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2007 YEAR-END TAX REVIEW AND TIPS

As the 2007 tax year rapidly draws to a close, it is important to consider the changes to the tax laws that may affect you and the tax strategies that may still be advantageous to you. We suggest that you review these topics as some may apply to you or a family member.

New in 2007

Splitting of Pension Income – applies to income eligible for the pension income credit. Generally, this is income in the form of a pension from a registered pension plan (RPP), regardless of the recipient's age. Income from an RRSP annuity, a RRIF, a LIF or a DPSP, if the recipient is 65 years of age or older.

Registered Education Savings Plan (RESP) – eliminated the \$4,000 annual contribution limit replacing it with a lifetime contribution limit of \$50,000. Annual educational saving grant increased to \$500 (20% of the first \$2,500 contributed).

Increasing RRSP age limit to 71 – the age RRSPs, RPPs and DPSPs, must be converted to either a RRIF or to an annuity has been increased from 69 to 71. If you are 70 or 71 and made what you thought were mandatory withdrawals from your RRIF this year, the new rules can offer you some tax relief.

Lifetime Capital Gains Exemption – on qualifying small business shares and farm and fishing property has been increased from \$500,000 to \$750,000 (awaiting approval).

Child Tax Credit – the tax credit is equal to 15.5% of \$2,000 or up to \$310 per child under the age of 18.

Physical Activity Program – the tax credit is equal to 15.5% of \$500 or up to \$77.50 per child, under the age of 16, for eligible fees paid.

Flow-Through Shares – the Investment Tax Credit of 15% on flow-through shares is extended through 2008.

October Mini Budget

- **Personal Income Tax Cuts** – reduction in the lowest marginal tax rate from 15.5% to 15%
- **Basic Personal exemption** – increase in the basic personal exemption from \$8,929 to \$9,600

Coming in 2008

- **GST Decreased** – from 6% to 5% effective January 1, 2008
- **Corporate Tax** – reduced to 20% falling to 15% in 2012
- **Small Business Tax** – reduction in small business tax to 11% (awaiting approval)
- **Registered Disability Savings Plan** – new program designed to help families save for children with disabilities - lifetime contribution limit of \$200,000 can be made up until the year in which the beneficiary turns 59
- **Increase in Installment Threshold** – to \$3,000 from \$2,000 (\$1,800 from \$1,200 for Quebec residents)



RRSPs and Tax-Deferred Plans

- **Transferring assets into an RRSP** – any gain on these assets will be taxable to you in the year of transfer. However, any losses cannot be claimed – *so if you wish to utilize the losses, sell the assets first and transfer the cash.*
- **Home Buyers’ Plan** – if funds were withdrawn from an RRSP prior to 2006 under the Home Buyers’ Plan, a repayment equal to 1/15 of the amount withdrawn must be made by **February 29, 2008**. Failure to do so will result in the required repayment amount being included as income for 2007.

Maximum contribution limits for tax-deferred plans for 2007 and 2008 are as follows:

Year	Registered Retirement Savings Plan (RRSP) Limit	Defined Contribution Registered Pension Plan (RPP) Limit	Deferred Profit Sharing Plan (DPSP) Limit
2007	\$19,000	\$20,000	\$10,000
2008	\$20,000	\$21,000	\$10,500

- **Contribution Deadlines** – note that the final day to contribute to an **employer’s RPP** is **December 31, 2007**. The final day for all regular 2007 **RRSP contributions** is **February 29, 2008**. This is also the final day to contribute to a surviving spouse’s RRSP for a deduction on the deceased’s final tax return.
- **If you turn 71 in 2007**, you must convert your **RRSP/LIRA** to a RRIF/LIF/LRIF before **December 31, 2007**. Note that the beneficiary designation for your RRSP/LIRA *does not* automatically transfer to your newly established RRIF/LIF/LRIF. If you want your spouse or someone else to be the specific beneficiary of your new account, this must be indicated on your application. If you have contribution room available, make your contribution prior to conversion. *Individuals turning 71 this year DO NOT have the extra 60 days after year-end to make a contribution to their own RRSP.*
- **If you have a spouse who is younger than you**, you can base the minimum withdrawals from your **RRIF/LIF/LRIF** on his/her age. Another benefit of a younger spouse is that you may contribute to their RRSP until the end of the year in which *they* turn 71, based on *your* RRSP limit.



Investments

- **Eligible Dividends** – the change to the taxation of ‘eligible’ dividends may create some unexpected results. An investor receiving a \$100 dividend would include \$145 of “taxable” dividends in their income, pay income tax, and then claim a dividend tax credit. This should result in less tax payable. However, certain government benefits and credits are reduced based on “net” income, which includes ‘taxable’ dividends, as opposed to the amount actually received. As a result, **an individual might need to repay government benefits based on income that they never received!** A couple of examples where this might apply include Old Age Security and the Canada Child Tax Benefit.
- **Non-registered GICs** – if you have GICs maturing in late 2007, defer reinvesting the proceeds in a new GIC until January 2008. The interest on a GIC purchased in December 2007 will be taxable in 2008, while the interest on a GIC purchased in January 2008 will be taxable in 2009.
- **Non-registered mutual funds** – if you invest in a mutual fund (outside of your registered accounts) between now and **December 31**, you may be in for a shock when you file your 2007 income tax return. Mutual funds must distribute all interest, dividends and realized capital gains to unit holders in the fiscal year in which they receive them. Many Canadian funds use the calendar year as their fiscal year. A year-end distribution results in you paying tax on the distribution allocated to you, although you have not enjoyed the income.
- **In Trust accounts** – for those parents or grandparents who have In Trust accounts for their children or grandchildren, capital gains can be purposely triggered now to avoid paying taxes in the future. Since minor children generally have no taxable income, they can effectively realize almost \$19,000 of gross capital gains and pay no tax as a result of their basic personal exemption. Realizing these gains now, will increase the adjusted cost base and decrease the taxable capital gains on future dispositions.
- **The deadline to contribute to an RESP** – for 2007 is **December 31, 2007**. *You DO NOT have 60 days after the end of the year to contribute as with an RRSP.* Also if you want to receive the maximum **Canada education savings grant** of \$500 you must contribute at least \$2,500. You may also contribute an additional amount of up to \$2,000 if you have that much unused contribution room from past years, and this will generate an additional grant of up to \$400.



Capital Gains and Losses

- **The disposition of securities** is deemed to take place not on the day that the order is placed, but rather on the 'settlement date'. For most securities, settlement occurs three days after placing a sell order. As such, to be considered on your 2007 tax return, Canadian transactions should be placed by **December 24, 2007** and U.S. transactions should be made by **December 26, 2007**.
- **Capital Gains and Losses** – 50% of your **capital gains** are included in your income. **Capital losses** can be carried back and claimed against any capital gains reported in the previous three years (2004, 2005, or 2006) or carried forward indefinitely. *However, your current year losses must first be used to offset your current year gains (if any).*
- **Appreciation in the Canadian dollar** relative to the U.S. dollar may have created substantial foreign exchange issues in terms of capital gains or losses.
- **Superficial loss rule** – can negate the tax benefit of selling at a loss if you, your spouse or common-law partner, or another related entity acquires the same investment in the 30 days preceding or following the sale of the security on which you are claiming the loss. Note that an **RRSP** is considered to be a related entity.
- **Employer stock options** – are taxed as employment income, *not* capital gains; hence, capital losses cannot be applied to reduce the tax payable.
- **Deemed Disposition** – be aware that you may trigger a deemed disposition or acquisition of assets even though no transaction occurs. Examples include a marriage break-up, entering or leaving Canada, RRSP contributions 'in kind', and 'change of use' of assets.

Borrowing for Tax Purposes

- **Carrying Charges** – as a general rule, interest is deductible for tax purposes as long as the loan is used for the purpose of earning income from a business or property. This is often referred to as '**carrying charges**', and several tax cases exist regarding the application of this rule. Other carrying charges include investment counselling fees, broker management costs, safety deposit box fees, etc. There is draft legislation at the Federal level to limit the amount of interest deductible to the cumulative income of the investment. Quebec has already changed its rules to provide distinct limitations.
- **Spousal loans** – established between **October 1, 2007** and **December 31, 2007**, the CRA prescribed interest rate is 5%. The deadline for payment of loan interest due in 2007 is **January 30, 2008**.



Charitable Donations

- **Share Security and Option donation** – consider making a **charitable donation** of a security with an accrued capital gain instead of using cash. As a result of donating the security, *none of the gain* will be included as taxable income rather than the standard 50% inclusion. A tax receipt will be issued for the entire fair market value of the donated security. This special tax treatment is also available for proceeds received through the exercise of employee stock options if the proceeds are donated within 30 days of acquisition directly by the exercising broker.
- **Donation of air miles or other loyalty program points** – companies often make it difficult to redeem air miles and loyalty program points, which result in an accumulation of miles and points with little or no value. Donating these miles or points to charity is a great way to redeem them and make a difference at the same time. Depending on the organization, these donations may yield a tax receipt.

Employment-Related Issues

- **Stock options** – give employees the right to purchase shares in their employer's company at a set price, known as the exercise price. The difference between the fair market value and this exercise price is taxed as employment income (*we emphasize - not capital gains*). Most employees can claim a deduction of 50% of the taxable benefit on qualified options, resulting in only 50% of the stock option benefit being taxed.
- **Defer taxation of stock option income** – employees may be able to defer the taxation on option income until the year the shares are actually sold. This deferral is subject to a limit of \$100,000 per year of vesting. **If you exercised any of your options in 2007 and continue to hold the stock on December 31, you must notify your employer in writing by January 15, 2008** in order to qualify for this deferral.
- **If you received a loan from your employer**, and you did not use the proceeds for the purpose of generating income; you can reduce the amount of the taxable benefit by making an interest payment before **January 30, 2008**.
- **If you have a company car**, there is a taxable benefit attributable to your use of the vehicle that is reported on your T4 and Relevé 1. Keep a log of your personal and business-use kilometers for your company vehicle to ensure easy reconciliation for your tax return. You may qualify for a reduced *standby charge* and *operating cost benefit* based on usage.
- **Employees who use their own car for business purposes** can receive a tax-exempt allowance from their employer if the allowance is based on the kilometers driven for business purposes, as opposed to a lump-sum allowance. The limit is 50 cents for the first 5,000 kilometers and 44 cents thereafter.



- **If you have eligible employment expenses or work from home more than half of the time**, your employer will be required to provide a form T2200, *Declaration of Employment Conditions*. Be sure you obtain a T2200 if it is applicable.
- **If you have tax-deductible expenses** such as RRSP contributions, support payments, childcare expenses, investment carrying charges, rental losses, etc., application can be made to the CRA or Revenu Québec to reduce your tax deductions at source for 2008. If approved, your employer may reduce the tax withheld at source resulting in increased cash flow. The approval process generally takes six weeks.

Income Tax Instalment

- If the difference between your **federal tax payable** and your income tax withheld at source is greater than \$2,000 (\$1,200 if you are a resident of Quebec), you are generally asked to make **income tax installment payments**. The reporting notices provided by the CRA can be confusing. If you expect that your liability will be more or less than previously calculated, you may want to adjust your final payment accordingly. While you do not want to overpay your tax, the CRA will charge you interest, and possibly penalties, if you underestimate the amount owing. The final federal income tax installment for 2007 is due **December 15, 2007**, to the Receiver General for Canada.
- If the difference between your **Quebec tax payable** and your Quebec tax withheld at source is greater than \$1,200, you are generally asked to make instalment. The final Quebec income tax installment for 2007 is due **December 15, 2007**, to le Ministère du Revenu.

Alternative Minimum Tax

- Certain tax-deductible items may expose you to **Alternative Minimum Tax (AMT)**. While this tax may be carried forward and applied in future years, it can be lost if you leave Canada and have no further taxable Canadian income. Residents of Quebec can lose the provincial AMT simply by leaving the province.



Business Owners

- For **business owners** who employ family members, pay salaries by **December 31, 2007** to ensure earned income for RRSP and CPP/QPP contributions.
- **Owner managers** with control over their income may want to ensure that they have enough employment income to maximize their **RRSP contributions**. In order to reach the maximum contribution level for 2008 (\$20,000), you must have \$111,111 of earned income in 2007.
- **If purchasing capital assets** (such as computers, furniture or equipment) in the near future, consider making the purchase(s) before the calendar year-end, or fiscal year-end for businesses, as applicable. This will allow for a depreciation claim on your 2007 return.

Quebec Changes, Proposals and Differences

- Changes will be made to the tax credit for minor children engaged in vocational training or post-secondary studies.
 - The portion of the tax credit for tuition fees and examination fees that a student does not use may be transferred to a parent or grandparent.
 - Introduction of a refundable tax credit for an RESP, equal to 50% of the Canada Education Savings Grant (CESG) for contributions after budget day (Feb 20, 2007). The lifetime maximum is \$3,600 per child.
 - Increase in the tax credit for retirement income from \$1,000 to \$1,500.
 - Introduction of a refundable tax credit for people providing respite services to informal caregivers.
- The **stock option deduction** for Quebec provincial tax purposes is 25%, compared to 50% for federal tax purposes.
 - For **investors in Quebec**, the amount of **deductible interest and carrying charges** is **limited** to the investment income, including capital gains realized in the taxation year. Exempt from this limitation are both rental losses and active business losses. These expenses can be carried back three years or carried forward indefinitely to apply against investment income and capital gains. Be aware that many tax shelter write-offs are included in the limitations and may not be deductible depending on your circumstances.

Please contact your E.E.S. Consultant for further details
concerning any of these tax topics.

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