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## 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, 2009 represents the last date for transactions that affect 2009 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 2009.

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 2009. 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.



### 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 2009, this benefit is equal to 24¢ per personal kilometre driven and applies unless all amounts paid for personal operating expenses are reimbursed to the employer by February 14, 2010.

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 2009. For an operating benefit reduction, your payment must be made by February 14, 2010.

### 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, tradespersons can qualify for a tax deduction of up to \$500 for eligible 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 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 gifts and awards.

This policy should make it somewhat easier for employers to administer their gifts and awards programs, as it generally removes 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 that are 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.

In June of this year, the CRA announced administrative policy changes for taxable employment benefits and in particular for non-cash gifts and awards effective for 2010. To learn more about the policy changes, read our *Tax Alert "Canada Revenue Agency Announces New Employee Benefit Rules"*.

## 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 2009 must be reported on T4 slips, which are due on or before March 1, 2010 (as February 28, 2010 falls on a Sunday).

### 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 2010, 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 2010 returns which are due April 30, 2011.

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 2009, the corporation must prepare and file T5 slips to report the dividends on or before March 1, 2010 (as February 28, 2010 falls on a Sunday).

If your corporation had business income after 2000 in excess of the federal small business limit or received public company dividends after 2005, the corporation 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 complex 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 the 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 (\$500,000 effective January 1, 2009, prorated for non-calendar year-ends), 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 \$500,000 will be taxed at the small business tax rate. Note that the small business limit is lower in British Columbia, Manitoba, Nova Scotia and the Yukon, but it is set to increase in British Columbia.

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 tax 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 have made this rule of thumb more difficult to apply. Also, the changes to the taxation of dividend rules for dividends paid after 2005 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.

In our current tax environment, owner-manager remuneration strategies are being further complicated by changing tax rates. In particular, there will be significant reductions in the federal corporate tax rate (until 2012) while the personal tax rate on eligible dividends will be increased. As a result of this, over the next few years, integration will work best for business income taxed at the top corporate rate and paid out as an eligible dividend, only where the dividend is paid in the same year. In cases where the dividend is being deferred to a subsequent year, integration will not work as well and there will be an integration cost, as the tax rate on eligible dividends is increasing. Therefore, consideration should be given to paying out an eligible dividend this year while the tax rate on eligible dividends is lower. For a more detailed discussion on integration, see the article "[The Impact of Integration on Owner-Manager Remuneration Strategies](#)" in our *Tax Factor* 2009-03 publication.

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 scientific research and experimental development, as beneficial tax rules are phased out where a corporation's (or associated group's) taxable 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 numerous factors to consider in establishing the optimal salary/dividend mix, 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 \$500,000 of active business income, you could 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 reduced, and in some cases eliminated, 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 certain limits (on an associated group basis) will begin to lose access to the small business deduction and the enhanced 35% investment tax credit for scientific research and experimental development. Taxable capital for the prior year is generally used in determining how much of these benefits are lost. Access to the small business deduction is eliminated when taxable capital reaches \$15 million and access to the enhanced 35% investment tax credit is eliminated when taxable capital reaches \$50 million. The \$50 million amount is applicable for taxation years ending on or after February 26, 2008 and is subject

to proration for taxation years that include this date (previously the amount was \$15 million). 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 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 dividends significantly lowered 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 in 2009 (rather than the 25% gross-up that continues to apply for ineligible dividends) and are eligible for a higher dividend tax credit (for 2009, 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. Note that with federal corporate tax rate reductions being phased in until 2012, there will be adjustments to the eligible dividend gross-up and dividend tax credit rates from 2010 to 2012 that will increase the tax rate on eligible dividends.

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, 2008, must be accrued as at October 31, 2009 and included in 2009 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 one year Guaranteed Investment Certificate towards the end of 2009, you may want to consider delaying the purchase to early 2010 to defer the recognition of the income to 2011.

### 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.

### Consider delaying mutual fund purchases

If you’re considering purchasing units of a mutual fund, you may want to defer the purchase until early 2010 (or later in December 2009). 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 2009.

### Consider using your Tax-Free Savings Account

Since January 1, 2009, you have been able to incorporate the use of a new tax-paid savings vehicle, called the Tax-Free Savings Account (TFSA), into your mix of investments. The TFSA will allow you to save for many purposes, including shorter term savings goals such as buying a home or new car and longer term savings goals such as saving for retirement.

Canadian residents 18 years of age or older can open up a TFSA and contribute amounts to the TFSA up to the contribution room available. You will acquire a \$5,000 contribution room every year (which will be indexed to inflation and rounded to the nearest \$500 on an annual basis). Any withdrawals made in the previous year as well as any unused contribution room from the previous year will be added to the contribution room for the current year. A TFSA will generally be permitted to hold the same investments as an RRSP, including mutual funds, publicly traded securities, GICs, bonds and certain shares of small corporations. However, note that unlike RRSPs, there are additional restrictive rules for investments that are not available on the open market.

While contributions to a TFSA will not be tax deductible, income, losses and gains in respect of investments held within a TFSA, as well as amounts contributed, will not be included in computing income for tax purposes or taken into account in determining eligibility for income-tested benefits or credits.

Generally, if you make an interest-free loan or gift funds to a spouse to invest, the income on the

investment will be attributed to you and taxed in your hands. In the case of funds used by your spouse to make a TFSA contribution, there will be no taxable income, and therefore, the attribution rules will not be a concern. The same will be true where you make an interest-free loan or a gift to an adult child so that they can invest in a TFSA. Loaning or gifting money to family members to contribute to a TFSA will be an important personal tax planning consideration.

For more information on TFSAs, read our [Answering Your TFSA Questions](#) bulletin.

## 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 2009 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 on or 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 or contribute an asset to your RRSP or TFSA at a loss (or your spouse's plan) or where you sell an asset at a loss and that asset is repurchased in an RRSP or TFSA belonging to you or your spouse within 30 days.

These rules are complex and can apply in situations not discussed here, so consult with your BDO advisor. As well, read our *Tax Factor* 2008-02 article "[Tax Rules to Remember When Triggering Capital Losses](#)".

## Saving for retirement

### Make a contribution to your RRSP for 2009

Your contribution limit for 2009 is 18% of your 2008 earned income (to a maximum of \$21,000) less the value of any benefits that accrued to you in 2008 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 2008 T4 slip. Also, your 2008 Notice of Assessment should include the CRA's calculation of your 2009 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



March 1, 2010 to be deductible for 2009. If you don't have the necessary funds, consider borrowing to make the contribution. Although interest on an RRSP loan is not deductible, borrowing may still make sense if you can repay the loan quickly. 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 2009, your ability to do so carries forward indefinitely. However, even if you don't need the deduction for 2009, you should still consider making 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 tax deferral of income earned in the plan. For 2010, the RRSP limit is the lesser of 18% of your 2009 earned income (less your 2009 PA) or \$22,000.

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 2009 earned income allows the maximum 2010 RRSP contribution**

Your right to make an RRSP contribution for one year depends on your earned income for the previous year. For 2010, your contribution will be limited to 18% of your 2009 earned income, to a maximum of \$22,000. Therefore, you need at least \$122,222 of earned income in 2009 to maximize your 2010 contribution. This limit is further reduced by your PA for 2009.

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 2009 salary is at least \$122,222 to allow a full \$22,000 contribution in 2010.

#### **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 \$40,726 for 2009 federal tax purposes; threshold 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.

#### Review pension income splitting with spouse

If you or your spouse earns pension income eligible for the pension tax credit, an election can be made to transfer up to one-half of the eligible pension income to the other spouse. This is a joint election that can be taken advantage of when filing your and your spouse's tax returns. The amount transferred reduces the transferor spouse's net income, and increases the transferee spouse's net income so a tax saving should generally arise where the transferee 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. With this in mind, in certain cases it may be beneficial to elect to transfer from the lower-income spouse to the higher-income spouse.

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.

If you have questions about pension income splitting, consult with your BDO advisor.

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

If you qualify, you and your spouse can withdraw a specific amount tax-free from your RRSP towards the purchase of a principal residence. The limit for HBP withdrawals made after January 27, 2009 has increased from \$20,000 to \$25,000. 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 by January 2010. Under the HBP rules, multiple withdrawals are possible, but all withdrawals must be made in the same calendar year or in January of the following year. Consequently, if you want to withdraw funds after January 2010, you shouldn't make an HBP withdrawal in 2009.

#### Remember to make your required Home Buyers' Plan repayment by March 1, 2010

If you participated in the HBP prior to 2008, you have a repayment due in the 2009 taxation year. A repayment made on or before March 1, 2010 will be considered to have been made in the 2009 taxation year. A repayment is made by making a regular contribution to your RRSP. When you file your 2009 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 2009, you can designate an amount to cover your required repayment. The CRA sends an HBP Statement of Account each year with your Notice of Assessment or Reassessment.

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

You can't have an RRSP past December 31, 2009 if you're 71 or older at year-end. So, prior to December 31, 2009, 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 an annuity or the conversion to an RRIF.

If you will generate RRSP contribution room for 2010 because you have earned income in 2009, but you have to collapse your RRSP before the end of 2009, consider making an overcontribution to your RRSP in December, immediately before collapsing it. The amount of the overcontribution should equal \$2,000 plus the 2010 contribution limit. A 1% penalty tax on the overcontribution in excess of \$2,000 will apply for December 2009 — however,

this will end on January 1, 2010 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. If you won't have earned income after 2009, then you may not want to make an overcontribution. 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, 2009. This is an excellent way to build up your spouse's RRSP.

If you want more information on RRSPs, read our [Answering Your RRSP Questions](#) bulletin.

### 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 changes on bankruptcy reform, the treatment of RRSPs has become more consistent with the treatment of pension plans.

### 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. 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%, none of the stock option benefit will be taxed when shares are gifted. 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.

For donations made on or after February 26, 2008, the capital gains tax exemption was further extended to capital gains realized on the exchange of certain unlisted securities for publicly-traded securities, when the publicly-traded securities are then donated within 30 days of the exchange.

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% federal non-refundable credit in 2009 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 \$2,011 (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.

#### Make use of the Home Renovation Tax Credit

If you haven't already, you should consider whether you have taken full advantage of the Home Renovation Tax Credit (HRTC) before it disappears on February 1, 2010. For 2009, you will be able to claim a 15% non-refundable tax credit for qualified expenditures made in respect of eligible dwellings.



The credit will apply to expenditures in excess of \$1,000, but not more than \$10,000, resulting in a maximum credit of \$1,350 (\$9,000 x 15%). Expenditures for renovations or alterations to your home that are of an enduring nature can qualify for the credit. The CRA has provided a list of eligible and ineligible expenditures on its website.

Expenditures for work performed or goods acquired after January 27, 2009 and before February 1, 2010, will be eligible for the credit. The credit will, however, not be available in respect of expenditures for work performed or goods acquired in that period if the expenditure is made pursuant to an agreement entered into before January 28, 2009.

For more information on the HRTC, read the article "[A Good Tax Reason to Renovate your Home](#)" in our *Tax Factor* 2009-02 publication.

## 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, 2010 for 2009.

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. 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](#) bulletin.

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 \$3,000 (\$1,800 in Québec) for 2010 and for either 2009 or 2008, 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 does issue 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 is no longer an annual RESP contribution limit, however, there is a lifetime RESP contribution limit of \$50,000. When you contribute money to an RESP, the federal government will deposit an additional amount – the Canada Education Savings Grant (CESG) – equal to 20% of your contribution up to certain limits. The maximum CESG each year is \$500 (equal to 20% of a contribution of \$2,500) and the lifetime CESG limit is \$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 totaled 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.

The 2008 federal budget extended certain time limits with respect to RESPs, applicable for 2008 and subsequent taxation years, as follows:

- the number of years you can contribute to an RESP has been extended from 21 to 31 years (25 to 35 years for disabled beneficiaries),
- the deadline for terminating an RESP has been extended from the end of the year that includes the 25th anniversary of the opening of the plan to the 35th anniversary (30th anniversary to the 40th anniversary for disabled beneficiaries), and
- the contribution age limit for a beneficiary of a family plan has been increased from 21 to 31 years.

The recent changes to RESPs have made them more advantageous. Although the elimination of the annual RESP contribution limit means you may have more decisions to make about how much to contribute each year, your BDO advisor can assist if you have questions. With the high cost of post-secondary education, be sure to consider this savings vehicle as part of your year-end tax planning.

## 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.



This is a publication of BDO Dunwoody LLP on developments in the area of taxation. This material is general in nature and should not be relied upon to replace the requirement for specific professional advice. The information in this document is current as of October 30<sup>th</sup>, 2009.

Comments and suggestions should be addressed to National Tax, by Fax: (416) 367-3912 or E-mail at [info@bdo.ca](mailto:info@bdo.ca). We invite you to visit our web site at [www.bdo.ca](http://www.bdo.ca) to find out more about our firm and the offices near you. Or call us at 1-800-805-9544.

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