Straight Forward

Winter 2020

Family Income Splitting Basics

Wealth Advisory Services, TD Wealth

Income splitting is a tax planning strategy which results in income being transferred from a high tax bracket to a family member in a lower tax bracket, thereby decreasing the overall tax burden to the household. Although income splitting with family members is an acceptable tax planning method, the attribution rules contained in the Income Tax Act restrict the ability to split income.

These rules were designed to prevent taxpayers from transferring assets between family members in an attempt to reduce taxes. Under the income attribution rules, income earned on capital that has been transferred (as a gift/loaned) will be attributed back to and taxed in the hands of the transferor.

The table below provides an overview of whether attribution applies when investment income is earned with respect to transfers of gifts and loans to spouses and children:

Income earned on Gift/Loan.	For example:		
Person/Strategy	Fixed income investment	Income from publicly traded shares	
	Interest	Dividends	Capital Gains
Minor Child under 18			
Gift	Attribution	Attribution	No
No Interest Loan or Below prescribed rate loan	Attribution	Attribution	No
At or Above Prescribed Rate Loan	No	No	No
Income on Income	No	No	No
Adult Child 18 and over			
Gift	No	No	No
No Interest Loan or Below prescribed rate loan	No	No	No
At or Above Prescribed Rate Loan	No	No	No
Income on Income	No	No	No
Spouse			
Gift	Attribution	Attribution	Attribution
No Interest Loan or Below prescribed rate loan	Attribution	Attribution	Attribution
At or Above Prescribed Rate Loan	No	No	No
Income on Income	No	No	No

Note: The chart above assumes that earned income is from a non-related business.

The following discusses general income splitting rules and opportunities and does not take into consideration the newly expanded tax on split income (TOSI) rules that were enacted in 2018 and effective for tax years after 2017. While beyond the scope of this article, TOSI can impact taxpayers that receive directly or indirectly dividends, interest, and certain types of capital gains from a related business, partnership or trust. If caught under these new rules, the amounts will be deemed to be split income and will be taxed in the hands of the individual at top marginal tax rates.

Income Splitting Opportunities

Contributions to a spousal RRSP

Contributing to a spousal RRSP offers future tax benefits because it provides an opportunity for spouses to equalize income during retirement, reducing the overall tax liability. Contributions can be made by the higher earning spouse to a Spousal RRSP belonging to the lower-income spouse. Contributions need to remain in the spousal plan for at least three years otherwise the amount withdrawn will be taxed in the hands of the contributing spouse. However, RRIF (Registered Retirement Income Fund) withdrawals are not subject to the attribution rules in the year of contribution or the two previous years as long as only the minimum amount is withdrawn.

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TD Economics

The 2020 Global Outlook

Remaining Grounded

Derek Burleton, VP and Deputy Chief Economist, TD Economics

Since the autumn, there have been growing signs of optimism around the prospects for global economic growth in 2020. After plunging through the summer months partly on hopes for rate cuts, global bond yields have since staged a partial recovery. The slope of the U.S. yield curve is no longer inverted. World equity markets have been particularly sensitive to the potential for a growth revival, turning in impressive gains during the second half of this year. Beyond just the signalling effect of record equity market highs, there is also the wealth effect that could flow from the rapid rise in asset prices.

Investors have taken some encouragement from economic data over the past few months. While global manufacturing purchasing managers indices (PMIs) have largely remained stuck in contraction mode, there have been signs of stabilization in the U.S., China and the beleaguered eurozone. Service sector PMIs continue to point to a broad expansion, while job markets have remained resilient across the major economies.

What these developments suggest is that the steady downdraft in global growth – from almost 4% in 2017 to a decade-low of around 2.8% in 2019 – is in the rear-view mirror. But as importantly, after focusing almost exclusively on downside risks to their economic outlooks, forecasters can more confidently speak about potential upside risks as they look ahead to 2020.

We remain cautious around our 2020 baseline view, not anticipating anything more than a modest ramp up in the pace of global expansion. The are several key factors that leave our forecast anchored at roughly half a point below the global economy's average running speed of about 3.3%:

Geo-political uncertainty to stay elevated: There has been some de-risking of political events in recent months following the progress by the U.S. and China around the broad outline of a Phase 1 trade deal in October. But almost two months have passsed and a final agreement has yet to be reached, highlighting the ongoing fragile nature of the talks. In any event, its unlikely that any mini-deal will eliminate trade policy uncertainty, especially as the U.S. continues to take tariff action against other countries.

Leading indicators: Recent signs of stabilization can't be confused with evidence of a bounce-back, which remains scant. Consumer and business sentiment surveys and other key leading indicators continue to point to persistent below-trend growth in the coming months.

Lack of room to grow/policy room: unemployment rates remains low around the world, which is good news. Still, a lack of spare labour could act as a constraint to a pickup in growth. Moreover, with central bank rates already close to zero or negative in many cases, there is not a lot of wiggle room for monetary policy to stimulate demand. Fiscal policy could take up some of the slack, but based on plans announced to date, we don't see a much of a lift relative to last year.

Regionally, the U.S. is on track to remain the growth leader in the G-7 in the year ahead (1.8%), narrowly edging out Canada (1.7%). Elevated uncertainty has continued to put a chill on U.S. business spending, but the American household has been responding well to the 75 bps of insurance cuts delivered by the Fed in 2019. And with the benefit of lower rates and strengthening balance sheets carrying over into the New Year, we anticipate the household sector to underpin trend-like growth conditions. In this environment, the Fed can afford to sit patiently on the sidelines, with stable short-term rates anchoring Treasury yields at under 2.00%.

On this side of the border, the Canadian economy is coming off a year of moderate but choppy growth. After its struggles over the past few years, business fixed investment has been showing some signs of life over the past few quarters. Highly-indebted Canadian consumers remain more cautious to spend than their U.S. counterparts but continue to be supported by solid 4% y/y income gains and a rising savings rate. Within resale housing markets, sales activity across most key markets has been trending higher since last winter despite an ongoing lack of supply.

These trends are expected to prevail in 2020. Steady gains in domestic spending and housing activity are likely to counter ongoing headwinds in key export-oriented industries. We do see some limited improvement in oil and gas activity as production curtailment is further eased in Alberta, while the LNG Canada project will underpin growth in construction spending. The federal government is also expected to provide a modest fillip to growth through a boost to its spending plans.

The Bank of Canada (BoC) has bucked the trend of central banks over the past year by leaving its rate setting on hold. BoC officials have highlighted trade uncertainty as a key downside risk to its forecast but are also concerned that easing policy could exacerbate household financial imbalances. We still see the risks tilted towards an insurance rate cut by the BoC this spring. A potential trigger for this rate cut would be a further leg up in global bond yields in the months ahead. A cut in the policy rate would help to counter this "imported" upward pressure on debt servicing obligations.

The Canadian dollar is expected to remain rangebound (75-77 US cents) over the next 12 months, with little sway from solid domestic fundamentals that include the elimination of the negative spread in Canadian-U.S. 2-year yields. The sideways trading pattern is also consistent with that of WTI crude oil prices, which are expected to remain stuck at around US$55 in 2020. □

TD Wealth Asset Allocation Committee

Expecting the Unexpected

Bryan Lee, Vice President & Director, PIC Portfolio Strategist, TD Asset Management

What would you do if global stock markets suddenly fell precipitously and you knew that trade tensions between the U.S. and China would oscillate without resolution, that corporate earnings would slow, that U.S. manufacturing would fall into contraction, and that the popular recession guide - the U.S. yield curve - would invert? How would you have invested?

Well, all those things actually happened this year after stock markets fell during the final months of 2018. And while 2019 has been a dismal year for headlines, it's been a great time to be an investor as global stock markets continued to advance and some even hitting new record highs.

Yet few seem happy because the future is uncertain. Humans have a need for answers and when we don't know what's going to happen many of us get scared. And one way in which we make ourselves feel secure is to build stories to help us make sense of the uncertainty. But in the process of building these stories, we sometimes lose sight of important information that can help us make better informed decisions because we generally tend to focus on the negative, not the positive. Many of us tend to be so prone to pessimism that even the English language reflects our negativity. The English language has approximately 3,000 words to describe emotions - two-thirds of which describe negative emotions (source: Merriam-Webster, November 15th 2019). This bias to pessimism can lead us to focus on headlines that validate what we are feeling. But while world events and news are important to understand, it is equally important to understand what the data is showing us.

Our focus today is on the U.S. economy, which is the world's largest, and Canada's largest trading partner, which means our fates are inextricably linked. According to TD Economics, history has shown that a U.S. recession is a necessary condition for a Canadian downturn. Not since the Korean War has Canada entered a true recession without the U.S.

At over a decade long, the U.S. expansion is the longest on record which from a historical perspective suggests we are late in this economic cycle. Consequently, it wouldn't be unreasonable to expect that market pundits will argue that we are due for a recession. This is a view that we are comfortable not sharing currently because notwithstanding pockets of weakness in trade exposed sectors like manufacturing, the world's largest economy is performing well. Here are just some data points that keep us optimistic.

People have Jobs

In October, the U.S. unemployment rate was 3.6%, which is just a hair above the 50-year low set in September. And jobless claims are at low levels not seen in 50 years. The jobless claims report is issued by the U.S. Department of Labor on a weekly basis and is important for macroeconomic analysis, because it has been a good gauge of the job market. This report tracks how many people have filed for unemployment benefits. When an economy slows, companies sell fewer goods which lowers profits. One of the fastest ways to defend your profits in a slowing environment is to cut back production, which means laying off workers. Laid off workers file for unemployment benefits, which causes the jobless claims number to rise. With jobless claims at historically low levels and no signs of it trending higher yet, this leads us to conclude that the U.S. employment situation is stable.

Wages have been Increasing

So, more people are working now and companies who want to expand to meet the demands of a growing economy need to hire more workers. But companies are starved for employees because more people are employed, which means companies must pay higher wages in order to entice qualified people to come work for them or even just to keep existing workers. Wages have been increasing at an annualized 3% rate, while inflation has been hovering below 2%. In other words, people are getting paid more and their wages are increasing faster than inflation, which is a positive for disposable income.

Remember that last financial crisis? The overleveraged U.S. consumer who had record high debt to income levels? Well personal debt levels in the U.S. have fallen to levels not seen in 20 years and personal savings rates are at levels not seen in 30 years.

Jobs + Higher Wages = Happy Consumers

More Americans are working, getting paid more, saving more, and Americans have paid down debt that was one of the causes of the last recession.

It's no wonder that American consumers are happy as consumer confidence is at a 19-year high. Consumer confidence is an economic indicator of sentiment that is tracked because it suggests where consumer spending will be over the next several months. If a consumer is more confident about the economic outlook and their personal financial circumstances, they have historically been inclined to spend more.

Food for Thought

The U.S. economy remains the world's largest, and while it may show signs of slowing, labour markets remain strong, consumer spending healthy and we do not anticipate a near-term recession; rather the U.S. economy likely still has life left.

So, while we may be in a more mature phase, it does not mean a recession is around the corner. Business cycles need a catalyst to end, and the familiar triggers for a recession are absent. With interest rates expected to remain tame and with no signs of material imbalances, we expect the economic expansion to continue. □

TD Wealth

Family Income Splitting Basics (continued from page 1)

Prescribed rate loan
Under this strategy, the higher earning spouse loans money to the lower-income spouse at Canada Revenue Agency's (CRA) prescribed interest rate at the time the loan is made. As long as a formal loan agreement is executed, and interest payments are paid within the required timeline, attribution will not apply. All income and capital gains earned from this loaned money will be taxed in the hands of the lower-income spouse. The lower-income spouse will deduct the interest paid while the higher income spouse will report interest income on the loan; however, this should be offset by the greater return generated on the money in the hands of the lower income spouse.

If the deadline for the interest payment is missed, all of that year's income and all future years' income will be attributed back to the lending individual.

Higher income spouse pays for family expenses
This strategy requires the higher earning spouse to pay household expenses so that the lower-income spouse can invest so that the investment income is taxed in the hands on the lower-income spouse at a lower rate.

Transfer capital property to minor children
Because attribution rules do not apply to capital gains with respect to minor children, you can transfer assets to them which you expect to grow in value. Although dividend income will be attributed back to you, any capital gain resulting from the sale of those assets will not be attributed back.

Parents often set up in-trust accounts with their minor children as beneficiaries. The investment strategy is designed to provide capital gains so that the eventual taxes upon sale will be paid by the children. If you are a parent contemplating the use of this strategy, ensure that the in-trust account is properly set up otherwise you may contravene Section 75(2) of the Income Tax Act. This rule provides that, if the terms of the trust stipulate that the trust property may only be disposed of with the consent of, or in accordance with, the direction of the settlor, capital gains as well as income may be attributed back to the parent (i.e. the settlor). CRA has generally interpreted this to include the situation where the settlor is also the sole trustee of an in-trust account.

Here are a few general anti-avoidance rules which further limit income-splitting opportunities:

Rule	Example:
If a spouse or minor child receives a loan based only on a guarantee of the other spouse, this loan will be treated as if that spouse had loaned the funds directly, and attribution will therefore apply.	Bobby receives a loan at the bank based solely on the fact that his spouse Jesse has fully guaranteed the loan. In this case it will be deemed as though Jesse has directly loaned the funds to Bobby, and attribution will apply.
If an individual transfers property or loans money to a third party, who in turn transfers or loans that property to the spouse or minor child of the original transferor, the amount will be treated as if the spouse had loaned or transferred the funds directly, and attribution will therefore apply.	Blair loans money to Leslie, who in turn loans that money to Blair's spouse Pat. In this case it will be deemed as though Blair has directly loaned the funds to Pat, and attribution will apply.
If a person indirectly transfers property to a trust for the benefit of the spouse or minor child, it will be treated as if that transfer was made directly, and attribution will therefore apply.	Joe transfers money to a trust specifically for the benefit of his minor child. In this case it will be deemed as though Joe has directly loaned the funds to his child, and attribution will apply.

Due to the complex nature of the attribution rules, speak to your TD advisor and tax specialist prior to implementing any of these tax-planning strategies. □

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