

2013 Year End Tax Tips

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*With December 31st fast approaching, 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 2013.***

1. Consider taking dividends in 2013, where possible

A corporation may distribute its after-tax income as dividends to shareholders, who then pay tax on the dividend income. An individual who receives dividends from a Canadian corporation may claim a dividend tax credit (DTC) that is meant to compensate for tax that was paid by the corporation. Two common types of dividends that an individual may receive from a Canadian corporation are eligible dividends and non-eligible dividends. Eligible dividends are paid from income that was taxed at high rates in a corporation, so these dividends are eligible for an enhanced DTC in an individual's hands. Non-eligible dividends are paid from income that was taxed at low rates in a corporation, so a lower DTC is available to individuals for these dividends. Canadian dividends received by an individual are first "grossed-up" (increased) to determine taxable income and then a DTC is allowed to reduce taxes payable.

Non-eligible dividends

Starting in 2014, the federal government will be changing the personal tax calculation for non-eligible dividends. As a result of changes to the gross-up rate and DTC rate on non-eligible dividends, the marginal tax rates on these dividends will be going up in 2014.

The top combined federal/provincial marginal tax rates for non-eligible dividends are expected to increase between 1.0 and 4.3 percentage points in 2014, depending on the province, as shown in Figure 1.

Figure 1 – Combined Federal/Provincial Top Marginal Tax Rates on Non-eligible Dividends in 2013 and 2014

Province	2013	2014	Increase in 2014
Alberta	27.7%	29.9%	2.2%
British Columbia	33.7%	38.0%	4.3%
Manitoba	39.2%	40.8%	1.6%
New Brunswick	33.1%	36.0%	2.9%
Newfoundland and Labrador	30.0%	31.0%	1.0%
Nova Scotia	36.2%	39.1%	2.9%
Ontario	36.5%	40.1%	3.6%
Prince Edward Island	38.6%	40.0%	1.4%
Quebec	38.5%	39.8%	1.3%
Saskatchewan	33.3%	35.3%	2.0%

This change can be particularly significant for business owners who are contemplating whether to distribute dividends from their corporations in 2013 or 2014. Income that can be distributed as non-eligible dividends (after paying corporate tax) includes business income that is subject to the small business deduction limit (\$500,000 federally and in most provinces), interest income and the taxable portion of capital gains. If you pay tax at the top marginal rate and can receive \$10,000 of non-eligible dividends in 2013, rather than 2014, you'll save between \$100 and \$430 of tax, depending on the province.

Ontario dividends

Ontario has announced that it will parallel the federal changes for non-eligible dividends in 2014. In addition, the *Ontario Economic Outlook and Fiscal Review 2013* contained proposals that would change the method for calculating the DTC in Ontario. Ontario levies a surtax when provincial income tax exceeds \$4,289 in 2013, which occurs with taxable income of at least \$69,959. For 2013, the Ontario surtax is calculated after deducting the DTC, such that the surtax effectively increases the amount of the DTC for taxpayers with higher incomes. Starting in 2014, the government has proposed that the Ontario surtax will be calculated before deducting the DTC, with consistent DTC rates being applied for all individual taxpayers.

Figure 2 shows the top marginal tax rates for eligible and non-eligible dividends in 2013 and 2014.

¹Tax rates in this report reflect combined federal and provincial marginal tax rates, including surtaxes where applicable, based on known rates as at November 8, 2013.

²For individuals with taxable income exceeding \$509,000 in 2013, Ontario has a Deficit-Fighting High-Income Tax Bracket that increases the marginal tax rates. The marginal tax rates include the effect of proposals in the *Ontario Economic Outlook and Fiscal Review 2013*.

Figure 2 – Combined Federal/Ontario Top Marginal Tax Rates on Dividends in 2013 and 2014

	Income from \$135,054 to \$509,000		Income over \$509,000	
	2013	2014	2013	2014
Eligible dividends	29.54%	29.52%	33.85%	33.82%
Non-eligible dividends	32.57%	36.45%	36.47%	40.13%

If you are an Ontario resident with taxable income exceeding \$135,000, tax rates for eligible dividends will be virtually consistent in 2013 and 2014; however, tax rates for non-eligible dividends are expected to increase by almost four percentage points in 2014. You should consider receiving non-eligible dividends in 2013, rather than 2014, where possible.

2. Plan for upcoming personal tax rate increases in British Columbia and New Brunswick

When tax rates are expected to rise in the future, it may make sense to take advantage of existing lower rates before the increase takes effect. In both British Columbia and New Brunswick, tax rates are slated to rise in 2014 for certain individuals.

For these provinces, affected individuals may wish to realize income in 2013 by taking steps such as selling investments with a capital gain, exercising stock options or taking bonuses, where feasible, in 2013 rather than 2014.

It may also make sense to defer deductible expenses until 2014 where possible. For example, you could claim a deduction for your 2013 RRSP contribution in 2014. By accelerating income and delaying deductions, you could save up to \$427 of tax for each \$10,000 of income that is accelerated or deductions that are deferred.

British Columbia

For 2014 and 2015, the provincial tax rate that applies to personal taxable income exceeding \$150,000 in B.C. will increase temporarily from 14.7% to 16.8%. The top effective combined federal/B.C. marginal tax rates applicable to investment income for 2013 and 2014 are shown in Figure 3.

Figure 3 – Combined Federal/B.C. Top Marginal Tax Rates on Investment Income in 2013 and 2014

	2013	2014
Interest	43.70%	45.80%
Eligible dividends	25.78%	28.68%
Non-eligible dividends	33.71%	37.98%
Capital gains	21.85%	22.90%

New Brunswick

As of July 1, 2013, New Brunswick personal tax rates were returned to higher 2006 levels, as shown in Figure 4.

Figure 4 – New Brunswick Marginal Tax Rates in 2013

Taxable income	Before July 1, 2013	Starting July 1, 2013
Up to \$38,954	9.10%	9.68%
\$38,954–\$77,908	12.10%	14.82%
\$77,908–\$126,662	12.40%	16.52%
\$126,662 and over	14.30%	17.84%

The top effective combined federal/New Brunswick marginal tax rates applicable to investment income for 2013 and 2014 are shown in Figure 5.

Figure 5 – Combined Federal/New Brunswick Top Marginal Tax Rates on Investment Income in 2013 and 2014

	2013	2014
Interest	45.07%	46.84%
Eligible dividends	24.91%	27.35%
Non-eligible dividends	33.05%	36.02%
Capital gains	22.54%	23.42%

3. 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 2013 (or one of the prior three years), the settlement must take place in 2013, which means the trade date must be no later than December 24, 2013.

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 a trust of which you or your spouse 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.

4. 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.” The prescribed rate will decrease from 2% to 1% on January 1, 2014. If you implement a loan at 1% in January 2014, 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 \$48,845 of eligible dividends in 2013 without paying any tax, other than in the provinces of Manitoba, P.E.I., Quebec and Nova Scotia where the amount is lower.

You should consult with tax and legal advisors to make arrangements to implement a prescribed rate loan. By preparing before year end, you can put a loan into place early in 2014 at the lower 1% prescribed rate, so that you can benefit from income splitting throughout the upcoming year and for many years to come.

5. Retirement Considerations

Convert your RRSP to a RRIF by age 71

If you turned age 71 in 2013, 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 2013 that will generate RRSP contribution room for 2014. While you will pay a penalty tax of 1% on the overcontribution (above the \$2,000 permitted overcontribution limit) for December 2013, new RRSP room will open up on January 1, 2014 so the penalty tax will cease in January 2014. You can then choose to deduct the overcontributed amount on your 2014 (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 2013 to make spousal contributions to their RRSP until the end of the year your spouse or partner turns 71.

Canada Pension Plan (CPP) Retirement Benefits

If you are between ages 60 and 64 in 2013 and are considering taking CPP pension benefits prior to age 65, you may wish to apply by December 31, 2013. If you start

CPP benefits in 2013, your pension will be reduced by a "downward monthly adjustment factor" of 0.54% for each month before age 65 that you began receiving it. Starting in 2014, however, the downward monthly adjustment factor will increase to 0.56% (and will gradually continue increasing to 0.6% by 2016), thus decreasing your CPP pension.

If you start to receive CPP retirement benefits after age 65, you will receive an additional 0.7% for each month after age 65 that you begin receiving benefits, up to age 70. Retroactive benefits are available after you reach your 65th birthday but only for up to 12 months, including the month that you apply. You should, therefore, apply for benefits before the month that you turn age 71 at the very latest, to avoid missing out on payments.

Quebec Pension Plan (QPP) Retirement Benefits

If you are considering taking QPP pension benefits prior to age 65, you may wish to apply by December 31, 2013. If you start QPP benefits in 2013, your pension will be reduced by a "downward monthly adjustment factor" of 0.5% for each month before age 65 that you began receiving it. Starting in 2014, however, if you were born after 1953 the downward monthly adjustment factor could increase and may be up to 0.53%, depending on the amount of pension you receive.

If you are age 60 to 65 and have made QPP contributions, you can apply for a retirement pension in 2013 only if you have stopped working or have a salary reduction agreement. Starting in 2014, you will be able to receive a retirement pension even if you continue to work, which may affect your decision to discontinue working in 2013 so that you can receive QPP retirement benefits.

Old Age Security (OAS) benefits

In July 2013, Service Canada implemented a process to automatically enroll seniors who are eligible to receive the Old Age Security pension. If you can be automatically enrolled, Service Canada will send you a notification letter the month after you turn 64. If you do not receive an automatic enrolment letter, you must apply for your Old Age Security pension.

As of July 2013, you can also choose to defer your OAS pension by up to 60 months beyond the date on which you become eligible. Your monthly OAS pension payments will be increased by 0.6% for every month that you delay receiving the pension beyond age 65, to a maximum of 36% at age 70. You will not be eligible to receive OAS benefits, such as the Guaranteed Income Supplement, Allowance and Allowance for the Survivor, until your OAS pension begins and these benefits will not be increased as a result of the deferral.

Effective March 1, 2013, if you have been receiving the OAS pension for less than six months, you can cancel the pension and defer the start date to receive a higher amount, although you will be required to repay any OAS pension and related benefits that you have already received.

You can also request payment of OAS pension to which you were entitled but that you did not receive. Pension payments will only be made retroactively for a maximum period of 12 months, including the month of application, so be sure to apply by the month in which you turn age 71 at the latest, to avoid missing pension payments.

The OAS pension is “clawed back” (reduced or eliminated) if your net income exceeds \$70,954 in 2013. To minimize the clawback and maximize your OAS pension, consider the following strategies:

- Delay converting your RRSP to a RRIF (to a maximum of age 71), to avoid annual RRIF minimum withdrawals and minimize net income prior to conversion.
- Canadian dividends can accelerate OAS clawback, since 138% of eligible dividends and 125% (118% in 2014) of non-eligible dividends is included in net income due to the gross-up. Consider the composition of your non-registered investments to reduce the clawback impact, perhaps looking to half-taxable capital gains.
- Consider deferring the start of your CPP pension after you reach age 65 to reduce your annual net income and the impact of the clawback.

6. Review asset allocation

Non-registered Investments

Investment income can be taxed in different ways, depending on the type of income (e.g. interest, Canadian dividends, or capital gains), and the type of account in which investments are held (non-registered or registered). 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 2014. You should also consider the impact of any tax rate changes anticipated for future years, such as those described for B.C., New Brunswick and Ontario.

Registered Investments

Investments held within registered plans such as TFSAs, RRSPs or RRIFs, are not taxed while held in the plan.

RRSP Contributions

Although you have until March 3, 2014 to make RRSP contributions for the 2013 tax year, contributions made as early as possible will maximize tax-deferred growth. If you have maximized RRSP contributions in previous years, your 2013 RRSP contribution room is limited to 18% of income earned in 2012, with a maximum contribution of \$23,820, less any pension adjustment.

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 2014, rather than late in 2013.

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 \$25,500 to a TFSA in 2013 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 re-contribution to avoid an overcontribution problem.

If you are planning a TFSA withdrawal in early 2014, consider withdrawing the funds by December 31, 2013, so you would not have to wait until 2015 to re-contribute that amount.

7. 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 to the year the beneficiary turns 17, there are a couple of situations in which it may be beneficial to make a 2013 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 in 2013 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 2013. Consider making a contribution by December 31, 2013 to receive the current year's CESG and create CESG eligibility for 2014 and 2015.

If your child (or grandchild) is an RESP beneficiary and attended a post-secondary educational institution in 2013, 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 (such as the basic personal amount or tuition and education 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 2013, 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. Effective until the end of 2016, if an adult individual's ability to enter into a contract is in doubt in the opinion of an RDSP issuer, the individual's parent or spouse or common-law partner is permitted to open an RDSP for the individual.

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 2013.

8. Certain payments must be made by December 31

Charitable donations

This year saw the introduction of the new Federal First-Time Donor's Super Credit (FDSC), which was announced in the March federal budget. You can claim this credit if neither you nor your spouse or common-law partner has claimed the charitable donations tax credit in any of the five preceding tax years, from 2008 to 2012. The FDSC, which can be claimed once from the 2013 to 2017 taxation years, provides an additional 25% tax credit on total monetary donations up to \$1,000 that are made after March 20, 2013. When added to the regular federal charitable donations tax credit, tax savings would be 40% for total monetary donations up to \$200, and 54% for total monetary donations between \$200 and \$1,000. Provincial charitable donations credits are also available to increase your tax savings.

December 31 is the last day to make a donation and get a tax receipt for 2013. Keep in mind that many charities offer online, internet donations where an electronic tax receipt is generated and e-mailed to you instantly.

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. In-kind donations of securities are not eligible for the FDSC.

Other expenses

Certain expenses must be paid by year end to claim a tax deduction or credit in 2013. This includes investment-related expenses, such as interest paid on money borrowed for investing, investment counseling fees for non-RRSP/RRIF accounts, and safety deposit box rental fees. Note that 2013 is the last year you can claim safety deposit box fees since, as of 2014, they will no longer be tax 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 \$2,152 in 2013. If your medical expenses will be less than this minimum threshold, consider prepaying expenses that you would otherwise pay in 2014. For example, if you expect to pay monthly instalments for your child's braces in 2014, consider paying the full amount upfront in 2013 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 2014, you can claim the credit(s) in 2013 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 have been planning to purchase in 2014. Under the "half-year rule," you are permitted to deduct one half of a full year's tax depreciation (capital cost allowance) in 2013, even if you bought it on the last day of the year. For 2014, you can then claim a full year's depreciation.

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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