



2008 Personal & Corporate Tax Update

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AGENDA

- i. Tax Rates
- ii. Recent Tax Changes
- iii. January 27, 2009 Federal Budget
- iv. Tax Free Savings Accounts (“TFSA”)
- v. Tax Planning Ideas
- vi. Integration



TAX RATES

• 2008 Personal Tax Brackets - Federal

<u>Taxable Income</u>	<u>Federal Rate</u>
\$ 0 – 37,885	15%
\$ 37,886 – 75,769	22%
\$ 77,770 – 123,184	26%
\$ 123,185 and over	29%



TAX RATES

• 2008 Personal Tax Rates – British Columbia

<u>Taxable Income</u>	<u>Rate</u>
\$ 0 – 35,016	5.06%
\$ 35,017 – 70,033	7.70%
\$ 70,034 – 80,406	10.5%
\$ 80,407 – 97,636	12.3%
\$ 97,637 and over	14.7%



TAX RATES – TOP MARGINAL RATES IN 2008

Personal

	BC
Salary and Interest	43.7%
Capital Gains	21.85%
Eligible Dividends	18.5%
Non-Eligible Dividends	31.6%



RECENT TAX CHANGES

- **Personal Tax Credits Enhanced**
 - **Children's Fitness Tax Credit**
 - New non-refundable tax credit for 2007 and later years for up to \$500 of eligible fees for the enrolment of a child under age 16 in an eligible program of physical activity
 - A working definition of an "eligible program of physical activity" is:
 - *An ongoing program suitable for children in which substantially all of the activities undertaken include a significant amount of physical activity that contributes to one or more of cardio-respiratory endurance, muscular strength, muscular endurance, flexibility and balance.*



RECENT TAX CHANGES

- **Personal Tax Credits Enhanced (cont'd)**
 - **Public Transit Passes**
 - New non-refundable tax credit effective July 1, 2006 for the cost of monthly transit passes (and passes of longer duration), including passes for transit by local bus, street car, subway, commuter train or bus and local ferry
 - Claimable by the individual or his or her spouse or common-law partner for the eligible transit costs of the individual and his or her spouse or common-law partner and dependent children under age 19.
 - The receipts or passes should be retained for verification purposes
 - 2007 extended to certain weekly public transit passes



RECENT TAX CHANGES

- **Reduction of Capital Gains on Eligible Donations**
 - Effective May 2, 2006, capital gains inclusion rate will be reduced to zero for gains on
 - publicly-listed securities donated to charitable organizations and public foundations
 - ecologically sensitive land donated to a conservation charity
 - Extended to private foundations effective March 19, 2007



RECENT TAX CHANGES

▪ Pension Income Splitting

- Allows up to one-half of eligible pension income to be allocated to lower income spouse thereby reducing joint taxes
- Required to file joint election, Form T1032, *Joint Election to Split Pension Income*
- Also effects amount of personal tax credits available, i.e. age credit, spouse credit etc. Note: watch out for Old Age Security clawback (\$64,718)
- Tax withheld at source is allocated on a pro-ratio basis as well



RECENT TAX CHANGES

▪ Qualifying Eligible Pension Income

- For individuals aged 65 years and over includes:
 - pension from registered pension plans
 - income from registered retirement savings plan annuity
 - payments out of or under a registered retirement income fund
- For individuals under 65 years of age, major type of qualifying income is that received through a registered pension plan
- Income that is ineligible includes Old Age Security receipts, CPP/QPP payments



RECENT TAX CHANGES

▪ Pension Income Splitting Example

- Assume that taxpayer earns \$140,000 in taxable income in 2008, comprised of \$80,000 in investment income and \$60,000 in pension income
- Assume taxpayer's spouse earns \$30,000, including \$5,000 from a spousal RRSP
- Taxpayer and their spouse jointly elect to report half of taxpayer's pension income, \$30,000, on spouse's return
- Taxpayer's total taxes would be approximately \$13,600 lower, while spouse would pay an additional \$9,600
- Overall tax savings of approximately \$4,000



NOVEMBER 27, 2008 ECONOMIC STATEMENT

2008 Minimum RRIF Withdrawals

- Reduced by 25% for 2008 only
- Able to re-contribute any excess withdrawal until March 1, 2009
- Re-contribution deductible in 2008
- Note OAS clawback threshold



2009 FEDERAL BUDGET – TOP RATES IN 2009

	Salary & Interest	Capital Gains	Eligible Dividends	Non-eligible Dividends
BC	43.7	21.8	19.9	32.7
Alberta	39.0	19.5	14.6	27.7
Ontario	46.4	23.2	23.1	31.3

2008 Budget proposes to increase Eligible dividend rates by 4.8% from 2010 to 2012 consistent with planned corporate tax cuts



2008 Tax Update

13

2009 FEDERAL BUDGET – SELECTED TOPICS

2009 Home Renovation Tax Credit

- Maximum credit of \$1,350
- Expenditures >\$1,000 & up to \$10,000
- One credit per family group
- Work performed after January 27, 2009 &
- Before February 1, 2010



2008 Tax Update

14

2009 FEDERAL BUDGET – SELECTED TOPICS

- **First Time Home Buyers' Credit**
 - Acquire home after January 27, 2009
 - Maximum credit of \$5,000 at 15%
 - Neither individual or spouse have owned & lived in another home during current & preceding 4 calendar years



2009 FEDERAL BUDGET – SELECTED TOPICS

- **Home Buyers' Plan**
 - Tax free withdrawal from RRSP for home purchase
 - Previous limit of \$20,000 increased to \$25,000
 - Effective for withdrawals after January 27, 2009
 - Must be repaid to RRSP over 15 years





Tax Free Savings Accounts “TFSA”

TFSA – THE BASICS

Who can contribute?	Resident of Canada and 18 years of age or older
How much?	\$5,000 per year
Contribution deductible?	No
Income earned inside the plan taxable?	No!
Withdrawals taxable?	No!!



TFSA - CONTRIBUTIONS

- Can open a TFSA and contribute in 2009
- Unused contributions carry forward indefinitely
- Indexed to inflation in \$500 increments starting in 2010
- Excess contributions attract a penalty tax of 1% per month
- If you withdraw an amount, you can re-contribute that amount in the following year or later.



TFSA - INVESTMENTS

- The same investments permitted in an RRSP are permitted in a TFSA
- Private Companies:
 - not more than 10% of the value of the company's assets can be cash, investments, loans and other non-business assets
 - you, your spouse, and related parties cannot own, collectively or individually, 10 percent or more of the shares



TFSA - EXAMPLE

- In 2009 open TFSA with \$5,000
- Invest in Next Big Thing Inc. which triples in value
- In 2010 sell out for \$15,000
- NO TAX ON CAPITAL GAIN
- In 2010 withdraw \$10,000
- NO TAX ON WITHDRAWAL
- In 2011 could contribute:
 - + 2010 regular contribution room \$ 5,000
 - + 2011 regular contribution room 5,000
 - + Amounts withdrawn 10,000
 - = Total \$20,000



TFSA - SPOUSES

- Direct contributions to spousal TFSA not allowed
- Funds can be transferred to spouse to make own TFSA contributions
- Income attribution rules do not apply to such a transfer provided:
 - Funds are held and continue to be held in TFSA of spouse; and
 - At time spouse used funds to make TFSA contribution, he/she did not have excess TFSA amount



TFSA - DEDUCTIONS?

- Fees paid non-deductible
- Interest on funds borrowed to make contribution non-deductible
- Losses realized on “in kind” contribution denied
- Capital losses realized inside the plan are not deductible



TFSA - SENIORS

- No age limit
- Income earned in a TFSA does not affect
 - OAS clawback
 - GST credit
 - Guaranteed Income Supplement
 - Property Tax Credit



TAX PLANNING IDEAS

- **RRSP/TFSA vs. Non Registered Accounts**
 - Consider structuring your investments based upon tax treatment
 - Withholding taxes and the dividend tax credit are lost in registered accounts
 - Capital Gains are taxed at full rates in registered accounts
 - Consider the tax deferral issue



RRSP? TFSA? PAY DOWN DEBT?

Scenario	Recommendation
Have debt, the interest on which is not tax deductible?	Pay down the debt
Retirement income will put you in a lower tax bracket than you are now?	RRSP
Retirement income will put you in a higher tax bracket than you are now?	TFSA
Over 71?	TFSA – no age limit



RRSP? RESP? TFSA? PAY DOWN DEBT?

Scenario	Recommendation
Young person not in top bracket who expects to earn much more in the future	Save RRSP deduction room when will be in a higher tax bracket: <ul style="list-style-type: none">- contribute to TFSA- When tax rate higher contribute to RRSP, possibly using funds from TFSA
Saving for child's education?	RESP



TAX PLANNING IDEAS

- **Dividend versus Interest Income**
 - Dividend income taxed at lower rate than interest income
 - Eligible dividends grossed up by 45%, subject to offsetting federal dividend tax credit equal to 19% of the grossed-up dividend and taxed at a top rate in BC of 18.5%
 - Interest income taxed at same marginal rates as employment income (top rate in BC of 43.7%)



TAX PLANNING IDEAS

▪ Dividend versus Interest Income - Example

- Taxpayer at top marginal rate in BC would pay \$44 in tax on \$100 of interest income
- After-tax return of \$56
- In order to earn the same after-tax return, taxpayer would only need to earn \$69 in eligible dividends
- For example, this equates to dividend yield of 2.8% versus interest rate of 4%



TAX PLANNING IDEAS

▪ General Income Splitting

- Each individual taxed separately (unlike U.S.)
- Attribution rules prevent shifting income from high tax rates to lower tax rates between certain related parties



TAX PLANNING IDEAS

▪ General Income Splitting

- Generally income on loaned, gifted, transferred funds between spouses is attributed back to the transferor spouse
- Certain exceptions apply such as:
 - Reinvested attributed income
 - FMV transfers with consideration paid



TAX PLANNING IDEAS

▪ General Income Splitting

- Ensure that daily living expenses are paid by the higher-income spouse, in order to allow lower-income spouse to have a larger investment base
- Pay your spouses income tax instalments and tax payment in April
- If you carry on a business, consider paying a 'reasonable' salary to your spouse or children
 - a salary is considered 'reasonable' in light of the services provided by your spouse or children
 - examples of services include bookkeeping, filing, business development planning, etc.



TAX PLANNING IDEAS

- **General Income Splitting**
 - To achieve longer term income splitting, consider contributing to a spousal RRSP
 - Withdrawals from a spousal RRIF in future years will not be attributed back to you as long as your spouse withdraws only the minimum amount within the first 3 years of the RRIF
 - Maybe less relevant with the new Pension Income Splitting rules discussed earlier



TAX PLANNING IDEAS

- **General Income Splitting**
 - Consider providing spouse with a spousal loan, as no attribution between spouses if interest is actually paid
 - Allows taxpayer to lock in at lower interest rates, while spouse earns at current market rates
 - Must pay interest at CRA's prescribed rate (currently 2%)
 - Interest must be paid annually by January 30



TAX PLANNING IDEAS

▪ Spousal Loan Example

- On January 1, 2009, taxpayer loans spouse \$10,000
- Spouse invests the money and earns \$700 during the year
- In order to avoid attribution, interest would have to be charged at the minimum rate which is the lower of CRA's rate at the time of loan (2%) and the rate that would apply between arm's length parties (assume 6%)
- Spouse pays taxpayer \$200 in interest which can be deducted as interest paid
- Taxpayer must include \$200 as interest income in the year



TAX PLANNING IDEAS

▪ Tax Loss Selling

- Consider selling investments with unrealized losses before year-end
- Can apply these losses against any capital gains realized during the current year or in one or more of the last three years
- Special rules apply to stop artificial creation of tax losses, therefore cannot own or buy a similar property 30 days before or after the sale
- Helpful in managing OAS clawback?



TAX PLANNING IDEAS

- **Turning 71 in 2009 with Earned Income?**
 - Must convert RRSP by December 31, 2009
 - 2009 earned income results in 2010 RRSP room
 - Contribute 2010 RRSP in December 2009 before collapsing your RRSP
 - Over-contribution penalty less than tax savings



Background of the New Dividend Regime

WHY WAS THE DIVIDEND REGIME CHANGED?

- Introduced by the government to remove the disadvantage of earning income above the small business limit through a corporation vs. by an individual or partnership
- Under old regime, individuals paid more tax on business income above the small business limit earned through a corporation vs. earning same income directly by an individual or partnership
- Both the new & old regimes operate under a gross-up & credit mechanism; however, the old regime only integrated corporate & personal tax on corporate income subject to the small business deduction



NEW TAX REGIME – WHATS CHANGED?

- Lower corporate income tax rates
- Increased annual small business limit
- Lower tax rates on “eligible dividends” to eliminate most of the double tax problem



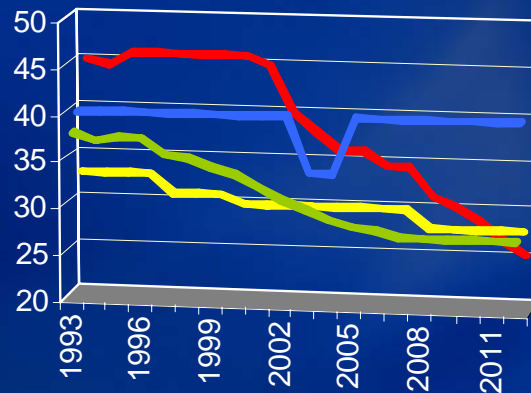
BONUS VS DIVIDEND

- It is common for shareholders to pay a salary/bonus equal to a significant portion of the taxable income of the company
- Under the old regime, this resulted in a prepayment of tax however an ultimate tax savings
- Under the new regime, coupled with the lower corporate tax rates, the decision is not as clear



CORPORATE TAX RATES

Corporate Tax Rates ... Where are they headed??



CORPORATE TAX RATES

● Scheduled Federal and BC rates (Calendar Year End)

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
General rate					
Federal	19.5%	19.0%	18.0%	16.5%	15.0%
Provincial	11.5%	11.0%	10.5%	10.0%	10.0%
	31.0%	30.0%	28.5%	26.5%	25.0%
Small business rate					
Federal	11.0%	11.0%	11.0%	11.0%	11.0%
Provincial	* 3.5/2.5%	2.5%	2.5%	2.5%	2.5%
	14.5%	13.5%	13.5%	13.5%	13.5%

* Effective December 1, 2008 BC rate reduced to 2.5%



2009 INTEGRATION – SMALL BUSINESS

Income < SB Limit

INCOME EARNED THROUGH A CORPORATION:

Corporate Income		1,000
Corporate Tax		(135)
Available for Distribution	A	865

Personal Tax		283
Net to Individual	B	582

INCOME EARNED DIRECTLY BY AN INDIVIDUAL:

Personal Income		1,000
Personal Tax		(437)
Net to Individual	C	563

SUMMARY:

Tax savings (cost) of earning income through a corporation B – C	19
Tax deferral advantage A – C	302



2009 INTEGRATION – HIGH RATE

Income > SB Limit

INCOME EARNED THROUGH A CORPORATION:

Corporate Income		1,000
Corporate Tax		(300)
Available for Distribution	A	700

Personal Tax		139
Net to Individual	B	561

INCOME EARNED DIRECTLY BY AN INDIVIDUAL:

Personal Income		1,000
Personal Tax		(437)
Net to Individual	C	563

SUMMARY:

Tax savings (cost) of earning income through a corporation B – C		(2)
Tax deferral advantage A – C		137



INTEGRATION - BC HIGH RATE BUSINESS INCOME

For High Rate Business Income Earned Through a Corporation	Before New Dividend Regime	2008	2009 -2012
Tax Deferral	9.6%	12.7%	13.7% - 18.7%
Tax Savings (Cost)	(11.2%)	(.07%)	Negligible

- ◆ Tax deferral increasing by 2012
- ◆ Tax Cost virtually eliminated in 2008 and onward
- ◆ Implications on year end bonus decision



CORPORATE TAX CHANGES

- Summary of 2008 to 2009 Corporate Tax Rates (Federal and Provincial Combined)
- Comparison of other provinces to British Columbia

	Alberta		Ontario	
	2008	2009	2008	2009
Low Rate ABI	(1.0%)	+5%	+1.5%	+3.0%
High Rate ABI	(1.5%)	(1.0%)	+2.5%	+3.0%
Investment Income	(1.5%)	(1.0%)	+2.5%	+3.0%



QUESTIONS?

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