

2016 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. As we enter the final weeks of 2016, here are some tax tips you may wish to consider for:

- Investors
- Families with children
- Students
- Teachers and early educators
- Charitable donors
- Business owners

INVESTORS

Tax-Free Rebalancing of Corporate Class Mutual Fund Investments before December 31st (new for 2016)

A Canadian mutual fund can be structured as either a trust or a corporation. Many mutual fund corporations are organized as “switch funds” and offer different types of asset exposure in different funds. Each fund, however, is structured as a separate class of shares within the same mutual fund corporation.

The benefit of the switch fund structure is that investors are able to exchange shares of one class of the mutual fund corporation for shares of another class, in order to switch their economic exposure among the mutual fund corporation’s different funds, without triggering a disposition for tax purposes.

Under the current tax rules, the exchange from one class of shares to another is deemed not to be a disposition for income tax purposes, allowing investors to take advantage of this rule and rebalance their portfolios on a tax-deferred basis. This deferral benefit is not available to taxpayers investing in mutual fund trusts or investing on their own account directly in securities.

This year’s federal budget announced a change, which will be effective January 1, 2017, such that a switch within the mutual fund corporation from one class of shares to another will result in a disposition for tax purposes at fair market value. Where the switch occurs between different series of the same class, where the underlying portfolio does not change but merely the fees or expenses differ, the switch will continue to occur on a tax-deferred basis.

This measure will apply to switches after December 31, 2016, meaning that investors have just a few weeks to continue to take advantage of the current rules and rebalance their mutual fund corporation portfolios on a tax-deferred basis before the new rules take effect on January 1, 2017.

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 2016 (or one of the prior three years), the settlement must take place in 2016, which means the trade date must be no later than December 23, 2016.

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. The decline in the value of the Canadian dollar may increase capital gains or decrease capital losses, or, in some cases, turn what looks like a loss into a gain.

For example, Sam 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. = \$1.31 CDN, selling the U.S. shares for US\$9,000 yields \$11,790 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 \$1,790 (\$11,790 — \$10,000) for Canadian tax purposes. If Sam 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 2016!

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, 2017, to make RRSP contributions for the 2016 tax year, contributions made as early as possible will maximize tax-deferred growth. If you have maximized RRSP contributions in previous years, your 2016 RRSP contribution room is limited to 18% of income earned in 2015, with a maximum contribution of \$25,370, less any pension adjustment.

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 2017, rather than late in 2016.

Make TFSA Contributions

The TFSA dollar limit for 2016 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 \$46,500 to a TFSA in 2016 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 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 2017, consider withdrawing the funds by the 31st of December, 2016, so you would not have to wait until 2018 to re-contribute that amount.

Pay Investment Expenses

Certain expenses must be paid by year end to claim a tax deduction or credit in 2016. 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 2016, 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 2016 that will generate RRSP contribution room for 2017. While you will pay a penalty tax of 1% on the overcontribution (above the \$2,000 permitted overcontribution limit) for December 2016, new RRSP room will open up on January 1, 2017 so the penalty tax will cease in January 2017. You can then choose to deduct the overcontributed amount on your 2017 (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 2016 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 2016. 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 2016 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.

Consider Upcoming Life Insurance Changes (new for 2016)

There will be some changes to the tax treatment of permanent life insurance policies, which are sometimes used for investment purposes, issued after 2016. Life insurance policies issued in 2016 will continue to be covered by the existing rules, including term insurance policies converted to permanent insurance policies in 2016.

FAMILIES WITH CHILDREN / STUDENTS

Children's Fitness and Arts Credits (final time in 2016)

This year is the final year that you can claim two popular federal credits for your children's activities. The non-refundable children's arts credit is based on up to \$250 of qualifying expenses, and the refundable children's fitness tax credit is based on up to \$500 of qualifying expenses.

If you won't be spending enough in 2016 to maximize these credits, consider prepaying these expenses for 2017. For example, if you plan to enroll your child in soccer or piano programs for 2017, you can claim the credit(s) in 2016 if you pay for the activities by December 31.

Education and Textbook Amounts (final time in 2016)

The education and textbook tax credits will also be eliminated as of January 1, 2017. The tuition tax credit, however, will continue. The education amount is a non-refundable federal credit worth 15% of \$400 for each month of full-time post-secondary education or \$120/month for each month of part-time schooling. The textbook amount is a similar credit that is only available if you can claim the education amount, which is worth 15% of \$65/month of full-time post-secondary attendance or \$20/month of part-time schooling.

If the student does not have sufficient income to use the credits in the year of attendance, up to \$5,000 can be claimed by the student's spouse or partner, or supporting parent or grandparent. The carryforward rules will continue to apply so that any remaining amount that arose prior to 2017 can be carried forward for use by the student in a future year.

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 2017 and 2018.

Take RESP Withdrawals for Students

If your child (or grandchild) is an RESP beneficiary and attended a post-secondary educational institution in 2016, 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 2016, 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 2016 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 (new for 2016)

The 2015 federal budget introduced a new non-refundable Home Accessibility Tax Credit (HATC), beginning in 2016, to assist seniors and those eligible for the disability tax credit with certain home renovations. Those entitled to the credit include not only the seniors and those eligible for the disability tax credit, but also many people related to such a person.

The tax credit will be 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 2016. A single expenditure may qualify for both the HATC and the medical expense tax credit, and both may be claimed.

Examples of expenditures that will qualify for this new tax credit include: the installation of grab bars, wheelchair ramps, and walk-in bathtubs and showers. Some expenses such as those for routine maintenance, household appliances, or those made with the primary intent of improving or maintaining the value of the property will not qualify.

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, although this may be less of a priority since unused CDSG and CDSB room can be carried forward for up to ten 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 2016.

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 \$2,237 in 2016. If your medical expenses will be less than this minimum threshold, consider prepaying expenses that you would otherwise pay in 2016. For example, if you expect to pay monthly instalments for your child's braces in 2017, consider paying the full amount up front in 2016 if it will raise total medical expenses over the threshold.

For medical expenses, it may be worthwhile to look for unclaimed expenses prior to 2016 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

December 31 is the last day to make a donation and get a tax receipt for 2016. 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 2016. 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 from 2008 to 2016. The FDSC provides an additional 25% tax credit on total monetary donations up to \$1,000.

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.

BUSINESS OWNERS

Purchasing new equipment

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 2017. Under the "half-year rule," you are permitted to deduct one half of a full year's tax depreciation (capital cost allowance) in 2016, even if you bought it on the last day of the year. For 2017, you can then claim a full year's depreciation.

Changes to ECE

Beginning January 1, 2017, eligible capital property (ECP) will be converted into a new class of depreciable property. An "eligible capital expenditure" (ECE) is an expense incurred by a business to purchase intangible rights or benefits for the purpose of earning income. It includes the cost of goodwill when a business is purchased but also includes the cost of certain intangible property such as customer lists and licenses, franchise rights and farm quotas of indefinite duration.

The 2016 federal budget announced the repeal of the ECP regime which will be replaced with a new capital cost allowance (CCA) class available to businesses and provide rules to transfer taxpayers' existing cumulative eligible capital (CEC) pools to the new CCA class.

Under the current ECP regime, 75% of an eligible capital expenditure is added to the CEC pool and is amortized at 7% annually.

Under the new rules, a new class of depreciable property for CCA purposes will be introduced and expenses that are currently added to the CEC pool (at a 75% rate) will be included in the new CCA class (at 100%), but with a reduced depreciation rate of 5% (vs. 75% of 7%). For the first ten years (until 2027), the depreciation rate of the new CCA class will continue to 7% for ECE incurred before January 1, 2017. CEC balances will be transferred to the new CCA pool as of January 1, 2017. All the existing normal CCA rules will apply.

Speak to your corporate tax advisor for advice on potential ECE planning prior to December 31, 2016.

TEACHERS AND EARLY EDUCATORS

School Supply Tax Credit (new for 2016)

Announced formally in the 2016 budget, the new Teacher and Early Childhood Educator School Supply Tax Credit is meant to compensate teachers and early childhood educators who often incur personal, unreimbursed costs to purchase teaching supplies to enhance the students' classroom learning environment.

The new tax break, for 2016 and future tax years, allows eligible educators to claim a 15% refundable tax credit for up to \$1,000 in qualifying school supply expenses each year. For the cost of supplies to qualify, employers will be required to certify that the supplies were purchased "for the purpose of teaching or otherwise enhancing learning in a classroom or learning environment." Educators should retain their receipts in case they need to be verified.

IF YOUR TAX RATE MAY CHANGE IN 2017

If you anticipate that your income tax rates will be substantially different in 2017, it may be worthwhile to shift income and expenses between 2016 and 2017, where feasible.

You may expect that your tax rate could increase in 2017 if, for example, you plan to return to work, or expect to receive deferred compensation or exercise stock options. Conversely, you may anticipate that your tax rate could decrease in 2017 if you plan to retire or if you received a bonus in 2016 that may not reoccur.

If you expect your income tax rate will increase in 2017, you may wish to realize income in 2016 by taking steps such as selling investments with a capital gain, exercising stock options or taking bonuses, where feasible, in 2016 rather than 2017. It may also make sense to defer deductible expenses until 2017 where possible. For example, in Newfoundland and Labrador, the top personal marginal tax rate will increase in 2017.

Conversely, if you expect your tax rate will decrease in 2017, you may 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 2017 rather than 2016.

CONCLUSION

These tips highlight various ways you can act now to benefit from tax savings when you file your 2016 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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