
Business Report

YEAR END TAX PLANNING
December 2008



For most people, dealing with their own income taxes is a chore. As a result, the only time they really get involved is in April, as the filing deadline looms. Unfortunately, by that time there is very little you can do to reduce your income taxes for the previous year.

Planning ahead over the entire year is ideal, but by considering specific tax planning matters *now*, you may be able to reduce your tax bite next April and save tax for you and your family for 2008. These planning points are not intended to serve as specific advice. Always seek the advice of your D&H advisor before implementing any of the suggestions contained in this newsletter.

□ **Capital Losses**

Capital losses may be used to offset capital gains realized during the year, reducing the income taxes that are payable for 2008. Therefore, it may make sense to sell investments that have dropped in value in order to realize the loss. To trigger capital losses before the end of the year, the transaction settlement date must be on or before December 31, 2008. The time it takes to settle a trade will vary depending on the nature of the security and the exchange on which it is listed. Check with your broker to determine the last date your trade can take place while still being settled by December 31, 2008.

Want to buy back in to the same investments? Wait until 30 days have elapsed after the settlement date – otherwise, your losses will be denied and added to the cost base of your re-purchased investments.

If your capital losses exceed your capital gains in 2008, the net capital losses may be carried back three years or carried forward indefinitely to offset taxable capital gains in other years.

Please see our October 2008 *Business Report* for more options to consider in order to make use of capital losses.

□ **Tax-Free Savings Account (TFSA)**

Starting in 2009, you can contribute up to \$ 5,000 annually (indexed after 2009) to a TFSA if you are a Canadian resident age 18 or older. Contributions to a TFSA are not tax deductible and the contribution room can be carried forward indefinitely. Investment income earned in the TFSA will be tax-free and you can make a tax-free withdrawal from a TFSA at any time. When you make a withdrawal, the amount withdrawn will be added to your contribution room in the next year and can be re-contributed in the future.

An attractive feature of a TFSA is that if you have more money than your spouse, you can give funds to your spouse to establish his or her own TFSA and the normal income attribution rules that would tax the investment income in your hands will not apply while the funds remain in the TFSA.

Unlike an RRSP, which has to be wound up when you reach age 71, you can maintain your TFSA for your entire lifetime.

TFSA's will generally be allowed to hold the same qualified investments as RRSP's. This includes cash, mutual funds, publicly traded securities, GICs, bonds and certain shares of small business corporations.

□ Owner-Manager Remuneration

The right mix of salaries and dividends to the owner manager will ensure taxes are minimized while taking into consideration RRSP entitlements and CPP requirements. Income splitting may also be possible if a spouse or family member provides services for which the individual can be paid a reasonable salary. This works particularly well where your spouse or children have little or no income.

Remuneration strategies should account for increases in personal tax rates on eligible and non-eligible dividends after 2008. Remember that the receipt of dividends (especially eligible dividends) can increase exposure to alternative minimum tax. For more information on “eligible dividends”, please see our October 2006 *Business Report*.

If a family trust owns shares of a corporation, dividends must be paid on or before December 31st in order to be included in the family trust’s income for its taxation year ending December 31, 2008.

□ Trust Income Allocations

Income (e.g. dividends and other income) not allocated from an inter-vivos trust to an income beneficiary is taxed at the highest marginal personal tax rate (43.7% in B.C.) in the trust. In order to allocate the income from an inter-vivos trust to a beneficiary in 2008, the income must be paid or payable to the beneficiary on or before December 31st.

Care should be taken when allocating certain types of income, such as private company dividends, to beneficiaries under the age of 18 as the “Kiddie Tax” may apply to tax such income at the highest marginal personal tax rate.

□ Allowable Business Investment Losses

While capital losses can only be used to offset capital gains, allowable business investment losses (ABILs) can be used to reduce income from all sources. Therefore, if you are a shareholder or creditor of a financially unviable private *small business corporation*, consider selling your shares or debt to an unrelated person, or claiming a special write-down for the shares or debt, before December 31, 2008 to realize an ABIL for 2008. Keep in mind that if you have already claimed any capital gains deductions (CGD) in the past, the amount of the ABIL will be reduced by the CGD claimed. In addition, certain rules may disallow the ABIL claimed if you made non-interest bearing loans to a company.

□ Year-end Planning for Certain Investments

As a planning point, you may want to delay certain investments outside of your RRSP until January 2009. Purchases of mutual funds that are expected to make taxable distributions near the end of 2008 should be delayed until 2009 to avoid paying tax sooner than necessary. Likewise, consider selling mutual funds before year end to minimize your allocation of taxable income for 2008. When it comes to purchasing interest bearing securities (such as GIC’s) with a maturity date of one or more years, consider waiting until 2009 so that you won’t have to pay tax on accrued interest until 2010, the year of the investment’s first anniversary.

□ RRSP Contributions

March 2, 2009 is the last day you can contribute to an RRSP and deduct the contribution on your 2008 personal tax return. However, the earlier you make the contribution, the more time you have to let your tax sheltered retirement income grow.

Your 2008 RRSP “contribution limit” is based on your 2007 earned income up to the maximum RRSP contribution limit of \$ 20,000, and can be found on your 2007 Notice of Assessment. Unused RRSP contribution room can be carried forward indefinitely until fully utilized.

If you turned 71 during 2008 you must wind up your RRSP by the end of the year. Therefore, the last day you can contribute to your RRSP is December 31, 2008. However, if you have earned income in 2008, you will be entitled to contribution room for 2009. Since you must terminate your RRSP by December 31, 2008, what can you do? Consider making a contribution in December 2008 before your plan is wound up. Although you may be assessed a small over-contribution penalty for the month of December, you will be entitled to a tax deduction in 2009 for the contribution made. In addition, even if you are over age 71, you can still make contributions to a spousal RRSP if your spouse is 71 or younger.

Income splitting in the future may be achieved by contributing to a spousal RRSP. However, to ensure your spouse pays the income tax on any withdrawals from the plan, make certain your spouse waits until the third calendar year after the year of contribution to make a withdrawal. Making the spousal contribution before year end will effectively reduce the waiting period to just over two years.

❑ **RESP Contributions**

December 31, 2008 is the last day you can contribute to an RESP and receive a Canada Education Savings Grant (CESG) for 2008. There is no longer a maximum annual RESP contribution and the lifetime maximum has increased to \$ 50,000. CESG grants are calculated at 20% of your RESP contributions, subject to an annual limit of \$ 500 per child under the age of 18. Additional age restrictions apply for RESP contributions and withdrawals.

Families with a total income of less than \$ 74,357 may qualify for increased CESG benefits on the first \$ 500 of RESP contributions.

❑ **Registered Disability Savings Plan (RDSP)**

Commencing in 2008, you can set up a RDSP for a child if he or she qualifies for the disability tax credit. Maximum lifetime contributions of \$ 200,000 per child are not tax deductible to the contributor. Income earned inside the plan is exempt from tax and withdrawals are taxable to the beneficiary. You will have to consider whether an RDSP might disqualify your child from receiving provincial or territorial income supports. Contributions may be supplemented to a maximum of \$ 3,500 by payments from the Canada Disability Savings Grant Program depending on the beneficiary's family income and contribution level.

❑ **Defer a Bonus**

If you are going to receive a bonus for 2008, you may want to talk to your employer about deferring the bonus until January of 2009. That way, you will defer paying income taxes on the bonus for a full year.

Also, assuming you have the contribution room available, consider having your employer transfer the bonus directly into your RRSP after year-end. This will enable your employer to avoid the income tax withholdings on the bonus, and will enable you to take an RRSP deduction in 2008 despite the bonus being included in your 2008 income.

❑ **Interest Deductibility**

In order to deduct loan interest when computing your income, the loan must have been borrowed for the purpose of earning income from a business or property. If you are currently paying interest that is not deductible (for example, on a home mortgage loan), contact your D&H advisor to discuss the possibility of reorganizing your affairs to make the interest deductible.

Also note that interest charged on related party loans structured to avoid the attribution rules must be paid before January 30, 2009 in order to be effective.

Finally, keep in mind that a deduction for your life insurance premiums is permitted where the life insurance policy is assigned as collateral for a loan, provided the assignment is required by the lender, the lender is a Canadian or Quebec licensed financial institution, and the interest payable on the loan is deductible.

❑ **Purchasing Assets**

If you are self employed or own a business and are planning to buy certain assets for your business, you may want to consider purchasing them before year-end. Doing so will enable you to claim capital cost allowance on the assets a full year sooner than if you wait until the new year. In addition, if you are registered for GST, you can claim a full GST credit in the year of purchase, which will allow you to reduce the GST you owe for 2008.

❑ **Deferred Stock Option Benefits**

If you exercised employee stock options in 2008, you can defer the taxable benefit from exercising these options, subject to a \$ 100,000 limit based on the fair market value of the option shares at the time the options vested. To qualify for the deferral, you cannot have disposed of the shares acquired under the options, and to defer the benefit, you must notify your employer in writing before January 15, 2009 so that the deferral can be reflected on your T4 slip, which must be provided to you before February 28, 2009.

Note that special rules exist if you exercised stock options in a Canadian controlled private corporation. Such stock options generally do not have the same dollar limits or notification requirements.

❑ **Review Your Personal Use of Employer-Provided Automobiles**

A taxable benefit called a “standby charge” applies to an individual who uses a company owned automobile for personal purposes. If your total personal driving is less than 20,000 kilometres and represents less than 50% of total use, you may qualify for a reduction of the standby charge. Also, if your business driving exceeds 50% of your total kilometres, you can calculate your operating cost benefit as one-half of the standby charge (otherwise 24 cents per km of personal use), less reimbursements, should this prove beneficial.

Review your automobile log to see if you fall within these thresholds. If you intend to use the alternate 50% method for calculating the operating benefit, you must advise your employer in writing by December 31, 2008.

❑ **Moving Expenses**

If you moved within Canada during the year, your moving expenses may be deductible. In order to qualify, you must start working or operating a business at a new location, and your new home must be at least 40 km closer to the new location than your old home. The moving expenses are limited to the income earned at the new location, and may be deducted in either the year of the move or the immediately following year. Moving expenses include out-of-pocket costs for moving, realtor’s commissions and legal fees on the sale of your old home, and the property transfer tax and legal fees paid on the purchase of your new home.

If you moved into or out of Canada during the year, but remained a Canadian resident for income tax purposes while you were abroad, you may also be able to deduct your moving expenses.

❑ **Public Transit Passes**

This credit will apply to the cost of public transit passes that have a duration of at least one month. The credit may be claimed by an individual in respect of such costs incurred by the individual, the individual’s spouse or common-law partner, and dependent children under the age of 19 for passes purchased before December 31, 2008. Public transit includes transit by bus, streetcar, subway, commuter bus, commuter train and local ferry. Expired transit passes should be retained to support any claims. The costs of certain electronic payment cards and certain weekly public transit passes may also be claimed.

□ **Political Donations**

Political donations must be made on or before December 31, 2008 to qualify for a tax credit in 2008. The maximum credit available for federal political donations is \$ 650 on \$ 1,275 of donations. The maximum credit available for provincial political donations is \$ 500 on \$ 1,150 of donations. For political donations in excess of these amounts, no additional tax credits are available.

□ **Charitable Donations**

Charitable donations must be made on or before December 31, 2008 to qualify for a tax credit in 2008. Donations may be claimed in an amount not exceeding 75% of net income. Donations in excess of 75% of net income can be carried forward for up to 5 years. For deceased taxpayers, this limit is increased to 100% of net income in both the year of death and the preceding year (taking into account bequests or legacies in the deceased's will).

Donations of publicly-traded marketable securities that have appreciated in value can offer even greater income tax benefits than cash donations. The inclusion rate for capital gains realized on the disposition of securities by way of donation is reduced to 0% (compare this to the normal capital gains inclusion rate of 50%). The 0% inclusion rate is also available for donations made to private foundations.

Therefore, instead of selling securities with accrued gains to make a cash donation, consider donating the securities instead. Keep in mind that most charities require more time to process and receipt donations of securities than donations of cash.

Donating publicly-traded marketable securities that are in a loss position can also be effective because you will receive a donation receipt for the fair market value of the securities at the date of the donation and you will be able to use the capital loss.

□ **Medical Expenses**

Medical expenses you wish to claim in 2008 must be paid within any twelve month period ending in 2008 to obtain a tax credit. The credit is equal to the medical expenses incurred, minus the lesser of 3% of net income or \$ 1,962 (\$ 1,911 for BC tax), multiplied by 15.0%. A similar calculation applies for B.C. provincial tax purposes, albeit at a credit rate of 5.24%. A calculation is required to establish whether it is beneficial to claim medical expenses in the current year or defer them to the following year when it may be more advantageous.

If you are a self-employed person, you may be allowed to deduct from your income certain premiums paid to a private hospital or medical expense insurance plan. As a result of various limitations within these provisions, contact your D&H advisor to discuss your individual situation.

□ **Child Tax Credit**

A non-refundable child tax credit of \$ 2,038 for each child under the age of 18 at the end of the year is available. The credit will result in a federal income tax savings of \$ 306 per child in 2008. The credit may be claimed by either parent.

□ **Adoption Costs**

Individuals who successfully adopt a child will be entitled to claim a tax credit for the year in which the adoption is finalized based on the adoption related expenses paid, less reimbursements, up to a maximum of \$ 10,643 (2007 – \$ 10,445). Parents may each claim a portion of the credit per adopted child.

□ **Child Care Expenses**

Subject to certain limitations, child care expenses incurred during the year may be claimed as a deduction from income. In two parent families, child care expenses must generally be claimed by the lower income spouse. The maximum deductible amounts are \$ 7,000 for each child under the age of seven at the end of the year, and \$ 4,000 for each child between the ages of seven and sixteen at the end of the year.

If your child is eligible for the disability tax credit, the limit for child care expenses increases to \$ 10,000. The total deduction for child care expenses cannot exceed 2/3 of the income of the individual claiming the deduction.

Remember that boarding school and camp fees can qualify for the child care deduction (limits apply), and to get receipts for all child care expenses.

□ **Children's Fitness Expenses**

Parents can claim up to \$500 per year for eligible fitness expenses paid for each child who is under 16 years of age at the beginning of the year. Parents can claim up to \$1,000 per year for a child that qualifies for the disability tax credit and who is under 18 years of age at the beginning of the year.

□ **Universal Child Care Benefit**

The Universal Child Care Benefit (UCCB) is \$ 100 per month, for each child under the age of six. The UCCB is subject to income tax in the hands of the recipient parent with the lowest income.

□ **Alimony and Maintenance**

Alimony and maintenance payments made during the year are generally deductible for income tax purposes. There is an exception for child support payments made pursuant to an agreement, court order, or an amendment to an agreement or court order, dated after April 30, 1997. These payments are not deductible by the payer, and are not includible in the recipient's income. Certain payments made to third parties may also qualify as alimony and maintenance payments, provided this is specified in the related agreement or court order.

□ **Students**

Scholarships and Other Prizes – All scholarship, fellowship, bursary or prize income received from a program that entitles the student to the education tax credit is tax exempt. For other scholarships, fellowships, bursaries or prizes, the first \$ 500 is tax exempt. These exemptions are important to remember because the tax forms issued for such scholarships generally do not explicitly indicate the exemptions.

Tuition Credits – Tuition fees and student loan interest must be paid on or before December 31, 2008 to qualify for a tax credit in 2008. Unclaimed tuition and education credits can be carried forward indefinitely, while unclaimed credits for student loan interest can be carried forward for five years.

Foreign University Tuition Fees – If you attended a foreign university, your tuition fees may be eligible for a tuition credit in Canada. In support of such fees, you must have the foreign university complete a Form TL11A certificate of tuition fees paid outside Canada.

□ **File Tax Returns for all Family Members who Receive Income or are Eligible for TFSA Contribution Room**

All family members who receive income should file income tax returns even if they do not have to pay any tax because their income is below the taxable threshold. Filing an income tax return prevents taxpayers from further assessments after a period of three years. In addition, if your child or spouse earns income from employment or business, their RRSP room will begin to grow if they file a tax return each year.

With the new TFSAs, it is important that all individuals who are 18 or older file income tax returns even if they do not have any income because the Canada Revenue Agency is tracking TFSA contribution room only for individuals who file income tax returns.

□ **U.S. Citizens Living in Canada**

U.S. citizens or green card holders are subject to U.S. taxation on their worldwide income even if they live in Canada. U.S. personal income tax returns for citizens or green card holders living outside of the U.S. are due June 15, 2009.

D&H Group LLP continues to keep you informed of changes (and proposed changes) that can affect you and your business. D&H Group LLP is a seventy person firm with over 50 years experience in providing clients with sound professional advice. We are a member of IAPA which has over 130 offices located throughout the world, including major cities in Canada, the U.S., the Pacific Rim countries and Europe.

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