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# Marmer Penner Newsletter

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## INCOME SPLITTING OPPORTUNITY EXPIRES SOON

As late as the early eighties, adults could loan funds interest free to related children. Funds would be invested on behalf of the children with the income taxed as the child's income. Since every taxpayer has tax-free room from the personal exemption, the tax savings could be significant.

The Department of Finance wised up to this and introduced the attribution rules, which require such investment income to be included in the parents' or grandparents' income not the child's. An exception exists where the funds are loaned to the child or grandchild at the prescribed rate of interest. At present (and until June 30, 2002), the prescribed rate is at an historically low 2%.

This means an adult can lend a child say \$10,000 at 2% per annum. The child can then purchase a long-term government bond, which yields about 5%. The parent must report the 2% loan interest or \$200 as income. The child must report the \$500 bond interest less the 2% interest expense, or \$300 net income. A child with no other income would pay no tax on the \$300. The parent, if taxed at the highest rate, would have paid \$139 tax on this income.

Taken to extremes, a parent can lend \$250,000 to a child using this technique. The child will report \$12,500 bond interest income (\$250,000 at 5%) and deduct \$5,000 as loan interest expense (\$250,000 at 2%) for net income of \$7,500. As this is exceeded by the child's personal exemption, there will be no tax payable on this \$7,500! The parent has now sheltered \$7,500 from tax and saved almost \$3,500.

This loan technique applies with all relatives and requires that the related party interest be paid no later than January 30<sup>th</sup> after each year-end.

Until June 30<sup>th</sup>, these 2% loans can be arranged for periods of up to five years. After June 30<sup>th</sup>, while the rules remain the same, the rate is expected to increase.

***This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper professional planning. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at [www.marmerpenner.com](http://www.marmerpenner.com).***