

Top 10 Tax Tips

By Jamie Golombek

With tax season now officially well underway, there are several tax strategies that you can implement now for the 2008 tax return filing and to get a head start for the 2009 tax year.

Tips for your 2008 Return

1. File on time

This year, most Canadians must file their tax returns by Thursday, April 30th, 2009. If you or your spouse or common-law partner were self-employed in 2008, you have a bit more time to file as your returns are due on June 15. But, any taxes owing for 2008 must still be paid by April 30th.

If you file your return late, there is an automatic 5% penalty on the amount of tax unpaid, plus an additional 1% per month penalty on the amount due each month the return is late, up to a maximum of 12%. Late filers are also subject to arrears interest.

If you have filed late in previous years, and have been assessed a late-filing penalty in any of the prior three years, the penalties double to 10% of the unpaid amount plus a 2% penalty for each late month to a maximum of 20 months. Fortunately, this higher penalty is only charged if you have also received a formal demand to file from the Canada Revenue Agency.

However, if you fail to pay the required amount of tax owing on time, but your return is filed on time, you will only be subject to arrears interest. The interest, which is not tax deductible, is compounded daily and charged at the CRA's prescribed interest rate. (Q2 2009 - 5 %.)

What if you are owed a refund?

It is still a good idea to file on time, just in case your return is audited and reassessed by the CRA, turning what was originally a tax refund into an amount owing. In that situation, late filing of the return would attract the penalties and interest discussed above.

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Tips for your 2008 return

1. File on time
2. Report all capital losses
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5. File tax returns for minors

Tips for 2009

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7. Consider renovating your home
8. Contribute to an RRSP/TFSA/RESP/RDSP
9. Convert non-deductible debt to tax deductible debt
10. Consider a spousal loan strategy

What if you don't have the cash to pay by April 30th?

The CRA may be willing to accept a payment arrangement from you, but only after you demonstrate to them that you have made a reasonable effort to try to obtain the cash by either borrowing or rearranging your financial affairs.

To make such an arrangement, contact your local tax services office to discuss an acceptable payment plan. Note, however, that daily compounded interest will continue to accrue on any taxes owing, beginning May 1, until you pay your balance in full.

2. Report all capital losses

Under our tax system, capital losses from the sale of stocks, bonds, mutual funds or other securities can only be deducted against capital gains. They can also be used to offset any capital gains distributions from mutual funds.

Be sure to report all your capital losses, even if you can't use them in 2008. While a capital loss must first be applied against any capital gains in the current year, the balance of the loss may either be carried back to offset capital gains in any of the three prior years (2005, 2006 or 2007) or carried forward indefinitely to offset capital gains in future years.

The procedure to carry back a loss from 2008 to a prior year is straightforward. You would simply complete and file CRA Form T1A "Request for Loss Carryback," which is available on the CRA's Web site and included in most tax preparation software packages. On this Form you would select the year(s)

in which to apply the 2008 capital loss and the CRA will reassess those years' returns and refund any taxes paid on those capital gains.

While it's generally advisable to carry back the loss first against 2005 capital gains as they will "fall off the table" in 2009, the decision may also depend on your tax rate in 2005 as compared to your tax rate in 2006 and/or 2007.

3. Claim Charitable donations

All donations under \$200 are credited at 15% federally, plus between 4% to 11% provincially while donations over the \$200 threshold are eligible for a 29% federal credit plus 11% to 21% provincially (ignoring additional provincial surtax savings, where applicable).

If you're married or have a common-law partner, you can pool your donations when you file your tax return. This allows you take advantage of the higher donation credit faster.

Also, if you've donated shares, mutual funds or other publicly traded securities to charity in 2008, not only are you entitled to a donation tax credit for the fair market value of the securities you donated, but you won't have to pay any capital gains tax on the appreciated value of the share donated. Be sure to complete Form T1170, "Capital Gains on Gifts of Certain Capital Property" to report (and exempt) those gains.

4. Look into pension splitting

If you received pension income in 2008, you may wish to split up to half of your pension with your spouse or partner. Note that no physical splitting is required but rather it is simply a notional split that is accomplished by electing in each spouse's or partner's tax return (using CRA Form T1032, "Joint Election to Split Pension Income") the amount that is desired to be deducted from the person that actually received the pension income and included in the income of his or her spouse or partner.

Naturally, since the pension income being transferred will increase the transferee's own tax payable, both spouses and partners must specifically agree to the allocation in their tax returns for the year. (Both the agreement and amount can be changed from year to year.)

If you're 65 years or older, the main types of qualifying pension income that can be transferred to a spouse's or common law partner's return are:

- pension income from a defined benefit or defined contribution registered pension plan;
- income from a Registered Retirement Savings Plan (RRSP), as long as it has first been converted to an annuity; and
- Registered Retirement Income Fund (RRIF) withdrawals (including Life Income Funds).

If you're under age 65, the list is far more restrictive, essentially only including income from a Defined Benefit or Define Contribution pension plan.

Aside from benefiting from your spouse or partner's lower rate of taxation, pension income splitting may allow you and your spouse or partner to double up on the \$2,000 federal pension credit, preserve some or all of the age credit and reduce or even avoid the Old Age Security benefits clawback.

5. File tax returns for minors

Minors with earned income from part time jobs, or even casual employment such as babysitting or yard work, should file tax returns to begin establishing RRSP contribution room for use in future years.

It's also a good idea to file returns for kids for which you have "in-trust" or informal trust accounts. In such cases, a parent opens up an account at a financial institution, and no formal trust deed is drawn up. The money in these accounts is typically invested in equity mutual funds, which generate little if any income, but produce capital gains. Those gains are not attributed back to the gift or under an exception to the normal attribution rules.

Assuming the minor child has income below the basic personal amount for 2008 or \$9,600, he or she would not have to pay tax on the capital gains.

Filing a return establishes a good paper trail with the CRA that may help prove that the in-trust account is truly the child's as opposed to the parents' account.

Tips for 2009

6. Plan not to receive a refund

You may find this hard to believe, but if you are anticipating a tax refund this spring, that's a sure sign of poor tax planning. You've essentially loaned your hard-earned money to the government, interest-free for up to sixteen months.

A tax refund typically arises when the amount of tax owing on your return is less than the amount of tax withheld from your income during the year.

Employment income is the most common type of income from which tax is deducted at source. The amount of tax withheld by your employer is calculated without taking into account various deductions or credits normally claimed, such as RRSP contributions or child-care expenses or charitable donations, all of which ultimately reduce your taxes payable.

Fortunately, by taking advantage of the "undue hardship provision" under the Income Tax Act, it's possible to get your tax refund throughout the year, on every paycheque, instead of waiting until your return is filed the following spring

To apply, simply complete the Canada Revenue Agency's one-page Form T1213, "Request to Reduce Tax Deductions at Source." On this Form you indicate the various deductions or credits that, if not taken into account, would otherwise result in a tax refund for the year.

This Form is then sent to your local CRA tax services office for approval. If approved, the CRA will send you a letter of authority, which must be given to your employer, allowing the employer to begin deducting less tax at source.

7. Consider renovating your home

For 2009 only, individuals will be able to claim a 15-per-cent non-refundable tax credit, known as the temporary Home Renovation Tax Credit (HRTC), for eligible expenditures made in respect of their homes.

The credit applies to any expenditure above \$1,000 and up to \$10,000. As a result, the value of this new federal credit is equal to a maximum of \$1,350 ($[\$10,000 - \$1,000] \times 15\%$).

Only expenditures made after January 27, 2009 and before February 1, 2010, will be eligible for the 2009 credit.

As with various other credits, eligibility for the HRTC is family-based. For this purpose, a family will consist of an individual and his or her spouse or common-law partner (if applicable) and any children under age 18.

While only one family member will likely claim the entire credit, it can be shared among family members if necessary, perhaps where it cannot be fully utilized by one individual. The total amount claimed, however, cannot exceed \$1,350 per family, no matter how it is allocated.

If more than one family (as defined above) shares the ownership of one property, they can each claim the credit. For example, two sisters living together in a co-owned property, who each contribute at least \$10,000 towards renovating their shared kitchen could each claim their own \$1,350 credit.

What if you rent part of your home?

You can still claim the credit for the full amount of any expenditure made in respect of the personal-use portion of the home.

For common-area expenses that benefit the home as a whole, such as a new roof, an allocation of the amount spent between business and personal may be required.

What expenses qualify?

Expenditures that qualify include any expenditure that is "incurred in relation to a renovation or alteration, provided that the renovation or alteration is of an enduring nature and is integral to the eligible

dwelling". This would include both the cost of labour and professional services, as well as building materials, fixtures, equipment rentals, and permits.

Examples of non-qualifying expenses include the cost of routine repairs and maintenance that are generally done on annual (or more frequent basis) as well as appliances, furniture, drapery or audio-visual electronics. Also specifically excluded is interest expense associated with financing that renovation.

One final restriction meant to prevent potential abuse: expenditures won't be eligible if they are provided by a non-arm's length person, unless that person is legally registered for GST/HST purposes.

All eligible expenditures must be supported by receipts.

8. Contribute to an RRSP / TFSA / RESP / RDSP

Canadians now have up to four special plans in which to invest in a tax-deferred manner (or tax-free in the case of TFSAs): a Registered Retirement Savings Plan, the new Tax-Free Savings Account, a Registered Education Savings Plan, and the Registered Disability Savings Plan.

Registered Retirement Savings Plans

For Canadians with earned income, why not get a head start on your 2009 RRSP contribution. Your limit for this year is equal to 18% of your 2008 earned income less any pension adjustment, up to a maximum of \$21,000.

Tax Free Savings Accounts

If you still haven't opened up a TFSA, now is the time. The TFSA lets investors set aside money after-tax in eligible investments which can earn income and/or grow tax-free for life. The TFSA limit for 2009 is \$5,000 for anyone age 18 or older. Withdrawals from a TFSA are tax-free and re-establish contribution room beginning the following calendar year.

For more information on TFSAs, see my Special Report, "[Tax Planning with TFSAs.](#)"

Registered Education Savings Plans

RESPs continue to be the number one way for investors to save in a tax-deferred manner for post-

secondary education. The addition of government grants and bonds provide additional incentives to save. If you've never opened up an RESP before, consider contributing as much as \$5,000 to an RESP for each child under 18 in order to collect both last year's and this year's Canada Education Savings Grants.

Registered Disability Savings Plans

The new RDSP is a tax-deferred savings plan that allows a disabled person who is 59 years of age or younger (and qualifies for the disability tax credit) to save up to \$200,000 in a tax-deferred account. Parents and other qualified individuals may also be able to contribute to the plan on a disabled person's behalf.

For beneficiaries age 49 and younger, generous government assistance is available in the form of a matching grant, known as the Canada Disability Savings Grant (CDSG) and the Canada Disability Savings Bond (CDSB). Note that both the grant and bond are income-tested.

For more information on RDSPs, see my Special Report, "[Planning with RDSPs.](#)"

9. Convert non-deductible debt to tax deductible debt

Consider making your interest expense tax-deductible by paying off non-deductible debt with non-registered funds and then borrowing back for investment purposes.*

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 potentially making the interest on the loan tax-deductible.

10. Consider a spousal loan strategy

Income splitting is the transferring of income from a high-income family member to a lower-earning spouse or, in some cases, a "no-income" family member, to reduce the overall tax burden of the family.

Since our tax system has graduated tax brackets, by having the income taxed in the lower income-earner's hands, the overall tax burden of the couple can be reduced.

Unfortunately, complex rules in the Income Tax Act attempt to block the splitting of income between spouses or partners by requiring any income, as well as capital gains earned on money transferred or gifted to a spouse, to be "attributed" or taxed back to the "transferor" spouse.

In other words, if high-income earner Jill gives money to her lower-income earning husband, Jack, to invest, any income earned or capital gains realized upon the sale of these investments are taxed back to Jill -- even if the investments are legally registered in Jack's name.

But what if, instead of giving the money to Jack to invest, Jill loaned it to him using the spousal-loan strategy?

As long as interest is charged on the loan at the Canada Revenue Agency's prescribed rate, any investment return generated above the prescribed rate can be taxed in Jack's hands, at his lower tax rate.

As well, the interest paid on the loan by Jack to Jill is tax-deductible on Jack's return since it is being paid for the purpose of earning investment income.

Note that the interest must be paid by Jack by January 30 following each calendar year for this strategy to work. Failure to pay the interest by January 30th will cause the strategy to fail, not only for the first year but for all future years.

Couples who wish to split their investment income should hold off until at least April 1, 2009 to take advantage of the lowest prescribed rate in CRA history — 1% for the second quarter of 2009. That's because even though the prescribed rate varies by quarter and could ultimately rise, you need only use the prescribed rate in effect at the time the loan was originally extended.

For a complete, up to date list of quarterly prescribed rates, visit:

<http://www.cra-arc.gc.ca/tx/fq/ntrst-rts/menu-eng.html>



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Disclaimer:

As with all planning strategies, you should seek the advice of a qualified tax advisor.

* Using borrowed money to finance the purchase of securities involves greater risk than a purchase using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same even if the value of the securities purchased declines.

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