

# 2011 Year End Tax Planning Considerations

Tax planning is a year-round activity and a vital component of the financial planning process. Now, as fall season approaches, is the time to pay special attention to various tax issues in advance of the end of the 2011 taxation year.

The following outlines some common tax planning ideas and items that may need to be addressed, as well as some considerations for 2011.

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## Corporate Planning Opportunities

- Shareholder Loans
- Capital Gains Exemption
- Allowable Investment loss (ABIL)
- Salary
- Business Income Reserve
- Capital Gains Rollover

**Note:** These points are general and brief, and not applicable to all situations. Consult with your own tax advisor before implementation of any of these strategies to determine if any of these options are relevant and prudent as it pertains to your own specific situation.

## Year End -Tax Loss Selling

### 1. Tax loss selling to crystallize Unrealized Capital Losses:

As we approach the end of the 2011 personal taxation year, it is just about that time to review your portfolio in an effort to identify positions currently trading at a loss that may be sold in order to take advantage of the associated tax benefit. This is the time for you to sell positions that may be used to offset taxable gains.

**Note:** Canada's tax rules require sellers to wait at least 30 days before repurchasing the same security in order to be able to claim the full amount of the Capital Loss.



## 2. Utilizing previous Realized Capital Losses:

The simplest remedy to offset Capital Gains is with realized Capital Losses within your portfolio. Capital Losses are generated by selling securities and/or mutual fund units for less than the cost at which they were acquired. If these losses are currently available, then they can be used to directly offset the capital gains generated from other stock in your portfolio. As a rule, Capital Losses do not expire and thus can be carried forward indefinitely and applied to offset Capital Gains generated in the future, or back to prior years.

## 3. Transferring Unrealized Capital Losses from spouse or common-law partner:

A more complex version of tax loss selling is using the Unrealized Capital Losses of a spouse or common law partner. This might be an attractive option if an individual does not have Capital Losses themselves. In short, to be able to access Capital Losses of a spouse (or a common law partner) the capital loss can be transferred by selling the security on the open market at fair market value, and then having your spouse reacquire the same security. Although a superficial loss will be triggered, your spouse will be able to use this loss on his/her own tax return. Given that the mechanics of this type of transaction has a higher degree of complexity and requires that certain conditions be met and adhered to, we strongly advise that you contact your own tax accountant/tax advisor for more details of this strategy in order to find out if this alternative is a suitable option for you.

## 4. Utilizing Future Capital Losses:

In the event that you have no Capital Losses to utilize, you should keep in mind that Capital Losses can be carried back three years to offset any capital gains in those years and recover some of the taxes already paid. Thus, if in the coming years you have Capital Losses, they can be carried back and used against the Capital Gain realized in the 2010 taxation year. It is important to note that dispositions of securities by individuals that are repurchased in their RRSP will be subject to the superficial loss rules.

Remember, in order to maximize any of the above-mentioned tax loss selling strategies, consider deferring sales of securities with gains until January 2012 (this strategy could also be used to defer tax in instances where there are no accumulated losses).

## Year End Securities Trading Considerations

- Final trade date for security transactions for Toronto trades is December 23, 2011.
- Final trade date for securities transactions through New York is December 27, 2011.
- Key: Settlement must take place not later than December 31st.
- Consider delaying the purchase of annual pay/accrual fixed income securities (e.g. 1 year T-Bill or annual pay GIC) until 2012, thereby deferring the taxation of the income by a year.
- Election to defer the income inclusion of stock option benefits must be filed with the individual's employer by January 15, 2012 (Form T1212).



## Registered Plans

- Deadline for 2011 RRSP contributions is February 29, 2012.
- **Reminder:** The annual contribution limit for 2011 is the lesser of 18% of 2010 earned income up to a maximum of \$22,450, less the Pension Adjustment for 2010. The 2010 Notice of Assessment will indicate the allowable amount along with any unused amounts from prior years.
- If the annuitant turns 71 in 2011, RRSPs must be terminated and, to avoid being fully taxable in 2011, converted to a RRIF and/or annuity by December 31.  
**Note:** Contributions to the plan must be made by December 31 (not 60 days after year end as the plan won't exist after this date). Where the individual still has contribution room, contributions can continue to be made to a spousal plan if the individual's spouse is not over 71 years of age.
- The RRSP limit for 2012 will be \$22,970.
- The over contribution limit is \$2,000. If this is exceeded the penalty is 1% per month.
- Residents of Canada aged 18 and older can save up to \$5,000 every year in a Tax Free Savings Account (TFSA). All income (interest, dividends and capital gains) earned in your TFSA is tax-free for life. You can withdraw from your TFSA at any time, for any reason and all withdrawals are also tax-free. Consider maximizing the remaining amount of contribution room for 2011 and take steps to make an additional \$5,000 contribution anytime after Jan 1<sup>st</sup> 2012 for the 2012 taxation year.  
**Note:** Withdrawals made from a TFSA in the year will be added back to your TFSA contribution room at the beginning of the following year. To calculate your TFSA contribution room use the [TFSA Contribution Room Calculator](#).
- Contribute to Registered Education Savings Plans (RESPs) no later than December 31 to maximize the income deferral and benefit from the Canada Education Savings Grant (20% of contribution to maximum of \$500 per year if beneficiary is under 18).  
**Note:** The maximum lifetime contribution limit is \$50,000 per beneficiary.

## Personal Payments

- Final tax installment payment for 2011 is December 15.
- Remember: In addition to non-deductible interest on late or deficient installments (currently 5%), if your installment interest charges are more than \$1,000 the penalty is calculated by first determining which is higher, \$1,000 or one-quarter of the installment interest. Then, the higher amount is subtracted from the installment interest and the difference is divided by two.
- Interest on intra-family loans (generally at the prescribed rate) must be paid by January 30, 2012 to avoid income attribution. Consider new arrangements while the prescribed rate is low – currently 1%
- Charitable donation payments must be made before the end of the year. The maximum annual claim is 75% of net income. Unused amounts can be carried forward up to five years. Where publicly listed shares are donated, the gain is no longer taxable.
- Eligible medical expenses can be claimed for any 12 month period ending in the calendar year. Only amounts in excess of the lesser of 3% and \$2,052 are eligible.



- **Note:** When claiming medical expenses for a deceased person, it may help to adjust the prior year tax return to remove medical expenses regarding that person, and claim them on the year of death tax return.
- A reminder that parents of children under the age of 16, are entitled to a non-refundable tax credit of up to \$500 for each child registered in an eligible program of physical activity.
- Other payments that must be made by December 31 to be considered in the 2011 tax return include:
  - Investment management & custody fees
  - Loan interest
  - Safety deposit box
  - Alimony/maintenance payments
  - Political contributions
  - Tax shelter payments
  - Moving expenses
  - Tuition fees
  - Child care
  - Professional fees
  - Review family trusts for any action that's required by December 31 2010.

### Flow -Through Shares - Tax Benefits

Flow-through shares are special securities issued by Canadian resource companies – typically juniors or intermediates -- to encourage exploration and development of oil, gas, or mining resources. A variety of federal and provincial tax incentives encourage companies to engage in exploration and development of resources by allowing a full deduction of expenses against income. With most early stage projects, companies do not have income to deduct against. Companies may, however, renounce these tax benefits and “flow through” the deductions to investors in the form of flow-through shares.

Flow-through shares come in a variety of formats. Flow-through shares may be purchased individually, or through limited partnerships that convert into mutual funds within one or two years. There are additional federal and provincial tax credits available to certain issues of flow-through shares that may increase the investor's tax savings to above the highest marginal tax rate. These issues are known colloquially as “super” flow-through shares.

Investors are able to use the deductions associated with the flow-through shares against other income. As a result, investor's tax cost base is reduced by the deducted amount, typically the full amount of the investment. The result is the full value of the share is considered a capital gain. This capital gain is eliminated if the securities are donated to charity.

### Transit Pass Tax Credit

A non-refundable tax credit is issued for the cost of public transit passes (yearly, monthly, weekly and cost-per-trip electronic cards) provided that certain conditions are met. The amount claimed is multiplied by the lowest personal income tax rate for the year (currently 15%) and then deducted from the amount of taxes otherwise payable.



## Mutual Fund Purchases

Defer the purchase of non-registered mutual fund units near the year-end to avoid having to report year-end distributions.

## U.S. Persons and Considerations to Holding Canadian Mutual Funds

**Individuals resident in Canada with various ties to the U.S. may be affected by some recent U.S. tax initiatives relating to US persons owning Canadian mutual funds**

We wish to draw your attention to some of these changes and encourage you to seek professional, independent cross-border tax advice if you think you may be affected.

### Recent Changes in U.S. Tax Legislation

As background, the U.S. imposes tax on U.S. Persons (U.S. citizens, residents and green card holders) on their worldwide income, regardless of where they live. As a result, U.S. persons have annual U.S. income tax filing and reporting requirements regardless of their country of residence or how little time they spend in the U.S., even if they have no U.S. tax liability to pay.

### Passive Foreign Investment Corporations (PFICs)

Recent changes to U.S. tax legislation require U.S. Persons who are shareholders of “Passive Foreign Investment Corporations” (referred to as PFICs) to file an annual report (in addition to their U.S. income tax return) containing information required by the U.S. Internal Revenue Service (IRS) and impose additional U.S. taxes on PFICs held in a tax year. **All Canadian mutual funds (including Canadian Exchange Traded Funds) are caught by these revised PFIC rules.**

These changes are a result of the IRS taking the position that a Canadian mutual fund should, on a go forward basis, be classified as a corporation rather than a trust for U.S. tax purposes, despite the fact that many Canadian mutual funds are classified as trusts for Canadian tax purposes.

In previous years, there was only a U.S. reporting obligation with respect to PFICs if you were reporting a distribution from a PFIC, sold shares of a PFIC, or were making certain elections in respect of the PFIC. **This new reporting obligation can arise solely from holding a Canadian mutual fund. As a result, U.S. Persons who are holders of Canadian mutual funds may be subject to the PFIC rules and penalties.**

**Given the above noted potential U.S. tax consequences for U.S. Persons residing in Canada holding Canadian Mutual Funds, careful consideration of these new rules should be factored into the analysis of whether a Canadian mutual fund is a desirable investment from a U.S. tax perspective for an individual who is a U.S. Person. Please consult your U.S. tax advisor for more information and guidance, after which, your Advisor would be pleased to discuss with you any changes you may wish to make regarding your current investments.**



## Non-deductible Interest on Your Loans

If you have investments outside a RRSP or RRIF, consider liquidating some of the investments (calculating the tax cost first) and use the proceeds to pay down the debt. Then re-borrow to replace the investments.

**Note:** Be aware of the Superficial Loss Rules before embarking on this strategy. Canada's tax rules require sellers to wait at least 30 days before repurchasing the same security in order to be able to claim the full amount of the capital loss.

## Allocating Pension Income to Your Spouse

You are able to allocate up to one-half of your income that qualifies for the existing pension income tax credit to your resident spouse/common-law partner. This may result in greater after tax income from your retirement plans.

## Pension Eligible Income Will Vary Depending on Age

### *For people age 65 and older*

Eligible Pension Income: includes payments from a registered pension plan (RPP – a pension from an employer-sponsored defined benefit plan or a defined contribution plan), income from a registered retirement savings plan (RRSP) annuity, a registered retirement income fund (RRIF), a LIF (a locked-in RRIF), or a deferred profit sharing plan (DPSP) annuity.

### *For individuals younger than 65*

Eligible Pension Income: includes only payments from a registered pension plan (RPP – defined benefit or defined contribution).

**Note:** Ineligible Pension Income: includes guaranteed income supplement (GIS), old age security (OAS), RRSP withdrawals and income from retirement compensation agreements (RCAs).

## Estate Planning

Do you need to update your Will? Do you know what taxes your estate will be burdened with upon your death? Why wait to make it a New Year's resolution to get your estate planning in order. Take the initiative now and consult with your legal advisor.



## Tax Implications after Death

### When is the due date for the final tax return and any balance owing?

The deceased's final return and any balance owing are due on or before the following dates:

- If the period when death occurred is January 1 to October 31, the due date is April 30 of the following year
- If the period when death occurred is November 1 to December 31, the due date is six months after the date of death

**Note:** The due date for filing the T1 return of a surviving spouse or common-law partner who was living with the deceased is the same as the due date for filing the deceased's final return indicated above. Any balance owing on the surviving spouse's or common-law partner's return still has to be paid on or before April 30 of the following year to avoid interest charges.

If the deceased or the deceased's spouse or common-law partner was carrying on a business during the year when the death occurred, the following filing due dates apply:

- If the period when death occurred is January 1 to October 31 the filing due date is June 15 of the following year, although any balance owing is still due on April 30 (the balance due date)
- If the period when death occurred is November 1 to December 15 the filing due date is June 15 of the following year, although any balance owing is still due six months after the date of death (the balance due date)
- If the period when death occurred is December 16 to December 31 the filing due date and the balance due date is six months after the date of death

If you file the final return late and there is a balance owing, a late-filing penalty will be charged. If you do not pay the balance owing from the final return in full by the balance due date (whether April 30 of the following year or six months after death of the individual, as applicable), interest on the unpaid amount will be charged. The interest will start to accumulate from the day after the balance due date.

### Previous year return

If a person dies after December 31, but on or before the filing due date for his or her return (usually April 30), and that person had not yet filed that return, the due date for filing it, as well as for paying the balance owing, is six months after the date of death. The filing due dates for previous year returns that are already due but which the deceased had not yet filed, remain the same.



## Stock Option Deferral (A Reminder)

### Employee Stock Options

The 2010 federal budget amended the taxation of stock options. Prior to the Federal budget announcement, employees of publicly-traded companies could have elected to defer tax on up to \$100,000 of employee stock option benefits vesting in a particular year. The budget repealed this tax deferral election for employee stock options exercised after 4:00 p.m. (EST) on March 4, 2010.

The 2010 budget also clarified that employers are required to withhold and remit an amount in respect of the tax on the employment benefit associated with the issuance of a security. This measure does not apply to options granted before 2011 that were documented under a written agreement entered before 4:00 p.m. (EST) on March 4, 2010 where the agreement included restrictions on the optioned securities' disposition.

The 2010 budget also proposed a special election to ensure that the tax liability on previously deferred stock option benefits do not exceed the proceeds from the shares' disposition. As of 4:00 p.m. (EST) on March 4, 2010, the employee stock option deduction of one-half of the employment benefit can only be claimed where the employee exercises his or her options by acquiring securities from their employer. Previously, where employees disposed of their stock option rights for cash, the employment benefit could be eligible for the stock option deduction while the cash payment was fully deductible to the employer. Employers may continue to allow employees to cash out their stock option rights and claim the deduction, provided the employer makes an election to forgo the deduction for the cash payment.

### Tax Shelters

Tax shelters are by their very nature a known means of reducing income taxes. More importantly as the year end approaches, many of these shelters are aggressively marketed to many Canadians. The most important aspect of a tax shelter is the quality of the product and not the immediate tax savings that may be had. Thus before making any decisions about investing in a tax shelter, no matter how simplistic they seem and no matter how enticing they are, you should consult with your own tax professional before doing so.

### Corporate Planning Opportunities

If you are an owner/manager of a Canadian private corporation, there are some planning opportunities uniquely available to you.

### Shareholder Loans

Shareholder loans not repaid before the year-end may result in the full amount of the loan being fully taxable on your 2011 tax return. If the loan was made to help with the purchase of a home, automobile for work, or corporate shares an exemption would apply.





## \$ 750,000 Capital Gains Exemption (LCGE)

Shares of a qualified small business corporation, fishing property and farm property (including shares of a corporation or partnership interest) still qualify for the lifetime capital gains exemption. This exemption has been increased from \$500,000 to \$750,000 for taxable capital gains after March 18, 2008. You should consult with your own tax advisor/professional since if you have any outstanding cumulative net investment loss (CNIL) or active business investment losses (ABIL) may affect the amount and use of the capital gains exemption.

## Allowable Business Investment Loss (ABIL)

If you have an ABIL, you will be able to reduce your overall taxable income. An ABIL is simply a loss on shares and/or debt you own of a small business corporation. The benefit of an ABIL versus a capital loss is that an ABIL can be used to reduce one's overall income as opposed to a capital loss that can only be used to reduce capital gains.

Be mindful that the administration, paperwork and requisite documentation including the overall financial details must be in place prior to claiming the ABIL on your tax return. As with most tax filings, prudent preparation and planning will go a long way to ensuring that the ABIL is claimed properly on your tax return and readily accepted by CRA.

## Salary

Review with your tax advisor on the optimal mix of salary, bonus and dividends for you (and if applicable) other family members for 2011 taxation year. Pay a reasonable salary to a spouse or child who is in a lower tax bracket that provides services to your business.

## Business Income Reserve

If you sold goods in 2011, but don't receive the proceeds of the sale of those goods until after the end of the year, you may be in a position to claim a reserve over a maximum of three years.

## Capital Gains Rollover

If you sold or will be selling eligible small business investments in 2011, invest the proceeds in other eligible small business investments by April 30, 2012 to be eligible to defer all or part of the capital gain.

**\* Please Note\* It is strongly recommended that you engage your own tax advisor/accountant to review the above-noted corporate planning considerations before strategically engaging in the implementation of any of them.**

The commentary and/or information provided herein should not be construed as legal or tax advice. Clients are strongly encouraged to seek the expertise of independent professionals, such as tax, legal and accounting experts prior to the final implementation of any strategy. Only after a diligent analysis of the client's needs, objectives and financial position and tolerance for risk can an appropriate recommendation be made.

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