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YEAR-END TAX PLANNING IDEAS

It's December, and time to think of some tax planning ideas. If you wait until your tax return is due next April or June, it will generally be too late to change your tax situation for this year.

Below, in no particular order, are some ideas and tips which may be useful to you before year-end.

1. Charitable Donations

Charitable donations have to be made by December 31 to be counted for this year.

Charitable donations receive special tax assistance. Once your donations exceed \$200 per year, they give you a tax credit calculated at the highest marginal rate. If your taxable income for 2009 (after all deductions) exceeds \$126,265, the charitable donations credit is worth the same as a deduction. If your taxable income is lower, then the donations credit is *better* than a deduction.

In British Columbia, for example, if you have \$72,000 of taxable income, additional income is taxed at 32.5%, while each dollar of charitable donation (above \$200) saves you 43.7%.

In fact, if you are not in the top tax bracket, you can benefit by receiving income and donating the excess to a charity. This may be possible if you already volunteer for a charity. If the charity pays you for your volunteer work, and you donate the income back to the charity, your tax bill will go down.

For example, suppose you are in the 32.5% tax bracket in B.C. and you have already made over \$200 in donations this year. If the charity pays you \$10,000 for work you have done for it, your tax bill will go up \$3,250 (maybe a bit higher, if you move up to the next bracket). If you donate the same \$10,000 back to the charity, your tax bill will go down \$4,370. The net is a saving of over \$1,000 after tax. (The numbers in other provinces will differ slightly, but the same principle applies generally.)

An even simpler route is to have the charity reimburse you for expenses you incur as a volunteer (e.g., travel and parking costs). Such reimbursements, provided they are reasonable, are not taxable to you. You can then donate the reimbursed amount back to the charity and get a tax credit.



Another idea to consider is donating publicly-traded shares or mutual fund units to a charity. If you do this, you do not report any capital gain on the securities, but the donation is valued for tax purposes at its current fair market value. If you are considering making a donation to a charity, and you have some securities that have gone up in value, donating the securities will be very tax effective.

You can claim charitable donations up to 75% of your “net income” for tax purposes. Net income is basically your income after most deductions, but before claiming the capital gains deduction (capital gains exemption) or any loss carryovers from other years.

2. Owner-manager remuneration

If you own a small business that is incorporated and has a December 31 year-end, you will want to make year-end decisions about paying yourself (or family members) a bonus to reduce the corporation’s income and possibly split income. Traditionally, private corporations used to “bonus out” their income over the small business deduction threshold, which is now \$500,000. However, the calculations have changed in recent years. Dividends from income taxed at the high rate (so-called “eligible dividends”) now generate a higher dividend tax credit, and the corporate tax rate has gone down.

The precise calculations and decisions about owner-manager remuneration should take into account federal and provincial corporate tax, the federal and provincial dividend tax credits, personal tax rates, your other sources of income, how soon you need to extract the funds, future changes in tax rates, the corporation’s need to retain cash in the business, and other considerations. Although the calculations can be complex, it is worth paying attention to this issue before year-end.

3. RRSP contributions

If either you or your spouse are not yet 71 this year, then you can normally make contributions to a registered retirement savings plan (RRSP) and deduct them from your income for tax purposes. Your RRSP contribution limit for 2009 is based on your 2008 “earned income” as well as your pension adjustment (reflecting future pension credited to you in 2008 by being a member of a company pension plan).

Your available RRSP contribution room should be printed on the Notice of Assessment that you received from the Canada Revenue Agency (CRA)





after you filed your 2008 return in the spring of 2009. Your maximum contribution room for 2009 is:

18% of your 2008 earned income
(maximum \$21,000 if your 2008 earned income exceeded \$116,666.67)

minus

your pension adjustment

plus

any contribution room from earlier years since 1991
that you have not yet used up.

Your deadline for contributions for 2009 is **March 1, 2010**. However, if you have any excess cash you should consider planning for your 2010 contribution as well. You can make that contribution any time from January 1, 2010. Putting funds into an RRSP will allow them to grow tax-free, rather than you having to pay tax on any interest that you earn during the year. (You can also put \$5,000 per year into a tax-free savings account, or TFSA, for which you get no deduction but interest will not be taxable.)

Consider also a contribution to a **spousal RRSP**. (This also applies to a common-law partner or same-sex partner even if you are not legally married.) Your maximum deductible contribution is the same regardless of whether you contribute to your RRSP or your spouse's, or some combination of the two. If your spouse is likely to have lower income than you in future years, then a spousal RRSP contribution will allow your spouse to take the income out down the road (once the third year has passed from when you make any spousal contributions). Your spouse will then pay tax on that income at a lower rate than you would if you withdrew the funds from your own RRSP.

A spousal RRSP is also useful if you are already over 71 but your spouse is younger. Once you reach the year in which you turn 71, you cannot contribute to your own RRSP and must convert your RRSP to an annuity or a registered retirement income fund (RRIF) from which you draw income every year. However, you can still make contributions to a spousal RRSP if your spouse is under 71 at year-end.

4. Trigger capital losses

Capital gains are half-taxed; that is, half of the gain is included in your income as a taxable capital gain. Capital losses can be claimed only against





capital gains (and can be carried back three years and forward indefinitely against such gains).

If you have capital gains this year — for example, from selling some shares for a gain earlier in the year — you may wish to trigger capital losses by selling securities that have gone down in value.

You should also ensure that you are not caught by the “superficial loss” rules. If you (or an “affiliated person”, which includes a corporation you control) acquire the same (or identical) securities within 30 days of selling them, then your capital loss will be disallowed.

5. Pay your instalments

If you have instalments to pay for the year, and you have not been paying them as per the notices you receive from the CRA during the year, now would be a good time to catch up. If you wait until next April, you will owe four months additional interest, and possibly penalties, on the late instalments.

To avoid interest from applying, instalments should be paid on March 15, June 15, September 15 and December 15. Prepaid or “early” instalments earn credit (called “offset interest”) against interest that applies to late instalments for the same year.

You are allowed to calculate instalments based on any of three methods, without interest applying. The instalments can total your tax payable (on income from which tax is not withheld at source) for this year, or for last year, or based on the amounts that the CRA advises you. The CRA’s notice to you for March and June is based on the amounts you paid two years ago, and then for September and December the suggested instalments are adjusted so that the total for the year equals the amount you paid last year.

If you have not been paying your instalments, you should estimate as best as you can the tax that will be owing for the year on your self-employment and investment income (and other sources from which tax is not withheld). You should then make a catch-up instalment payment as soon as possible, to reduce interest charges.

Where interest does apply to late instalments, it is calculated at 5%, compounded daily. (The rate changes each quarter.) You do not get interest on overpaid instalments, other than as an offset to late instalments for the same year as explained above.





TAX-FREE INCOME: SCHOLARSHIPS FOR FAMILY MEMBERS

We discussed this issue in our April 2008 Tax Letter when it was still in flux, as the Tax Court of Canada had issued a decision which was under appeal. Now it is fully resolved.

Scholarships paid to students for their education are non-taxable in most cases.

Employment benefits are generally taxable to employees, unless there is a specific exemption or an administrative policy not to tax the benefit.

What happens when an employer offers scholarships to spouses and children of employees? For example, a university may offer a discount on tuition to children of employees who meet certain academic qualifications; or a corporation may offer to pay part or all of post-secondary tuition for children of employees.

The CRA's former policy was that such a discount or payment would be a "scholarship" only if it was for children "who are selected on the basis of their scholastic records or other achievements or qualities", and recommended that this be done by an outside board or committee. If the "scholarship" was generally available to all students who qualify for university, the CRA's view was that the discount or payment was taxable to the employee as an employee benefit.

This policy was successfully challenged in a group of appeals that were decided by the Tax Court of Canada and then the Federal Court of Appeal: *Bartley, DiMaria* and *Okonski*. Two of the appellants were employees of Dow Chemical Canada Inc., which paid \$3,000 scholarships to their children who qualified by having at least a 70% high school graduating average. The third was an employee of the University of Western Ontario, which paid her \$1,200 to use for her daughter's education at the university.

The CRA assessed the employees in each case as having received a taxable benefit from employment, and they all appealed.

The Tax Court ruled that the payments were **not taxable to the employees**, because they were paid to the children. **Parents do not have a legal obligation to pay for their children's university education.** As a result, the parents were considered not to have been "enriched" by the payments to their children, and they did not receive a taxable benefit. (Even the univer-





sity employee who received \$1,200 was considered to have received those funds in trust for her daughter, so she did not really receive them for tax purposes.) The Court further ruled that the amounts paid were “scholarships”, since they required a minimum average grade of 70%. Therefore, a T4A slip should be issued to the family member.

These amounts reported on a T4A will normally be exempt to the student under the rules for scholarships, in most cases.

This “scholarships for the kids” route can be an effective way of getting tax-free income to employees.

NO MORE GAME-PLAYING WITH THE TFSA

The Tax-Free Savings Account (TFSA) came into effect in January 2009. You can put up to \$5,000 per year into a TFSA, and the interest or other income earned on the money invested is tax-free. You can withdraw the income or capital at any time with no tax cost, and any funds withdrawn can be recontributed beginning the next year.

Since TFSAs started, some tax planners have found creative ways of using them to get tax-free benefits beyond what was contemplated by the government. As a result, on October 16, 2009, the Department of Finance announced changes to curtail various strategies involving TFSAs:

- Asset transfer transactions, or “swap transactions”, between a TFSA and any other account of the taxpayer (or a family member) will be effectively prohibited. Any amount swapped into a TFSA in this way will be subject to a 100% tax.
- Overcontributions above the \$5,000 per year are already subject to a tax of 1% per month. In addition, any income attributable to *deliberate* overcontributions will be taxed at 100% .
- “Prohibited investments”, such as shares of the TFSA owner’s corporation, are already subject to a 50% refundable tax. In addition, any income from a prohibited investment will be taxed at 100%.
- Income attributable to “non-qualified investments” (outside the list of things that qualify for a TFSA, which is generally the same as for an RRSP) will be taxable at regular rates, as well any income earned on such income.





These changes will eliminate most of the “game-playing” that has gone on with TFSAs, where creative schemes were being designed to place into a TFSA nominally small investments that might generate huge tax-free incomes.

Draft legislation to implement these changes has not yet been released, but it will be released and enacted in due course, and will be retroactive to October 17, 2009.

BE WARY OF CHARITABLE-DONATION SCHEMES

If you are considering a tax shelter that involves use of the charitable donation credit, be very very careful!

The CRA is reviewing all tax shelter-related donation arrangements, and for most shelters has been reassessing every single donor to deny all of the tax benefits claimed. If the reassessment comes a couple of years after the credit has been allowed, there is usually a substantial amount of interest on top of the additional tax. In some cases the CRA imposes penalties as well. The CRA has also revoked the charitable registrations of a number of charities involved in tax shelters. (A revocation does not invalidate genuine donations made to such charities before the notice of revocation is officially published.)

Note that a **Tax Shelter Identification Number** does not mean the CRA has approved the shelter. It means only that the CRA knows the shelter exists. Tax shelters are *required* to provide you with this ID number, and you must report the number to claim any tax shelter benefits on your return—otherwise your claim will be disallowed. All the number does is give the CRA auditors an easy method of finding all the investors in any particular shelter, so that they can reassess you.

The only charitable donation shelter that is known to work, and has been approved in several CRA advance rulings, is the purchase and donation of flow-through shares. This is a very efficient way to make charitable donations, provided you genuinely want to make a donation. By combining the tax deductions available for flow-through shares with the special rule eliminating capital gains on publicly traded securities that are donated, you may be able to make a donation to a charity for only 8-20% of the amount that the charity will receive.





In summary, make sure you receive personal, independent advice from a competent tax professional before relying on any tax shelter.

TAX TIP IF YOU'RE MANAGING AN ESTATE

Read this tip if:

- You are involved with an estate (e.g. you are the executor or estate trustee), *and*
- the deceased passed away in 2008, *and*
- the deceased had an RRSP or RRIF which was included in income at death (rather than being transferred to the RRSP or RRIF of a spouse or family member).



A new rule introduced by the January 27, 2009 Budget allows a **carryback of losses** in the RRSP or RRIF to the deceased's final return, provided the last payment out of the RRSP or RRIF is made by December 31 of the year following death. Thus, if the deceased passed away in 2008, you have until December 31, 2009 to wind up the RRSP or RRIF if you want to take advantage of this rule.

This carryback is important if the value of the RRSP or RRIF has dropped since the death. The amount included in the deceased's final year income is based on the value of the RRSP or RRIF at death. Tax has to be paid by the estate on this income. By carrying back the loss, the deceased's income is reduced.

The carryback is calculated by comparing the amounts actually received on winding up the RRSP or RRIF with the amount included in income on death. As a result, not only losses, but selling commissions and other fees charges to the RRSP or RRIF effectively become deductible and can be carried back.

NEW SERVICE TO PAY THE CRA ONLINE THROUGH YOUR BANK

The Canada Revenue Agency recently announced **My Payment**, a new electronic payment service that allows individuals and businesses to send payments directly to the CRA from an account at a participating financial institution.



My Payment is currently available if you bank with BMO Bank of Montreal, Scotiabank, TD Canada Trust, or RBC Royal Bank, and you already have online banking. There are no fees for My Payment, other than what your bank might otherwise charge you for withdrawals.

My Payment can be used to pay personal income tax, corporate income tax, GST/HST, payroll deductions and various other kinds of payments to the CRA.

To use My Payment, go to www.cra-arc.gc.ca/mypayment, indicate which tax account you want to pay, and then link from there to your financial institution and log in to make the payment. The CRA does not obtain or retain any of your banking information, other than receiving your payment.

AROUND THE COURTS

'Without Prejudice' did not accomplish anything

You might think that putting "Without Prejudice" at the top of a letter will prevent the recipient from using the letter against you. Think again.

In the recent *Woodland* case, the CRA was auditing Ms. Woodland and wrote to her about her tax situation. She replied with a letter headed "Without Prejudice". Later, in appealing her reassessment to the Tax Court of Canada, Ms. Woodland tried to prevent the CRA from introducing this letter into evidence.

The Court ruled that the letter could be used as evidence against her. There is a "settlement privilege", but it protects only communications made during a settlement negotiation or in an attempt to effect a settlement. Since no settlement discussions were ongoing during the CRA audit, the words "Without Prejudice" did not prevent the letter from being used in evidence

* * *

This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with us before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.





Please contact me to discuss my financial and tax needs.

Please add my name to your tax letter mailing list.

Name: _____

Company: _____

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