

Issue**2007-04**

- Employment income
- Business income
- Owner-manager considerations
- Investment income
- Capital gains and losses
- Saving for retirement
- Deductions and credits
- Other year-end planning

Year-End Tax Planning Checklist

As the end of the year approaches, many people turn their attention to income tax planning. Individuals are taxed on a calendar year basis so December 31, 2007 represents the last date for transactions that affect 2007 taxes. There are other “tax deadlines” that fall around this time or early in the new year, such as the Registered Retirement Savings Plan (RRSP) contribution deadline. Therefore, the year-end is generally a good time to take stock of your income and deductions and to make decisions about your overall tax position for 2007.

Ideally, tax planning should be considered on an ongoing basis throughout the year as part of an overall financial plan. All taxpayers should review their particular situation regularly to ensure that they’ve structured their financial affairs to minimize tax as much as possible. In particular, any major transactions should be examined in advance to ensure that tax considerations are taken into account.

However, even if you haven’t actively monitored your tax situation throughout the year, there are still a number of steps you can take before year-end to minimize your taxes for 2007. This edition of the Tax Factor summarizes many of these tax planning ideas. Not all of our suggestions may be appropriate for your particular situation. Others, though included as year-end points, could also apply throughout the year. Your BDO advisor can assist you in determining which of these ideas make sense for you.

Employment income

Pay interest on employee loans before January 30th

If you had a low-interest loan from your employer during any part of the year, you’re deemed to have received a taxable employment benefit. This is calculated as interest at the Canada Revenue Agency’s (CRA’s) prescribed rate for the period during which the loan was outstanding. The amount of the benefit is reduced by any interest you actually paid on the loan. However, the interest must be paid within 30 days of the end of the calendar year.

Note that if you have received a loan by virtue of your shareholdings rather than employment, the amount of the loan will be included in your income, even where interest is charged at the prescribed rate. However, an exception to this rule applies if the loan is repaid by the end of the taxation year of the lender following the taxation year in which the loan was received, in which case the loan balance will not be included in your income.



Any major transactions should be examined in advance to ensure that tax considerations are taken into account

Reimburse personal operating costs on employer-provided automobiles before February 14th

If your employer provides you with a company car, a taxable benefit will be included on your T4. The actual benefit is made up of two parts. The first part is a standby charge based on a percentage of the original cost or the monthly lease payments for the automobile. The second part applies if your employer pays the automobile's operating expenses. In 2007, this benefit is equal to 22¢ (no change from 2006) per personal kilometre driven and applies unless all amounts paid for personal operating expenses are reimbursed to the employer by February 14, 2008.

The standby charge and the operating benefit are reduced by the amounts you pay to your employer. For a standby charge reduction, your payment must be made during 2007. For an operating benefit reduction, your payment must be made by February 14, 2008.

Review your personal use of employer-provided automobiles

If your total personal driving is less than 20,004 kilometres (being 1,667 kilometres a month for 12 months) 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 driven, you can calculate your operating cost benefit as one-half of the standby charge, less reimbursements, if this is beneficial.

Review your automobile log to see if you're close to these thresholds. If so, you may want to reduce personal travel with the company car where possible between now and the end of the year, to reduce your taxable benefits. Also, if you intend to use the alternate 50% method for calculating the operating benefit, you must advise your employer in writing by December 31st.

Purchase employment-related assets before year-end

Employees are entitled to claim tax depreciation called Capital Cost Allowance (CCA) on only three types of assets—automobiles, aircraft and musical instruments—if conditions are met. If you're entitled to deduct CCA and you're considering purchasing a new asset, you should do so prior to the end of the year. This will accelerate CCA claims by one year. The asset must actually be available for your use to qualify for a CCA claim. In addition, specified tradespersons can qualify for a tax deduction of up to \$500 for tools they purchase, and a deduction for tools purchased by qualified apprentices is also available. There are conditions that must be met for both deductions.

Review tax-free gifts, awards and social events

The CRA has set administrative policies with respect to employer-provided gifts and awards. As an employee you

As an employee, you can receive two non-cash gifts a year from your employer on a tax-free basis for special occasions, such as Christmas, Hanukkah, a birthday or a similar event



can receive two non-cash gifts a year from your employer on a tax-free basis for special occasions, such as Christmas, Hanukkah, a birthday or a similar event. Similarly, you can receive two non-cash awards a year from your employer, on a tax-free basis, in recognition of employment achievements such as reaching a set number of years of service or similar milestones. In both cases, the total cost of the gifts or awards to the employer, including taxes, must not be more than \$500 per year. Where the cost of each gift or award exceeds \$500, the full fair-market value of the gift or award will be included in your income. Where the total cost of the gifts or the total cost of the awards (maximum of two each) is more than \$500, the fair market value of one or more of the gifts or awards will be included in your income. The employer can deduct the cost of the awards.

This policy should make it somewhat easier for employers to administer their gift and awards programs, as it will generally remove the need to determine the fair market value of small, non-monetary gifts and awards where they are within the limitations noted above. Note that this policy does not apply to certain gifts and awards. For example, this policy does not apply to cash or near-cash gifts and awards which may include gift certificates or any item that can easily be converted to cash—the value of these gifts and awards will be considered a taxable employment benefit. For more information on gifts and awards that the CRA considers to be taxable employment benefits and not covered by their policy above, contact your BDO advisor.

The CRA also has a policy concerning work-related social events. If your employer provides free parties or other social

events to all employees and the cost is not more than \$100 per person, this will not be considered a taxable benefit to you. Note that ancillary costs such as transportation home will increase the \$100 per person amount. If the cost of the party is greater than \$100 per person, the entire amount including the ancillary costs will be a taxable benefit and included in your income.

Business income

Many planning points are also available to individuals who carry on business.

Pay reasonable salaries to family members before year-end

If your spouse or children work for you, consider paying them salaries. Salaries paid reduce your income and are taxed in their hands, possibly at lower marginal tax rates than if the income had been paid to you. They also provide family members with earned income for RRSP contributions.

Any salary paid must be reasonable given the services performed. A good rule of thumb is to pay them what you would have paid a third party. A record should be kept of the time actually spent and the services actually performed.

Also, whenever you pay salaries to your spouse or children, ensure that withholdings for income tax, Canada/Québec Pension Plan (CPP/QPP), Employment Insurance (EI) (where an exemption is not available) and any applicable provincial payroll taxes are remitted as required. The salary and the amounts withheld for 2007 must be reported on T4 slips, which are due on or before February 29, 2008.

Purchase capital assets before year-end

If you're planning to purchase capital assets in the near future, consider doing so before the end of your fiscal year. If the assets are acquired and in use before year-end, you can claim one-half the usual CCA rate. Even if you're in a loss position this year, purchasing the asset now will allow a full year's CCA claim next year. Bear in mind that title to the asset must be acquired and it must be available for use in order to claim CCA.

Owner-manager considerations

If you carry on your business through a corporation, there are even more planning points available to you.

Pay dividends from your corporation

In certain situations, a corporation can be used to split income with family members. For instance, if your spouse or children, who are 18 years of age and older, subscribe for shares of your corporation at fair market value using their own funds, they can receive dividends from the corporation out of its after-tax profits and you can split income. Dividends paid by the corporation before its

year-end could generate a tax refund on its corporate tax return, if it has previously earned investment income on which it paid tax. If your corporation has a year-end early in 2008, say January 31st, you could declare a dividend in January, which would generate a tax refund for the corporation on its current return. The recipients of the dividend would then be taxable on their 2008 returns which are due April 30, 2009.

There could be a problem with this type of planning if you've loaned or transferred property to the corporation. In this case, you must ensure that the company maintains its status as a Small Business Corporation (SBC). Otherwise, you could be subject to an imputed interest penalty if your spouse or children are shareholders.

Income splitting with minor children is more difficult because of the income splitting tax. Under these rules, minor children are taxed at top personal rates on dividends received from your corporation, as well as certain types of business income. Make sure you ask your BDO advisor for a copy of our *Income Splitting* bulletin for further information on this tax.

You should review your corporation's status throughout the year, and again at year-end in conjunction with tax planning for you and your family. If dividends are required, they should be properly documented and recorded in the company's minute book. Also, for any dividends paid in 2007, the corporation must prepare and file T5 slips to report the dividends on or before February 29, 2008.

If your corporation has had business income after 2000 in excess of the federal small business limit or received public company dividends after 2005, you may be able to pay an eligible dividend. These dividends are subject to a lower tax rate and must be designated as eligible. As these rules are fairly new and strict documentation rules apply, you should consult with your BDO advisor before declaring dividends to take advantage of the eligible dividend rules.

Establish your salary/dividend mix from the corporation

If you draw funds from your corporation throughout the year for personal expenses, you should determine whether these amounts will be characterized as salary or dividends before year-end. Otherwise, the funds withdrawn could be treated as a shareholder loan, unless certain conditions are met. A shareholder loan would be included in your income without benefit of the dividend tax credit, and without being deductible to the corporation as salary. Also, it would not be considered earned income to you for RRSP purposes.

In general terms, if your company earns active income that is less than the small business limit (\$400,000 for taxation years beginning after 2006), it's usually better to declare dividends, the payment of which can offset the shareholder loan. For federal tax purposes (and for certain provinces and territories), active business income up to \$400,000 will

be taxed at the small business tax rate. Note that the small business limit is higher in Alberta and Saskatchewan and is set to increase further in both provinces.

In the past, where active income exceeded the small business limit, the general rule of thumb was to have the corporation pay you a salary or bonus to reduce its income to the small business limit as the total corporate and personal tax associated with retaining excess income and paying it out as a dividend to you exceeded the tax cost of a bonus (referred to as a “tax integration cost”). At the same time, not paying a bonus resulted in a tax deferral, as general corporate income tax rates on income retained by the corporation are lower than the top personal rate. Despite the deferral, paying a bonus was often the rule of thumb as the integration cost was just too high.

However, in recent years, beneficial tax reductions, such as reductions in corporate tax rates and increases in the provincial small business limits (beyond the federal limit), have made the rule of thumb more difficult to apply. Also, the changes to the taxation of dividend rules for dividends paid after 2005 will either partially or fully remove the integration cost where corporate business income in excess of the small business limit can be paid out as an eligible dividend. So, depending on what province or territory your corporation operates in, there may not be a need to declare a bonus when looking solely at income tax rates.

Of course, there are other considerations to make in the salary versus dividend decision. Drawing dividends alone will not provide you with earned income for RRSP purposes. Also, if you have no other sources of earned income and your spouse works and earns more than you, neither one of you will be eligible to claim child care expenses. Child care expense deductions are generally limited to 2/3rds of the earned income of the lower income spouse. Therefore, you should ensure that you receive enough salary to allow a maximum RRSP contribution and a claim for child care expenses. Another important consideration is whether your corporation is engaged in research and development, as beneficial tax rules are phased out where a corporation’s (or associated group’s) income for the prior year exceeds the federal small business limit. Finally, where a corporation begins to retain high-rate income, its tax instalment base will increase at the same time additional income tax for the prior year becomes payable, which could create a short-term cash flow issue.

Given the changes in the taxation of dividend rules are fairly recent, specific advice will be important—speak to your BDO advisor.

Consider paying interest on shareholder loans

If you’ve paid yourself sufficient salary to maximize your RRSP and family’s child care deduction claim and your corporation still has more than \$400,000 of active business

income, you should consider charging interest on any loans you’ve made to the company. The interest would be deductible to the corporation and would not be subject to provincial payroll taxes (the decision on whether to pay interest or an eligible dividend would be similar to the decision above for bonuses).

To be deductible to the corporation, the interest must be charged at a reasonable rate. Also, there must be a legal obligation to pay interest established in advance. Therefore, if you intend to charge interest on your loans to the corporation, you should establish the terms at the beginning of the year. It should be noted that where a minor child or a trust for a minor child makes a loan in support of a business carried on by a relative, the interest will be subject to the income splitting tax (or kiddie tax).

Consider planning to reduce your corporation’s taxable capital before year-end

Depending on their size, corporations can be subject to provincial capital taxes. The jurisdictions vary in how they calculate taxable capital and the rate at which the tax is charged. Note that some jurisdictions have begun to reduce, and in some cases eliminate, capital tax. For those jurisdictions which continue to levy capital tax, taxable capital usually includes share capital and debt and may require some tax-based adjustments. All jurisdictions that impose capital tax provide an allowance which reduces taxable capital for certain specified investments.

There are a number of very simple steps that can be taken prior to year-end to reduce capital tax. For instance, using excess cash to pay off some debts may reduce your taxable capital. Consult your BDO tax advisor for further information on planning points that may be applicable to your situation.

You should note that Canadian-Controlled Private Corporations (CCPCs) with taxable capital in excess of \$10,000,000 (on an associated group basis) will begin to lose access to the small business deduction and the enhanced 35% investment tax credit for research and development. Taxable capital for the prior year is generally used in determining how much of these benefits are lost, with the incentives being eliminated when taxable capital reaches \$15,000,000. The “clawback” of these benefits represents another reason why capital tax planning should become an important part of your year-end tax review.

Purchase older automobiles from your corporation

If you use an older corporate-owned automobile for personal use, you may want to purchase it at fair market value. As discussed in our *Automobile Expenses and Recordkeeping* bulletin, the standby charge benefit included in your income is based on the original cost of the automobile, no matter how old it is. Buying the older automobile now will ensure that

Be sure to take into consideration the timing of the receipt of income and the tax consequences when investing

you won't be taxed on a large automobile benefit next year.

Your BDO advisor can help you determine whether this strategy makes sense for you.

Investment income

Review the mix of investments in your portfolio

Each type of investment income is taxed differently. Most interest must be accrued annually and is fully taxed. Dividends are only taxed as received and are eligible for a dividend tax credit. Capital gains are taxed when realized and, after the reduction of the capital gains inclusion rate to 50%, were generally taxed at a lower rate than dividends.

However, the capital gain vs. dividend comparison changed significantly in 2006 as the changes in the taxation of dividend significantly lower the tax rate that applies on eligible dividends. In general, most dividends paid by a Canadian public company after 2005 will be an eligible dividend. These dividends will be subject to a 45% gross-up (rather than the 25% gross-up that continues to apply for ineligible dividends) and are eligible for a much higher dividend tax credit (approximately 19% of the taxable amount federally vs. 13 1/3% for an ineligible dividend). Most provinces have also introduced a higher tax credit on eligible dividends. Overall, the changes will greatly reduce the top marginal tax rate on public company dividends. For more information on tax rates, see *Tax Facts 2007* on www.bdo.ca.

Year-end is an excellent time to review the mix of investments in your portfolio to ensure that you're getting the best returns on an after-tax basis.

Consider the timing of the taxation of interest-earning investments

Interest on investments purchased after 1990 must be accrued annually on the anniversary date of the investment, unless you receive the interest more frequently. For instance, interest on Canada Savings Bonds (CSBs) purchased on November 1, 2006, must be accrued as at October 31, 2007 and included in 2007 income. This applies even if you have not yet received the interest, such as with compound interest CSBs.

Also, some investment products pay interest at increasing rates over the term of the investment. For tax purposes, you may find that you must report the interest at an "average rate," with higher income recognized in the earlier years, when the actual interest received is lower.



Be sure to take into consideration the timing of the receipt of income and the tax consequences when investing. Also, if you're thinking of purchasing a Guaranteed Investment Certificate towards the end of 2007, you may want to consider delaying the purchase to early 2008 to defer the recognition of the income to 2009.

Review your outstanding debt to ensure that you make your interest expense deductible to the maximum extent possible

To be deductible, interest expense must relate to debt incurred to earn business or investment income. Interest on personal debts, such as mortgages or car loans and interest incurred to make RRSP contributions, are not generally deductible. Another point to keep in mind is that investment income doesn't include capital gains. The CRA takes the position that interest on funds borrowed to invest in assets producing only capital gains isn't deductible.

Review your loans outstanding at year-end and your overall cash position. Where possible, pay off non-deductible debt as quickly as possible. Avoid using excess funds to pay off business or investment loans, if you know you will have to make large personal expenditures in the near future. Where you have a choice, always borrow for investment or business purposes over personal uses.

Also, note that where you've sold an investment at a loss and continue to carry debt incurred to purchase the investment, you should leave these loans outstanding as long as you have other non-deductible debt that could be paid off first. Interest from debts relating to the loss on an investment (other than real estate or depreciable property) continues to be deductible as long as those debts remain outstanding and all of the proceeds from the loss asset are reinvested.



Utilize your capital gains exemption for qualified small business shares and qualified farm/fishing property

Consider delaying mutual fund purchases

If you're considering purchasing units of a mutual fund, you may want to defer the purchase until early 2008 (or later in December 2007). Many mutual funds (and most equity funds) distribute income and capital gains once a year, during December. Consequently, if you purchase units of these funds just prior to a distribution, you will be allocated a full share of the mutual fund's income and gains for that year. Deferring the purchase until after the mutual fund distribution will ensure that you won't be allocated taxable income for 2007.

Capital gains and losses

Only 50% of capital gains and losses realized are recognized in calculating taxable income. Capital losses can generally only be deducted to the extent you have realized capital gains in the year. Capital losses may also be carried back three years or forward indefinitely to offset taxable capital gains that have been realized in other years (to the extent that your 2007 capital losses exceed capital gains).

Review your asset sales for the year to determine your net capital gain/loss position, and consider the following planning points.

Utilize your capital gains exemption for qualified small business corporation shares and qualified farm/fishing property

A \$750,000 (\$500,000 prior to March 19, 2007) capital gains exemption is available for capital gains from qualified small business shares, qualified farm property and for dispositions after May 2, 2006, qualified fishing assets. If you own such

assets with accrued gains, you can trigger the gain by means of an actual sale to a third party, or by transferring the asset to your spouse (if you elect to transact at fair market value) or to a corporation you control. Before doing so, you should consult with your BDO advisor to ensure that any gain will qualify for the exemption. Note that if you previously triggered a \$500,000 gain, it may make sense to enter into a similar arrangement to use up the additional \$250,000 exemption amount that became available on March 19, 2007.

Defer capital gains where proceeds reinvested in a small business corporation

If you own shares of a small business corporation and dispose of the shares, recognition of the capital gain may be deferred if you reinvest the proceeds from the sale of those shares in another small business corporation. There are several conditions that must be met to be eligible to defer the capital gain. You should consult with your BDO advisor to determine if you are eligible for the deferral.

Consider selling investments with accrued losses before the end of the year

If you've realized capital gains in the year, consider selling assets with an accrued loss to offset the gains. You may also want to realize the loss if you've had capital gains in the last three years that weren't offset by your capital gains exemption.

Note that rules (known as the stop-loss rules) apply to deny losses on certain dispositions of property, such as:

- ◆ where you transfer an asset to your spouse or a corporation controlled by you and/or your spouse; or
- ◆ where you sell an asset on the open market, and you, your spouse or a corporation controlled by you or your spouse reacquires it within 30 days of its disposition.

Note that these stop-loss rules will also apply where you sell an asset to your RRSP at a loss (or your spouse's RRSP) or where you sell an asset at a loss and that asset is repurchased in an RRSP belonging to you or your spouse within 30 days.

These rules are complex, so consult with your BDO advisor.

Saving for retirement

Make a contribution to your RRSP for 2007

Your contribution limit for 2007 is 18% of your 2006 earned income (to a maximum of \$19,000) less the value of any benefits that accrued to you in 2006 as a member of a Registered Pension Plan or a Deferred Profit Sharing Plan (your Pension Adjustment—PA). Your PA was reported by your employer on your 2006 T4 slip. Also, your 2006 Notice of Assessment should include the CRA's calculation of your 2007 contribution limit, with any unused amounts carried forward from previous years. This information is also available on the CRA's "My Account" service.

Your RRSP contribution must be made on or before February 29, 2008 to be deductible for 2007. If you don't have the necessary funds, consider borrowing to make the contribution. Although interest on an RRSP loan is not deductible, borrowing still makes sense if you can repay the loan within a year. If you receive a tax refund, you can apply it to the loan to reduce the balance outstanding.

If you decide not to contribute for 2007, your ability to do so carries forward indefinitely. However, even if you don't need the deduction for 2007, you should still make the contribution if you have excess funds which would otherwise earn taxable income in your hands. You can claim the deduction in any future year. The income from the funds will accumulate tax-free in your RRSP.

If you have excess investment funds, make your RRSP contribution for next year as soon after December 31st as possible, to maximize the deferral of income earned in the plan. For 2008, the RRSP limit is the lesser of 18% of your 2007 earned income (less your 2007 PA) or \$20,000.

You can also make a one-time overcontribution to your RRSP. Penalties do not apply if the amount is less than \$2,000 and, as noted above, income from the funds will accumulate tax-free in your RRSP. You should keep in mind that the CRA does track RRSP overcontributions, and penalties apply on most overcontributions in excess of \$2,000.

Withdraw RRSP funds in low income years

If your income is abnormally low, consider withdrawing funds from your RRSP before the end of the year. This alternative would generally only appeal to someone in the lowest tax bracket who would otherwise waste available deductions and credits.

Keep in mind that once RRSP funds are withdrawn, the amounts can only be recontributed to the extent you have RRSP contribution room available in the future. Also, income earned on the funds withdrawn will no longer benefit from tax-free accumulation in the RRSP.



When you withdraw funds from your RRSP, you'll receive a T4RSP slip showing the amount of the withdrawal and the tax withheld. When you file your tax return, include the amount in income, calculate the final tax and claim the withholdings as a tax payment.

Ensure that your 2007 earned income allows the maximum 2008 RRSP contribution

Your right to make an RRSP contribution for one year depends on your earned income for the previous year. For 2008, your contribution will be limited to 18% of your 2007 earned income, to a maximum of \$20,000. Therefore, you need at least \$111,111 of earned income in 2007 to maximize your 2008 contribution. This limit is further reduced by your PA for 2007.

In general terms, earned income is income you receive from employment, business or the rental of real property, as well as any alimony and taxable maintenance. It is reduced by business or rental losses and any alimony and maintenance payments made. If you have some control over your income level, ensure that it's high enough to allow the maximum RRSP contribution. For instance, if you carry on business through a corporation, ensure that your 2007 salary is at least \$111,111 to allow a full \$20,000 contribution in 2008.

Sell non-qualified assets in your RRSP before December 31st

There are specific rules as to the types of assets your RRSP can hold. If you have a self-directed RRSP, you may have purchased assets which don't qualify. When you purchase a non-qualifying asset, the cost of the asset is included in your income in the year of purchase. You're allowed a deduction for the amount of the proceeds when the asset is sold, up to the original inclusion. Therefore, if the purchase and sale are in the same year, the deduction may offset a part or all of the income. So, make sure your RRSP sells non-qualifying assets before December 31st.

Purchase an annuity or RRIF to claim the pension income credit

If you're 65 or over, you're entitled to claim a federal tax credit on your first \$2,000 of pension income. The credit is equal to the tax that would be paid on the income at the lowest tax bracket. If you don't currently receive pension income and are in the lowest tax bracket (income less than \$37,178 for 2007 federal tax purposes; threshold

Your RRSP contribution must be made on or before February 29, 2008

varies by province/territory), consider transferring funds to a registered retirement income fund (RRIF) and withdraw \$2,000 per year. If you're in the low tax bracket, the income will effectively be received tax-free federally. Note, however, that some of the pension income will be taxed in most provinces (provincial pension credit amounts vary, but most credit amounts are less than \$2,000). If you're in a higher bracket, there will be a tax cost, depending on your marginal tax rate. This strategy will also work if you use a portion of your RRSP funds to purchase an annuity which pays at least \$2,000 per year.



A new option to split pension income with a spouse is available starting with the 2007 taxation year

Review pension income splitting with spouse

A new option to split pension income with a spouse is available starting with the 2007 taxation year. If you or your spouse earns pension income eligible for the pension tax credit, the higher income spouse can elect to transfer up to one-half of his or her eligible pension income to the lower income spouse. This is a joint election that can be taken advantage of when filing the 2007 tax returns. The amount transferred reduces the higher income spouse's net income, and increases the lower-income spouse's net income so a tax saving should generally arise where the lower-income spouse has a lower marginal tax rate. However, one should keep in mind that there can be negative effects that arise from increasing a lower income spouse's net income. For example, some tax credit amounts (particularly the age credit) and the OAS clawback are based on net income.

Another possibility to consider if you or your spouse is age 65 or over is whether additional amounts should be withdrawn from your RRIF with a view to splitting some of the additional amount. This could allow you to take further advantage of a spouse's low tax rates, or a spouse's losses carried forward (other than capital losses). However, you can only split up to 50% of the additional amount received, so some of the extra RRIF withdrawals will be taxed in your hands — this cost would have to be compared with the tax benefit from splitting more income.

Delay RRSP Home Buyers' Plan (HBP) withdrawals until after year-end

If you qualify, you and your spouse can withdraw up to \$20,000 tax-free from your RRSP towards the purchase of a principal residence. The home must be purchased by October 1st of the year following the year of withdrawal. Amounts withdrawn must be repaid to RRSPs in 15 equal instalments, starting with the second taxation year following the year of withdrawal (amounts not repaid are taxed as an RRSP withdrawal).

If you're planning on using the HBP towards year-end, consider deferring your withdrawal until after December 31st. This will extend your time period for purchasing your home and repaying the amounts withdrawn by one year. You'll also want to delay your HBP withdrawal if you won't be withdrawing the full amount in 2007. Under the HBP rules, multiple withdrawals are possible, but all withdrawals must be made in the same calendar year. Consequently, if you want to withdraw funds in 2008, you shouldn't make an HBP withdrawal in 2007.

Remember to make your required Home Buyers' Plan repayment by February 29, 2008

If you participated in the HBP prior to 2006, you have a repayment due in the 2007 taxation year. A repayment made on or before February 29, 2008 will be considered to have been made in the 2007 taxation year. A repayment is made by making a regular contribution to your RRSP. When you file your 2007 tax return, you'll have to complete Schedule 7. On this form, you'll designate that the RRSP contribution is to be applied as an HBP repayment and is not a deductible contribution.

If you have already made RRSP contributions during 2007, you can designate an amount to cover your required repayment. The CRA generally sends an HBP notification towards the end of each year.

Remember to collapse your RRSP if you will turn 71 this year

You can't have an RRSP past December 31, 2007 if you're 71 or older at year-end (up from age 69 as part of the 2007 federal budget changes). So, prior to December 31, 2007,



You can't have an RRSP past Dec. 31, 2007 if you're 71 or older at year-end (up from age 69)

you must collapse your RRSP and pay tax on the fair market value of the plan's assets at that time, purchase an annuity or transfer your RRSP assets to an RRIF. No tax is paid on the purchase of annuity or the conversion to an RRIF.

If you will generate RRSP contribution room for 2008 because you have earned income in 2007, but you have to collapse your RRSP before the end of 2007, consider making an overcontribution to your RRSP in December, immediately before collapsing it. The amount of the overcontribution should equal \$2,000 plus the 2007 contribution limit. A 1% penalty tax on the overcontribution in excess of \$2,000 will apply for December 2007—however, this will end on January 1, 2008 when the new contribution room becomes effective. The basic \$2,000 overcontribution will become deductible when you generate additional RRSP room in the future and will never attract the 1% overcontribution penalty tax. Ask your BDO advisor if this type of planning makes sense for you.

If you must collapse your RRSP this year, you can still contribute to your spouse's RRSP if you have contribution room and your spouse has not reached age 71 by December 31, 2007. This is an excellent way to build up your spouse's RRSP.

If you want more information on RRSPs, read our bulletin *Answering Your RRSP Questions*.

Consider contributing to an Individual Pension Plan

In addition to RRSPs, another retirement savings option is available to owners of incorporated businesses, including professionals who have incorporated. Under the rules for defined benefit pension plans, it is possible to set up an individual pension plan or IPP for business owners. Under an IPP, the benefits are set by reference to your salary, and contributions are made to build sufficient funds to fund this defined pension benefit. For many individuals (generally, in their 50s or older), the use of an IPP can allow for greater contributions when compared to an RRSP.

Additional benefits of an IPP include the ability to make up for poor investment performance and the possibility of making lump-sum contributions for past service. As well, historically, IPPs have provided greater protection of assets from business risks. However, with the proposed changes on bankruptcy reform, the treatment of RRSPs will become more consistent with the treatment of pension plans once the proposed changes become law and are proclaimed into force.

Deductions and credits

Pay amounts eligible for deduction or credit prior to December 31st

Many items which are creditable or deductible for tax purposes must be paid by the end of the year. These amounts include alimony and maintenance, child care expenses, investment counsel fees, professional dues, charitable donations, medical expenses and political contributions.

In addition, gifts of certain publicly traded securities are not subject to capital gains tax for gifts made after May 2, 2006 (and 25% for shares gifted prior to May 3, 2006). Where certain conditions are met, employees who donate certain securities acquired through a stock option plan to a qualifying charity may deduct a portion of their taxable stock option benefit. Specifically, when combined with the regular stock option deduction of 50%, only 25% of the stock option benefit will be taxed when shares are gifted before May 3, 2006 and none of the benefit will be taxed for gifts made after May 2, 2006. An employee may also be allowed to deduct a portion of their stock option benefit if the proceeds from the disposition of the securities acquired through the stock option plan are donated. Consult with your BDO advisor for further details on how these measures apply.

Pay for medical expenses and charitable donations in one year

There is usually an added benefit if payments for charitable donations for two years are grouped into one year. This is due to the fact that the first \$200 of donations is eligible for a 15.5% federal non-refundable credit in 2007 while the excess over \$200 is eligible for a 29% credit. You'll receive a larger credit if you group two years of donations in one year.



In the case of medical expenses, only amounts in excess of \$1,926 (limit may vary by province) or 3% of net income (whichever is less) are eligible for a credit. Note that in Québec, eligible medical expenses must be reduced by 3% of family income. If your medical expenses for the current year are already in excess of the threshold, consider paying for additional expenses which are expected to arise in the near future now. Although most medical expenses are only paid as the medical services or supplies are required, some types of expenses can be moved up to get a higher credit, such as glasses or contact lenses. If you're paying for a major expense on an instalment basis (such as braces for a child), consider paying the balance owing early to maximize your medical credit claim.

Other year-end planning

Review your family trust's tax situation

Many individuals set up inter-vivos or family trusts to split income and better manage family finances. Inter-vivos trusts are taxed as individuals, but with all income subject to tax at the top marginal rate if the trust was set up after 1971. All inter-vivos trusts must have a December 31st year-end, and the tax return (called a T3 return) is due 90 days after year end—by March 31, 2008 for 2007.

A trust can deduct from its income any amounts that were paid or became payable to beneficiaries in the year. This income is then taxed in the hands of the beneficiaries to whom it was allocated. This is usually advisable where the beneficiaries are family members who will be taxed at lower marginal rates. Beginning January 1, 2000, minor children are taxed at top personal rates on certain types of income distributed from a trust. For more information on this income splitting tax, read our *Income Splitting* tax bulletin.

Set up family trusts to split income and better manage family finances

In the past, income of the trust could be taxed in the beneficiaries' hands even though it was not paid or payable to them. If the trust had been structured to allow this type of tax planning, the trustees and the beneficiaries could jointly make a "preferred beneficiary election" (PBE) to have the income taxed in the beneficiaries' hands even though it was retained in the trust. The ability to make PBEs is now only available for beneficiaries who are disabled.

Ensure that you review the tax status of your family trust with your BDO advisor before year-end to determine the amount of income earned in the trust and the way it will be taxed.

If a PBE is not available, you must ensure that the income is either paid or payable to the appropriate beneficiaries on or before December 31st. Otherwise, the income will be taxable in the trust at top marginal rates.

Another point to keep in mind is that certain trusts are deemed to dispose of capital property every 21 years. There are strategies which you can use to minimize the impact of these rules. Consult your BDO advisor.

Make tax instalments by the required due dates to avoid non-deductible interest and penalties

If your total tax exceeds your tax deducted at source by more than \$2,000 (\$1,200 in Québec) for 2008 and for either 2007 or 2006, you may be required to make quarterly tax instalments. The deadlines for instalments are the 15th of March, June, September and December. If you fail to make the payments, or pay less than the required minimum, you'll be charged interest and possibly penalties. Interest and penalties on tax instalments are non-deductible.

Calculating the appropriate instalments can be difficult. Generally, you can base your payments on either the current or previous year's tax, whichever is lower. However, the CRA now issues notices to taxpayers advising them of the amounts. The March and June amounts are based on the second preceding year, with the September and December amounts based on the previous year. The Ministère du Revenu du Québec also issues instalment notices to taxpayers. As long as the amounts in the notices are paid on time, instalment interest will not be charged.

If your income has increased over the last few years, the CRA's method should be beneficial. However, the CRA may not always have the most current information and, in some situations, one of the other methods may be more advantageous for you. If you're uncertain as to the amounts appearing on the notices, contact your BDO advisor for assistance in determining your appropriate instalment amounts.

Contribute to your RESP

You can start saving now for your children's education by making contributions to a Registered Education Savings Plan (RESP). Earnings on RESP investments accumulate tax-free and are generally taxed in your child's hands when withdrawn from their plan. With a lower marginal tax rate, your child should pay much less tax on the income than you would pay.

There were some recent changes in this area. Previously, you were allowed to contribute up to \$4,000 annually to an RESP—with a cumulative lifetime contribution limit of \$42,000. For contributions made after 2006, the \$4,000 annual RESP contribution limit was eliminated and the lifetime RESP contribution limit was increased to \$50,000. What this means is that you can contribute \$50,000 immediately to an RESP if it makes sense in your particular circumstances.

When you contribute money to an RESP, the government will deposit an additional amount, equal to 20% of your contribution. The maximum Canada Education Savings Grant (CESG) each year has increased in 2007 to \$500

(equal to 20% of a contribution of \$2,500) from \$400. The lifetime CESG limit remains unchanged at \$7,200. Also, higher CESG rates apply to certain contributions made by low and middle-income families.

If you fail to make a contribution in a year, the unused "CESG room" will be carried forward. But your ability to utilize CESG room in future years will be limited. Consequently, if you are considering an RESP contribution in the near future, you should try to make a contribution before year-end.

Another CESG rule is important to consider as part of your year-end tax planning. The CESG can be restricted during the years the beneficiary turns 16 and 17. A CESG will only be allowed if:

- ◆ contributions to all RESPs for the child have totalled at least \$2,000 before the year the child turned 16, or
- ◆ contributions of at least \$100 per year were made for the benefit of the child during any four years prior to the year the child turns 16.

Therefore, you may need to make an RESP contribution this year so that your child's RESP is eligible for a CESG in future years.

For more information on RESPs, including the higher CESG rates for low and middle-income families, read our bulletin *RESPs: Saving for your child's education*. For more details on the recent changes in this area, read our article "New RESP Enhancements" in our *Tax Factor 2007-02* publication.

Conclusion

We hope you find these tax planning ideas useful. Many of them can be easily implemented with little or no cost or administration. Others are more complicated and will require professional advice. If you need assistance with your year-end tax planning, contact your BDO advisor.

For contributions made after 2006, the \$4,000 annual RESP contribution limit was eliminated and the lifetime RESP contribution limit was increased to \$50,000





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