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2017 Year End Tax Tips

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Tax planning should be a year-round affair. But as year-end approaches, now is a particularly good time to review your personal finances and take advantage of any tax planning opportunities that may be available to you before the December 31 deadline. Incorporated business owners may particularly be interested in the discussion of steps to consider in light of the July 18, 2017 proposals for changes to taxation of private corporations. As we enter the final weeks of 2017, here are some tax tips you may wish to consider for:

- *Investors*
- *Families with students*
- *Family members with disabilities*
- *Charitable donors*
- *Individuals with changes to tax rates; and*
- *Incorporated business owners.*

Investors

Tax-Loss Selling

Tax-loss selling involves selling investments with accrued losses at year end to offset capital gains realized elsewhere in your portfolio. Any net capital losses that cannot be used currently may either be carried back three years or carried forward indefinitely to offset net capital gains in other years.

In order for your loss to be immediately available for 2017 (or one of the prior three years), the settlement must take place in 2017. **New for 2017**, Canada has adopted a shorter settlement period for equity and long-term debt market trades, to coincide with a change to a T+2 standard on American markets. This means that, rather than the previous three-business-day settlement period, effective September 5, 2017 trades are now settled in two business days. To complete settlement by December 31st, the trade date must be no later than December 27, 2017.

If you purchased securities in a foreign currency, the gain or loss may be larger or smaller than you anticipated once you take the foreign exchange component into account. For example, Jake bought 1,000 shares of a U.S. company in November 2012 when the price was US$10/share and the U.S. dollar was at par with the Canadian dollar. Today, the price of the shares has fallen to US$9 and Jake decides he wants to do some tax loss harvesting, to use the US$1,000 [(US$10 — US$9) X 1,000] accrued capital loss against gains he realized earlier this year.

Well, before knowing if this strategy will work, he'll need to convert the potential U.S. dollar proceeds back into Canadian dollars. At an exchange rate of $1 U.S. = $1.25 CDN, selling the U.S. shares for US$9,000 yields $11,250 CDN. So, what initially appeared to be an accrued capital loss of US$1,000 (US$10,000 – US$9,000) turns out to be a capital gain of $1,250 ($11,250 - $10,000) for Canadian tax purposes. If Jake had gone ahead and sold the U.S. stock, he would actually be doing the opposite of tax loss selling and accelerating his tax bill by crystallizing the accrued capital gain in 2017!

Superficial loss

If you plan to repurchase a security you sold at a loss, beware of the "superficial loss" rules that apply when you sell property for a loss and buy it back within 30 days before or after the sale date. The rules apply if property is repurchased within 30 days and is still held on the 30th day by you or an "affiliated person", including your spouse (or partner), a corporation controlled by you or your spouse (or partner), or a trust of which you or your spouse (or partner) are a majority beneficiary (such as your RRSP or TFSA). Under the rules, your capital loss will be denied and added to the adjusted cost base (tax cost) of the repurchased security. That means any benefit of the capital loss could only be obtained when the repurchased security is ultimately sold.

Transfers and swaps

While it may be tempting to transfer an investment with an accrued loss to your RRSP or TFSA to realize the loss without actually disposing of the investment, such a loss is specifically denied under our tax rules. There are also harsh penalties for "swapping" an investment from a non-registered account to a registered account for cash or other consideration.

To avoid these problems, consider selling the investment with the accrued loss and, if you have the contribution room, contributing the cash from the sale into your RRSP or TFSA. If you want, your RRSP or TFSA can then "buy back" the investment after the 30-day superficial loss period.

Make RRSP Contributions

Although you have until March 1, 2018, to make RRSP contributions for the 2017 tax year, contributions made as early as possible will maximize tax-deferred growth. Your 2017 RRSP deduction is limited to 18% of income earned in 2016, to a maximum of $26,010, less any pension adjustment plus any previous unused RRSP contribution room and any pension adjustment reversal.

Delay RRSP Withdrawals Under the HBP or LLP

You can withdraw funds from an RRSP without tax under the Home Buyer's Plan (up to $25,000 for first-time home buyers) or the Lifelong Learning Plan (up to $20,000 for post-secondary education). With each plan, you must repay the funds in future annual instalments, based on the year in which funds were withdrawn. If you are contemplating withdrawing RRSP funds under one of these plans, you can delay repayment by one year if you withdraw funds early in 2018, rather than late in 2017.

Make TFSA Contributions

The TFSA dollar limit for 2017 is $5,500 but there is no deadline for making a TFSA contribution. If you have been at least 18 years old and resident in Canada since 2009, you can contribute up to $52,000 in 2017 if you haven't previously contributed to a TFSA.

Take TFSA Withdrawals

If you withdraw funds from a TFSA, an equivalent amount of TFSA contribution room will be reinstated in the following calendar year, assuming the withdrawal was not made to correct an over-contribution.

Be careful, however, because if you withdraw funds from a TFSA and then re-contribute in the same year without having the necessary contribution room, overcontribution penalties can result. If you wish to transfer funds or securities from one TFSA to another, you should do so by way of a direct transfer, rather than a withdrawal and recontribution, to avoid an overcontribution problem.

If you are planning a TFSA withdrawal in early 2018, consider withdrawing the funds by the 31st of December, 2017, so you would not have to wait until 2019 to re-contribute that amount.

Pay Investment Expenses

Certain expenses must be paid by year end to claim a tax deduction or credit in 2017. This includes investment-related expenses, such as interest paid on money borrowed for investing and investment counseling fees for non-RRSP / RRIF accounts.

Convert Your RRSP to a RRIF by Age 71

If you turned age 71 in 2017, you have until December 31 to make any final contributions to your RRSP before converting it into a RRIF or registered annuity.

It may be beneficial to make a one-time overcontribution to your RRSP in December before conversion if you have earned income in 2017 that will generate RRSP contribution room for 2018. While you will pay a penalty tax of 1% on the overcontribution (above the $2,000 permitted overcontribution limit) for December 2017, new RRSP room will open up on January 1, 2018 so the penalty tax will cease in January 2018. You can then choose to deduct the overcontributed amount on your 2018 (or a future year's) return.

This may not be necessary, however, if you have a younger spouse or partner, since you can still use your contribution room after 2017 to make contributions to a spousal RRSP until the end of the year your spouse or partner turns 71.

Use a Prescribed Rate Loan to Split Investment Income

If you are in a high tax bracket, it might be beneficial to have some investment income taxed in the hands of family members (such as your spouse, common-law partner or children) who are in a lower tax bracket; however, if you simply give funds to family members for investment, the income from the invested funds may be attributed back to you and taxed in your hands, at your high marginal tax rate.

To avoid attribution, you can lend funds to family members, provided the rate of interest on the loan is at least equal to the government's "prescribed rate," which is 1% until at least the end of 2017. If you implement a loan before the end of the year, the 1% interest rate will be locked in and will remain in effect for the duration of the loan, regardless of whether the prescribed rate increases in the future. Note that interest for each calendar year must be paid annually by January 30th of the following year to avoid attribution of income for the year and all future years.

When a family member invests the loaned funds, the choice of investments will affect the tax that is paid by that family member. It may be worthwhile to consider investments that yield Canadian dividends, since a dividend tax credit can be claimed by individuals to reduce the tax that is payable. When the dividend tax credit is claimed along with the basic personal amount, a certain amount of dividends can be received entirely tax-free by family members who have no other income.

For example, an individual who has no other income and who claims the basic personal amount can receive about $51,000 of eligible dividends in 2017 without paying any tax, other than in the provinces of Manitoba, P.E.I., Quebec, Newfoundland and Labrador, and Nova Scotia where the amount of eligible dividends that can be received is lower.

You should consult with tax and legal advisors to make arrangements to implement a prescribed rate loan. By putting a loan into place before the end of the year, you could benefit from income splitting

throughout the upcoming year and for many years to come.

Families with Students

Make RESP Contributions

RESPs allow for tax-efficient savings for children's post-secondary education. The federal government provides a Canada Education Savings Grant (CESG) equal to 20% of the first $2,500 of annual RESP contributions per child or $500 annually. While unused CESG room is carried forward to the year the beneficiary turns 17, there are a couple of situations in which it may be beneficial to make an RESP contribution by December 31.

Each beneficiary who has unused CESG carry-forward room can receive up to $1,000 of CESGs annually, with a $7,200 lifetime limit, up to and including the year in which the beneficiary turns 17. If enhanced catch-up contributions of $5,000 (i.e. $2,500 x 2) are made for just over 7 years, the maximum total CESGs of $7,200 will be obtained. If you have less than 7 years before your child or grandchild turns 17 and haven't maximized RESP contributions, consider making a contribution by December 31.

Also, if your child or grandchild turned 15 this year and has never been a beneficiary of an RESP, no CESG can be claimed in future years unless at least $2,000 is contributed to an RESP by the end of the year. Consider making your contribution by December 31st to receive the current year's CESG and create CESG eligibility for 2018 and 2019.

Take RESP Withdrawals for Students

If your child (or grandchild) is an RESP beneficiary and attended a post-secondary educational institution in 2017, consider having Educational Assistance Payments (EAPs) made from the RESPs before the end of the year. Although the amount of the EAP will be included in the income of the student, if the student has sufficient personal tax credits, the EAP income will be effectively tax-free.

If your child (or grandchild) is an RESP beneficiary and stopped attending a post-secondary educational institution in 2017, EAPs can only be paid out for up to six months after the student has left the school. You may, therefore, wish to consider having final EAPs made from RESPs of which the student is a beneficiary.

Pay Interest on Student Loans

You can claim a non-refundable tax credit in 2017 for the amount of interest paid by December 31 on student loans received under the Canada Student Loans Act, the Canada Student Financial Assistance Act, the Apprentice Loans Act or a similar provincial or territorial government law. Note that while only the student can claim the student loan interest credit, the interest on the loan itself can be paid either by the student or by someone related to the student, such as a parent.

Family Members with Disabilities

Make Renovations for Home Accessibility

The non-refundable Home Accessibility Tax Credit (HATC) assists seniors and those eligible for the disability tax credit with certain home renovations.

The tax credit is equal to 15% of up to $10,000 of expenses per year towards renovations that permit these individuals to gain access to, or to be more mobile or functional within, their home, or reduce their risk of harm within their home or from entering their home.

The HATC will apply in respect of payments made by December 31st for work performed and and/or goods acquired in 2017. A single expenditure may qualify for both the HATC and the medical expense tax credit, and both may be claimed.

Contribute to an RDSP

RDSPs are tax-deferred savings plans open to Canadian residents eligible for the Disability Tax Credit, their parents and other eligible contributors. Up to $200,000 can be contributed to the plan until the beneficiary turns 59, with no annual contribution limits. While contributions are not tax deductible, all earnings and growth accrue on a tax-deferred basis.

Federal government assistance in the form of matching Canada Disability Savings Grants (CDSGs) and Canada Disability Savings Bonds (CDSBs) may be deposited directly into the plan up until the year the beneficiary turns 49. The government will contribute up to a maximum of $3,500 CDSG and $1,000 CDSB per year of eligibility, depending on the net income of the beneficiary's family. Eligible investors may wish to contribute to an RDSP before December 31 to get this year's assistance. Starting from 2008 (the year RDSPs first became available), there is a 10-year carryforward of CDSG and CSDB entitlements. For beneficiaries who have been DTC-eligible since 2008, CDSG and CSDB entitlements may be lost after 2018.

RDSP holders with shortened life expectancy can withdraw up to $10,000 annually from their RDSPs without repaying grants and bonds. A special election must be filed with Canada Revenue Agency by December 31 to make a withdrawal in 2017.

Pay Family Medical Expenses

While expenses must be paid by December 31 to claim a tax deduction or credit in many cases, the related good or service does not always need to be acquired in the same year. This provides an opportunity to prepay certain items and claim the tax benefit currently.

A tax credit can be claimed when total medical expenses exceed the lower of 3% of your net income or $2,268 in 2017. If your medical expenses will be less than this minimum threshold, consider prepaying expenses that you would otherwise pay in 2017. For example, if you expect to pay monthly instalments for your child's braces in 2018, consider paying the full amount up front in 2017 if it will raise total medical expenses over the threshold.

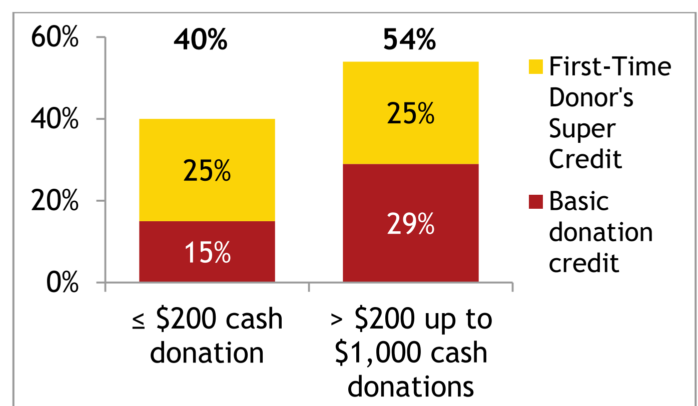
For medical expenses, it may be worthwhile to look for unclaimed expenses prior to 2017 as well. The medical expense tax credit (METC) may be claimed for eligible medical expenses that were paid during any 12-month period that ended within the calendar year (extended to 24 months when an individual died in the year.)

Charitable Donors

Make Charitable Donations
(Last chance to claim FDSC in 2017)

Both the federal and provincial governments offer donations tax credits that, in combination, can result in tax savings of up to 50% of the value of your gift in 2017.

Figure 1 - Federal charitable donation credit and FDSC with income up to $202,800 in 2017



This is the last year that you may claim the federal First-Time Donor's Super Credit (FDSC) if neither you nor your spouse or common-law partner has claimed the donations tax credit from 2008 to

2016. The FDSC provides an additional 25% tax credit on total monetary donations up to $1,000.

As shown in Figure 1, with total cash donations up to $200 in a year, the federal donation credit with FDSC is 40% of the donation amount. For total cash donations between $200 and up to $1,000 in a year, the federal donation credit with FDSC jumps to 54% (58% to the extent total income exceeds $202,800) of the donation amount.

December 31 is the last day to make a donation and get a tax receipt for 2017. Keep in mind that many charities offer online, internet donations where an electronic tax receipt is generated and e-mailed to you instantly.

Make gifts in-kind

Gifting publicly-traded securities, including mutual funds, with accrued capital gains to a registered charity or a foundation not only entitles you to a tax receipt for the fair market value of the security being donated, it eliminates capital gains tax too.

Individuals with changes to tax rates

If you anticipate that your income tax rates will be substantially different in 2018, it may be worthwhile to shift income and expenses between 2017 and 2018, where feasible. Provincially, the top federal/B.C. personal marginal tax rate will increase from 47.7% in 2017 to 49.8% in 2018, and all marginal tax rates in Saskatchewan will decrease by 0.25% for 2018.

You may also expect that your tax rate could increase in 2018 if, for example, you plan to return to work, or expect to receive deferred compensation or exercise stock options.

If you expect your income tax rate will increase in 2018, you may wish to realize income in 2017 by taking steps such as selling investments with a capital gain, exercising stock options or taking bonuses, where feasible, in 2017 rather than 2018. It may also make sense to defer deductible expenses until 2018 where possible. For example, in Newfoundland and Labrador, the top personal marginal tax rate will increase in 2018.

Conversely, you may anticipate that your tax rate could decrease in 2018, perhaps if you plan to retire or if you received a bonus in 2017 that may not reoccur. You may, therefore, wish to defer income by taking steps such as waiting to sell investments with a capital gain, exercise stock options, take bonuses or distribute dividends to owner-managers from a corporation, where feasible, in 2018 rather than 2017.

Incorporated Business Owners

During "Small Business Week", which took place from October 15 to 21, 2017, the federal government announced substantial modifications to the proposals for taxation of private corporations that had been introduced by the Department of Finance on July 18, 2017. The originally-proposed measures focused on three areas: income sprinkling among family members, passive investment income earned within corporations and converting regular income from a corporation into capital gains. The government had invited interested parties to comment on the proposals by October 2, 2017 and they ultimately received over 21,000 submissions from various business groups, industry associations and other interested parties. In response to comments received, the Department of Finance made a series of announcements modifying and, in some cases, withdrawing some of the proposals.

Our report, Taking Action: Revised CCPC Tax Proposals,[1] reviews the proposals, as well as the announced modifications, and sets out action steps that you may wish to consider. Here is a summary of steps you may wish to take for your incorporated small business by December 31.

Income Splitting

Background

Effective for 2018, the proposed changes would expand existing kiddie tax rules so that they would apply to more types of income and would also cover certain adults (the "split income" rules).

The new split income rules would look at whether income received by an adult individual is "reasonable," taking into account the person's labour and capital contributions to the business along with any previous returns and remuneration, in comparison to a situation where an arm's length investment was made.

These new rules would likely affect anyone who has done an estate freeze. The split income rules would subject dividends paid on most shares received on an estate freeze to tax at the highest rate.

The government announced on October 16, 2017 that it "will simplify the proposed measures with the aim of providing greater certainty for family members who contribute to a family business." Specifically, it was indicated that work will be done towards reducing the compliance burden associated with this proposal.

The consultation process also raised concerns that investors in start-up businesses ("angel investors") may not be able to be adequately compensated under the proposed "reasonableness" test. On October 20, 2017 the government addressed this matter by recognizing that, "An investment in a start-up carries greater risk and may warrant a relatively high return under a reasonableness standard."

Steps to take by December 31, 2017

Watch for revised draft legislation incorporating these changes that is expected to be released later in the fall of 2017.

If your private corporation has other shareholders, such as your spouse, partner, or other adult relatives as shareholders, consider whether it makes sense to pay additional dividends to family members who are in lower tax brackets in 2017 to maximize any income sprinkling opportunities before any proposed rules could increase the tax rate on such income commencing in 2018.

Consider the full effect of these proposed rules before finalizing any contemplated estate freeze transactions. Dividends and gains earned after 2017 on shares purchased for a nominal amount may be subject to tax at the highest rate.

Consider these proposed rules before setting up a new business with funding or a guarantee from a family member. Dividends, interest and gains earned after 2017 on shares / debt held by the family member could be caught by the new rules and taxed at the highest tax rate if they are not considered "reasonable." If you borrow to put capital into a private corporation, and the debt is guaranteed by a relative, the capital contributed by you may be disregarded for purposes of determining a reasonable rate of return.

Review the share structure of any private corporations to determine if more than one shareholder own shares of the same class. Corporate law might require you pay the same amount of dividends to all shareholders of the same class of shares. If you cannot pay dividends to one shareholder without causing another shareholder to be taxed at the highest tax rate on dividends received by them, you may consider a corporate reorganization so that the shareholders own shares of different classes.

Passive Investment Income

Background

The tax rate on income earned in a corporation is generally much lower than the top personal

marginal tax rate for an individual income earner; consequently, until income is withdrawn from a corporation as a dividend, there is more after-tax income to invest within the corporation than there would be if the income was earned by the individual.

As these funds are invested inside the corporation over long periods of time, a shareholder can end up with more after-tax income from the corporation at the end of the investment period because of the higher starting capital. This is commonly referred to as the "tax deferral advantage." Where income earned in the corporation is taxed at the lower small business rate, the tax deferral advantage, ranging from 35% to 40% in 2017, is magnified. The government considers this unfair and would like to neutralize this tax deferral.

The approach that the government appears to be considering would make the currently refundable tax on investment income no longer refundable, unless the investments arose from capital contributions from shareholders. It has been estimated that this would result in a tax rate of over 70% on certain passive income earned within a private corporation and approaching 60% on capital gains.

On October 18, 2017 the government announced that this measure will now be limited in scope: there will be a $50,000 annual investment income threshold before this new tax regime will apply. Mention was made that this would be the return on $1 million of investments, assuming a 5% rate of return.

Further, on October 20, 2017 the government acknowledged concerns raised by the venture capital community, which pointed out that private corporations are an important source of funding for this sector. Although no assurance was provided, the government indicated that in developing the new rules, they will consider whether capital gains from the sale of shares of a corporation that carries on an active business should be excluded.

Draft legislation to implement this proposal will be released as part of the 2018 federal budget. It was expressed that any new rules would apply on a go-forward basis.

Steps to take by December 31, 2017

Since the rules should only be applied prospectively, there should not be a need to withdraw already-taxed retained earnings from your corporation. The new rules, when enacted, would only tax future investment income on future earnings at the higher, non-refundable, rate of tax.

RRSPs and TFSAs may offer benefits beyond those available with corporate investments, as outlined in our reports RRSPs: A Smart Choice for Business Owners[2] and TFSAs for Business Owners… A Smart Choice.[3] Consider withdrawing sufficient funds from your private corporation to maximize contributions to RRSPs and TFSAs. Receiving salary of at least $145,723 by December 31, 2017 will allow the maximum RRSP contribution of $26,230 in 2018. Reasonable salaries may also be paid to family members who work in the business to allow them to make contributions to RRSPs and TFSAs.

Conclusion

These tips highlight various ways you can act now to benefit from tax savings when you file your 2017 personal tax return. But keep in mind that tax planning is a year round affair. Speak to your tax advisor well in advance of tax filing season if you want information on reducing your taxes.

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[1] The report "Taking Action: Revised CCPC Tax Proposals" is available online at https://www.cibc.com/content/dam/small_business/day_to_day_banking/advice_centre/pdfs/business_reports/private-corporation-tax-changes-en.pdf.

[2] The report "RRSPs: A Smart Choice for Business Owners" is available online at https://www.cibc.com/content/dam/small_business/advice_centre/business-reports/RRSPs-for-business-owners-en.pdf.

[3] The report "TFSAs for Business Owners… A Smart Choice" is available online at https://www.cibc.com/content/dam/small_business/day_to_day_banking/advice_centre/pdfs/personal_finances/tfsas-for-business-owners-en.pdf.

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