TAX MATTERS

Prevent family feuds to get the most out of your income

TIM CESTNICK
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Not all families can get along. An unnamed Italian woman lost a court case last fall and was ordered to pay the equivalent of $1,360 in compensation and court fines after threatening her mother over her mother's Bolognese sauce. You see, the daughter is a vegan and took offence to her mother's ragu which, of course, includes meat. "If you won't stop on your own then I'll make you stop. Quit making ragu, or I'll stab you in the stomach," the daughter said, according to the mother's complaint. Apparently, the most recent smell of the sauce simmering for hours in the small apartment they shared was the last straw.

A notable problem with family feuds is that they really put a stop to tax planning as a family – particularly income-splitting. And so, I encourage you to keep peace in the family, and keep more money in your pocket by splitting income – the idea of moving income from one family member who will pay tax at a higher rate to another who will pay less tax. Here's a primer on the topic.

THE ATTRIBUTION RULES

The problem with income splitting is that the "attribution rules" in our tax law could prevent you from moving income to a family member and could result in the income earned being attributed back to you to face tax in your hands. Specifically, moving income to your spouse or common-law partner, or minor children (including nieces and nephews), will often be caught. It's easier to split income with adult children, but even then, there are some cautions. The good news? There are many strategies that will allow you to side-step the attribution rules.

THE BENEFITS

How much tax can be saved by moving income from your hands to a family member? It depends on the difference between your marginal tax rate (the rate of tax you pay on your last dollar of income) and the marginal tax rate of your family member. This difference will depend on the province of residence and level of income of you and your family member. Having said this, the tax savings could be as high as $31,182 annually (the Canadian average).

THE STRATEGIES

There are well over 20 different ideas for splitting income with family. Today, I want to focus on the following five:

Lend money and charge interest. Lend money to your spouse or common-law partner so that he or she can invest that money. If you charge the prescribed rate of interest on the loan (currently 2 per cent) and the interest is paid to you by Jan. 30 each year for the prior year's interest charge, then you'll avoid the attribution rules and your spouse will pay the tax on any income earned.

Lend money, then take repayment. You can lend money to any family member, with no interest, and take repayment after, say, five or 10 years. While the attribution rules may apply to any income earned on the original loan until it's repaid, any income earned each year can be reinvested without attribution applying to the income on that income. This second-generation income can increase and take on a life of its own over time.

Transfer money for business purposes. You'll manage to avoid the attribution rules if you lend or give money to a family member for use in a business, even if you don't charge interest. There may be tax relief available if you structure this as a loan, the business goes defunct and you aren't repaid. Lending to a corporation rather than directly to your family member may provide additional tax relief in the form of an allowable business investment loss (ABIL).

Transfer money to cover interest on loans. When you lend money to a lower-income family member and those funds are used to pay expenses and not to invest, the attribution rules won't apply. So, consider giving money to your family member to pay the interest on an investment loan from the bank. There should be no attribution of income earned on those investments. Be careful that you don't guarantee or provide collateral for the loan, otherwise the attribution rules could apply.

Swap assets with another family member. This involves transferring some of your investment assets, or cash, to a family member in exchange for other assets in return. The assets you take back should be worth at least as much as the assets you're giving up, and should not produce income (things such as jewellery, artwork, a coin or collection, or even your spouse's half of the family home come to mind). Keep in mind that the transfer could result in taxes if the assets being transferred have appreciated in value, so count that cost first.

I'll share more ideas next time.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca.