Planning" in *The Estate Planner* (January 2015). He presented "Topical Tax & Succession Planning Issues" to TD advisors on November 13, 2014 and to Manulife Financial advisors on November 19, 2014. He also hosted a session of *Tax Talk* on November 19, 2014 and *infoEXCHANGE* published Michael's article "Sell Now!" in October 2014.

Matt Maurer was quoted in "Case a reminder to get it in writing: Real estate broker out $100K commission and $150K in costs" in *Law Times*, January 29, 2015. He continues to publish his blog on Slaw.ca, including "Plaintiff Nearly Loses $8,000 Because She Went to Trial Too Fast". The

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TLA Weekly Verdict republished "Real Estate Agent Loses $120,000 Commission for Not Sending Simple Email or Letter" (November 6, 2014) and "Should Self-Represented Litigants Be Entitled to Costs?" (October 9, 2014).

Irvin Schein continues to publish his blog including "When Will the Court Refuse to Enforce an Arbitration Clause?" on irvinschein.com. Irvin also presented a webinar on Just Cause for *HRInsider* on October 15, 2014.

Reuben Rosenblatt spoke on "Remedies for Misrepresentations before Closing" and **Steven Pearlstein** spoke on "Problems with the Standard Form DRA" at the LSUC Six-Minute Real Estate Lawyer on November 18, 2014.

Stephen Messinger, **Stephen Posen**, **Christina Kobi**, **Michael Horowitz**, **Boris Zayachkowski**, **Benjamin Radcliffe** and **Carly Caruso** of the Commercial Leasing Group presented "Dealing with the Lease: State of the Union! Today's Top Ten Lease Issues, Plus the Franchise Triangle" on November 26, 2014 for Lexpert Events. Stephen, Stephen, Christina and Michael participated in the ICSC Whistler Conference held January 25-27, 2015. Stephen, Stephen and Christina published "MPAC Working Papers" in *eFocus Municipal Assessment & Taxation* on October 13, 2014.

Michael Goldberg and **Matthew Getzler** republished "Sell Now! (How the 2014 Budget May Impact on Business Owners' Exit Strategies)" in the November issue of *Giving Advice*.

Joan Jung moderated "Surplus Stripping - What's Acceptable, What's Not, and What Should Be?" and "Fixing Mistakes" at the Ontario Tax Conference held on October 27-28, 2014. She published "Canadian Family Law Matters: Trust Disclosure for Family Law" in the December 2014 *Canadian Family Law Matters* and "Trust Disclosure for Family Law" in *STEPInside* (October 2014). Joan also spoke on "Death and Taxes for the Business Owner" at the LSUC seminar Taxation Issues for General Practitioners on September 22, 2014.