STRATEGIES BY LAURA URMONEIT

Birth and taxes

New parents face a range of new tax-planning opportunities

THE ARRIVAL OF A FIRST child can have a significant impact on your clients' financial goals, making it necessary for them to reassess their financial plans and reconsider their tax strategies.

The federal government has put in place several incentives for young families. According to John Grummett, a partner at St. Catharines, Ont.-based **Grant Thornton**, a firm of chartered accountants and management consultants, the first step for new parents should be applying for a child tax benefit.

The amount of the non-taxable monthly cash payment will be dependent on the number of children in the household and the parents' combined income, he says.

"When your clients file their income tax returns, the **Canada Customs and Revenue Agency** looks at the return, determines the number of kids and automatically sends the payment."

When tax returns are filed in April, the first payment is due in July. The monthly payments will stay the same until the following June. Then the CCRA will look at the most recent year's return and adjust the payments in July for the next year, says Grummett.

While the tax benefit is helpful, your client is likely to agree that it's not enough to offset the cost of supporting a child completely. Many parents find it necessary to have both spouses earning income, which often means sending the children to daycare, nursery school and summer camps.

"Child-care expenses are probably the biggest things on people's minds," says Nora Jones, senior manager of private client advisors at Toronto-based **Deloitte & Touche LLP.**

"These expenses are deductible just the way an RRSP contribution is deductible. However, only the lower-income earner may deduct the expenses."

Your clients will have to keep several other issues in mind before trying to claim child-care expenses, she says.

Clients must get a receipt from the child-care provider. Most nurseries or daycare centres have preprinted receipts. If the child-care provider is an individual who comes to the home, they should issue a receipt that includes their name, address and social insurance number.

"You'll sometimes hear people say, 'Oh, I'm paying her on the side.' Well, if you don't have a receipt, it's not deductible. You don't have to file the receipt with your tax return, but hang on to it, in case it comes into question," says Jones.

A deduction will not be allowed if one of the parents is being paid by the other to watch the children. Nor can money paid to a sibling under 18 years of age be deducted, says Jones. It is, however, acceptable to hire the underage teenager from next door.

The limits for claiming child-care expenses are $7,000 a child per year under the age of seven. For children between seven and 16, it's $4,000 per child annually.

There are some circumstances when a higher-income spouse can claim the child-care expenses, says Jones.

"It's usually if the other spouse is in full-time attendance of post-secondary education, or if they're in jail, or if they're confined to a bed or wheelchair," she says.

Daycare is usually the highest deductible child-care expense and the most widely used child-care deduction. But it's important to caution your clients about trying to claim too much, says Grummett. Some people try to claim summer hockey programs, piano lessons or swimming lessons, but these activities are not deductible child-care expenses, he says.

Private school can't be claimed as an expense, but it's never too early for new parents to start thinking about education expenses.

"When a child is born, from my standpoint as a financial advisor, there are several flags that are raised," says Paul Shirer, president and financial coach at Toronto-based **Perfect Timing Network.**

"Obviously one of the first things that comes to mind is education."

Shirer suggests clients with young children consider investing in a registered education savings plan (RESP) as a way of saving for post-secondary education.

Clients with children are allowed to invest $4,000 into an RESP each year per child but will not get a tax reduction for it. Instead, the government pays an additional 20% grant into the RESP, to a maximum of $400 per year.

"You don't pay tax on the income that's inside the RESP right away as it continues to build," says Grummett. The child can withdraw the money when he or she goes to college or university, paying the tax at that time. "Presumably, the child has tuition fees and very low income, and wouldn't pay any tax," he says.

Problems can arise if your client's child doesn't go to college or university. Then the parent will end up having to repay the grant portion paid by the government. To avoid that, Grummett suggests setting up a family RESP. If there are two or three children in the family, only one need go on to university to make the RESP valid.

Because parenthood has clients looking to the future, it can also be a good time to revisit RRSP strategies.

Grummett recommends reminding clients that their RRSP limit is 18% of the previous year's earned income minus a pension adjustment. A pension adjustment is the value of any pension benefits that have accrued to the individual in his or her company pension plan. That pension adjustment is usually shown on the client's T4 slip.

To advise your client to make the most of RRSP contributions, Grummett suggests you calculate what the RRSP contribution room is and then how much room each individual has left to contribute.

"If I have $6,000 of RRSP room and my wife is working and she has $6,000 of RRSP room, I could contribute $6,000 either to my RRSP

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A STRATEGY FOR SINGLE PARENTS

If your client's spouse has very little income, he or she will not be able to take full advantage of his or her basic personal credit. The client can then claim the spouse's credit.

This is a benefit, especially for single-parent clients, says John Grummett, a partner at Grant Thornton, a St. Catharines, Ont., firm of chartered accountants and management consultants.

"The spousal equivalent is when you have a single-parent family and there is no spouse to be able to claim the spousal amount for. In these instances, the Canada Customs and Revenue Agency allows you to claim the spousal equivalent for one of the children," he says.

There are a few caveats that advisors should point out to clients in such a situation.

For example, if the child has income, that income could reduce the amount of the credit. As well, in a situation in which the parents are separated, there are a few rules.

"The child is supposed to live with the person that is claiming the spousal equivalent credit. If your client is a husband who doesn't have custody of the child but pays child support, technically he shouldn't be claiming the spousal equivalent," says Grummett.

However, if it's joint custody, where the child is living part of the time with one parent and the rest of the time with the other parent, then one of the spouses can claim the spousal equivalent but both spouses can't claim the spousal equivalent for the same child. But if there were two children, then each parent could claim a credit on one child, he says.

Tax-planning strategies for new parents

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or to a spousal RRSP. Similarly, my wife could contribute $6,000 to her RRSP or to a spousal RRSP. But she can't claim more than what my limit is.

"So you couldn't put $6,000 into your RRSP and then $6,000 into your spouse's. But you can put $3,000 into yours and $3,000 into your spouse's," he says.

For clients with separate RRSPs, it may make sense for the spouse who is taking maternity or paternity leave to make little or no contribution, because they won't have much income beyond federal Employment Insurance against which the RRSP deduction will be made.

In the long run, though, you should try to ensure that your clients' incomes upon retirement is going to be similar, says Grummett.

If a spouse isn't working, the working spouse can still contribute to a spousal RRSP so that the working spouse gets the deduction, but the spouse who isn't working eventually takes the money out and pays tax on it when he or she retires.

"Otherwise, if you had all of your money in one spouse's RRSP and you retire, you'd have one spouse with maybe $50,000 of income and the other with none, [but] you'd rather have each of them with $25,000 because it's less tax," says Grummett. IE