TAX TALK

Tax Ideas and Recent Developments

2008

2008 Tax Tips

25 Easily Adaptable Tax Ideas for You and Your Family

Our annual *Tax Tips* can assist you in your tax planning. It presents some quick ideas and strategies. Please take the time to review your 2008 tax situation and call us for specific recommendations tailored to your needs. We will be pleased to work with you on these and other tax-saving ideas.

Investment Income

1. Consider the effective tax rates have changed to largely favor dividend income over interest income.

- The top personal tax rates are as follows: 24% for eligible dividends (generally, dividends received from public corporations); 31.3% for non-eligible dividends (generally, dividends received from small business corporations); and 46.4% for interest income. [For further information on eligible and non-eligible dividends, please refer to our "Changes to the Taxation of Dividends" article in our Fall 2006 *Comments* publication.]
- Re-evaluate your investment strategy comparing the pre-tax dividend rates with pre-tax interest rates **using the chart provided in this publication**.

2. Defer tax on interest income to the following year by investing funds for a one-year term ending in the next calendar year.

3. Existing holding companies that have built up refundable dividend tax should consider paying dividends to recover this tax. Depending on the year-end of the company, it may have up to 24 months to enjoy the benefits of the tax refund before the shareholder is required to pay the personal tax on the dividend.

Capital Gains and Losses

4. If you own qualified small business shares or qualified farm and fishing property, you may benefit from the lifetime capital gains exemption of $750,000.

5. Consider realizing accrued losses on investments to shelter capital gains already realized this year and in the previous three years (other than for exempt gains on small business shares or farming or fishing property as described above).

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Watch for New Changes to the Canada - U.S. Tax Treaty

On September 21, 2007, Canada and the United States signed the Fifth Protocol to the Treaty, which amends certain provisions of the Treaty. Americans and Canadians that have cross-border dealings are strongly urged to consider whether new proposed changes to the tax treaty between the two countries will impact them.

The highlights of the proposed changes to the treaty include:

- *Elimination of withholding tax on conventional interest payments*

  The current withholding tax of 10% on cross-border interest payments between arm's length persons will be eliminated. For interest payments between related persons, the withholding tax rate will be phased out over a three-year period.

- *Extension of treaty benefits to Limited Liability Corporations ("LLCs")*

  Currently, US LLCs are not considered resident in the US for purposes of the Treaty. The Protocol effectively allows more flexibility in structuring cross-border businesses and investments in certain cases. However, there may now be a denial of treaty benefits for other entities that can presently rely on the treaty.

When will these changes take effect?

The Protocol will take effect once it has been ratified by both the Canadian and US governments. These changes could take effect as early as January 1, 2009. Please contact us for further information if you think that this may apply to you.

Charitable Donations

6. Consider donating publicly-traded securities instead of cash:

- A tax-advantaged gift of securities can now be made to a private foundation as well as public charities. Any appreciation in the value of marketable securities will not be subject to capital gains tax if the securities are donated to:
  - a registered charity; or
  - a private foundation after March 18, 2007. (Please be aware of new special rules that apply to persons not dealing at arm's length with the foundation. For more information, please contact us.)
- The donation credit (for individuals) or deduction (for corporations) continues to be available for the fair market value of the security donated.
- To avoid capital gains tax on the appreciated security, the actual securities must be transferred to the charity (i.e. the gift will not qualify for the preferential capital gains treatment if the securities are sold and the cash proceeds are donated).
- Similar rules will apply to a capital gain on donated ecologically sensitive land to a conservation charity.

Investment Income - A Closer Look…

It may be a good time for you to consider whether your investment income is tax efficient and consider investment alternatives.

This table below has been prepared to assist you in this matter. It assumes that your investment goal is to earn an after-tax rate of 5%. It compares what the pre-tax yield is required in order to achieve this 5% after-tax rate, by earning:

(1) interest income;
(2) eligible dividends (generally, dividends received from public corporations); or
(3) non-eligible dividends (generally, dividends received from small business corporations).

[For further information on eligible and non-eligible dividends, please refer to our "Changes to the Taxation of Dividends" article in our Fall 2006 *Comments* publication.]

Note: The table below assumes that the recipient of the investment income is an Ontario resident individual.

If Your Total Taxable Income is:	The pre-tax rate required to achieve a 5% after-tax yield is:		
	If you receive interest income	If you receive eligible dividends	If you receive non-eligible dividends
Between $1,000 and $37,900	6.3%	5%	5.2%
Above $37,900 but below $75,800	7.3%	5.4%	5.9%
Above $75,800	8.8% - 9.3%	6.2% - 6.6%	6.9% - 7.3%

DID YOU KNOW?

You may obtain access to your tax accounts online by applying for an account, "My Account", on Canada Revenue Agency's website. This service allows you to check for your tax refund, obtain your RRSP limit, change your address, to name a few examples.

For more information, please visit:

http://www.cra-arc.gc.ca/eservices/tax/individuals/myaccount/menu-e.html.

Interest Deductibility

7. Where possible, maximize interest deductions by structuring or arranging your borrowings first for business purposes, second for investment purposes and last for personal use.

- Please note that the federal government recently announced proposed restrictions on the interest deduction on funds borrowed to make investments in foreign affiliates. Please contact us for further information if you think that this may apply to you.

8. Where certain business or capital property (e.g. shares, but not real estate or depreciable property) is lost or ceases to earn income, interest incurred on related borrowed money continues to be deductible.

Pensioners, Retirees and Pre-Retirees

9. *Income splitting opportunity* - Individuals receiving pension income that qualifies for the pension credit can allocate up to half of this income to their spouse or common-law partner. A determination of the optimal allocation should be considered in tandem with the couple's continued ability to qualify for Old Age Security payments and certain personal tax credits.

10. The age limit for a maturing Registered Retirement Savings Plan (RRSP) and Registered Pension Plan has been extended by two years: an individual's RRSP now must be converted to a Registered Retirement Income Fund (RRIF) or be used to acquire a qualifying annuity by the end of the year in which the individual turns 71.

- An individual who turns 71 in 2008 can make RRSP contributions by the end of 2008 where contribution room is available.
- An individual can continue to make a contribution to a spousal RRSP until the end of the year in which their spouse turns 71, where contribution room is available.

If You Have Young Children...

11. Consider saving for your child's education by Registered Education Savings Plan (RESP):

- An RESP is a trust arrangement that earns tax-free income to be used to fund the cost of a child's post-secondary education. Contributions to an RESP are not deductible for tax purposes; however, withdrawals of capital are not taxed. The beneficiary is taxed on the income portion when withdrawn from the RESP for the purposes of funding his or her post-secondary education. While at school, the child tends to have relatively low sources of other income, and, thus, the income is usually taxed at lower rates, if at all.
- For RESP contributions in 2008:
  - There is no annual contribution limit;
  - The lifetime contribution limit is $50,000;
  - Federal government grants of 20% of annual RESP contributions are available for each beneficiary under the "Canada Education Savings Grant" (CESG). The maximum annual RESP contribution that qualifies for the federal government grants is $2,500.

12. Maximize child-care expense deduction and consider the Child's Fitness Tax Credit:

- If you have a child under the age of 16 enrolled in a program of physical activity, you may be able to claim up to $500 of related expenses under the non-refundable children's fitness tax credit. Costs eligible for the credit will include costs for administration, instruction, rental of required facilities and certain uniforms and equipment.
- The maximum amounts deductible for child-care expenses are $10,000 for a disabled child, $7,000 for children under age seven, and $4,000 for other eligible children (generally, age 16 and under). In most cases, the spouse with the lower net income (and earned income) must claim the child-care expenses.
- You will not be able to claim the expenses incurred for the child's physical activity program for both the child-care expense deduction and the fitness tax credit.

13. Remember to apply for the Universal Child Care Benefit (UCCB) program:

- Under this program, families will receive up to $1,200 per year for each child under the age of six, paid in installments of $100 per month per child.
- The application form is available by visiting the following website address: http://www.cra-arc.gc.ca/benefits/uccb/menu-e.html.
- Please note that the UCCB payments that your family receives will be taxable to the lower income spouse.
- *Income splitting opportunity*: If you decide to transfer the UCCB payments to a child, any income earned on the payments by that minor child will be taxable to the child, not the parent. If the child's taxable income is below $8,681 in 2008, the income will not be subject to federal or Ontario tax.

DID YOU KNOW?

Ontario announced a temporary Retail Sales Tax exemption on certain purchases of energy-efficient household products before July 20, 2008. These products include qualifying appliances, such as refrigerators, dishwashers, clothes washers, freezers, dehumidifiers and room air conditioners.

If You Have Your Own Corporation...

14. Consider your optimum salary/dividend mix to achieve less overall tax:

- Salary will qualify you and other family members active in the business for RRSP contributions, Canada Pension Plan (CPP) contributions and child-care deductions. Dividends will not.
- Dividends, on the other hand, may cost the family unit less in current taxes. Each family member, over 17 years of age and receiving dividend income of approximately $30,000 or less of non-eligible dividends, or $45,000 or less of eligible dividends, from taxable Canadian corporations, will pay little or no income tax, but a small Ontario Health Tax premium. The split income tax eliminates the tax benefits of paying dividends to children under 18 years of age. [For further information on eligible and non-eligible dividends, please refer to our "Changes to the Taxation of Dividends" article in our Fall 2006 *Comments* publication.]

WATCH FOR IN 2009

15. Consider installment changes:

- The threshold above which corporations must pay income tax, GST and source deductions installments is $3,000. The threshold will be based on 2008 tax amounts payable.
- Certain Canadian-controlled private corporations will be allowed to make quarterly, instead of monthly, income tax installments. To qualify, certain conditions must be met including criteria relating to the 2008 taxation year:
  - the corporation was entitled to the small business deduction;

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REMINDER TO PRIVATE CORPORATIONS:

Remember to Designate Eligible Dividends Paid to Shareholders

Companies wishing to pay eligible dividends must designate these dividends in writing as “eligible dividends” at the time the payment is made. Examples of notification include notation on the dividend cheque stub or a letter to the share–holders declaring that the dividend is an eligible dividend.

A corporation that wishes to pay both “eligible” and “ineligible” dividends on the same class of shares must declare and pay two separate dividends.

- the taxable income of the associated group did not exceed $400,000; and
- the taxable capital of the associated group did not exceed $10 million.

Instalment planning for 2009 can be addressed during 2008 by meeting the conditions where applicable.

If You Are Self-employed...

16. If you have a home office, you can deduct eligible home office expenses, including a portion of your mortgage interest, home insurance, property taxes, utilities, and minor repairs.

17. Consider the potential benefits of incorporating your business.

If You Are Employed...

18. Reduce tax withheld at source:

- If you will have large tax deductions available to you (e.g. RRSP contributions, tax shelters, interest, business losses, work-related car expenses and alimony), apply in advance to the Canada Revenue Agency (CRA) for a reduction in the payroll withholdings from your salary.
- You may also arrange for a reduction in tax withholdings if you are entitled to the new 2008 Child Tax Credit of $2,038 for each child.

19. Minimize taxable employee benefits:

- Arrange to receive non-taxable benefits from your employer instead of taxable benefits. Examples include: employer contributions to a registered pension plan (the pension is taxable when you receive it); contributions to a “private health services plan”, such as those covering medical expenses, hospital charges and drugs not covered by public health insurance, and dental fees.
- If you received interest-free and low-interest loans from your employer, it will generally result in a taxable benefit.
  - Some of the benefit can be offset by an “interest” deduction if used for certain purposes.
  - If not deductible, be sure to pay any interest payable on the loan for 2008 by January 30, 2009, to reduce or eliminate your taxable benefit.
  - Consider renegotiating any home purchase loans from your employer in order to minimize taxable benefits by “locking in” the loan at a lower prescribed interest rate for a five-year term.

If Your Employer Provides You With an Automobile...

20. The taxable benefit is based on original cost and does not decrease as the car ages. Consider purchasing the car from the company by way of an interest-free loan from your employer and personally claiming depreciation on the car.

21. Avoid employer-owned vehicles costing over $30,000.

22. You can reduce the taxable benefit if your automobile is used primarily (generally, greater than 50%) for business purposes and by keeping your personal use to less than 20,000 kilometers per year.

Income Splitting With Family Members - Other Opportunities

Consider the following legitimate means of shifting income to family members whose taxable income is below the minimum tax rate level of approximately $35,000. This will allow them to take advantage of certain non-transferable credits, as well as lower tax rates.

23. Income splitting with children over the age of 17 ("adult children"):

- Shift investment income by gifting money to your adult children, or to a trust for their benefit, if you wish to maintain control.
- Lend funds to, or purchase shares in, a corporation whose shareholders are your adult children.

24. Income splitting with adult or minor children:

- Purchase appreciating assets in the names of your children regardless of their ages. Capital gains will be taxed in their hands, not yours.
- Lend money to your children with actual interest payable at the prescribed rate. Earnings in excess of this rate will be taxed in their hands.

25. Income splitting with your spouse or common-law partner:

- Lend money to your spouse or common-law partner to earn business income.
- Have the higher-income spouse or common-law partner incur all household expenses, thus allowing the lower income person to acquire investments which could be taxed at a lower rate.
- Lend money to your spouse or common-law partner with actual interest payable at the prescribed rate. Earnings in excess of this rate will be taxed in your spouse or common-law partner's hands.

Please contact us at info@soberman.com if you would like to receive future tax updates by email.

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