2014 Year End Tax Tips

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As year end approaches, here's our updated, annual look at some year-end tax tips you may wish to keep in mind as we enter the final weeks of 2014.

1. 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 capital losses that cannot be used currently may either be carried back three years or carried forward indefinitely to offset capital gains in other years. Note that 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. In order for your loss to be immediately available for 2014 (or one of the prior three years), the settlement must take place in 2014, which means the trade date must be no later than December 24, 2014.

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 the benefit of the capital loss can only be obtained when the repurchased security is 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 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.

2. Use a prescribed rate loan for income-splitting

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 the end of 2014. 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, 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 $49,285 of eligible dividends in 2014 without paying any tax, other than in the provinces of Manitoba, P.E.I., Quebec 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 can benefit from income splitting throughout the upcoming year and for many years to come.

3. Retirement considerations

Convert your RRSP to a RRIF by age 71

If you turned age 71 in 2014, 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 2014 that will generate RRSP contribution room for 2015. While you will pay a penalty tax of 1% on the overcontribution (above the $2,000 permitted overcontribution limit) for December 2014, new RRSP room will open up on January 1, 2015 so the penalty tax will cease in January 2015. You can then choose to deduct the overcontributed amount on your 2015 (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 2014 to make contributions to a spousal RRSP until the end of the year your spouse or partner turns 71.

Canada Pension Plan (CPP) / Quebec Pension Plan (QPP) Retirement Benefits

If you are between ages 60 and 64 in 2014 and are considering taking CPP/QPP pension benefits prior to age 65, you may wish to apply by December 31, 2014. If you start CPP (QPP) benefits in 2014, your pension will be reduced by a "downward monthly adjustment factor" of 0.56% (up to 0.53% for QPP) for each month before age 65 that you began receiving it. Starting in 2015, however, the downward monthly adjustment factor will increase to 0.58% (up to 0.56% for QPP), thus decreasing your CPP or QPP pension.

4. Review asset allocation

Non-registered Investments

Year end is an excellent time to review the types of investments that you hold, and the accounts in which you hold them. In non-registered accounts, Canadian dividends are still taxed more favourably than interest income due to the dividend tax credit; however, in all provinces except Alberta, the highest marginal tax rate on eligible dividends exceeds the highest marginal tax rate on capital gains. Consider whether tilting a non-registered portfolio towards investments that have the potential to earn capital gains is the right move for 2015.

Registered Investments

RRSP Contributions

Although you have until March 2, 2015 to make RRSP contributions for the 2014 tax year, contributions made as early as possible will maximize tax-deferred growth. If you have maximized RRSP contributions in previous years, your 2014 RRSP contribution room is limited to 18% of income earned in 2013, with a maximum contribution of $24,270, less any pension adjustment.

Budget 2014 proposes to allow income that is contributed to an amateur athlete trust in 2014 to qualify as earned income for the purpose of determining the athlete's RRSP contribution limit. In addition, an election is available so that income contributed to an amateur athlete trust in the 2011, 2012, and 2013 taxation years may also qualify as earned income and be added to the individual's RRSP contribution room for 2014. The election must be made by March 2, 2015.

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 2015, rather than late in 2014.

TFSA Contributions

There is no deadline for making a TFSA contribution. If you have been over age 18 and resident in Canada since at least 2009, you can contribute up to $31,000 to a TFSA in 2014 if you haven't previously contributed to a TFSA.

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 to correct an overcontribution. But be careful, 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 over-contribution problem.

If you are planning a TFSA withdrawal in early 2015, consider withdrawing the funds by December 31, 2014, so you would not have to wait until 2016 to re-contribute that amount.

5. Contribute to an RESP & RDSP

Registered Education Savings Plans (RESPs)

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 up 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. $1,000 ÷ 20%) are made for just over seven years, the maximum total CESGs of $7,200 will be obtained. If you have less than seven 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 in 2014 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 2014. Consider making a contribution by December 31, 2014 to receive the current year's CESG and create CESG eligibility for 2015 and 2016.

If your child (or grandchild) is an RESP beneficiary and attended a post-secondary educational institution in 2014, 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 tax-free.

If your child (or grandchild) is an RESP beneficiary and stopped attending a post-secondary educational institution in 2014, 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.

Registered Disability Savings Plans (RDSPs)

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, although this may be less of a priority since unused CDSG and CDSB room can be carried forward for up to 10 years.

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 2014.

6. Certain payments must be made by December 31

Charitable donations

December 31 is the last day to make a donation and get a tax receipt for 2014. Keep in mind that many charities offer online, internet donations where an electronic tax receipt is generated and e-mailed to you instantly.

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 2014. You may also be able to 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 in any of the five preceding tax years, from 2009 to 2013. The FDSC provides an additional 25% tax credit on total monetary donations up to $1,000.

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.

Medical expenses

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).

Starting in 2014, two new items have been added to the list of medical expenses that are eligible for a tax credit. The first is amounts paid for the design and subsequent adjustment of an individualized therapy plan, provided that the cost of the therapy itself would be eligible for the METC. This could include applied behaviour analysis (ABA) therapy for children with autism, assuming certain conditions are met. The second new eligible expense is for service animals specially trained to assist an individual in managing their severe diabetes.

Other expenses

Certain expenses must be paid by year end to claim a tax deduction or credit in 2014. This includes investment-related expenses, such as interest paid on money borrowed for investing and investment counseling fees for non-RRSP/RRIF accounts. As of 2014, fees for safety deposit box rentals are no longer deductible. Other expenses that must be paid by December 31st include child-care expenses, medical expenses, interest on student loans and spousal support payments.

Prepayments

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 $2,171 in 2014. If your medical expenses will be less than this minimum threshold, consider prepaying expenses that you would otherwise pay in 2015. For example, if you expect to pay monthly instalments for your child's braces in 2015, consider paying the full amount up front in 2014 if it will raise total medical expenses over the threshold.

Prepayments can also be used for expenses that qualify for the children's fitness tax credit and the children's arts credit, each based on up to $500 of qualifying expenses. For example, if you plan to enroll your child in baseball or guitar programs for 2015, you can claim the credit(s) in 2014 if you pay for the activities by December 31.

Accelerate purchase of 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 be planning to purchase in 2015. Under the "half-year rule", you are permitted to deduct one half of a full year's tax depreciation (capital cost allowance) in 2014, even if you bought it on the last day of the year. For 2015, you can then claim a full year's depreciation.

7. Ontario individuals with income over $150,000

The 2014 Ontario Budget introduced higher tax rates for certain high-income individuals. The combined federal/provincial tax rate for 2014 increased 1.56 percentage points (from 46.41% to 47.97%) with income between

$150,000 and $220,000, and increased 3.12 percentage points (from 46.41% to 49.53%) with income between $220,000 and $514,090. For example, with income over $514,090 in 2014, the additional taxes could exceed $10,000.

Unfortunately, some employers have been unable to modify their payroll systems to account for the change. If you have income between $150,000 and $514,090 and are employed by one of these employers, you may not have sufficient income tax deductions withheld from your paycheques. This could be especially true if you receive a year-end bonus by December 31.

If you have income between $150,000 and $514,090 and are required to make income-tax instalment payments in 2014, perhaps because you are self-employed, you may find that your instalments are not sufficient to fully meet your tax liability.

If you fall into one of these categories, you should review the income tax that has been withheld or paid by instalments versus your expected 2014 income-tax liability. If there is a deficiency, you should ensure you set aside funds to pay any additional taxes owing by April 30, 2015. Even if your tax return isn't due until June 15, 2015, perhaps because you or your spouse were self-employed in 2014, you must still make your payment by the April 30 deadline.

Conclusion

These tips highlight just a few of the ways you can act now to benefit from tax savings when you file your 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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