

# Income splitting can save taxes

**EDITOR'S NOTE:** The following article is the first in a series on tax planning prepared by McCabe, Burns and Hubley Chartered Accountants.

One of the areas of tax planning which is generally of considerable interest is the potential for splitting income between family members.

Where one member of the family is paying tax at high rates, while the others have fairly low incomes, consideration is generally given to having the income more evenly distributed for income tax purposes.

Prior to the May 23, 1985 federal budget, there were many methods of achieving the desired income-splitting. Ranging from

simple to mind-numbing complex, the plans involved some or all of loans, gifts, trusts, partnerships and corporations, and could generally achieve most objections.

Now that some of the "smoke" surrounding the new rules has cleared, a description of the current status of family income-splitting is provided in this month's update.

One of the most frequently-used plans involved the higher-income spouse loaning funds at zero interest to the lower-income spouse (for ease of illustration, called "Dad" and "Mom" respectively).

The "old" attribution rules did not apply to a loan, as a bona-fide loan was not considered to be a "transfer" of funds. This meant that the income earned by Mom on

the borrowed funds was taxed in her hands, not in Dad's.

The tax saving would be equal to the interest earned times the difference in the individuals' marginal tax rates. The present rules relating to this type of arrangement are:

1. Where the loan was made before May 23, 1985, the income earned on the borrowed funds will continue to be taxed in Mom's hands during 1985, 1986 and 1987. However, if the loan is outstanding after December 31, 1987, any income earned in 1988 and thereafter will be taxed in Dad's hands.

2. Where the loan is made after May 22, 1985, any income earned on the borrowed

funds will be taxed in Dad's hands.

3. The attribution rules only apply to the property income (eg. interest, dividends, rent), not to business income. Therefore, if Mom used the funds to start up an incorporated business, the income (or loss) for the business would be taxed in her hands.

4. The attribution rules do not apply where the loan bears interest at a reasonable market rate, and where the interest is actually paid in the relevant taxation year or within 30 days after the end of the year.

Of course, charging interest lessens the amount of income which can effectively be split, but where the funds can be invested to earn income at a rate in excess of the "prescribed" rate, there may still be some advantage to an inter-spousal loan.

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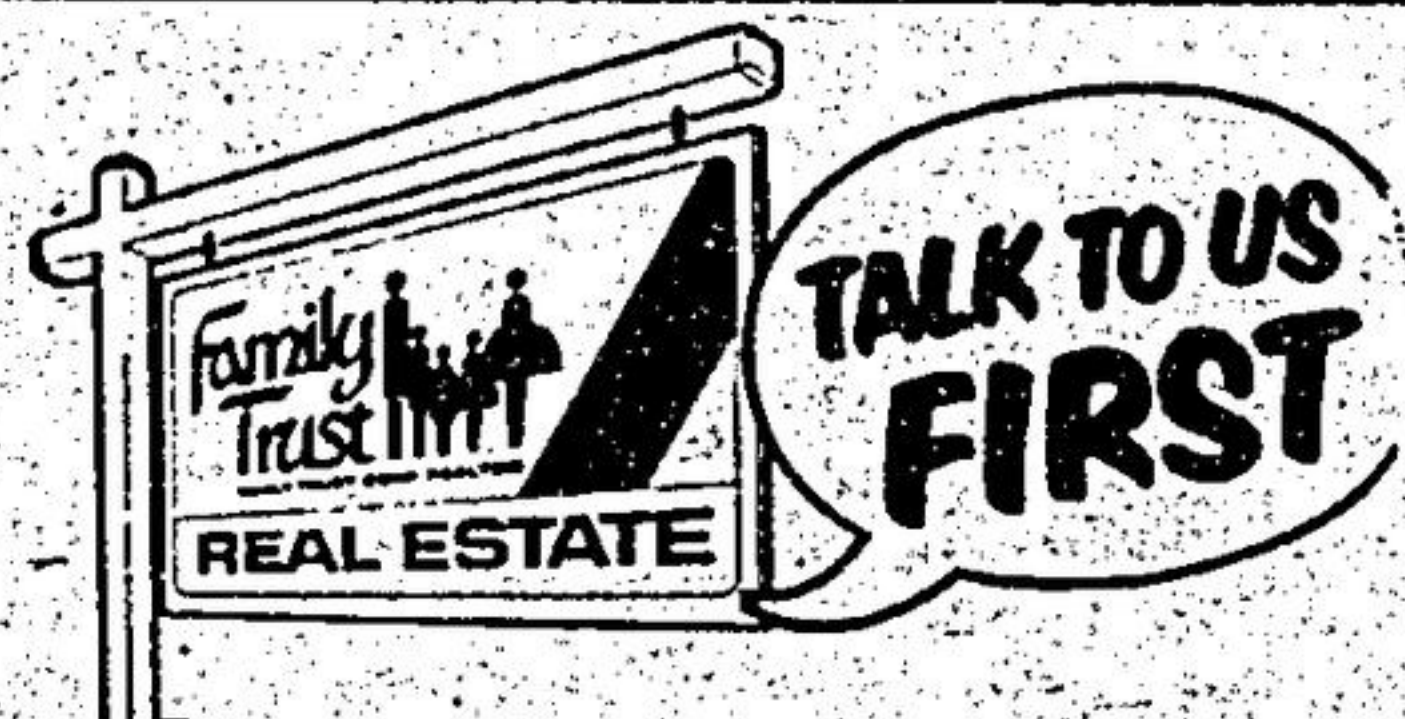
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