



Jamie Golombek

Year End Tax Tips

As 2009 draws to a close it is time again for Canadians to turn their attentions to their taxes. While it may still be months ahead of the annual filing deadline, December is often the best time of year to evaluate your overall tax strategy, especially as time will run out to realize a variety of tax-saving opportunities before the New Year.

With the arrival of new tax-efficient vehicles, credits and changes to certain policies this year, clients should be reviewing their situations and their options with a tax professional to make sure they're saving on tax where possible.

Looking ahead to 2010 it's also important to be aware of opportunities to save on tax all year round. Tax-planning is an integral part of any investment plan and everyone should take the time to consider the factors that may impact them as an individual or affect their business or family.

With that in mind, here are my top ten year-end tax planning tips.

1. Tax-Loss Selling

Tax-loss selling is the practice of selling investments which are in an accrued loss position at year-end in order to offset capital gains elsewhere in your portfolio.

For tax-loss selling, to guarantee that a trade of public securities is settled in 2009, the trade date must be December 24, 2009 or earlier. This will make sure that the settlement takes place in 2009 and that any losses realized are available to the taxpayer this year. Any trade made after December 24, 2009 will not settle until 2010 and therefore those losses would not be available until next year.

A capital loss must first be applied against any capital gains in the current year, including capital gains distributions from mutual funds which are generally distributed in mid- to late-December.

Once current-year capital gains have been offset, the balance of the loss may either be carried back to offset capital gains in any of the three prior years (2006, 2007 or 2008) or carried forward indefinitely to offset capital gains in future years.

The procedure to carry back a loss from 2009 to a prior year is straightforward. Next spring, you would simply complete and file a Canada Revenue Agency (CRA) Form T1A "Request for Loss Carryback," which is available on the CRA's website and included in most tax preparation software packages. On this form you would select the years in which to apply the 2009 capital loss and the CRA will reassess those years' returns and refund any taxes paid on those capital gains.

Still want to hold on to those losers in the hopes of a recovery? There are a couple of strategies you can take advantage of but be sure to execute them properly.

While it might seem like a good idea to sell your investment, realize the loss and then buy it back again, that won't fly with the tax man. The reason for that is the "superficial loss" rule.

A superficial loss occurs when you sell property for a loss and buy it back within 30 days before or after the sale date. The rule also applies if your spouse or partner (or a corporation controlled by you or your spouse or partner) buys it back within 30 days.

Should you be caught by the superficial loss rule, your capital loss will be denied and added to the adjusted cost base (tax cost) of the repurchased security. That means the benefit of the capital loss can only be obtained when the repurchased security is sold.

One of the most often suggested, yet ill-advised, strategies for realizing a loss without actually disposing of the investment is to transfer it to your RRSP or TFSA either as a contribution (if you have room) or as a swap. Note, however, that due to the recent government announcement, swaps to or from TFSAs should be avoided altogether due to the 100% tax proposed on any TFSA gains as a result of swap transactions. (For more information, see our [October TFSA Tax Flash](#)).

The problem with in-kind transfers or swaps is that any accrued loss on such a transfer will be permanently denied.

Instead, you should consider selling the investment outside your RRSP or TFSA, realizing the loss and contributing the cash from the sale into your RRSP or TFSA. Your RRSP or TFSA can then buy back the investment provided you wait 30 days before buying it back to ensure the superficial loss rule doesn't apply.

2. Advice for Homeowners and Prospective Homeowners

Home Buyers' Plan

The 2009 federal budget increased the amount a first-time home buyer can withdraw from his or her RRSP under the federal Home Buyers' Plan (HBP) to \$25,000 (up from \$20,000) to purchase or construct a new home without having to pay tax on that withdrawal.

If you are planning to buy a new home in early 2010, consider delaying your HBP withdrawal until 2010 to allow you one additional year before repayments must begin. For example, repayments of moneys withdrawn in December would need to be repaid beginning in 2011. By waiting until January, you can delay repayment until 2012.

First-Time Home Buyers' Tax Credit

Also keep in mind that there is a new non-refundable tax credit based on a \$5,000 amount for "first-time home buyers" who acquire a home after January 27, 2009.

Any unused First-Time Home Buyers' Tax Credit can be claimed by the individual's spouse or partner. Note, however, that even if each spouse or partner uses his or her own funds to jointly purchase a new home, the First-Time Home Buyers' Tax Credit is still limited to one credit on \$5,000 (as opposed to \$5,000 for each spouse or partner).

Home Renovation Tax Credit (HRTC)

Perhaps more attention has been given to the temporary Home Renovation Tax Credit (HRTC) than any other tax measure in 2009.

The HRTC is a 15% non-refundable tax credit for eligible renovation expenditures made to your home or vacation property. The credit applies to any amounts spent over \$1,000, up to a maximum of \$10,000 (prior to February 1, 2010), producing a maximum credit of \$1,350.

In the nine months or so since the credit was first introduced, the Canada Revenue Agency has released numerous technical interpretations over exactly which types of renovation expenses qualify for the HRTC. Here's a quick summary of some of the more recent qualifying expenditures:

- Air conditioners and heat pumps that are permanently installed
- Common areas of condos that are paid for either from the condo's reserve fund or a special fund
- Dock: The materials and installation costs for a dock are eligible provided the dock is attached to land that forms part of the eligible dwelling
- Driveways
- Sanding and refinishing of hardwood floors
- Permanently wired or installed home security systems qualify, but ongoing alarm monitoring costs do not
- Landscaping
- Sauna: The costs of installing a wood-fired, 10 x 10-foot, outdoor sauna building on the land that forms part of an eligible dwelling qualifies
- Solar panels on your home or on adjacent land qualify unless the cost is part of the purchase price of the home. You can still claim the full HRTC on the costs of the installation if you've received another government tax credit or grant for installing the solar panels
- Tree removal: if the removal relates to a renovation project that is of an "enduring nature and integral to the home"

3. RRSP Annuitants Who Turn 71 in 2009

If you turned 71 in 2009, you must convert your RRSP into either a Registered Retirement Income Fund (RRIF) or a registered annuity by Dec. 31. Be sure to discuss your RRSP conversion options with your financial advisor before it's too late.

In addition, you only have until Dec. 31 to make your last RRSP contribution, if you plan to do so. You don't have the advantage of delaying until March 1, 2010. If, however, you have a spouse or partner who is under 72, you can continue contributing to a spousal RRSP in his or her name, provided you still have contribution room.

Individuals who turn 71 in 2009 without a younger spouse or partner and who still have earned income this year that would create RRSP contribution room for 2010, might also consider making an overcontribution to their RRSP in December 2009. While a penalty tax of 1% would apply for the month of December, new contribution room for 2010 would open up in January 2010 and the "over" contribution made in 2009 would no longer be a problem and could be deducted against 2010 (or later years') taxable income.

4. Contribute to a Registered Education Savings Plan (RESP)

The Registered Education Savings Plan allows you to save for children's post-secondary level education in tax-effective manner. The government will also help you save by providing a Canada Education Savings Grant (CESG)

equal to 20% of the first \$2,500 of annual RESP contributions per child or \$500 annually. The deadline to get the 2009 CESG is December 31.

If you have a child or grandchild who has never participated as a beneficiary in an RESP, and who turned 15 sometime in 2009, December 31 is the last chance to contribute at least \$2,000 to his or her RESP to be allowed to collect the CESG for 2009 and create eligibility for CESGs for 2010 and 2011. If you miss the deadline, the child or grandchild will not be eligible for any grants in the future.

5. Charitable Donations

December 31 is also the last day to make a donation and get a tax receipt for 2009. Scrambling to donate? Remember that many charities now offer online, Internet donations where an electronic tax receipt is generated and e-mailed to you instantly.

Keep in mind that gifting publicly-traded securities with accrued capital gains to a registered charity or a private foundation not only entitles you to a tax receipt for the fair market value of the security being donated but eliminates any capital gains tax as well.

6. Contribute to a Registered Disability Savings Plan (RDSP)

The Registered Disability Savings Plan (RDSP) is a tax-deferred registered savings plan open to Canadian residents eligible for the Disability Tax Credit, their parents and other eligible contributors. Up to \$200,000 can be invested within the plan with no annual contribution limits. While contributions are not tax deductible, all earnings and growth accrue tax-deferred.

For eligible investors, now is the time to contribute to an RDSP before the December 31, 2009 deadline. Contributing before the deadline ensures eligible investors qualify for annual government assistance available to RDSPs in addition to the tax-efficient benefits the plan has to offer.

A main feature of the RDSP is the availability of government funds deposited directly into the plan in the form of matching Canada Disability Savings Grants and Canada Disability Savings Bonds. The government will contribute, up to a maximum, \$3,500 CDSG and \$1,000 CDSB annually, depending on the net income of the beneficiary's family.

Finally, an RDSP can also protect beneficiaries from losing valuable disability benefits in most provinces. For more information on RDSPs, see our bulletin entitled ["Planning with RDSPs"](#).

7. Purchase Business Assets

If you're self-employed or a small business owner, you may wish to consider accelerating the purchase of new business equipment or office furniture that you may have been planning to purchase in 2010. Under the tax rules, you are permitted to deduct, under the "half-year rule," one half of a full year's tax depreciation ("capital cost allowance") in 2009, even if you bought it on the last day of the year. For 2010, you can then proceed to claim a full year's depreciation.

Computers: Accelerated Tax Depreciation

To encourage investment by businesses in computer systems and related peripherals, the Income Tax Regulations were amended on May 13, 2009 to add new Class 52 to Schedule II with a 100-per-cent tax depreciation rate for eligible computers and software acquired after January 27, 2009 and before February 2011.

This 100-per-cent write-off rate is not subject to the "half-year rule" entitling the purchaser to write off the entire cost of the computer equipment purchased in the year of acquisition

8. Consider a Prescribed Rate Loan at 1%

The government's prescribed interest rate is set at the all-time low of 1% until at least December 31, 2009 providing couples with a significant income-splitting opportunity.

Income splitting is the practice of transferring income from a high-income spouse to a lower-income spouse to reduce the overall tax burden of the family. Having the income taxed in the lower income-earner's hands is a strategy prompted by our system of graduated tax brackets.

Unfortunately, "attribution rules" in the *Tax Act* make this strategy difficult by attributing any income or gains earned on money transferred or gifted to a spouse back to the original high-earner spouse.

Fortunately, the Act does provide an exception to this rule if funds are loaned, rather than gifted, at the prescribed government rate and the interest paid annually by January 30 of the following year.

So, if the loan is made before December 31 while the prescribed rate is 1%, any investment returns above the 1% rate can be taxed in the hands of the lower-income spouse. Note that even though the prescribed rate varies quarterly, you need only use the rate in effect at the time the loan was originally extended.

9. Pay an Investment Expense (Including Interest) by December 31st

In order to be able to deduct any investment-related expenses on your 2009 tax return, the amounts must be actually paid by year-end. Such expenses include interest you paid on money borrowed for investing, investment counseling fees for non-RRSP accounts, professional accounting services for tracking rental or business income and safety deposit box rental fees.

Making your interest tax deductible (Lipson)

In what will likely take the prize for the most important tax decision of 2009, the January 4-3 split decision of the Supreme Court of Canada in *Lipson* had a Toronto couple up against the CRA in a case that involved abusive tax planning that offended the General Anti-Avoidance Rule (GAAR).

The Lipsons lost the case, as the SCC found that they misused the attribution rules. While the Lipson plan itself may be dead, the bigger question is comfort we can now draw from the decision and its impact on a plain-vanilla debt-swap strategy, often known as the "Singleton Shuffle."

The Lipsons essentially used a variation on the classic "Singleton Shuffle," named after Vancouver lawyer John Singleton's 2001 Supreme Court victory, which upheld the notion that you can rearrange your financial affairs in a tax-efficient manner so as to make your interest on investment loans tax-deductible.

This technique has been employed by many Canadians who own non-registered investments and are advised to liquidate these investments and use the proceeds to pay off their mortgage. The investor would then obtain a loan secured by the newly replenished equity in their home, and use the loan for earning investment income, thus making the interest on the loan fully tax-deductible.

Based on the *Lipson* ruling, it appears that this strategy is still valid and would not invoke the GAAR. As the Supreme Court wrote, the CRA "has not established that in view of their purpose (the interest deductibility) provisions have been misused and abused. Mrs. Lipson financed the purchase of income-producing property with debt, whereas Mr. Lipson financed the purchase of the residence with equity. To this point, the transactions were unimpeachable. They became problematic when the parties took further steps in their series of transactions."

10. Apply Now for Reduced Source Deductions for 2010

With the new year just around the corner, now is the time to start planning for 2010, especially if you routinely get a large tax refund each spring. By applying to the CRA to take into account various tax deductions, such as RRSP contributions or childcare deductions, the CRA can authorize your employer to reduce the amount of income tax withheld on your employment income. This way you can pay less income tax over the year rather than overpaying and then applying for a refund in April.

The benefit is that you get to keep your own money instead of loaning it, interest-free, to the CRA.

To get a head start for 2010, now is the time to send a completed CRA Form T1213 "Request to Reduce Tax Deductions At Source for Year(s) _____", with all supporting documents to the Client Services Division of your local tax services office to ensure that the tax deduction can be in place early in 2010.

For clients who fear having their Old Age Security (OAS) payments clawed back for 2010 due to a one-time large capital gain or severance payment in 2009, consider completing the special CRA Form T1213(OAS) "Request to Reduce Old Age Security Recovery Tax at Source for Year _____" which can preserve the senior's OAS monthly cash flow.

As with all planning strategies, you should seek the advice of a qualified financial advisor or tax advisor to discuss planning opportunities.

Jamie Golombek, CA, CPA, CFP, CLU, TEP is the Managing Director, Tax & Estate Planning with CIBC Private Wealth Management in Toronto.

Jamie.Golombek@cibc.com

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