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TAX LETTER

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YEAR-END TAX PLANNING IDEAS

It's December, and time to think of some tax planning ideas. If you wait until your tax return is due next April or June, it will generally be too late to change your tax situation for this year.

Below, in no particular order, are some ideas and tips which may be useful to you before year-end.

1. Charitable Donations

Charitable donations must be made by December 31 to be counted for this year.

Charitable donations receive special tax assistance. Donations that exceed $200 per year give you a tax credit calculated at the highest marginal rate. If your taxable income for 2013 (after all deductions) exceeds $135,054, the charitable donations credit is worth the same as a deduction. If your taxable income is lower, then the donations credit is *better* than a deduction, usually around 45%. (In Alberta, a special high credit for donations brings the value of the donation up to 50%.)

In fact, if you are not in the top tax bracket, you can benefit by receiving income and donating the excess to a charity. This may be possible if you already volunteer for a charity. If the charity pays you for your volunteer work, and you donate the income back to the charity, your tax bill will go down.

For example, suppose you are in a 30% tax bracket (including provincial tax), and you have already made over $200 in donations this year. If the charity pays you $10,000 for work you have done for it, your tax bill will go up $3,000 (maybe a bit higher, if you move up to the next bracket). If you donate

the same $10,000 back to the charity, your tax bill will go down about $4,500 (varying slightly by province). The net is a saving of about $1,500 after tax.

Of course, the income has to represent real work you have done for the charity, and your donation must be voluntary. The charity also has to determine whether you are an employee or an independent contractor. If you are an employee, the charity must issue you a T4 and may have to withhold some tax at source. If you are an independent contractor, you may be able to deduct expenses from your "business income", providing you with further tax savings; and if your total business revenues for the year exceed $30,000 you may need to charge GST or HST. Professional advice may be useful in addressing these issues.

An even simpler technique is to have the charity reimburse you for expenses you incur as a volunteer (e.g., travel and parking costs). Such reimbursements, provided they are reasonable, are not taxable to you. You can then donate the reimbursed amount back to the charity and get a tax credit.

Another idea to consider is donating publicly-traded shares or mutual fund units to a charity. If you do this, you do not pay tax on any capital gain on the securities, but the donation is valued for tax purposes at its current fair market value. If you are considering making a donation to a charity, and you have some securities that have gone up in value, donating the securities will be very tax effective.

You can claim charitable donations up to 75% of your "net income" for tax purposes. Net income is basically your income after most deductions, but before claiming the capital gains deduction (capital gains exemption) or any loss carryovers from other years.

In all these cases, make sure to get a tax receipt from the charity that meets all of the conditions specified in the Income Tax Regulations, or you will not be entitled to the credit.

Note that, under rules that were passed in June 2013 and are retroactive to 2003, donations of property are valued at your cost of the property, if you acquired the property within the past 3 years or if you acquired it for the purpose of donating it. (This rule does not apply to publicly-traded securities or certain other property.) This prevents the so-called "art flip" schemes which used to attract many taxpayers, who would purchase art for less than its appraised value and then donate the art to a charity for a high-value tax receipt.

Finally, if you (or perhaps a child of yours who is over 18) have not claimed any donations for years after 2007, a special bonus "super credit" of an extra 25% is available for the first $1,000 of donations. This was discussed in our November 2013 Tax Letter.

2. *Owner-manager remuneration*

If you own a small business that is incorporated and has a December 31 year-end, you will want to make year-end decisions about paying yourself (or family members) a bonus to reduce the corporation's income and possibly split income. Traditionally, private corporations used to "bonus out" their income over the small business deduction threshold, which is now $500,000 federally and for most provinces' income tax systems. However, the calculations have changed in recent years. Dividends from income taxed at the high rate (so-called

"eligible dividends") now generate a higher dividend tax credit, and the corporate tax rate has gone down.

As well, the tax on non-eligible dividends (from corporate income taxed at the low corporate tax rate) is changing from 2013 to 2014 — in certain cases it will be going up.

The precise calculations and decisions about owner-manager remuneration should take into account federal and provincial corporate tax, the federal and provincial dividend tax credits, personal tax rates, your other sources of income, how soon you need to extract the funds, future changes in tax rates, the corporation's need to retain cash in the business, and other considerations. Although the calculations can be complex, it is worth paying attention to this issue before year-end, and deciding whether you want dividends or a bonus now or later.

3. RRSP contributions

If either you or your spouse are not yet 71 this year, then you can normally make contributions to a registered retirement savings plan (RRSP) and deduct them from your income for tax purposes. Your RRSP contribution limit for 2013 is based on your 2012 "earned income" as well as your pension adjustment (reflecting future pension credited to you in 2012 from you being a member of a company pension plan).

Your available RRSP contribution room should be printed on the Notice of Assessment that you received from the Canada Revenue Agency (CRA) after you filed your 2012 return in the spring of 2013. Your maximum contribution room for 2013 is:

18% of your 2012 earned income
(maximum $23,820 if your 2012 earned income exceeded $132,333)
minus
your pension adjustment
plus
any contribution room from earlier years since 1991 that you have not yet used up.

Your deadline for contributions for 2013 is **March 1, 2014**. However, if you have any excess cash you should consider planning for your 2014 contribution as well. You can make that contribution any time from January 1, 2014 through March 1, 2015. Putting funds into an RRSP will allow them to grow tax-free, rather than you having to pay tax on any interest that you earn during the year. (You can also put $5,000 per year cumulative for 2009-2012 and $5,500 for each of 2013-2014 into a tax-free savings account, or TFSA, for which you get no deduction but interest will not be taxable.)

Consider also a contribution to a **spousal RRSP**. (This also applies to a common-law spouse or same-sex partner who meets the *Income Tax Act*'s definition of "common-law spouse", even if you are not legally married.) Your maximum deductible contribution is the same regardless of whether you contribute to your RRSP or your spouse's, or some combination of the two. If your spouse is likely to have lower income than you in future years, then a spousal RRSP contribution will allow your spouse to take the income out down the road (once the third year has passed from when you make any spousal contributions). Your spouse will then pay tax on that income at a lower rate than you would if you withdrew the funds from your own RRSP.

A spousal RRSP is also useful if you are already over 71 but your spouse is younger. Once you reach the year in which you turn 71, you cannot contribute to your own RRSP and must convert your RRSP to an annuity or a registered retirement income fund (RRIF) from which you draw income every year. However, you can still make contributions to a spousal RRSP if your spouse is under 71 at year-end.

4. Trigger capital losses

Capital gains are half-taxed; that is, half of the gain is included in your income as a taxable capital gain. Capital losses can be claimed only against capital gains (and can be carried back three years and forward indefinitely against such gains).

If you have capital gains this year — for example, from selling some shares for a gain earlier in the year — you may wish to trigger capital losses by selling securities that have gone down in value.

Make sure the transaction is completed in time for it to settle before the end of the year. Depending on your broker, the security and the market on which it is traded, the settlement date may be from one business day to several business days after you instruct your broker to complete the sale.

You should also ensure that you are not caught by the "superficial loss" rules. If you (or an "affiliated person", which includes your spouse or a corporation you control) acquire the same (or identical) securities within 30 days of selling them, then your capital loss will be disallowed.

There are numerous other special rules for capital gains and losses. This is just a general overview.

5. Pay your instalments

If you have instalments to pay for the year, and you have not been paying them as per the notices you receive from the CRA during the year, now would be a good time to catch up. If you wait until next April, you will owe four months additional interest, and possibly penalties, on the late instalments.

To avoid interest from applying, instalments should be paid on March 15, June 15, September 15 and December 15. Prepaid or "early" instalments earn credit (called "offset interest") against interest that applies to late instalments for the same year.

You are allowed to calculate instalments based on any of three methods, without interest applying. The instalments can total your tax payable (on income from which tax is not withheld at source) for this year, or for last year, or based on the amounts that the CRA advises you. The CRA's notice to you for March and June is based on the total taxes you paid two years ago, and then for September and December the suggested instalments are adjusted so that the total for the year equals the amount you paid last year.

If you have not been paying your instalments, you should estimate as best as you can the tax that will be owing for the year on your self-employment and investment income (and other sources from which tax is not withheld). You should then make a catch-up instalment payment as soon as possible, to reduce interest charges.

Where interest does apply to late instalments, it is calculated at 6% compounded daily for October-December 2013, but 5% for all other quarters including, we expect, for the first quarter of 2014. (The rate changes each

quarter based on market rates, but has been mostly the same since July 2009.) You do not get interest on overpaid instalments, other than as an offset to late instalments for the same year as explained above.

EMPLOYER-PROVIDED PARKING

As you probably know, most benefits provided by employers to employees are taxable. If you are the employee, the value of the benefit is reported on your T4 and included in your income for tax purposes. There are a significant number of exceptions, however.

What about **parking** provided by an employer?

The Canada Revenue Agency's view is that parking is *not* a taxable benefit if it is provided *to benefit the employer*. The Courts have ruled in a number of cases that an employee who needed their vehicle for employment purposes (e.g. to go out on regular service calls, or to be available outside normal work hours) did not have a taxable benefit from parking.

Also, the value of the benefit from parking will depend on its fair market value. If free parking is available to the public at the employment location (e.g. a shopping centre), then the parking provided to employees is not a taxable benefit. If only "scramble" parking is provided (i.e., not enough space for all employees, first-come, first-serve), the benefit will not be taxable. Parking on gravelled lots has been held to be of lower value than paved parking.

ZAPPING THE ZAPPERS

"Zapper" software is software that **deletes a portion of sales from an electronic cash register**, so that the business appears to have less revenue than it actually does.

If you are in the restaurant business or another cash-heavy retail business, be very wary of obtaining or using "zapper" software. And if you are in the software business, be very wary of developing or selling such software.

Tax evasion has always been illegal, and subject to fines, penalties and jail terms. However, the Canada Revenue Agency will soon have additional weapons in its arsenal when it comes to zappers.

New section 163.3 of the *Income Tax Act* will allow the CRA to assess the following administrative penalties:

- $5,000 for *using* or *possessing* a zapper (actually $10,000 since the penalty can be imposed under both the *Income Tax Act* and the *Excise Tax Act* (GST/HST) — or $15,000 if a parallel provincial penalty applies as well)

- $10,000 for *designing, developing, manufacturing, possessing for sale, offering for sale*, *selling*, *transferring* or otherwise *making available* a zapper (actually $20,000 since the penalty can be imposed under both the *Income Tax Act* and the *Excise Tax Act* — or $30,000 if a parallel provincial penalty applies as well)

- For second and subsequent infractions, the penalties are generally 10 times higher.

These penalties will simply be imposed by the CRA in a Notice of Assessment and can only be contested though an objection and an appeal to the Tax Court of Canada.

In addition, the same infractions — using, possessing, designing, offering for sale, selling, etc. — permit **criminal charges to**

be laid under new section 239.1 of the *Income Tax Act*.

Note that all of these penalties and criminal sanctions are *in addition to* the existing penalties and criminal sanctions for tax evasion. It's like committing a criminal offence with a handgun — additional prison time is added because of the gun.

The new rules will take effect January 1, 2014 (assuming Bill C-4 is enacted by then, as is expected).

Note that the CRA has ways of finding zappers. In one Revenu Québec project reported in a Quebec Superior Court case in 2008 (*Weinstein & Gavino Fabrique*), auditors selected 234 restaurants at random. In each case, an auditor would eat 10 meals in the restaurant over a period of time and pay cash, keeping a copy of the receipt (or photographing it in the washroom if the waiter wanted the receipt returned). After this process was complete, the auditor and a computer specialist would come to the restaurant and demand to make a copy of the restaurant's computer databases that recorded its sales. The object was to then search the databases for the 10 meals to determine whether they had been recorded. The Court held that this was an acceptable method of auditing the business.

So, if you are using or involved in developing or selling zapper software, beware! The tax authorities may well catch you.

TAX-FREE DEATH BENEFITS TO EMPLOYEES

Most benefits provided by an employer to an employee are taxable benefits for income tax purposes.

On an employee's death, however, the first **$10,000** of death benefits paid by the employer to the employee's spouse or children is tax-free.

If the payments go to more than one person (e.g., both spouse and children), the spouse gets the exemption first. A "common-law partner" (as the term is defined in the *Income Tax Act*) qualifies for this exemption.

Even though the benefit is tax-free, the expense is normally deductible to the employer as a routine expense of doing business, especially if the death benefit is something the employer has agreed to pay in its contract of employment with the employee.

FINDING THE LAW

Do you ever want to look up and read legislation (passed by Parliament or a provincial legislature), or Court cases that you have read about? Here is a useful and free Web site to know about: www.canlii.org.

CanLII is the **C**anadian **L**egal **I**nformation **I**nstitute, a project of Canada's law societies. It provides free and very efficient access to virtually all of Canada's legislation, regulations and case law. You can search by title or case name, or search the full text of all the documents or a subset of them.

Of course, if you are trying to read complex legislation such as the *Income Tax Act*, it is almost impossible to read on its own without the annotations and explanations that are provided by the publishers of the commercial editions.

AROUND THE COURTS

Lawyer required to disclose trust account records and cancelled cheques

Solicitor-client privilege is a sacrosanct privilege in Canada. Where it applies, communications between lawyer and client are given protection above almost all other considerations. In a tax audit, for example, the CRA is not permitted to demand copies of advice given by a lawyer, and if it obtains such documents inadvertently, it is not permitted to use them.

However, **not everything that goes through a lawyer's office is privileged**. Transaction records, trust account records and cancelled cheques are generally not protected by solicitor-client privilege.

In the recent *Jakabfy* case, CRA Collections was seeking information about one Lavallee, who had some $120,000 in unpaid income tax and GST. The CRA wanted to track what Lavallee had done with the proceeds from the sale of a property. If the proceeds were transferred to a family member, the CRA would be able to assess that person under *Income Tax Act* section 160 and *Excise Tax Act* section 325 for Lavallee's tax debts.

The CRA therefore sent a Requirement for Information to Lavallee's lawyer, Jakabfy, asking for his trust account records and other documents that would show where the funds went.

Jakabfy was quite aware that these documents were not protected by solicitor-client privilege, but since Lavallee insisted that he not disclose the information, Jakabfy advised the CRA that he needed a Court Order to release it. (This was a reasonable step for Jakabfy to take, to protect himself from a claim that he should not have released the information.)

The CRA obliged by seeking an order from the Federal Court, requiring Jakabfy to release the requested documents. Jakabfy provided the requested documents to the Court in a sealed envelope.

The Federal Court issued the requested Order, noting that the documents in question were not privileged.

So don't assume that everything you send to your lawyer is protected by privilege. Privilege applies only where you are seeking or obtaining legal advice.

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This letter summarizes recent tax developments and tax planning opportunities; however, we recommend that you consult with an expert before embarking on any of the suggestions contained in this letter, which are appropriate to your own specific requirements.