TAXTALK

YEAR END TAX PLANNING - 2007

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As the end of 2007 approaches, this TaxTalk is a reminder to you to review your personal tax situation. Personal tax planning is important to the management of your financial affairs and should be considered throughout the year and not just late in the year.

The aim of tax planning is straightforward: to minimize your tax burden or to defer taxes to a later tax year. Tax planning can also include preventing events that could create unwelcome tax consequences.

This TaxTalk will assist those individuals resident in Ontario who want to take advantage of planning opportunities that exist for minimizing income taxes for 2007 and subsequent years.

On October 30, 2007, in his 2007 economic statement, the Minister of Finance proposed additional personal tax reductions for 2007, and other tax changes to start in 2008. These proposals are discussed in an appendix to this TaxTalk.

This TaxTalk is based on existing legislation and the current interpretation of the Income Tax Act (the Act) by the Canada Revenue Agency (CRA) and by the courts. In addition, recent proposals to amend the Act have been considered and are referred to below as proposed amendments[1]. Other than these proposed amendments, this TaxTalk does not anticipate any other changes to the Act or its interpretation.

Comments related to the Goods and Services Tax (GST) are based on existing legislation, proposed amendments to the legislation and the current interpretation of the Excise Tax Act by CRA and by the courts.

[1] *Certain proposed amendments to the Income Tax Act have not received Royal Assent as of the date of this TaxTalk.*

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For those turning 71 in 2007, Registered Retirement Savings Plans (RRSPs) mature on December 31, 2007 and contributions to these plans must be made by December 31, 2007.

The 2007 RRSP contribution deadline is February 29, 2008. Preauthorized RRSP contributions on March 1, 2008 cannot be deducted on your 2007 tax return.

IMPORTANT DATES AND DEADLINES

Many deductions and credits are available only if payments are made by December 31, 2007 or early in 2008. Important deadlines are summarized below:

Amounts to be paid by December 17, 2007

- final personal income tax instalment for 2007

Amounts to be paid by December 31, 2007

- investment counsel fees
- carrying charges on investments
- safety deposit box fees
- professional membership and union dues
- charitable donations
- medical expenses
- moving expenses
- interest expense (if claimed on a cash basis)
- alimony and support payments
- certain legal, tax, and accounting fees
- political contributions
- tuition fees
- tax shelter investments
- employment expenses (home office expenses, travel expenses, etc.)
- to ensure the settlement date occurs in 2007 for dispositions of most publicly traded securities, we recommend trades be executed on or before December 22, 2007
- contributions to Registered Education Savings Plans to qualify for 2007 Canada Education Savings Grant
- contributions to Registered Retirement Savings Plans for those reaching 71 years of age in 2007

Information returns to be filed by January 15, 2008

- an employee must advise their employer of their intent to elect to defer benefits from stock options exercised in 2007

Amounts to be paid by January 30, 2008

- interest owing for 2007 on loans to family members (including loans to family trusts) must be paid by January 30, 2008 so that the income attribution rules will not apply for 2007 and subsequent years
- interest owing by an employee to his or her employer must be paid by January 30, 2008 in order to reduce the interest benefit on a low-interest or interest-free loan for 2007

Amounts to be paid by February 14, 2008

- an employee can reduce or avoid an operating cost benefit related to an employer provided automobile, if he or she reimburses the employer for personal-use operating costs by February 14, 2008

Amounts to be paid by February 29, 2008

- deductible contributions to an individual's RRSP or a spousal RRSP (for 2007)
- repayments of RRSP Home Buyers Plan (for 2007)

Information returns to be filed by February 29, 2008

- 2007 T4s, T4As, T5s and the respective summaries

Amounts to be paid / information returns to be filed by March 17, 2008

- first personal income tax instalment for 2008
- Employer Health Tax allocation agreement to be filed by associated companies

Amount to be paid by April 30, 2008

- balance outstanding on 2007 personal taxes payable

Other amounts to be paid

- childcare expenses[2] paid for services rendered in the year, even if paid after December 31, 2007

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[2] *The maximum childcare expenses for 2007 are: $7,000 for each child under the age of 7 (at the end of the year), $4,000 for children 7 to 16 years of age (during the year), and $10,000 for a child eligible for the disability tax credit.*

HIGHLIGHTS OF PERSONAL TAX CHANGES IN 2007

In addition to annual adjustments to tax rates, thresholds and tax credits, the 2007 Federal and Ontario budgets announced several changes, some of which are highlighted below:

Federal Changes

The following table summarizes marginal tax rates (on regular income, i.e., salary, interest, etc.) that apply to the income tax brackets for 2007.

Taxable Income *	Federal Rate (%)	Ontario Rate (%)	Total (%)
$ 8,929 to $ 35,488	15.50	6.05	21.55
$ 35,489 to $ 37,178	15.50	9.15	24.65
$ 37,179 to $ 62,488	22.00	9.15	31.15
$ 62,489 to $ 70,976	22.00	10.98	32.98
$ 70,977 to $ 73,623	22.00	13.39	35.39
$ 73,624 to $ 74,357	22.00	17.41	39.41
$ 74,358 to $120,887	26.00	17.41	43.41
$ 120,888 and over	29.00	17.41	46.41

* Slight differences in the tax brackets for Ontario purposes have not been taken into account

For 2007, the top tax rate remains at **46.41** %, and will apply when taxable income exceeds $120,887[3].

Federal Tax Credits and Deductions

The basic personal credit for 2007 has increased from $8,839 to $8,929, the spousal[4] and eligible dependant credits have both increased from $7,505 to $8,929[5] and the age exemption has been increased from $5,066 to $5,177.

There is a new non-refundable credit of $2,000[6] for each child under the age of 18 in 2007. The credit can be claimed by either parent and any unused credit can be transferred to the other parent. The value of this federal credit in 2007 will be $310 per child[7] using a tax credit rate of 15.5%.

The non-refundable Child Fitness Tax Credit[6] of up to $500 eligible physical fitness expenses paid in the year for each child under age 16[8], became effective January 1, 2007. The value of this federal credit in 2007 will be $77 per child using a tax credit rate of 15.5%.

Age Limit for Maturing RPPs and RRSPs[9]

Beginning in 2007, the age at which Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs) mature has been raised from 69 to 71. Individuals can now make RRSP contributions to their own RRSP up to, and including, the year in which they turn 71, subject to available deduction limit.

Pension Income Splitting[9]

The budget reinforced the proposals in October 2006 to allow spouses to split qualifying pension income starting in 2007.

Registered Education Savings Plans (RESPs)[9]

The maximum annual contribution limit of $4,000 per child for RESPs has been eliminated and the lifetime limit has increased from $42,000 to $50,000. The maximum annual Canada Education Savings Grant (CESG) per child increases from $400 to $500. The lifetime CESG limit of $7,200 per child will, however, not increase.

Lifetime Capital Gains Exemption[6]

The budget proposed to increase the lifetime capital gains exemption from $500,000 to $750,000 for gains realized on dispositions after March 18, 2007 of qualified farm and fishing property and qualified small business corporation shares. Transition rules will apply for 2007.

Registered Disability Savings Plan (RDSP)[6]

The budget proposed a new Registered Disability Savings Plan (RDSP), a tax enhanced savings plan, expected to commence in 2008, to help provide long-term financial security for disabled individuals who are eligible for the disability tax credit. The mechanics of the RDSP will be similar to that of the RESP.

[3] In general, the tax brackets are indexed for inflation to protect taxpayers from automatic tax increases that would otherwise result. For 2007, the brackets have increased by 2.2%. As a result, the top tax rate will apply in 2007 when taxable income exceeds $120,887 (2006 - $118, 286).

[4] For purposes of this TaxTalk, references to "spouse" include a spouse by marriage, as well as a common-law partner, of the opposite or same sex.

[5] Although the spousal and eligible dependant credits have increased, the maximum income that may be earned by the spouse or eligible dependant without reducing the credit has been eliminated.

[6] This proposed amendment has not received Royal Assent as of the date of this TaxTalk.

[7] The $310 income tax saving would be increased to $431 if Ontario were to also introduce the credit.

[8] The 2007 budget proposed to extend the tax credit for children under the age of 18 who qualify for the disability tax credit.

[9] This proposal received Royal Assent on June 22, 2007.

Truck Drivers' Meal Expenses[6]

Long-haul truck drivers will be entitled to a larger deduction for meal expenses, increasing from 50% of the costs incurred to 60% for expenses after March 19, 2007 and before 2008, 65% in 2008, 70% in 2009, 75% in 2010 and 80% thereafter.

A corresponding GST amendment will allow input tax credits for the increased meal expense deduction.

Working Income Tax Benefit[6]

Commencing in 2007, and subject to certain restrictions, a new Working Income Tax Benefit *refundable* tax credit will be available to low and modest-income residents with employment or business income. The credit will be 20% of earned income in excess of $3,000 to an annual maximum of $500 or $1,000 for couples and single parents. The credit will be reduced by 15% of net family income in excess of $9,500 ($14,500 for couples and single parents).

Scholarships[6]

Currently, scholarships and bursaries received by students in post-secondary programs qualifying for the education credit are fully exempted from tax. The budget extends the exemption to students in elementary and secondary schools.

Public Transit Tax Credit[6]

Effective January 1, 2007, the Public Transit Tax Credit will be extended to cost-per-trip electronic payment cards if the cards are used for at least 32 one-way trips in a 31-day period. In addition, four consecutive weekly passes will qualify for the credit where they provide for unlimited transit use for a period of five to seven days.

Ontario Changes

Ontario did not introduce any new tax rate changes for 2007.

Pension Income Splitting

Ontario plans to parallel the federal proposal of pension income splitting, contingent on the federal legislation receiving Royal Assent.

Property and Sales Tax Credits for Seniors

The budget proposes to increase the income threshold for 2007 for purposes of the refundable Ontario Property and Sales Tax Credits for qualifying over the current $23,090 to reflect the change to the guaranteed income supplement amount for 2007.

Ontario Child Benefit

The 2007 Ontario budget announced the Ontario Child Benefit (OCB) which is a non-taxable amount paid to qualified families with children under 18 years of age, The OCB will be combined with the Ontario Child Care Supplement (OCCS). It will be phased in, commencing July 2007 with a lump sum payment of up to $250 per child under 18, which will be reduced by 3.4% of family net income over $20,000.

Locked-In Retirement Accounts

The Ontario budget proposes changes to locked-in retirement accounts, effective January 2008, at the earliest. The intention is to give seniors, with locked-in retirement savings transferred from employer pension plans, increased flexibility in planning their retirement income.

TAX DEFERRAL PLANS

Registered Retirement Savings Plans

Deduction Limits

For 2007, your RRSP deduction limit equals the **lesser of**:

- 18% of your 2006 **earned income** (see below) (i.e. the previous year) and
- $19,000

less:

- your "pension adjustment" for the prior year under a registered pension plan (RPP) for current or past service, and
- your net "past service pension adjustment" for the current year under an RPP

plus:

- any "pension adjustment reversal" for 2007 to restore lost RRSP deduction limit on termination of employment and
- your unused RRSP deduction limit carried forward since 1991.

CRA includes a "2007 RRSP Deduction Limit Statement" as part of your 2006 Notice of Assessment. This Statement indicates the maximum you can deduct on your 2007 tax return and any RRSP contributions you made in prior years that you have not claimed a tax deduction for. You should verify these amounts prior to making any RRSP contributions.

Earned income includes: employment income, business income, rental income, disability pension income received under the Canada Pension Plan, and taxable support payments received. Earned income does **not** include: business and rental income earned through a limited partnership, interest income, dividends, capital gains, pension benefits, retiring allowances or severance, death benefits and other amounts received from an RRSP or Deferred Profit Sharing Plan (DPSP).

Earned income is **reduced by**: deductible support payments, employment expenses, and business and rental losses. Business and rental losses incurred through a limited partnership do **not** reduce earned income.

When you contribute less than your RRSP deduction limit, the unused RRSP deduction limit carries forward indefinitely, allowing you to contribute to your RRSP in future years when you have more funds available.

You can choose to claim all or part of your current year contributions as a deduction on your current tax return. Any amount you do not claim this year can be carried over and deducted in a future year. This strategy will benefit you if your marginal tax rate is relatively low this year and you can use the deduction to reduce higher rate income in a later year. Even if you do not deduct the amount this year, your contribution is, in the meantime, earning tax-deferred income within your RRSP.

The limits for 2007 and subsequent years, before any pension adjustments, are as follows:

Year	Limit	Earned Income[10]
2007	$19,000	$105,556
2008	20,000	111,111
2009	21,000	116,667
2010	22,000	122,222
2011	Indexed for wage growth	Indexed for wage growth

Contributions for Those Aged 70 to 71 in 2007

Beginning in 2007, the maximum age limit for RRSP contributions is raised to 71. If you are either 70 or 71 years of age in 2007 and have RRSP deduction limit, you may contribute to an RRSP.

[10] *The amount of earned income must be earned in the previous year.*

Spousal RRSP

You can contribute all or part of your RRSP deduction limit to a "spousal" RRSP of which your spouse is the annuitant. Your ability to contribute to a spousal RRSP is limited to your own RRSP deduction limit. It is not limited by your spouse's RRSP deduction limit or their RRSP contributions. The advantages of a spousal RRSP include: splitting income and a longer tax-deferral period for income earned in the RRSP where your spouse is younger than you.

Generally, RRSP withdrawals from a spousal RRSP are taxed in the hands of the recipient spouse; however, if your spouse withdraws funds from a spousal plan in the same calendar year as your contribution or in the subsequent two calendar years following your contribution to any spousal plan, the withdrawal will be taxed in your hands.

For example, for spousal RRSP contributions made in 2007, your spouse will be taxed on withdrawals made on or after January 1, 2010. However, you would be taxed on the withdrawal if the withdrawal happened prior to January 1, 2010. This rule applies whether your spouse has one or many spousal RRSP accounts.

Finally, if, based on your age, you can no longer contribute to your own RRSP; you can still contribute to a spousal RRSP, for which you will receive a deduction, provided you have deduction limit and your spouse is 71 or younger at the end of 2007.

Timing of Contributions

RRSP contributions you make by February 29, 2008 may be deducted in your 2007 tax return, subject to your 2007 RRSP deduction limit.

As discussed earlier, the maximum age for holding an RRSP has increased from 69 to 71, beginning in 2007. **If you turn 71 in 2007, your RRSP contribution for 2007 must be made by December 31, 2007.** For more planning ideas, please refer to the discussions on "Spousal RRSP" and "Over-Contribute before Maturity".

By making your 2007 RRSP contribution as early as possible in 2007, you will benefit from a longer period during which your retirement fund can grow tax deferred,

If you wish to increase your RRSP deduction limit to the maximum of $20,000 for 2008, you will need earned income of $111,111 in 2007.

Borrowing to Contribute

Interest incurred on funds borrowed to make an RRSP contribution is not deductible for tax purposes. Generally, it is best to use available cash to make RRSP contributions and borrow to fund other income earning activities (such as acquiring non-RRSP investments) where the interest will be tax-deductible. If you want to borrow to contribute, it is generally advisable that the borrowing be for a short-term period (i.e. a few months).

Non-Cash Contributions

Your RRSP contribution is not restricted to contributions of cash. You can also contribute certain non-cash property (e.g. publicly traded shares) to your RRSP or spousal plan.

When you contribute non-cash property to your RRSP, or to a spousal RRSP, you are deemed to have disposed of the property at its fair market value at the time of the transfer. As a result, the contribution may trigger a capital gain or a capital loss. Only 50% of a capital gain would be taxable in your hands, however, any capital loss is deemed to be nil.

If you anticipate that you may incur a capital loss on property you want to transfer to your RRSP or a spousal plan, you should consider first selling the property in the open market (i.e. a third party), and then contributing the cash proceeds to your RRSP. Any losses actually incurred may be recognized, subject to the stop loss rules discussed below under “Investments with Accrued Losses”.

The list of qualified investments for RRSPs and other registered plans was broadened after March 18, 2007 to include any debt obligation that has an investment grade rating and that is part of a minimum $25 million issuance as well as any security, other than a futures contract, which is listed on a designated stock exchange.

Over-Contribute Before Maturity

If you have earned income in the current year and you are required to collapse your RRSPs by the end of the year (i.e. if you turn 71 in 2007), you should consider “prepaying” your 2008 RRSP contribution before the end of the current year. The contribution you make in late 2007 will be deductible in 2008 when new deduction limit (based on your 2007 earned income) becomes available.

Although this “excess” contribution is subject to a 1% penalty for each month that it is in the RRSP in 2007 (excluding the $2,000 over-contribution that is allowable - see below), your ultimate future after-tax income on this over-contribution may outweigh the penalty. This strategy will allow you to transfer a higher amount to your Registered Retirement Income Fund (RRIF).

You will benefit the most from this strategy if your marginal tax rate in 2008 is expected to exceed your marginal tax rate(s) in the year(s) that the RRSP contribution is to be ultimately withdrawn.

$2,000 Over-Contribution

You might consider making a lifetime (not annual), non-deductible over-contribution of $2,000 to your RRSP. Since the over-contribution is not deductible, the amount contributed is from your after-tax dollars. The younger you are when you make the $2,000 over-contribution, the longer the funds can grow tax-free in your RRSP.

However, unless you limit your RRSP contributions before the last year in which you are eligible to contribute to an RRSP, the $2,000 over-contribution will be subject to double taxation. Double taxation would occur since the initial $2,000 came from after-tax dollars and will be taxed again when you withdraw it from your plan. Even if you are subject to double taxation you may realize a benefit if the funds are allowed to grow tax-free in your RRSP for a considerable period of time.

You should also consider making an over-contribution for any of your children who are 18 or older. This over-contribution will be deductible by your child in a future year when he or she has earned income to create RRSP deduction limit.

Building Unused RRSP Deduction Limit for Children

If you have a child who has earned income in a particular year, your child should file a personal tax return, even if there is no tax payable. With each year’s tax return filed, your child will build up his or her unused RRSP deduction limit. The end result of this strategy is that your child will have a larger RRSP deduction limit available for future years.

Equity Investments in RRSPs

Although all income earned within your RRSP accumulates tax-free, the income will eventually be taxed as pension income at your full marginal income tax rate in the year that you withdraw funds from your RRSP.

You only pay tax on 50% of your capital gains on property you hold *outside* your RRSP. However, if you earn capital gains *inside* your RRSP, you will be taxed on 100% of the gain (as pension income) in the year of withdrawal, not as a capital gain. From a tax standpoint, therefore, it is better to hold equity shares that you expect to grow in value outside of your RRSP.

RRSP Investments in Small Businesses

Subject to certain restrictions, your RRSP can invest in shares of **private companies**[11]**.** Some of the specific rules and restrictions that apply are summarized below:

- Your RRSP cannot own shares of any corporation[12] that you control. In addition, anybody who is related to you (i.e. spouse, children, siblings or parents) is also precluded from owning shares in their RRSP of a company that you control.
- Where you, together with a related group, own 10% or more of the issued shares of a private company[12], inside and outside RRSPs, and you deal at arm's length with the company, your (combined) cost of the investment in the company must be less than $25,000.
- Where you, together with a related group, own less than 10% of the shares of any class of a private company[12], you may invest RRSP funds in this private company, **without limit,** provided that the shares held, inside or outside of the RRSP, after the investment, do not cause you, and the related group together, to own 10% or more of the issued shares of any class of the company.

Foreign Content

There are no restrictions on the foreign property content in an RRSP. Prior to 2005, foreign property content in an RRSP was limited to 30% of the cost amount of its qualified investments.

[11] *The company must either be an* ***"eligible corporation"*** *or a* ***"small business corporation"****. While the definitions for these terms are not the same, in general, the company must be a Canadian controlled private corporation that carries on an active business in Canada.*

[12] *Including shares of related companies.*

Source Deductions on RRSP Contributions

If you are an employee or owner-manager who receives a salary/annual bonus[13], you can choose to contribute all or a portion of your remuneration (subject to your RRSP deduction limit) directly to your RRSP provided your employer agrees to the direct transfer.

Your employer is not required to withhold income tax provided they make the contribution **directly** to your RRSP and the amount contributed does not exceed your RRSP deduction limit for the current year. Furthermore, you are not required to obtain a letter of authority from CRA to do this.

Subject to your RRSP deduction limit, this rule may enable you to immediately contribute 100% of your gross salary/bonus into an RRSP instead of an after-tax contribution. However, your gross salary/bonus will still be subject to CPP and EI premiums, if you have not reached the maximum contributions required for the year.

With this strategy, you will benefit from the fact that more of your money will be invested in your RRSP earlier, thereby creating a longer period for tax deferred compounded growth.

Reduction in Source Deductions

You may ask CRA for authorization to have the withholding tax on your salary reduced based on your own RRSP contribution(s). Once your employer receives the authorization, the amount of income tax your employer is required to deduct from your pay cheque will be reduced. Evidence of the RRSP contribution must be provided to CRA (i.e. the RRSP contribution receipts) before they will allow your employer to reduce the tax withholdings.

CRA will generally provide advance authorizations to allow reduced withholdings if you are making monthly pre-authorized RRSP contributions, and you provide them with suitable documentation (e.g. a copy of the pre-authorized RRSP contribution contract).

Retiring Allowances and Severance Payments

Lump-sum retiring allowances or severance payments are generally taxable when received, however, you may transfer some or all of these payments to your RRSP on a tax deferred basis. Eligible amounts transferred to your RRSP would not impact on your RRSP deduction limit.

[13] *This would include bonuses paid to owner/managers by companies who "bonus down" to the income level eligible for the special low rate of tax available to small businesses.*

The maximum "eligible" amount that you can transfer to your RRSP is limited to $2,000 times the number of full or partial years during which you were an employee **before 1996**, plus $1,500 times the number of full or partial years of service **before 1989** for which your employer did not make vested contributions to an RPP or a DPSP on your behalf. You must transfer the funds to your RRSP within 60 days following the year you received the lump-sum payment. There is no withholding tax on the eligible amount if your employer transfers the funds directly to your RRSP. The transfer cannot be made to a spousal RRSP.

A retiring allowance in respect of employment that began after 1996 or any retiring allowance you receive in excess of the eligible amount will **not** be eligible for rollover to your RRSP. However, to the extent that your RRSP deduction limit allows, you may choose to contribute any ineligible portion of your retiring allowance to your RRSP or to a spousal RRSP and claim an RRSP deduction[14].

This strategy allows you to defer income tax on your retiring allowance until such time as you withdraw funds from your RRSP.

Lump Sum Payments

If you receive lump sum payments from an RPP or a DPSP you can transfer the funds tax-free to an RRSP provided the transfer is made directly by the payor to your RRSP. You cannot first receive the funds and then later contribute them to your RRSP. In some cases, the transfer of vested pension benefits must be made to a locked-in retirement account (LIRA) which is subject to withdrawal restrictions under the relevant provincial and federal pension legislation.

Early Withdrawals

If your income for 2007 is unusually low, consider making a withdrawal from your RRSP in 2007 in order to raise your taxable income to $37,178. This income amount is the maximum for the lowest federal tax bracket. Please keep in mind, however, that RRSP withdrawals do not re-generate your deduction limit. You may only "re-contribute" to an RRSP to the extent your "earned income" has created additional RRSP deduction limit.

[14] *If your former employer has reasonable grounds to conclude that your RRSP deduction limit is sufficient to allow you to deduct the RRSP contribution in the current year, then your employer can transfer the retiring allowance* ***directly*** *to your (or a spousal) RRSP and no tax would be withheld.*

Transferring Out of an RRSP by Age 71

If you were older than 71 at the start of 2007, you can no longer contribute to your RRSP[15]. **If you turn 71 this year, you must mature (i.e. collapse) your RRSP accounts by December 31, 2007**[16].

In collapsing your RRSP, your choices are to:

- convert your RRSP into a fixed term or a life annuity (a tax deferred transaction),
- convert your RRSP to a RRIF (a tax deferred transaction), and/or
- be taxed on the value of your RRSP (a taxable event).

A RRIF allows you to manage your investments in much the same manner as a self-directed RRSP. You must make annual minimum withdrawals from your RRIF. These withdrawals are included in income in the year withdrawn.

The minimum annual withdrawal is not subject to withholding tax and may be based on your age or your spouse's age. If you wish to minimize your annual withdrawal (perhaps to defer tax) you should use the younger spouse's age. If you would rather maximize your minimum annual withdrawal you should use the older spouse's age. You can increase the withdrawals from your RRIF over the annual minimum required amount to perhaps meet cash requirements; however, withholding tax will apply to the excess amount withdrawn.

Minimum RRIF Withdrawals for 2007 and 2008

In addition to the 2007 changes in the maximum age limit for RRSP contributions, the annual minimum RRIF withdrawal requirement as discussed above is waived for 2007 if you are 70 or 71 years of age by the end of 2007 and is waived for 2008 if you turn 71 years of age by the end of 2008.

Pension Income Splitting

Beginning in 2007, Canadian residents can allocate up to one-half of their pension income that qualifies for the pension income credit (see discussion below) to their Canadian resident spouse or common-law partner when filing their annual tax return. Canada Pension Plan

[15] *But you can continue to contribute to a spousal RRSP if your spouse is under the age 71 in 2007.*

[16] *You do not have to wait until you are 71 to collapse your RRSP.*

(CPP)[17] and Old Age Security (OAS) payments do not qualify.

You and your spouse must jointly elect[18] to the income splitting each year. Any tax withheld at source on the pension income will be allocated to each spouse in the same ratio as the pension income.

Tax benefits and credits that are based on the combined net income of both spouses, such as the GST credit and Ontario property tax credit will not be affected by splitting the pension income. However, credits based on each spouse's net income may be impacted, such as the age and spousal amounts. The OAS clawback and the Ontario health premium, which are determined by each spouse's net income, may reduce the tax savings of pension income splitting. Their impact should be considered when determining the amount to pension income that will be allocated to each spouse.

Using the Pension Income Credit

You are entitled to claim a non-refundable tax credit on the first $2,000 of qualifying pension income. Qualifying pension income would include most types of retirement income received on a periodic basis, such as:

- life annuity payments out of a superannuation or pension plan, regardless of your age,
- if you are 65 years or older, annuity payments from an RRSP or DPSP and payments from a RRIF, or
- if you are under 65 years of age, annuity payments from an RRSP or DPSP and payments from a RRIF, if these payments are received by virtue of the death of your spouse.

The $2,000 non-refundable tax credit is computed at the lowest tax rate. If your income is greater than the lowest tax bracket, you will have some net tax payable on the first $2,000 of pension income.

[17] Spouses have already been able to "share" CPP benefits to achieve income splitting. To share CPP benefits, an application must be made to Services Canada.

[18] Form T1032, Joint Election to Split Income, must be filed with each spouse's tax return each year.

Transferring Rollover of RRSP and RRIF Upon Death

In general, when a taxpayer dies, the fair market values of his or her RRSPs and RRIFs are included in their final income tax return (i.e. terminal return) and are subject to tax.

There are exceptions to this rule. Where RRSP/RRIF funds are transferred to a spousal RRSP/RRIF or to an RRSP for the benefit of financially dependant children or grandchildren, the funds will not be taxed on the terminal return.

The mechanics to obtain a rollover can be complex and will depend on the facts of the situation. For instance, the procedures differ depending on whether the spouse is a beneficiary under the will or directly under the RRSP/RRIF, and whether or not the RRSP has matured at the time of death. In some cases, elections need to be filed with CRA in order for the transfer to be tax deferred. You should discuss this matter with your professional advisor.

RRSP Home Buyers' Plan

If you are a **"first-time"** home buyer,[19] consider using the RRSP Home Buyers' Plan (HBP). The HBP allows you and, if applicable, your spouse to withdraw up to $20,000 each from your existing RRSPs tax-free, to purchase a home.

Certain rules and restrictions apply. First, before making an HBP withdrawal, the funds must have been in your RRSP for at least 90 days before the withdrawal. Secondly, the home must be purchased by October 1st of the year following the year of the withdrawal. Thirdly, you must repay the withdrawn funds over time or you will pay tax on the withdrawal.

[19] A first-time home buyer includes any individual if neither that individual nor his or her spouse, have owned a home as a principal residence within 5 calendar years preceding the new HBP withdrawals. An individual may participate in the HBP more than once, provided that all HBP withdrawals have been repaid. Also, the "first-time buyer" prerequisite does not apply to individuals who qualify for the disability tax credit, and to individuals who support disabled individuals and who purchase a home that is better suited to the needs and care of the disabled individual.

The amount you withdraw under an HBP is treated like an interest-free loan from your RRSP and must be repaid annually over a maximum period of 15 years[20], beginning in the second year after the withdrawal. An HBP repayment is made by making a regular RRSP contribution and designating an amount of your contribution as an HBP repayment rather than a regular RRSP contribution in your income tax return for each year of repayment.

As a result, the HBP repayment does not reduce your taxable income. If this designation is not made, then no repayment would be recognized and the required repayment amount would be included in your income and be subject to tax. CRA will advise you of the minimum amount you must repay each year.

If you plan to withdraw funds from your RRSP under an HBP late in 2007, you should consider delaying the withdrawal until early in 2008. This strategy will extend the deadline for purchasing a home from October 1, 2008 to October 1, 2009, and delay the start of the required repayments by one year from 2009 to 2010.

When you withdraw funds from your RRSP to purchase a home under an HBP, you forego the tax-deferred growth in the RRSP of income on the funds. Whether an HBP makes sense for you will depend, in part, on what you intend to do with the cash savings that result from having a higher down payment and a lower mortgage. If you invest the savings by either paying down your mortgage or by increasing your RRSP contributions, then the HBP can be effective for you.

Lifelong Learning Plan (LLP)

Under an LLP, you can withdraw funds from your RRSP tax-free, if the funds are used to finance full-time post-secondary education for you or your spouse (or part-time education if the student has a mental or physical impairment). Certain other rules and restrictions may apply.

First, annual withdrawals are limited to $10,000, with a four-year maximum limit of $20,000. Secondly, the funds must have been in the RRSP for at least 90 days before the withdrawal. Thirdly, you must repay the withdrawn funds over time or you will pay tax on the withdrawal.

[20] *Repayment of the HBP and LLP withdrawals will be accelerated when the taxpayer dies (unless the deceased's spouse elects otherwise), or ceases to be a resident of Canada.*

Like an HBP, the amount you withdraw under an LLP is treated like an interest-free loan from the RRSP and must be repaid in equal instalments over 10 years, with the first repayment due no later than 60 days following the fifth year after the first withdrawal[16]. Any unpaid amounts will be included in income in the year that the repayment is missed (similar to the HBP). Future withdrawals can be made from your RRSP for education, provided all your previous withdrawals have been fully repaid.

Individual Pension Plans

Individual Pension Plans (IPPs) were introduced to compensate high-income earners disadvantaged by the RRSP rules. With many executives seeking retirement benefit packages that meet their individual needs, IPPs are becoming more popular in today's business world.

They are primarily suited for incorporated businesses looking to add benefits for their owner/managers and high net worth individuals. IPPs can offer a better retirement funding solution for individuals 45 years of age or older, with employment earnings of more than $100,000 and who have historically maximized their RRSP contributions.

Any contributions made by the company to an IPP are **tax deductible**[21]. Contributions to an IPP can significantly exceed normal RRSP deduction limits. The amount of the IPP contributions depends, in part, on your age - the older you are, the higher the allowed contributions.

An IPP is a **defined benefit** plan tailored for retirement where the benefits to be paid during retirement are actuarially determined based on your age, your career employment earnings, and other actuarial assumptions. Once the retirement benefits are estimated, the company, as plan sponsor, **must** fund the annual IPP contributions needed to create the benefits required for retirement.

Contributions to the IPP are tax deductible to the employer and are based on the following:

1. Funding for **current service** must be done annually with the yearly limit based on your earnings and age.
2. **Past service** may also be funded by the company. The past service contribution is computed from the *later of* (i) January 1, 1991 and (ii) the date of incorporation of the employer/employment of the employee. To make past service contributions, it is generally necessary to transfer RRSP assets related to the time of your past service to the IPP.

[21] *To be deductible, contributions must be made to the IPP within 120 days after the corporate year-end.*

3. **Additional funding** is required if the IPP does not maintain an annual compounded net rate of return of 7.5%. An actuarial valuation must be done every 3 years to determine if the IPP is underfunded or overfunded[22].

   The annual rate of return of 7.5% ensures that the plan will be adequately funded so that you receive a defined benefit on retirement.

Assets accumulating in the IPP are locked-in, and can generally only be withdrawn during retirement. Like an RRSP, the age at which the funds in the IPP must be withdrawn from the plan has been increased to 71, beginning in 2007.

The following table compares the current contributions that can be made to an IPP (setup for a 69 year old in 2007) and an RRSP at various ages:

Year	Age	IPP	RRSP	IPP Advantage
2007	60	$30,113	$19,000	$11,313
2009	62	34,799	21,000	13,799
2012	65	43,231	Indexed for wage growth	Indexed for wage growth

As the IPP is not an asset of the company[23], it is not available for corporate creditors to attack. Also, pension legislation provides creditor protection to you personally in respect of the IPP – your IPP retirement assets are held by a trust, not you personally.

As with any tax or retirement planning vehicle, there are disadvantages to weigh against the benefits of an IPP.

- The rules regarding IPPs are complex, and are governed by applicable pension legislation.
- There is little flexibility regarding annual funding requirements, which are mandatory pursuant to pension legislation.
- You can no longer make spousal RRSP contributions. Thus, the ability to split income using your retirement assets is not available with an IPP.
- Assets inside an IPP are locked in, as opposed to RRSP funds, which can be liquidated should there be an emergency cash need.
- There are costs including set-up, administrative and compliance fees to consider[24]. Compliance costs include fees to maintain records, file tax and information returns etc., as applicable. The 'good news' about these costs is that they are tax deductible[25].

In conclusion, an IPP may be suitable for a key executive and/or an owner/manager who:

1. is over 45 years old,
2. earns a base salary of more than $100,000 and expects to continue to do so,
3. has worked for the company for several years, and
4. has no foreseeable need to access the funds set aside for retirement (i.e. the retirement funds will *not be needed* for an emergency).

In addition, the company should have a stable cash flow such that it will be able to comfortably afford the requisite annual IPP contributions.

The key advantage of an IPP, compared to an RRSP, is the ability to make past, current and future service contributions in excess of normal RRSP contribution limits. IPPs are becoming an attractive option for high net worth individuals and should be considered as a viable retirement planning vehicle.

Exempt Life Insurance

An exempt life insurance product can provide insurance coverage together with retirement income that has benefited from tax-deferred growth. These products allow you to pay insurance premiums and, at the same time, make deposits to a tax sheltered investment account. The insurance premiums are generally not tax deductible when made, but the ultimate insurance receipt on death is tax-free.

This type of tax-sheltered investment is usually appropriate if you have maximized your RRSP contributions.

INVESTMENT STRATEGY

Return on Investments

As part of year-end tax planning, you should review your investment mix to ensure that you receive the best possible **after-tax** return on your portfolio.

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[22] *If the plan is over funded, the employer may be restricted from making current contributions.*

[23] *Not being a corporate asset, an IPP is not available to secure corporate debt.*

[24] *The costs to set up an IPP may range from $3,000 to $4,000. Annual administrative costs may range from $500 to $600, with an additional triennial fee of $1,000 to $1,500 for an actuarial report.*

[25] *Management expenses of an RRSP are not tax deductible.*

Each type of investment income is taxed differently:

- interest income is accrued annually and fully taxed;
- both eligible and ineligible dividends from taxable Canadian corporations receive preferential tax treatment. They are taxed as received and qualify for a dividend tax credit; and
- capital gains are not fully taxed (50% inclusion rate), and some capital gains are exempt from tax.

The table below shows the after-tax amount on $100 of investment income earned by an individual who is in the top tax bracket in Ontario. The 2008 rates may change with future federal and Ontario budgets[26].

Type of Income	After-tax Amount of $100	
	2007	**2008**
Interest[27]	$53.59	$53.59
Ineligible Dividends	68.66	68.66
Eligible Dividends	75.36	76.04
Capital Gains–Non-exempt	76.79	76.79
Capital Gains–Exempt	100.00	100.00

Based on the different tax treatment for each type of investment, where possible, it is preferable to:

- hold interest-yielding investments inside an RRSP (to defer tax on the higher-taxed interest) and
- hold equity investments, which yield dividends and capital gains, outside an RRSP.

Taxation of Dividends

The top marginal rate in Ontario for *eligible* dividends is *24.64%* in 2007[28] whereas the top marginal rate for *ineligible* dividends remains at *31.34%*.

Eligible dividends are most dividends paid after 2005 by public corporations resident in Canada and certain Canadian controlled private corporations (CCPCs) on their business income subject to the high rate of corporate tax[29].

Eligible dividends are grossed up to 145% for tax reporting whereas ineligible dividends continue to be grossed up to 125%.

Although the taxes on eligible dividends will be lower, your net income will increase due to the 145% gross-up and tax benefits and credits that are income based, such as the age and spousal credits and GST credits, may be reduced. In addition, the gross-up of eligible dividends received may trigger alternative minimum tax, OAS clawback and increased Ontario health premiums.

In 2007, if you are single and have no other source of income, you may receive a maximum of $48,929 eligible dividends or $35,078 ineligible dividends tax-free[30].

In general, those CCPCs that earn solely active business income eligible for the small business rate or investment income can only pay ineligible dividends to their shareholders (top tax rate remains at 31.34%).

As a result of these proposals, further planning may be required in order to optimize tax efficiency with respect to executive compensation (i.e. salary/bonus and/or dividends etc.)

Income Trusts

Income trusts are flow-through tax entities and have potentially provided investors with a greater after-tax return than more traditional investments in Canadian public companies. To address concerns about the unbalanced income tax treatment that applied to "specified investment flow-through" (SIFT) trusts or SIFT partnerships and their investors, compared to public corporations, a "Distribution Tax" has been introduced by the federal government. This new tax applies for taxation years ending in 2007 for new SIFT entities, but is deferred until 2011 for SIFTs that were publicly traded as of October 31, 2006.

Despite its name, the Distribution Tax is not a direct tax on distributions. Instead, certain distributions will not be deductible to a trust or partnership that is a SIFT. As such, the SIFT will pay tax on their non-deductible distributions at a rate comparable to the general combined federal/provincial corporate income tax rate. These distributions will be taxed as taxable dividends to investors. Any such dividends paid to Canadian resident individuals will be deemed to be "eligible dividends", thereby qualifying for the lower tax rate on dividends.

[26] *The top marginal rate in Ontario for eligible dividends is scheduled to drop annually to 22.38% in 2010.*

[27] *Also applies to foreign source investment income (such as interest and dividends).*

[28] *Although Ontario has paralleled the federal eligible dividend proposals, Ontario adopted a five year phase-in whereby the top tax rate on eligible dividends is 24.64% for 2007, 23.96% for 2008, 23.06% for 2009 and 22.38% for 2010.*

[29] *For CCPCs, eligible dividends can also be paid out of corporate business income that has been taxed at the high corporate tax rate since 2001.*

[30] *There will be Ontario Health premiums payable of $600 on eligible dividends of $48,929 and $450 on ineligible dividends of $35,078.*

Certain real estate investment trusts (REITs) may be excluded from the Distribution Tax, however, the criteria for exclusion are narrow. Generally, REITs that earn passive income meet the criteria for exclusion. Hotel REITs and retirement-resident REITs may not qualify for the exclusion.

Distributions from a SIFT affected by the new rules will decline due to the Distribution Tax. Given the availability of the dividend tax credit, most taxable Canadian individual unitholders should be indifferent to the new tax. However, the reduced distributions will be an absolute cost to non-residents, tax exempt entities (i.e. pension funds), and lower-income Canadians who are unable to fully use the dividend tax credit to reduce their taxes.

If you currently hold units in an income trust, please be aware that the cash distribution you receive may be a combination of income, subject to tax, and a return of capital which you receive tax-free[31]. As result, when you calculate your return on investment or yield, you need to exclude the capital receipt.

If you are considering acquiring an interest in a mutual fund or income trust which is expected to make a taxable distribution at the end of 2007, consider waiting until early 2008, thereby saving yourself the tax on the distribution.

Interest Income

In general, you must include interest income annually on your tax return, based on the anniversary date of the investment contract, whether you receive the interest in cash or the interest is accrued, as is the case with a compound interest investment.

If you plan on purchasing an interest-bearing investment near the end of 2007, you may want to consider whether delaying your purchase until 2008 will defer the forced accrual/recognition of interest income until 2009. Keep in mind that interest will accrue on the anniversary date of the investment contract, which will not necessarily coincide with the anniversary date of your purchase.

Interest Expense

Where you have fully paid investments and are also paying non-deductible interest related to the purchase of other assets, you should discuss the situation with your professional advisor to determine whether your financial affairs can be structured to make the interest payments tax-deductible.

When paying down debt, you will be better off if you reduce debts with non-deductible interest (e.g. personal mortgages and personal credit card balances) before debts on which interest is deductible.

If you purchased an investment using debt, subsequently sold this investment at a loss, and the proceeds were insufficient to pay off the debt, you can continue to reduce your income for interest paid on this remaining debt, provided the debt is not related to real estate or other depreciable property[32].

Capital Gains and Losses

Only one-half of your capital gains for the year are included in your income and subject to tax (i.e. the capital gains inclusion rate is 50%). Your selling costs reduce your capital gain or increase your capital loss.

To the extent that you realize capital losses in the year, these losses can reduce your taxable capital gains but cannot reduce any other type of income[33]. The inclusion rate for capital losses is the same as for capital gains - 50%.

If you cannot use all of your capital losses in the current year, the capital losses can be carried back three years and carried forward indefinitely. As is the case with applying losses in the current year, capital losses carried over to other years can only reduce capital gains.

[31] *The return of capital will, however, reduce the tax cost of your investment and thus increase your gain (or decrease your loss) on any disposition of the trust units.*

[32] *The interest restriction applies where the real estate assets or other depreciable property is earning income from property (i.e. passive rental income). Where the property was used to earn income from a business, interest will remain deductible after the sale.*

[33] *In the year a taxpayer dies, capital losses can reduce other income on his/her terminal return or his/her return for the immediately preceding taxation year, not just capital gains. However, to the extent that the deceased claimed the capital gains exemption during his/her lifetime, the amount of capital losses deductible against other income will be reduced.*

Investments with Accrued Losses

When you are deciding which investments to sell, you should consider the following tax planning points:

- If you have realized capital gains in 2007, you should consider selling investments with accrued losses before the end of 2007[34] to offset your taxable gains.
- Given the foreign currency fluctuations that we are currently experiencing, you may have accrued capital losses in investments held in foreign currencies that should be realized at this time.
- Further, you should consider triggering a capital loss if you paid tax on capital gains in any of the **preceding three years**.

- If you realize a capital loss in 2007, the "superficial loss" anti-avoidance rule will deny your loss to the extent the same investment is acquired by a person that is affiliated[35] with you within (i.e. before or after) 30 days of the sale. The denied loss is added to the cost of the investment acquired by the affiliated person, and reduces their gain or increases their loss on a subsequent disposition of the investment. This rule effectively defers the recognition of the loss until the investment is sold to a non-affiliated person.

Foreign Spin-Offs

If you own shares of a foreign corporation and the company distributed shares it owned of a subsidiary to you as part of a spin-off, the distribution is generally considered to be a dividend in Canada and is taxable as foreign source income (i.e. no preferential tax treatment). If however, the spin-off meets certain criteria, you may **elect**[36] to exclude the dividend from your income.

Once you elect, the cost of your original shares is split between your original shares and the spin-off shares based on the relative fair market value of those shares at the time of the spin-off. As a result, Canadian income tax on the spin-off:

- will be deferred until you dispose of the shares, and
- may be reduced if the deferral election converts what otherwise would have been a dividend to a capital gain which is currently subject to a lower tax rate.

Lifetime Capital Gains Exemption

You can exclude from your income a **lifetime maximum of $500,000** of capital gains realized on the disposition of shares of a qualified small business corporation and/or qualified farm property. The 2007 federal budget proposes to increase the limit to $750,000 for dispositions after March 18, 2007.

The exemption will provide you with significant tax savings. If you are at the top tax rate and you are able to shelter $500,000 of capital gains, your potential tax savings would be approximately $116,000 in 2007[37]. For gains after March 18, 2007, the potential tax savings would be $174,000.

While the exemption is designed to shelter up to $500,000/$750,000 of gains on a sale of qualified corporations (and/or farm property) to third-parties, it is possible to access the exemption without selling the shares to an "outside" party.

You should consider triggering a gain eligible for the exemption for two reasons: (i) the federal government may eliminate the exemption, and (ii) the exemption is only available under certain circumstances and you may have to plan to access the exemption.

You should be aware of the following:

- you can only claim the exemption in respect of certain shares of Canadian controlled private corporations or farm properties that meet specific criteria (i.e. not all shares or farm property will qualify for the capital gains exemption),
- you can only claim the exemption to the extent that your taxable capital gains in the year (net of allowable capital losses) exceed your Cumulative Net Investment Loss amount (see the discussion below),
- capital gains are preference items for the Alternative Minimum Tax (AMT) (see the discussion below) and, therefore, recognizing a gain which is exempt from regular tax may create an AMT liability,
- if you claimed an Allowable Business Investment Loss (ABIL) after 1984, the ABIL reduces your eligible exemption,

[34] *To realize a capital loss in 2007, we recommend security trades be executed on or before December 22, 2007.*

[35] *A person affiliated with you includes you, your spouse, your RRSP, your spouse's RRSP, a company controlled by persons affiliated with you, and certain trusts where more than 50% of beneficial ownership of the income interest or capital interest is held by you and/or persons affiliated with you. This restricted loss rule does not apply to sales made to, or repurchases by parents, children, nieces or nephews.*

[36] *The election should be filed with your tax return.*

[37] *Any current or future claim will be reduced by any previous exemption claimed.*

- if you claimed pre-1985 capital losses to reduce income (other than capital gains) after 1984, these losses reduce your eligible exemption, and
- to the extent that you have used some or all of your capital gains exemption (including your general $100,000 exemption), your access to the $500,000/$750,000 exemption is reduced.

Cumulative Net Investment Loss (CNIL)

Your use of the capital gains exemption is reduced to the extent of your CNIL balance in the year that the capital gain is recognized. Your CNIL is the cumulative excess of your investment expenses over your investment income after 1987. For example, interest expenses and limited partnership losses increase your CNIL while interest and dividend income reduce it.

To the extent you have a positive CNIL (i.e. more expenses than income), your capital gains exemption[38] is reduced by the CNIL. Your capital gains exemption is not affected if your CNIL is negative (i.e. more investment income than investment expense).

While the CNIL impact is not necessarily permanent, it does delay your ability to use the exemption until such time that your taxable capital gains exceed your CNIL. To minimize the effect of a positive CNIL balance, you should consider the following:

- defer the payment of investment expenses to a subsequent year or accelerate the receipt of investment income to the current year to offset the CNIL,
- if you are an owner/manager of a private corporation, you could receive dividends rather than salary, or earn interest on amounts that you lend to the company, to reduce your CNIL,
- maximize your borrowings for business purposes and use your savings for investment purposes, and
- realize eligible capital gains early if you anticipate a CNIL "problem" in the future.

Alternative Minimum Tax (AMT)

AMT is calculated on your "adjusted taxable income" which is your taxable income excluding "preference items". Preference items include: losses from limited partnerships and other tax shelters, the non-taxable portion of capital gains, and certain allowable deductions, including carrying charges related to investments in limited partnerships, tax shelters and rental properties (to the extent of rental losses).

AMT operates in a limited range of circumstances to reduce or eliminate the current tax savings otherwise generated by preference items. You are liable for AMT if your AMT is greater than your regular taxes payable.

Other than the observation that an individual with gross income of less than $40,000 is generally not subject to AMT, it is difficult to develop a rule of thumb with respect to when AMT will apply. If you have significant amounts of "preference items", you should speak with your professional advisor before you invest in a limited partnership (or other tax shelter), or realize capital gains.

If you pay AMT in one year, the amount is recoverable to the extent that your regular taxes payable exceeds your AMT in any of the next seven years. If you paid AMT in a previous year, you could discuss steps to generate a refund of this AMT with your professional advisor.

Small Business Capital Gains Deferral

In addition to the small business capital gains exemption discussed above, you can defer tax on capital gains realized on the sale of qualifying shares of a "small business corporation" **if you reinvest** the proceeds of disposition in shares of another eligible small business corporation or corporations.

The deferral is only available if you own the shares directly (i.e. not in a corporation or trust). The proceeds of disposition must be reinvested within 120 days after the year of disposition to be eligible for the deferral. To illustrate, for dispositions occurring in 2007, the reinvestment must occur prior to April 29, 2008.

Tax Shelters

Tax shelters are effectively tax-assisted investments in real estate, oil and gas, and other operating businesses. Although tax shelters can reduce and defer tax, **you should examine them first and foremost for their investment potential**. Your net worth will not increase if there is little chance of earning a return or recovering the after-tax cost of your investment. **The tax benefits should be a secondary consideration**. Consider the following tax issues when evaluating tax shelters:

- significant deductions from a tax shelter can create AMT (i.e. additional taxes),

[38] The CNIL amount reduces the taxable capital gains eligible for the capital gains exemption (i.e. the 50% taxable portion of the gain). The maximum exemption is $250,000 (1/2 of a $500,000 capital gain for dispositions before March 19, 2007) and $325,000 (1/2 of $750,000 for dispositions after March 18, 2007).

- most tax-shelter deductions are added to your CNIL balance,
- the "at-risk rules" limit the available deductions to the amounts you invested or earned, and
- a negative adjusted cost base in a limited partnership creates a capital gain.

If you will have significant tax shelter deductions for 2008, you should consider filing a request for a reduction of income tax withholdings from employment income in 2008, rather than waiting until 2009 to file your 2008 personal tax return to receive your tax refund.

In general, before you consider an investment in a tax shelter, you should be in the highest tax bracket **after** contributing the maximum to your RRSP or RPP.

An investment in a tax shelter must be made by December 31, 2007 in order to obtain a tax deduction for 2007.

For investments, other than flow-through shares, an investor should ensure that the shelter has a Tax Shelter Identification Number issued by CRA. Tax shelters are required to register with CRA and obtain a Tax Shelter Identification Number. CRA will deny deductions or credits if a tax shelter does not have an identification number.

Certain "gifting" arrangements are considered tax shelters and must be registered by the promoter. For this purpose, gifting arrangements include plans where it is reasonable to expect that a person will make a gift to a qualified donee or incur a limited recourse debt related to the asset acquired and subsequently gifted.

The tax rules for tax shelter investments have become more complex in recent years. Rules have been introduced to significantly curtail certain types of shelters[39] (e.g. computer software and film tax shelters). Buy-low, donate-high donation shelters, involving the purchase and donation of items, such as multiple works of art, have effectively been eliminated by legislative changes made in 2003. CRA continues to aggressively pursue donation plans, where the value of tax saved by the donors exceeded the cash cost of the asset purchased and then gifted to a charity.

The income tax implications (risks, etc.) of tax shelters can be complex. Therefore, you should speak with your professional advisor prior to purchasing a tax shelter.

Investment Holding Corporations

In general, there is no tax deferral benefit to holding investments (public stocks, bonds, etc.) in an investment holding corporation. Nonetheless, you may benefit from using an investment holding corporation, in certain circumstances.

For example:

- the use of a holding corporation may lower your income which may create higher personal tax credits and eliminate the Old Age Security clawback,
- it may be possible to use a holding corporation to convert non-deductible interest to deductible interest, and
- if you own certain property in a holding corporation, you may reduce or eliminate probate fees and/or U.S. estate tax.

If you own an investment holding corporation, but are not benefiting from it, you should consider winding up the company. In doing so, the benefits of winding up the corporation should be weighed against the potential costs, including any income tax to be paid on the wind-up either by the company on a deemed disposition of its assets, and/or by its shareholder(s) on the deemed dividend that could result.

Foreign Investment Entities

Proposed tax rules[40] will allow CRA to "attack" offshore investment plans.

To the extent that you hold an investment which meets the definition of a "foreign investment entity" you may have to include certain amounts in income, even if you do not actually receive any income from the particular investment. The new rules are intended to stop Canadian residents from deferring income tax on investment income earned outside Canada through investments in foreign entities.

If you have foreign holdings, you should speak with your professional advisor to determine the effect of these new rules on you.

[39] *In 2003, the Department of Finance released far reaching draft legislation which, if implemented, could have applied to deny loss and interest expense claims. In response to concerns raised by the public, the draft proposals have been withdrawn. In the 2005 Federal Budget, the Department of Finance indicated that it will develop a "more modest legislative initiative" which will address concerns raised. As yet, no new draft legislation has been introduced. Please refer to TaxTalk 2004 Issue 4, Cases of Interest for a more detailed discussion of the 2003 draft legislation.*

[40] *As drafted, the proposals are generally to be effective retroactively back to January 1, 2007.*

Non-Resident Trusts

Recent legislative proposals[40] expand the rules for determining when an offshore trust is **deemed to be a resident of Canada** and, therefore, subject to income tax in Canada. The new rules will deem more offshore trusts to be resident in Canada. If you are a trustee or beneficiary of an offshore trust, you may wish to seek professional advice to determine the implications of these new rules.

FAMILY TAX PLANNING

Registered Education Savings Plans

A Registered Education Savings Plan (RESP) is a contract between you and an issuer under which you make current payments toward the future post-secondary education of a designated beneficiary[41] (e.g. your child or children). The contributions are not deductible, that is, you **do not receive a tax deduction** for your contributions. However, income earned in the plan is not taxable until it is distributed. Upon distribution, the *income* element is taxed in the hands of your child, and may, therefore, attract minimal tax if your child is a student subject to low marginal tax rates with a tax credit for tuition fees.

Beginning in 2007, the annual limit for RESP contributions of $4,000 per child has been eliminated and the lifetime contribution limit has increased from $42,000 to $50,000 per child.

The federal government provides a Canada Education Savings Grant (CESG) based on the annual RESP contribution. The maximum annual RESP contribution per child qualifying for the 20% CESG[42] will increase from $2,000 to $2,500 for 2007 and subsequent years, thereby increasing the annual education savings grant from $400 to $500. If a $2,500 contribution is not made in a year, the grant entitlement carries forward to a subsequent year, however, the maximum grant for any year cannot exceed $1,000 ($800 for years prior to 2007).

[41] *The single beneficiary of an RESP plan may be a child or grandchild of the subscriber, but need not be. (i.e. your niece/nephew could be the sole beneficiary of an RESP that you contribute to.) In the case of a "family plan", however, each beneficiary must be related by blood or adoption (as defined in the Act) to the subscriber.*

[42] *For taxpayers with family net income of less than $74,357, the CESG rate is increased to 30% on the first $500 of contributions per child or to 40% if the family net income is less than $37,178 in 2007.*

The maximum lifetime grant of $7,200 per child is reached by contributing a total of $36,000 to the RESP over a 15-year period. The grant is paid directly into the RESP and must be repaid to the government if your child does not pursue higher education.

The RESP rules have been relaxed for 2007 and subsequent years for part-time programs so that the required 10 hours per *week* to be spent on courses is reduced to 12 hours per *month*. Educational Assistance Payments can be distributed from the RESP - up to $2,500 will be allowed for each 13-week semester of qualifying part-time study.

Subject to the terms and conditions of the RESP, all contributions made to the RESP by you can be returned to you when the contract ends or at any time before. Since RESP contributions (capital) are not deductible when made, they are not taxable when returned.

Under certain circumstances, if your child does not pursue a post-secondary education[43], you may be eligible to receive the income element of the RESP. To receive the income element that would otherwise be forfeited, all the intended children of the plan must be at least 21, not be pursuing a qualified educational program, and the plan must have been running for 10 years. You may transfer the income element to your RRSP (to a maximum of $50,000) to the extent of your RRSP deduction limit at that time. Any income not transferred to your RRSP will be subject to a special 20% tax, which would be in addition to the regular income tax that would apply to the investment income[44].

[43] *RESP properties (capital and income) can, in most cases, be transferred to another sibling's RESP, provided the sibling is under 21 years of age.*

[44] *The additional 20% tax is to ensure that the RESP is not used to unduly defer tax.*

Charitable Donations

The first $200 of your charitable donations in 2007 will reduce your taxes payable at a rate of 24.9%[45] of the donation amount. This is a combined federal and Ontario rate. Your donations in excess of $200 will reduce your taxes payable by 46.41%[46] of the donation amount.

In order to claim a donation in 2007, your donations must be made by December 31, 2007. To obtain a higher overall tax credit, donations made by both spouses should be claimed by only one spouse[47].

Your total allowable donation claim is limited to 75% of your net income for the year. This limit increases to 100% in the year of death and the year before death.

Further, the limit increases to 100% for gifts of:

- capital property with an unrealized capital gain, to the extent you do not shelter the gain from tax by claiming the capital gains exemption,
- depreciable property with potential recapture of capital cost allowance,
- gifts to Her Majesty in the right of Canada, or a province (i.e. Crown gifts),
- certified cultural property to designated institutions or public authorities, and
- ecologically sensitive land to Canada, a province or municipality in Canada, and certain charities.

If you choose not to use a donation to reduce your taxes in the current year, or the above restrictions limit your donations, your unused donations can be carried forward 5 years[48].

If you own shares or certain debt of a public company with unrealized capital gains, and you plan on making a cash contribution to a registered charity, your after-tax cost of the gift is lower if you donate the shares instead of donating cash. For these types of gifts (and ecologically sensitive land) the capital gains tax has been eliminated.

[45] *For those taxpayers who are subject to the maximum Ontario surtax. For those who are not subject to the surtax, the tax saving on the first $200 of donations is 21.53%.*

[46] *For those taxpayers who are subject to the maximum Ontario surtax. For those who are not subject to the surtax, the tax saving for donations exceeding $200 is 40.2%.*

[47] *It is CRA's administrative policy to allow either spouse to claim donations made.*

[48] *To the extent donations cannot be utilized in the year of death, they can be claimed in the immediately preceding year.*

The capital gains tax has been also eliminated for donations of shares of public corporations to private foundations. The following table compares selling shares with a fair market value of $10,000 and a cost base of $2,000 and then donating the cash versus donating the shares directly to a charity.

	Sell Shares & Donate Cash	Donate Shares
Donation	$10,000	$10,000
Net Tax Savings[49]	2,785	4,641
Net Cost of Donation	7,215	5,359

If you exercise employee stock options and donate these shares to a registered charity or a private foundation (after March 18, 2007), there is no income inclusion with respect to the benefit you received on exercising the options[50].

Donations of funds from your RRSPs, RRIFs or proceeds from life insurance, in the year of death, are treated as donations for tax purposes.

Qualifying Retroactive Lump Sum Payments

If you receive a lump sum payment of over $3,000 relating to prior years, this receipt can be included in income in the prior year(s) instead of in the year received. This measure is intended to relieve you of the higher tax liability that may result if the entire lump sum is taxed in the year you receive it, rather than year-by-year as the right to receive the payments arose[51].

The qualifying payments include wrongful dismissal and other employment related payments arising from a court order or similar judgment, arbitration awards, super-annuation and pension benefits, and spousal or child support payments.

[49] *The chart assumes the donor is at the top marginal tax rate of 46.41%. If the donor sells the shares and then donates the cash, the estimated tax on the capital gain of $8,000 would be $1,856.*

[50] *Generally, there is an income inclusion equal to 50% of the differences between the fair market value of the shares at the time that you exercise you options and the price that you pay for the shares.*

[51] *A notional income tax liability is calculated, as if such income had been included in each prior year to which it relates. A notional interest component, using prescribed interest rates, is also computed, and must also be considered to determine the better alternative with respect to income recognition.*

Child Support and Alimony

You cannot deduct child support payments that you made pursuant to an agreement or court order entered into or altered after April 30, 1997. These payments are also not taxed in the hands of the recipient. The amount payable for child support is determined using prescribed rates and depends on the income of the payor. In certain instances, it may be beneficial for you to change a pre-May 1997 agreement to the new rules. This can be done where both parties make a request in writing to CRA.

However, where the supporting spouse is in a higher tax bracket than the recipient spouse, the application of the new rules would result in increased combined taxes. In this case, it may be beneficial to preserve agreements entered into before May 1997.

Alimony (i.e. spousal support) payments remain deductible under the new rules; however, if there are payments in arrears, the payments apply first for child support and secondly for alimony. As a result, your ability to deduct alimony may be restricted if the payments are re-characterized to be non-deductible child support.

Legal fees paid to establish, enforce or increase spousal or child support are deductible for income tax purposes regardless of whether the support is taxable to the recipient.

Income Splitting

Benefits

The primary technique of income splitting is to remove income from a higher-tax-bracket individual and add it to the income of a lower-tax-bracket family member (spouse, child or parent). The benefits of income splitting are:

- lower taxes on income and
- access within a family to multiple $500,000 capital gains exemptions (increased to $750,000 after March 18, 2007) to reduce taxes on any future sale of shares.

Opportunities for Income Splitting

There are a number of "attribution rules" that prevent income splitting. For example, where one spouse earns interest income from property received as a gift from the other spouse, the attribution rules would require the income be included in the taxable income of the transferor spouse (i.e. attributed back).

The attribution rules are complex. While there are opportunities for income splitting, you will only benefit through careful planning.

You should consider the following opportunities for income splitting and family tax planning:

- Where your minor child earns income from property (e.g. interest or dividend income) and the funds to earn this income came from you as the child's parent by way of a gift or loan, the income will be taxed in your hands unless your child pays you interest on the capital amount[52]. The interest must be paid by January 30th of the following year, is taxable in your hands and is deductible by your child. Further, the interest on the loan must be at least equal to the lesser of CRA's prescribed rate at the time of the loan, and the interest rate that would have been charged to an arm's length party[53].
- The above attribution rule on income from property to minor children does not apply to: capital gains[54], business income, or income earned on reinvested income (i.e. the compound income portion). That is, any capital gains earned by your child on money you gave him or her would be taxed in your child's hands and not in yours.
- There is no attribution on gifts to children 18 years of age or older[55]. The funds can be used for any purpose including contributions to their RRSP.
- There is no attribution of income on gifts or loans made by a non-resident of Canada to a resident of Canada.
- In 2007, an individual who has little or no other income can receive approximately $35,100 of actual **ineligible** dividends from Canadian corporations without paying income taxes[56].

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[52] *This attribution rule also applies to loans or gifts from grandparents.*

[53] *Since interest rates are currently at low levels, **consider an income-splitting arrangement using a loan to your spouse or minor child**. The loan recipient must pay interest to you as creditor at the prescribed interest rate in effect at the time the loan is made. The rate is 5% for the period October 1 to December 31, 2007. Please refer to TaxTalk 2002 Issue 3, Tax Matters of Note for a more detailed discussion.*

[54] *Consider buying securities with high capital gains potential in the names of minor children.*

[55] *Gifts of assets with unrealized capital gains will give rise to a capital gain to the transferor. There is no "gift" tax in Canada.*

[56] *Assuming that the income splitting tax ("kiddie tax") and AMT does not apply. However, the Ontario health premium of $450 would be payable. Note: Receipt of a dividend may*

- In 2007, an individual who has little or no other income can receive approximately $48,900 of actual **eligible** dividends from Canadian corporations without paying income taxes.[57]
- You can make a low-interest or interest-free loan to your adult children to assist them to acquire a principal residence.
- You can deposit the child tax benefit cheques you receive into a bank account in your child's name. The income earned in the account will be taxed in your child's hands and not in yours.
- If you and your spouse both earn income, but one of you is taxed at a higher tax rate than the other, the higher income spouse should pay all or most of the "non-deductible" family expenses, including income taxes, while the lower income spouse should invest all or most of his or her earnings to generate investment income which would be taxed at the lower tax rate.
- The higher income spouse can contribute to a spousal RRSP and up to 50% of pension income can now be split between spouses (see Tax Deferral Plans above).
- You can contribute to an RESP for your child (see Family Tax Planning above).
- You can assign half of your CPP benefits to your spouse, provided that both of you are over 60 years of age.
- You can create multiple testamentary trusts in your will. Each trust would be taxed separately resulting in multiple lower-tax-rate brackets.
- The charitable donation credit is generally maximized by having either you or your spouse claim all donations.
- In general, unless net income for both you and your spouse exceeds $64,200[58], the lower income spouse should claim all medical expenses to maximize the medical expense credit.

Subject to the income splitting tax (see discussion below), the following opportunities for income splitting may be available:

- Your spouse or your children can participate in your incorporated business through share ownership if they purchased the shares with their own funds.
- If you are a professional carrying on your practice in your own name, you could consider setting up an entity to provide either management or technical services to your practice[59].
- In addition, doctors and dentists who incorporate can have other family members own shares to allow for income splitting (as discussed on page 25).

Income Splitting Tax

The income splitting tax ("kiddie tax") is intended to discourage high-income taxpayers from splitting certain types of income with **minor children.**

Under the "kiddie tax" rules, the minor child is subject to tax at the **highest income tax rate**[60] on the first dollar of "split income" and every dollar thereafter (i.e. no graduated rates). As a result, the benefits from some income splitting techniques have been reduced significantly.

The tax applies to:

- taxable dividends from private corporations to minor children, received either directly or through trusts;
- income from a service partnership or trust arrangement where fees are derived from a professional practice of a parent or a related corporation; *and*
- income[61] from a partnership or trust[62] derived from the business of providing goods or services to a business carried on by a relative of the minor or a business in which the relative participates.

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reduce or eliminate the tuition and education credits that may be transferred to the parent.

[57] *Assuming that the "kiddie tax" and AMT does not apply. However, the Ontario health premium of $600 would be payable. Note: Receipt of a dividend may reduce or eliminate the tuition and education credits that may be transferred to the parent.*

[58] *Medical expenses must be reduced by 3% of net income to a maximum amount, which for 2007 is $1,926 for federal purposes.*

[59] *However, if the management company provides services to a professional who provides GST tax-exempt services, there will be a GST cost that may exceed the income splitting benefits of the plan.*

[60] *For 2007, the highest rate is 40.2% without the Ontario surtax, which starts to apply to "kiddie tax" income over $55,836, excluding dividends. After this income threshold, the top marginal rate is 46.41%.*

[61] *Income from property [e.g. rent, interest] earned from a business carried on by a related individual would also be subject to the "kiddie tax".*

[62] *If structured properly, and depending on your specific circumstances, there are still advantages to income splitting using family trusts.*

The "kiddie tax" does **not** apply to:

- income from employment or personal services of a minor;
- capital dividends;
- dividends[63] received on public stocks, including mutual fund corporations; *or*
- income from property acquired on the death of a parent.

Salaries to Spouse and Children

One form of tax planning that is permitted is the deduction of *reasonable* salaries paid to spouses and children by sole proprietors, partnerships and corporations. This technique allows your spouse or your children:

- to make CPP and RRSP contributions (subject to their RRSP deduction limits) and
- to contribute to EI, in certain situations.

The salary must be reasonable in relation to the services performed. To the extent a portion of the salary is unreasonable, your business will be denied this deduction, yet, at the same time, your spouse or child will still pay tax on this income, which will result in double taxation. Further, as an employer, you must withhold and remit income taxes, CPP and EI as required. Their salaries would be included in your company's Ontario Employer Health Tax (EHT) calculation. You may also be required to pay premiums to the Workplace Safety and Insurance Board in respect of the "family" salaries. The maximum salary that can be paid on which there will be no income taxes payable (assuming no other income) for 2007 is $10,462, using a tax credit rate of 15.5%.

PLANNING FOR PROFESSIONALS AND OWNER/MANAGERS

Incorporated Business Owners

Remuneration

There are several factors that you should consider when determining how best to carry on business in your corporation and how to receive profits from it.

A Canadian controlled private corporation (CCPC) is taxed in **2007** on active business income (ABI) at the following rates (*assuming a December 31 fiscal year end*):

Income	Federal Rate * %	Ontario Rate %	Total Rate %
ABI up to $400,000	13.12	5.50	18.62
ABI from $400,001 to $1,128,529**	22.12	18.67	40.79
ABI from $400,001 to $1,128,529 with M&P ***	22.12	15.57	37.69
ABI > $1,128,529	22.12	14.00	36.12
ABI > $1,128,529 with M&P ***	22.12	12.00	34.12

* including federal surtax of 1.12%
** includes clawback of Ontario small business deduction
*** M & P - manufacturing and processing tax credit

The low rate of tax in 2007 (i.e. 18.62%) applies to active business income of $400,000 per associated group.

There are federal and Ontario rules that "clawback" the low rates of tax in certain cases (see discussion below for clawback rules).

A CCPC with ABI over $400,000 should generally reduce its income to $400,000 through the use of year-end bonus accruals.[64] If income is not bonused down[65] to $400,000, an overall tax burden (combined corporate and individual, at the top marginal rate) of approximately 51.86%[66] (or 55.38% if the Ontario small business deduction is being clawed back) could be incurred by the time dividends are ultimately distributed to you. These rates are higher than the top rate on bonuses of 46.41%[67].

[63] *Other attribution rules could apply to this income.*

[64] *If the income in excess of $400,000 is eligible for the manufacturing and processing tax credit, the decision to bonus income down to $400,000 depends on how long the funds (after corporate tax) would otherwise remain in your company before being distributed to the owner/managers as dividends.*

[65] *There are alternatives to a "bonus down" strategy, including the potential use of an employee profit sharing plan or a retirement compensation arrangement.*

[66] *This assumes that dividends received are eligible dividends and taxed at the top individual tax rate of 24.64%; receipt of ineligible dividends will result in an overall tax burden of 56.14%, or 59.35%, if the corporate income is subject to the Ontario claw-back.*

[67] *47.44% if the Employer Health Tax (page 24) applies to the bonus.*

	ABI < $400,000	Ontario Clawback	High Rate Tax
Corporate income	$100.00	$100.00	$100.00
Corporate tax	18.62	40.79	36.12
Retained earnings	81.38	59.21	63.88
Personal tax *(31.34%)*	25.50	-	-
Personal tax *(24.64%)*	-	14.59	15.74
After-tax cash	$55.88	$44.62	$48.14
Total tax rate	44.12%	55.38%	51.86%

If your corporation's income fluctuates from year to year, you could consider paying tax (in the corporation) at the high rate in one year if the high rate tax can be recovered by future loss carrybacks[68].

A bonus accrual can also result in a tax deferral since payment of the bonus (and any related taxes) can be delayed for up to 179 days from the end of the company's taxation year. For example, a July 31, 2007, fiscal year bonus accrual can be paid as late as January 26, 2008. In this case, the corporate deduction would be in the 2007 fiscal year, but the related income would not be taxed in your hands until the year 2008[69].

Where the ABI in your corporation is eligible for the low rate of tax (i.e. below $400,000), the combination of salary and/or ineligible dividends to you and the owner/managers of your company are dependent on a number of other factors.

Advantages of Paying a Salary

- provides a source of earned income to maximize CPP, RRSP and RPP contributions
- is not subject to AMT
- does not create a personal instalment base due to tax withheld at source
- some or all of the salary may be eligible for the SR&ED[70] credit

Advantages of Paying an Ineligible Dividend

- an overall tax savings to a top rate taxpayer of approximately 3.3%[71] of the pre-tax corporate income if the corporation pays EHT on salaries
- dividend payments are not subject to EHT
- provides investment income to reduce your CNIL account
- dividend payments may trigger a refund of refundable dividend tax on hand in the company

The cash requirements of your company and its owner/managers, and other income sources of the owner/managers should also be considered when deciding the salary/dividend mix.

Employee Profit Sharing Plans

Under certain circumstances, an **Employee Profit Sharing Plan** (EPSP) can be used as an alternative to the traditional salary/dividend remuneration strategies to potentially defer tax or split income with other family members. An EPSP is an arrangement whereby an amount is paid to a trustee for the benefit of certain employees, which could include yourself and any family members employed by your company.

The payments made by an employer to an EPSP are based on the employer's profits. The employer contributions to the plan are deductible. All employer contributions and any income earned in the EPSP must be allocated to the employee beneficiaries on an annual basis; that is, the employee participants in the plan pay tax each year on income allocated to them. The allocated amounts qualify as earned income for RRSP/IPP deduction limit, but are not subject to CPP and EI contributions by either the employer or the employee. Income tax withholdings are not required when amounts are allocated to an employee from an EPSP.

EPSP's can be used to facilitate income splitting in companies where two or more members of a family unit are bona fide employees of the company.

An EPSP can allow a tax deferral of one year beyond that provided by bonus accruals. Contributions are deductible to an employer in a particular taxation year if made within 120 days after the particular year-end. The income inclusion to an employee is in the calendar year that the EPSP allocation is actually made.

As such, for an employer with a December 31 year-end which makes a contribution in the 120 day period following year-end, the employee is allocated income in the same calendar year that the contribution is made. As there is no withholding tax on the payment from the EPSP, the payment of personal tax is deferred (i.e. employee pays the related tax liability by the end of April in the subsequent calendar year). However, if regular allocations are made on an annual basis, employees will

[68] *Losses may be carried back up to three years.*
[69] *In this example, source deductions on the bonus, including income tax, would need to be remitted in February 2008.*
[70] *Scientific Research and Experimental Development.*
[71] *There is a 2.3% tax savings if the corporation does not pay EHT on salaries.*

have to start making quarterly instalments, effectively eliminating this deferral advantage.

Interest in Lieu of Salary

If you are a shareholder and lend money to your corporation, you should consider charging interest on the loan, instead of receiving a salary. Any interest paid on a shareholder loan should be deductible by the company, would not be subject to EHT, and would reduce your CNIL account balance, if any.

Federal Clawback of the Low Corporate Rate

The lower federal tax rate of 13.12% available on the first $400,000 of active business is limited if the prior year's taxable capital[72] (including the taxable capital of associated corporations) exceeded $10 million. The amount of income eligible for the low rate of tax is eroded when taxable capital exceeds $10 million, and is reduced to zero when the taxable capital of the company (and the associated group) equals or exceeds $15 million.

As a result of the federal clawback, it may be prudent to bonus your company's income down to the amount of income, if any, eligible for the low rate of tax.

Ontario Clawback of the Low Corporate Rate

A surtax is imposed in Ontario on corporate taxable income (including the taxable income of associated corporations) between $400,000 and $1,128,519. This "clawback" gradually eliminates the Ontario tax rate benefit of the portion of the lower tax rates on the first $400,000 of active business income for Ontario[73].

A company with taxable income (including the taxable income of the associated group) over $400,000 and earning both active and investment income should consider transferring the investment income earning assets outside the associated group to avoid the Ontario clawback. However, there may be tax implications associated with the transfer that would need to be considered.

[72] *Taxable capital includes debt and equity invested in a company, net of investments in other corporations.*

[73] *The effect of the Ontario clawback is to increase the corporate tax rate on non-M&P income to 40.79% within this income range.*

Retirement Compensation Arrangement

A Retirement Compensation Arrangement (RCA) can be a valuable retirement and estate planning tool that, in some circumstances, can also lead to reduced taxes. In appropriate circumstances, an RCA can be used as an alternative to paying a bonus to a shareholder/manager, and can be attractive for higher income owners and executives who are looking for a retirement benefits in line with their present and future income.

RCAs are a useful means of providing for the retirement of a key employee, including the owner-manager of a business. Tax savings may be realized where the employee expects to be taxed at lower marginal rates after retirement.

An RCA is a trust arrangement between an employer and an employee. Contributions are made by the employer[74] to an RCA trust, under which the employee is the beneficiary. The trust is then required to make payments to an employee (or an employee's beneficiary) on, after, or in contemplation of the employee's retirement or loss of office.

The RCA pays a 50% refundable tax on (i) contributions made to it and (ii) any income earned or gains realized by the RCA. When distributions are made from the RCA to the beneficiary, this 50% refundable RCA tax is recovered by the RCA at a rate of $1 for every $2 distributed to the retired employee.

Since the RCA is subject to the 50% tax on contributions to it and on its income, the employee is not taxable in respect of employer contributions to the plan or the income earned in the RCA. Instead, the employee pays tax on distributions from the RCA on or after retirement, and, in this way, may be able to take advantage of the lower graduated income tax rates. This may be of particular benefit after retirement if the key employee has few other sources of income, or plans to retire in a lower-taxed jurisdiction, so that lower tax rates will apply to amounts received from the RCA.

[74] *Contributions made by the employer are based on actuarial calculations and are deductible by the employer on a paid basis.*

Other potential benefits of an RCA include:

- it may be used as a vehicle to raise funds for the operating business and
- its assets can be creditor-proofed - since RCAs are established within a trust, the RCA assets are separated from the operating business assets.

As with any planning vehicle, it is necessary to consider the pros and the cons. Some pros have been outlined above. The cons include the added complexity and the initial and on-going costs to set-up and administer the RCA. In addition, a prepayment of income tax occurs since the 50% RCA tax rate is currently higher than the highest income tax rate that applies to a bonus in Ontario in 2007 (46.41%, rising to 47.44% when the Employer Health Tax is payable on the bonus).

CCPCs Corporate Tax Instalments

The 2007 federal budget included proposals to allow certain small CCPCs[75] to make quarterly (rather than monthly) tax instalments beginning in 2008 and to raise the threshold for making instalments from $1,000 to $3,000.

Capital Tax Reductions

Pursuant to the 2004 Ontario Budget, the capital tax exemption increased from $10 million to $12.5 million for 2007 and will increase to $15 million on January 1, 2008. Effective January 1, 2007, the current capital tax rate of 0.3% was reduced to 0.285% and will be further reduced to 0.225% by 2009, and then eliminated by July 1, 2010.

Research and Development

The Federal and Ontario governments have a number of tax incentives to encourage Scientific Research and Experimental Development (SR&ED). The incentives are very attractive to private companies engaged in SR&ED, and can significantly reduce the after-tax cost of SR&ED. Taxpayers should review their operations to determine if they are performing SR&ED. Measures were introduced to simplify and streamline SR&ED claims. Please refer to TaxTalk 2003 Issue 5, *Research and Development* for more information with respect to SR&ED.

[75] *To qualify for quarterly instalments, in either the preceding year or the current year, the CCPC's taxable income cannot be greater than $400,000, taxable capital (including associated companies) cannot exceed $10 million,* ***and*** *the small business deduction must have been claimed. The company must also be in compliance with its reporting and remittance requirements for the past 12 months.*

Shareholder Loans

If your corporation lends you money in your capacity as a shareholder, you and your professional advisor should review the loan annually. The general rules with regard to these loans are as follows:

- loans (whether or not they bear interest) made to you as a shareholder, from the company must generally be repaid before the end of the first taxation year of the company following the year in which the loan was made to you[76]. Otherwise, the amount of the unpaid loan is treated as income in your hands in the calendar year that you received the loan.
- certain loans (such as qualifying housing, share purchase or automobile loans) may be exempt from this "one year" repayment rule.

  In this case, a taxable benefit is required to be included in your income to the extent that the interest rate on the loan is less than the prescribed interest rate. However, you can offset the benefit by a deduction of the same amount if the low-interest loan is used by you for income-producing purposes.

  A loan to you or an individual "connected" to you[77] is exempt from the repayment rule only if it is received in the capacity of employee and is available to other similar employees. This rule significantly restricts the ability of a shareholder to receive a housing, share purchase or automobile loan that is exempt from the "one year" repayment rule.
- if the loan is included in your income, and you subsequently repay it, then the amount repaid may be a deduction to you in the year of repayment.

Review Shareholder Agreements

Shareholder agreements should be reviewed periodically. As a shareholder, it is important to have a shareholder agreement to protect your estate in the event of death or disability. It is common for the agreement to provide for the purchase of shares of the deceased by the remaining shareholders and/or a buy-back directly by the corporation.

[76] *These payments cannot be a series of loans and repayments.*

[77] *A person is connected with a shareholder of a particular corporation if he or she does not deal at arm's length with that shareholder.*

In certain circumstances, a life insurance policy can be purchased on the life of a shareholder to help fund the purchase and/or buy back of the deceased shareholder's shares.

Specific provisions in the Act dealing with share redemptions and life insurance proceeds may result in negative tax consequences and/or restrict tax planning opportunities. You should discuss the preferred wording and structure of a shareholder agreement with your professional advisor in order to access tax planning opportunities and avoid tax pit falls.

Employer Health Tax (EHT)

EHT is payable on remuneration paid to employees in Ontario. The first $400,000 of the annual payroll is exempt from EHT.

Associated employers must share the $400,000 EHT exemption. An allocation agreement to share the exemption must be filed with the EHT return, and is due by March 15th of the following calendar year. If the agreement is not filed, all employers in the associated group will be denied the exemption for the year.

EHT is calculated on all payroll amounts, including bonuses and lump sum payments made to former employees. Stock option benefits received by current and former employees are also included in the EHT base[78].

UNINCORPORATED PROFESSIONALS AND BUSINESS OWNERS

Unincorporated businesses and partnerships with individuals, as members, cannot defer income taxes by having a business year-end of other than December 31st. A taxpayer commencing business operations is required to either adopt a December 31st business year-end or make certain calculations to include in income an estimated amount of business income being deferred by the non-calendar year-end (i.e. by electing to use the "alternative method"). This election must be made in the year you commence your business even though you may not need to report business income until the following year.

You may switch your business from a non-calendar year-end to a December 31st year-end in any year. However, once you have switched the business to the December 31st year-end, you cannot switch it back to the non-calendar year-end. As a general rule, if your business income is increasing each year, keeping the non-calendar year end will provide some income tax deferral.

Extended Tax Return Filing Date

The filing deadline for the income tax returns of a self-employed individual (and his or her spouse) is June 15th of the following year[79]. However, the balance of income tax is still due and payable on April 30th of the following year, and should be paid at this time to avoid interest charges.

Incorporation of Professionals

Laws allowing professionals to incorporate in Ontario came into effect as of November 1, 2001. Incorporating a professional practice has its advantages, with the most compelling arising from the potential tax benefits: the deferral of income taxes, possible access to the capital gains exemption, and, more recently for physicians and dentists, the potential to income-split with certain family members.

However, to incorporate, the regulations or by-laws of the relevant professional governing body must allow the member to incorporate their practice. If you are a professional who does not require all the profits of your business for personal living, has significant business debt and/or wants to potentially access the small business capital gains exemption on the sale of your practice, you may wish to consider incorporating to take advantage (to the extent possible) of favourable corporate tax rates available to an active small business.

It should be noted that the incorporation of a professional practice will not limit your professional liability.

[78] *The EHT exemption will continue to be available with respect to stock options granted before May 18, 2004 by research-intensive employers and exercised by December 31, 2009.*

[79] *When an individual files an annual GST return, then that GST return is also due on June 15th of the following year, however, any GST balance payable is due on April 30th of the following year.*

For physicians and dentists, the benefits of incorporation were further enhanced with legislative changes introduced in 2006, which allow family members to hold non-voting shares of their professional corporation. The ability for the professional's family members to hold shares in the professional corporation provides for some income-splitting opportunities (via dividends), as well as multiplying access to the capital gains exemption.

Lawyers, accountants and other professionals cannot have other family members own shares in their professional corporations and thus are not able to income split with dividends.

Please refer to TaxTalk 2007 Special Issue 1, *Professional Corporations in Ontario* for a detailed discussion of incorporating a professional practice.

Home Office

If you are a self-employed individual who uses an office in your home:

- as your principal (i.e. more than 50%) place of business; **or**
- exclusively for earning business income **and** on a regular and continuous basis for meeting clients, customers or patients,

you may deduct home expenses related to the office space. These expenses[80] include the business portion of rent, mortgage interest, property taxes, utilities, home insurance, repairs, cleaning materials, and telephone. However, no capital cost allowance on the home may be claimed.

Canada Pension Plan (CPP) Premiums on Self-Employed Income

As a self-employed individual, you are allowed to deduct from income, one-half of the CPP premiums paid on income from self-employment. The remaining half will continue to qualify for a non-refundable personal credit.[81]

GST - Quick Method of Accounting

Certain self-employed individuals and small businesses may elect to use the "Quick Method" to simplify their GST record keeping. The Quick Method can be used by certain businesses (excluding lawyers, accountants, actuaries, financial consultants and bookkeepers) with annual revenues of $200,000 or less (including GST).

Under the Quick Method, you would charge GST on sales in the normal manner but remit GST to CRA based on a fixed percentage of revenues (including GST) that is lower than the GST rate. You will not be entitled to claim Input Tax Credits (ITCs) with respect to on-going expenses; however, you will still be eligible to claim ITCs on capital expenditures.

The Quick Method can simplify reporting of GST, and can lead to lower GST remittances if your business has few expenses subject to GST.

EMPLOYEES

Employee Benefits

Non-Taxable Benefits

Certain employee benefits are not subject to tax such as: employer contributions to RPP, DPSP, group sickness or accident insurance plans, private health care premiums, subsidized meals, social or athletic club memberships (when used primarily to promote the employer's business), certain training courses, relocation expenses and reimbursements of economic losses as a result of job transfers[82], as well as reasonable allowances based on a per kilometre charge for the use of an employee's automobile for employment purposes.

Your employer may provide you with **non-cash** gifts (no more than two in a calendar year) for special occasions. If the aggregate annual cost of the two non-cash gifts does not exceed $500, the gifts are not taxable to you and your employer is entitled to deduct the cost of the gifts. If the cost of the gift exceeds $500, the entire fair market value of the gift must be included in your income. Your employer may also give you non-cash awards for achievement with the same annual $500 limit and conditions applying. If the gift or award offered is cash or near cash, the full amount of the gift must be included in your income.

[80] *It is important to obtain receipts and document the expenses in your records, noting the date, purpose and GST paid in order to substantiate the deductions.*

[81] *For 2007, the maximum CPP contribution for self-employed persons is $3,979.80.*

[82] *One-half of employer-paid amounts in respect of eligible housing losses in excess of $15,000 is treated as an employment benefit received by the taxpayer.*

Taxable Benefits for Employer-Provided Vehicles

Where your employer provides you with an automobile for personal use or employment use, you will be taxed on the following:

1. "**Standby charge**." The standby charge is a notional benefit based on the cost of the automobile, or lease payments, for providing the automobile to you, the employee.

   The standby charge is 2% per month[83] (whole or partial month) of the original cost of the vehicle. Where your employer leases an automobile, the standby charge is two-thirds of the lease payments.

   The standby charge is reduced if two conditions are met: (i) your total personal use of the automobile, in a calendar year, is less than 20,004 kilometres, **and** (ii) your personal use is less than 50% of total use.

   The fact that an automobile depreciates in value does not reduce the standby charge. As a result, if the fair market value of a used vehicle is substantially less than its original cost, it may be prudent for you to purchase the vehicle from your employer[84]. Subsequent to your purchase, your employer could reimburse you for the employment use of the vehicle as discussed below.

2. "**Operating costs**." The operating costs benefit relates to your personal use of your employer's automobile.

   If your annual employment-related use exceeds 50% of total use, the operating cost benefit can be calculated as one-half of the standby charge, less reimbursements made by you to your employer. You must notify your employer in writing by December 31, 2007 if you wish to have the operating cost benefit calculated as one-half of the stand-by charge.

   If your employment-related use is less than 50%, or you choose not to have the operating cost benefit calculated as one-half of the standby charge, the operating cost benefit is calculated at 22 cents per kilometre of personal use (19 cents for automobile salespersons).

   You can avoid an operating cost benefit if you reimburse your employer for your personal-use operating costs. The reimbursement must be made by February 14, 2008. This topic is discussed in more detail in TaxTalk 2006 Issue 1, *Automobile Benefits and Deductions*.

You should review your personal use of your employer-provided automobile before December 31 to determine how close you are to the 50% employment-use threshold. It may be prudent to reduce personal use between now and the end of the year to reduce the stand-by charge and/or the operating cost benefits.

In addition to the taxable benefits to you, an employer-provided automobile creates a GST liability for your employer. The GST liability is 5/105 for 2007 of the standby charge and 4% for 2007 of the operating-cost benefit. Your employer is required to compute and self assess GST on the benefits.

Employee-Owned Vehicles

As indicated above, an allowance received by you for an employee-owned or leased vehicle can be received tax-free if the allowance is computed based solely on employment related kilometres.

An allowance received for employment-related use of your (owned or leased) automobile, which is **not** based on a per kilometre rate, is **not** considered reasonable and must be included in your income. If an allowance is included in your income, then you may deduct the portion of your automobile expenses that relates to employment use[85] to reduce or eliminate the impact of the income inclusion.

Stock Option Benefits

If you are an employee of a **public company** and you acquire shares under an employee stock option plan (ESOP), the difference between the fair market value of the shares on the date you exercise the option and the amount you pay for the shares is included in your income in the year you acquire the shares.

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[83] *If you are an employee of an automobile dealership, the 2% rate may be reduced to 1.5%.*

[84] *Alternatively, the standby charge would be reduced if your employer sells the car and then repurchases it based on the current value of the car.*

[85] *To deduct automobile expenses on your tax return, you must receive a duly-completed form T2200 - Declaration of Conditions of Employment - from your employer.*

This income inclusion may, however, be deferred to the year in which either the shares are sold, or an individual dies or becomes a non-resident. This deferral is subject to an annual ceiling of $100,000[86]. You must notify your employer in writing by January 15, 2008 in order to obtain the deferral in respect of option benefits arising in 2007.

If you are an employee of a **Canadian controlled private corporation** (CCPC) with which you deal at arm's length and acquire shares of the CCPC under an ESOP, the stock option benefit is included in income, as employment income, in the year in which **you sell the shares,** rather than the year you exercise the option.

If you acquired shares under an ESOP and either:

- the exercise price was at least equal to the fair market value of the shares on the date the option was granted, or
- they were shares of a CCPC (with which you deal at arm's length) acquired subsequent to May 22, 1985, and you have held them for at least two years,

you may deduct 50% of the stock option benefit in the year you must recognize the stock option benefit. This deduction effectively treats the increase between the exercise price and the fair market value of the shares on the date the option is exercised, similar to a capital gain (i.e. only 50% taxed).

Ontario Research Employee Stock Option Credit

Certain research employees of eligible research and development intensive companies who exercise eligible stock options qualify for an Ontario tax credit. The credit, which is subject to certain limitations, applies to stock options granted after December 21, 2000 and before May 18, 2004, provided the options are exercised and shares are disposed of before January 1, 2010.

Employee Loans

The taxable benefit that arises in 2007 from a low-interest loan by your employer to you is reduced by interest paid by you to the company by January 30, 2008. An interest deduction can be claimed by you to offset the taxable benefit for the imputed interest benefit, to the extent you used the borrowed funds to earn income from a business or property.

[86] *The application of the $100,000 annual limit to specific taxpayers can be complex. Professional advice should be sought before options are exercised.*

Employee Deductions

Employment Expenses

Certain expenses incurred by you to earn employment income are deductible against that employment income. It is important to retain receipts and document the expenses in your records, noting date, purpose and GST paid in order to substantiate the deductions. Employees are not entitled to claim capital cost allowance (CCA - depreciation for tax purposes), with the exception of CCA with respect to an automobile, airplane or musical instrument used to perform their employment duties. The types of expenses eligible for deduction differ if you earn commission income.

If you are a non-commission employee, you are restricted to deducting employment-related items, such as travel costs, automobile expenses, supplies, office rent and salary paid to an assistant.

If you are a commission employee and certain conditions are met, you are not restricted to the expenses noted above for non-commissioned employees. You are entitled to deduct a greater variety of expenses to the extent they are incurred to earn commission income. Cellular phones, computers and fax machines should be leased in order to obtain tax deductions for the lease expenses since CCA on these capital expenditures would not be deductible. For any year, the amount deductible is limited to the amount of commission income earned.

Office in Home

If you are required by your employer to maintain a home office, you may be able to deduct some expenses related to the office space.[87] For home office expenses to be deductible, you must either:

- perform more than 50% of your employment duties at home, **or**
- use the area exclusively in respect of earning income from your office or employment **and** used on a regular and continuous basis for meeting customers, clients, patients, etc.

To deduct office in home and other employment expenses from income, form *T2200 - Declaration of Conditions of*

[87] *Home office expenses that are deductible for employees include a prorated portion of rent, utilities, repairs, and cleaning materials. CCA insurance, property taxes and mortgage interest are **not** deductible. However, if you earn commission income you may also deduct a prorated amount of insurance and property taxes.*

Employment - must be completed and signed by your employer, and retained by you with your records.

GST Rebate

A GST rebate is available to an employee or a partner who incurs GST on employment-related or business expenses. The expenses, net of any allowance or reimbursement received, must be deductible from employment income or business income. The rebate is intended to parallel the input tax credit mechanism available for a GST registered business.

To receive a rebate, you should complete a GST rebate application form (Form GST 370) and file it with your personal income tax return. Alternatively, you have up to four years to claim the rebate. The rebate must be included in your income in the year in which it is received. For rebates related to CCA claims, the rebate will not be included in income, but instead will reduce the undepreciated capital cost of the related asset.

TRUSTS

Potential Deemed Disposition

With the introduction of tax on capital gains in 1972, rules were established to deem certain types of trusts to dispose of their capital assets at their market value every 21 years. Accordingly, trusts established in 1986 and 1987 may be subject to this 21 year deemed disposal rule in 2007 and 2008 respectively. There may be significant tax costs associated with the deemed disposition to the extent that the assets of the trust have appreciated in value, albeit planning options do exist to reduce, defer or eliminate income tax on the accrued gains.

In appropriate circumstances, trusts can be a valuable vehicle to meet estate, tax and probate planning objectives. Alter ego and joint partner trusts provide some unique planning opportunities for individuals over 65 years of age.

If you are a trustee of a trust which may in the near future be affected by the deemed disposition rules, or wish to explore the benefits of a trust, you should contact your professional advisor to discuss your options.

For more information with regards to Trusts please refer to TaxTalk 2000 Special Issue 1, *Family Trusts.*

Preferred Beneficiary Election

A preferred beneficiary election allows a trust to retain income but allocate this income to a "preferred" beneficiary who pays tax on it, rather than the trust. This election can only be made for a beneficiary of a trust who is mentally or physically impaired.

OTHER PLANNING POINTS

Personal Tax Instalments

You can avoid interest charges (compounded daily) and penalties if you pay the minimum required personal income tax instalments, and any final balance of tax, by their due dates. Tax instalments in respect of a taxation year are due in quarterly payments and must be received by CRA no later than March 15th, June 15th, September 15th, and December 15th. When the 15th of the month falls on a weekend or statutory holiday, the instalment is due the next business day.

You are required to pay instalments if the difference between your combined federal and provincial income tax payable and the amount deducted or withheld at source is greater than $2,000 (threshold to increase to $3,000 for 2008) in both the current year and either of the two preceding years.

Based on their records, CRA will send you a notice indicating your minimum required instalments. As long as you pay the required instalments, no interest or penalties will be charged. If you make late instalments, you can make future instalments before their due date to create an interest offset to reduce or eliminate interest and penalties.

CRA charges interest on overdue taxes at "prescribed" interest rates which are based on current treasury bill rates and are adjusted quarterly. The rate for all quarters of 2007 is 9%. The interest is not deductible, compounds daily, and equates to a pre-tax rate of approximately 16.8% for a taxpayer in the top tax bracket. Since, in most instances, commercial interest rates are lower, you will be better off borrowing from your financial institution to pay off any CRA debt.

In addition to interest on late payments, CRA assesses a penalty for late or deficient instalments equal to 50% of the interest payable where the instalment interest payable exceeds $1,000 in any year. As a result, where this additional penalty would apply, you will be further ahead if your payments are applied first to your instalment account for the current year instead of applying them to your prior year taxes.

Since interest and penalties paid to CRA, or on money borrowed to pay amounts owing to CRA, is not deductible, you may wish to seek professional advice to determine if you can re-arrange your debt to convert non-deductible interest into deductible interest.

SOCIAL ASSISTANCE AND FAMILY BENEFITS

Old Age Security Clawback

If your net income in 2007 is over $63,511, you are required to repay some or all of your Old Age Security (OAS) benefits. The clawback amount is the lesser of your OAS benefits and 15% of your net income that is over the threshold amount of $63,511. The OAS clawback is calculated solely on your net income and is not affected by your spouse's income.

If your net income is $103,191 or greater in 2007, you are required to repay all of your OAS benefits; therefore, you should consider steps to reduce your 2007 income to below this threshold.

For example, if you receive OAS and earn significant investment income which you do not require for day-to-day expenses, you may want to consider holding these investments through a corporation. The objective of this strategy is to reduce your net income and minimize your OAS repayments.

OAS benefits are subject to withholding tax. The amount the government withholds is based on your prior year's income. Any excess or deficiency in current year withholdings will be determined and adjusted when your tax return for the current year is filed.

Federal Child Tax Benefits

There are several federal programs which provide tax benefits for those who have children. Some benefits are tax-free but others are taxable, generally in the hands of the lower income spouse or common-law partner.

A qualifying family may be eligible to receive the non-taxable Canada Child Tax Benefit (CCTB). The benefit is paid monthly and is based on:

- your family net income (i.e. you and your spouse) of the prior year (i.e. 2006),
- the number of minor children you have, and
- your child care expense deduction in the prior year.

The basic benefit is $1,283 for each child under the age of 18 and there is a supplement of $90 for the third and each additional child. The benefit is reduced if your family income is more than $37,178.

You may also be eligible for the National Child Benefit Supplement (NCBS). The NCBS benefits are: $1,988 for one-child families, $3,746 for two-child families, and $3,746 plus $1,673 per child for the third and subsequent child. To receive the full benefit your family net income in 2006 must be below $20,883. When your family net income is over this threshold, the benefit is reduced. The benefit is eliminated when the income of a family with one child reaches $37,178.

In addition, families who care for a child under the age of 18 who is eligible for the disability credit may receive a tax-free Child Disability Benefit (CDB) of up to $2,351 per qualified child. The full benefit is received when your family net income is less then $37,178 and is reduced if your family net income exceeds this threshold. The benefit is fully eliminated for a family with one qualified child when the family income exceeds $154,728.

The Universal Child Care Benefit (UCCB) was introduced in 2006 and provides families with $100 per month taxable benefit for each child under the age of six. There are no income restrictions however the benefit is taxable in the hands of the lower income spouse or common-law partner. It is necessary to apply for this benefit.

Ontario Child Tax Supplement

The annual maximum Ontario Child Care Supplement (OCCS) for each child under age 7 for a single parent family is $1,310. For a two parent family the amount is $1,100 per child. For 2007, the benefits begin to be phased out when the family net income for 2006 exceeds $20,000.

The Ontario Child Benefit (OCB) is to be combined with the Ontario Child Care Supplement. It will be phased in, commencing July 2007 with a lump sum payment of up to $250 per child under the age of 18. The benefit is reduced when the family net income exceeds $20,000.

A memorandum of this nature cannot be all encompassing and is not intended to replace professional advice. Its purpose is to highlight tax-planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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APPENDIX – OCTOBER 30, 2007 ECONOMIC STATEMENT – PROPOSED TAX CHANGES

On Tuesday, October 30, 2007, the Honourable Jim Flaherty, Minister of Finance, introduced several tax changes for both individuals and corporations in the Government's 2007 Economic Statement. Some of the changes are to be retroactive to January 1, 2007, while others will be effective January 1, 2008.

Key tax changes include:

- The lowest federal personal income tax rate will be reduced to 15% (from 15.5%) effective January 1, 2007.
- The basic personal federal amount will increase for 2007 and 2008 to $9,600 (from $8,929 in 2007) and to $10,100 in 2009.

These proposals will reduce the taxes of a person with taxable income over $37,178 by approximately $240 in 2007. The following table summarizes marginal tax rates (on regular income, i.e., salary, interest, etc.) that apply to the income tax brackets for 2007 based on these proposed changes.

Taxable Income	Federal Rate (%)	Ontario Rate (%)	Total (%)
$9,600 to $35,488	15.00	6.05	21.05
$35,489 to $37,178	15.00	9.15	24.15
$37,179 to $62,488	22.00	9.15	31.15
$62,489 to $70,976	22.00	10.98	32.98
$70,977 to $73,623	22.00	13.39	35.39
$73,624 to $74,357	22.00	17.41	39.41
$74,358 to $120,887	26.00	17.41	43.41
$120,888 and over	29.00	17.41	46.41

For 2007, under the proposed changes, the maximum eligible dividend that can be received without paying income tax[88] is $49,290 and the maximum ineligible dividend is $35,599. The maximum tax-free salary (assuming no other income) that can be paid in 2007, under the proposed changes, is $11,182.

- The GST rate will drop to 5% (from 6%) effective January 1, 2008. The GST credit will remain at its current level. The threshold for a "small supplier" remains at $30,000.
- The general corporate income tax rate will decrease to 15% by 2012 (currently at 22.12%).
- The small business tax rate will decrease to 11% (from 11.5%) effective January 1, 2008. This rate reduction was originally scheduled to take place in 2009.

The following table summarizes the current and proposed federal corporate tax rates.

	2007	2008	2009	2010	2011	2012
Current General Rates	22.12	20.5	20.0	19.0	18.5	18.5
Proposed General Rate	***22.12***	***19.5***	***19.0***	***18.0***	***16.5***	***15.0***
Current SBD Rates	13.12	11.5	11.0			
Proposed SBD Rates	***13.12***	***11.0***	***11.0***			

Ontario corporate tax will be in addition. At 14%, the general combined corporate tax rate would decrease from 36.12% in 2007 to 33.5% in 2008 (for corporations with calendar year ends).

[88] *There will be Ontario Health Tax payable of $600 on the eligible dividend amount and $450 on the ineligible dividend amount.*