TAXTALK

2018 YEAR END TAX PLANNING

As the end of 2018 approaches, this TaxTalk is a reminder to evaluate your finances and contemplate ways to improve your tax position. Personal tax planning is important to the management of your financial affairs and should be considered throughout the year – 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 prevent certain events that create unwelcome tax consequences.

There were some major tax changes introduced in 2018 and they could affect you if you own a private company. Although some of these changes have already impacted certain taxpayers, others won't begin to apply until 2019.

This TaxTalk will assist individuals to take advantage of planning opportunities available before the end of this year to ensure you are dealing with these changes in a tax effective manner.

Below, we have included a checklist to help you make sure you are making the most of your potential tax savings opportunities for 2018. The checklist is broken down into sections that look at some key deadlines, your investments, your retirement and estate planning and some employee planning matters. Keep these in mind to save taxes in 2018.

IMPORTANT TAX DATES

Many deductions and credits are available only if payments are made by December 31, 2018 or early in 2019.

Important dates are summarized below:

December 27, 2018

- Final trading day for Canadian exchanges for those wishing to have trades settled in 2018.

December 31, 2018

Last opportunity to make a payment for the following items in order to utilize any applicable credit or deduction on your 2018 return:

- Investment counsel fees
- Carrying charges on investments
- Interest expenses
- Professional membership and union dues
- Charitable donations
- Political contributions
- Medical expenses
- Moving expenses
- Alimony and support payments
- Child care expenses
- Certain legal, tax, and accounting fees
- Tuition fees and interest on student loans
- Payments to employer to reduce standby charge
- Contributions to Registered Education Savings Plans to qualify for 2018 Canada Education Savings Grant
- Contributions to Registered Retirement Savings Plans for those reaching 71 years of age in 2018

January 30, 2019

- Interest owing for 2018 on loans to family members (including loans to family trusts), so that the income attribution rules will not apply for 2018 and subsequent years.
- Interest owing by an employee to his or her employer, in order to reduce the interest benefit on a low-interest or interest-free loan for 2018.

February 14, 2019

- 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.

February 28, 2019

- Last day to file T4, T4A, T5 Summary and Supplemental forms.

March 1, 2019

- Deductible contributions to an individual's RRSP or a spousal RRSP (for 2018).
- Repayments of RRSP Home Buyers Plan and Lifelong Learning Plan (for 2018).

March 15, 2019

- First quarterly personal income tax instalment due for 2019.
- Employer Health Tax Annual Return (EHT).
- Employer Health Tax allocation agreement to be filed by associated companies.

April 30, 2019

- Balance outstanding on 2018 personal taxes payable.
- Personal T1 return to be filed (however, returns for *self-employed persons* are due on June 15, 2019, but any tax owing is still due April 30, 2019).

A. INVESTMENTS

Investments Held in Corporations

If you have passive investment income earned through a private corporation that operates an active business, you may be adversely affected by the new passive investment income rules. If these rules do affect you, remember that they will generally apply to tax years that begin after 2018. As a result, you need to consider if there is any planning that you should implement before December 31, 2018.

Under the new rules, the small business deduction is reduced on a straight-line basis for affected companies with between $50,000 and $150,000 of investment income, so that the small business deduction is completely eliminated for corporations earning passive investment income of $150,000 or more.

Since these new rules apply to associated corporations and certain related corporations, isolated passive investments in a separate corporation may not prevent a reduction to a company's small business deduction.

Also, under the new rules, a private company will need to pay non-eligible dividends to obtain dividend refunds of certain taxes that could previously been refunded when an eligible dividend was paid.

TFSA Contributions

Canadian residents age 18 and over are eligible to open a TFSA. Income (interest, dividends, capital gains etc.) earned in a TFSA is ***not taxable*** as it is earned, nor is it taxable when withdrawn from the account.

Contributions to a TFSA are ***not tax deductible***. For 2018, the maximum contribution is $5,500 plus any outstanding contribution room carried forward. If no contribution has been made to a TFSA, the 2018 contribution limit will be $57,500. You are able to contact CRA by phone or online to confirm your contribution room. Contribution limits are not affected by income (although annual tax returns must be filed with CRA in order to generate contribution room), and any unused TFSA contribution room may be carried forward indefinitely.

It should be noted that the attribution rules do not apply to funds you gift to your spouse to invest in a TFSA, which makes the TFSA ideal to split income with a lower-earning spouse, common-law partner or adult child.

You can withdraw funds at any time and for any purpose without incurring any tax liability. The funds withdrawn will not affect your eligibility for income tested benefits such as Old Age Supplement, Canada Child Tax Benefit or Guaranteed Income Supplement. If you need to withdraw funds from your TFSA, consider withdrawing funds in 2018 rather than deferring to early 2019 because withdrawals from a TFSA are not added back to your TFSA contribution limit until the beginning of the year following the year you made the withdrawal.

Interest on money borrowed and fees incurred to invest in the TFSA are not tax-deductible. Capital losses realized with the TFSA cannot be applied against capital gains realized outside the TFSA. Unlike an RRSP, the TFSA may be used as loan collateral.

Crystalizing Capital losses

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

- Sell investments with accrued losses before the end of 2018 to offset your taxable gains if you have realized capital gains in 2018.
- Realize any accrued capital losses in investments held in foreign currencies (given the foreign currency fluctuations that we are currently experiencing).
- Crystalize a capital loss if you paid tax on capital gains in any of the preceding three years.

It should be noted that if you realize a capital loss in 2018, the "superficial loss" anti-avoidance rule will deny your loss to the extent the same investment is acquired by you or a person that is affiliated[1] 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 you or the affiliated person, and reduces the gain or increases the 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.

B. RETIREMENT & ESTATE PLANNING

Maximizing RRSP Contributions

Three factors limit the amount you can contribute to an RRSP.

- A dollar limit ($26,230 for 2018 and $26,500 for 2019);
- 18% of your 2017 (i.e. the previous year) earned income; and
- Your pension adjustment (which represents the value of pension contributions made by you and your employer in the year).

CRA includes a "2018 RRSP Deduction Limit Statement" as part of the 2017 Notice of Assessment. This Statement indicates the maximum amount deductible on the 2018 tax return and any RRSP contributions made in prior years that you have not claimed a tax deduction for. You should verify these amounts prior to making any RRSP contributions.

Spousal RRSP Contributions

You can contribute all or part of your RRSP deduction limit to a "spousal" RRSP in which your spouse[2] is the annuitant. Your ability to contribute to a spousal RRSP is limited to your own RRSP deduction limit, not by your spouse's RRSP deduction limit or RRSP contributions. Advantages of a spousal RRSP include income splitting and, where your spouse is younger than you, a longer tax-deferral period for income earned in the RRSP.

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 two subsequent calendar years following your contribution to a spousal plan, the withdrawal will be taxed in your hands.

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

Timing of RRSP Contributions

RRSP contributions you make by March 1, 2019 may be deducted on your 2018 tax return, subject to your 2018 RRSP deduction limit. To the extent contributions are made in 2019, those amounts could also be applied as a deduction on your 2019 tax return.

The maximum age for holding an RRSP is 71. If you turn 71 in 2018, your RRSP contribution for 2018 should be made by December 31, 2018.

Old Age Security (OAS) Claw back

If your net income in 2018 is over $75,910 ($77,580 for 2019) then you will have to repay 15% of the excess over this amount, to a maximum of the total amount of OAS received. The OAS claw back is calculated solely on your net income and is not affected by your spouse's income.

Individual Pension Plan (IPP)

An Individual Pension Plan (IPP) is an employer-sponsored defined benefit pension plan to provide enhanced retirement benefits and important tax advantages. An IPP offers several key benefits, including:

- May provide higher contributions than permitted by RRSPs;
- IPP investments grow on a tax-deferred basis;
- IPP contributions are tax-deductible to your corporation as a plan sponsor;
- Employer contributions are not considered a taxable benefit for the employee;
- Fees to set up and administer the IPP are tax deductible by the employer.

An IPP could be ideal if you:

- Are an incorporated self-employed business owner or professional;
- Between the ages of 40 and 71 with annual T4 income greater than $100,000; and
- An employer looking to enhance retirement benefits for a key employee.

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

[2] "Spouse" includes a spouse by marriage, as well as a common-law partner of the opposite sex or same sex.

C. EMPLOYEES

1. Employee Benefits

Taxable Benefits for Employer-Provided Vehicles

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

a) 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[3] (whole or partial) of the original cost of the vehicle. Where your employer leases an automobile for employee use, the standby charge is 2/3 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 20,000 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[4]. Subsequent to your purchase, your employer could reimburse you for the employment use of the vehicle as discussed below.

b) The **operating cost 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, 2018 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 26 cents per kilometre of personal use.

   You can reduce or eliminate the operating cost benefit if you reimburse your employer for personal-use operating costs. The reimbursement must be made by February 14, 2019.

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

In addition to your taxable benefits, an employer-provided automobile creates a HST liability for your employer. The HST liability is 13/113 of the standby charge plus 9% of the operating-cost benefit. Your employer is required to compute and self-assess HST 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 and not more than 55¢ for the first 5,000 kms 49¢ for any additional kms.

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[5] to reduce or eliminate the impact of the income inclusion.

Employee Loans

The taxable benefit that arises in 2018 from a low-interest loan by your employer to you is reduced by interest paid by you to the company by January 30, 2019. You can claim an interest deduction to offset the taxable benefit for the imputed interest benefits, to the extent you used the funds to earn income from a business or property.

2. 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 HST 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. More types of expenses are

[3] For employees principally employed in selling or leasing automobiles, the 2% is decreased to 1.5% per month, based on the average cost of all automobiles purchased by the employer in the year.

[4] Alternatively, the standby charge would be reduced if your employer sells the car and repurchases it at current value.

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

eligible for deduction if you earn commission income from your employment.

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 is not deductible. For any year, the amount of expenses 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[6]. 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 use it 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 Employment* - must be completed and signed by your employer and retained by you with your records.

We Can Help

Your MG advisor can help you review your personal or business tax situation and help you decide which steps you can take before the year-end to help you with the taxes you'll pay for 2018.

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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[6] *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.*