Manulife Investments

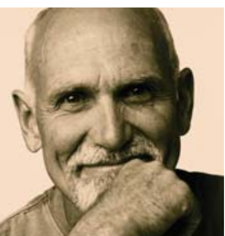
WealthStyles®

Tax tips: Helpful information you should know

The following are a few tax tips that you may wish to consider when planning for not only this year, but future tax years. Among other things, these tips may allow you to reduce the taxes you pay; more efficiently manage your family income; and use certain expenses to your best advantage.

REVIEW THE TAX EFFICIENCY OF YOUR PORTFOLIO

Review the type of income you earned on your portfolio outside of your RRSP this year. If you earned interest income, which is highly taxed, consider restructuring your portfolio so that it is more tax efficient. Think about placing investments that generate interest or have a history of large distributions within your RRSP and keeping investments that pay out smaller taxable distributions or that generate more dividend and capital gains outside of your RRSP.



TRANSFER INVESTMENTS TO A CHILD

Consider transferring investments that have dropped in value to a child. The transfer will trigger a capital loss that you can use to offset any capital gains earned this year. The excess, if any, can be carried back up to three years or carried forward indefinitely to offset other capital gains. If the child is 18 or older, all future income (interest, dividends and capital gains) will be taxed in their hands. If the child is under the age of 18, choose investments that produce primarily capital gains. With minor children, interest and dividend income are attributed back to a parent but capital gains are taxed in the child's hands. The income attribution rules also do not apply if you invest the Child Tax Benefit in your child's name. Keep these dollars separate from any other investments.

DONATE SECURITIES TO A CHARITY

Charitable donations made by year-end will provide you with a tax credit and tax savings for 2005. If you're going to sell certain publicly traded securities like stocks, bonds, mutual funds or segregated funds anyway,

consider transferring ownership of those assets directly to a charity. Under a special government incentive, the capital gains inclusion rate on donated securities is cut in half to just 25 per cent (the usual capital gains inclusion rate is 50 per cent). In other words, any taxes owing from the disposition will be 50 per cent less than if you had sold the property to make a cash donation. And don't forget that married and common-law couples can pool their donation receipts to maximize their tax credits.

CONTRIBUTE TO YOUR RRSP

You may deduct RRSP contributions made in the year or up to 60 days after the end of the year provided you have the contribution room. This means you have until March 1, 2006 to make a contribution to your RRSP (or spousal RRSP) and claim a deduction on your 2005 tax return. However, you should contribute to your RRSP as soon as possible. The earlier you contribute to your RRSP, the more time your money will have to grow sheltered from taxes. If you are not sure where to invest the money, you can always make the contribution and have it sit there until you figure out what you want to do with it. Note that if you have, or are turning 69 in this calender year, your RRSP contribution deadline remains December 31st.

CONTRIBUTE TO A SPOUSAL RRSP

Contributing to a spousal RRSP can be an effective way to split income, particularly where you expect a large disparity in pension income between spouses. The higher-income-earning spouse makes the spousal RRSP contribution and receives the tax deduction. The lower-income spouse will be able to withdraw the money and have it taxed at their lower tax rate provided they wait until the third year after the spousal RRSP contribution.

Therefore, if you make a contribution to a spousal RRSP before year end, your spouse will be able to withdraw money from their RRSP without having income attributed back to you a full year earlier than if you contribute after year end. For example, if you contribute to a spousal RRSP before the end of 2005, your spouse can withdraw those dollars on January 1, 2008 and have it taxed in their hands (at the lower rate) and not yours. If on the other hand you wait until January 2006 to contribute to a spousal RRSP, the earliest your spouse could make a withdrawal without having the income taxed in your hands would be January 1, 2009.

DEFER YOUR BONUS

If you can afford to wait, ask your employer to delay payment of this year's bonus until January of the new year. This will defer the tax on the bonus to next year.

FAMILY BUDGETING

One of the most effective income-splitting techniques is to have the higher-income earner pay for all family expenses (i.e. household and personal expenses, including personal taxes) and have the lower-income earner invest their income. This allows the family's investment income to be earned in the hands of the lower-income earner and, consequently, to be taxed at a lower marginal tax rate.

CHILD CARE EXPENSES

Qualifying child care expenses paid during the year, such as babysitting, can be claimed on your 2005 tax return. In addition to child care expenses paid to third parties, you can claim amounts paid to children 18 years or older who are looking after siblings, 16 years or younger, when it allows you to earn employment or business income. You will be eligible to claim a deduction, and the child you are paying will have to include the payments as income on their tax return – although this may result in little or no tax, depending on their annual income. This can be a very effective income-splitting strategy.

SALARIES TO FAMILY MEMBERS

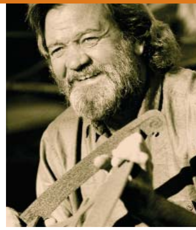
One effective income-splitting technique for individuals with a business is to pay family members a salary or wages for any services they provided in the year. The services must have genuinely been provided and the salary or wages must be reasonable. A family member could also be a director for a corporation and receive reasonable director's fees. This also generates RRSP contribution room for your family members.

MAKE NON-DEDUCTIBLE DEBT DEDUCTIBLE

If you are currently paying interest that is not deductible, for example on a home mortgage or RRSP loan and have non-registered investments (i.e., investments outside your RRSP or RRIF), you may be able to rearrange your affairs to make the interest deductible. This strategy involves selling some, or all, of your non-registered investments (however, consider the tax cost of any sale before deciding whether or not to sell any particular investment) and using the proceeds to pay down the non-deductible debt. Then take out an investment loan and re-purchase the investments. However, be careful of the superficial loss rules. If the sale of the non-registered investment triggers a capital loss, wait at least 30 days to buy the identical investment or purchase a similar but not identical asset, otherwise your capital loss will be denied. Recent court cases have suggested that this strategy may allow you to deduct the interest on the loan that was used to invest. If successful, you have now made your non-deductible debt deductible. Talk to your tax advisor to confirm if this strategy can work for you.

REDUCE TAX WITHHELD AT SOURCE

The idea of a tax refund is cause for celebration for most people, but it shouldn't be. The reality is that a tax refund means you have paid the Canada Revenue Agency (CRA) too much tax throughout the year. In essence, you have provided the government with an interest-free loan. If you have non-payroll RRSP contributions, child care expenses, interest expenses on investment loans, alimony, maintenance or support payments, charitable donations or rental losses, you can reduce the amount of tax deducted at source by your employer. Simply submit Form T1213, "Request to Reduce Tax Deductions at Source," to CRA for authorization. If approved, CRA will authorize your employer to deduct less tax from your pay. To make this even better, use this extra money to fund a periodic investment plan also known as a pre-authorized chequing plan (PAC) or to pay the interest on a leverage loan.



CONSIDER INVESTING IN A MUTUAL FUND CORPORATION

Mutual fund corporations allow you to switch between funds without triggering a capital gain, thereby deferring tax and allowing the investment to grow quicker. Fund switches within other non-registered investment structures are generally considered a taxable disposition and create a capital gain or loss.

THINK ABOUT YOUR ELDERLY PARENTS

Make sure that your elderly parents are making the most of their income and government benefits. The amount of tax your parents pay and government benefits they receive, such as Old Age Security (OAS) and the Age and Medical Expenses Tax Credits, are often based on the amount of income they report on line 234 of their tax return. Different types of income contributing to the amount on line 234 are "included" at different rates. For example, income from registered investments is included at 100 per cent (i.e. it is fully taxable). However, non-registered income is included at different rates depending on the investment source. By re-aligning your parents' investment portfolio to generate income in the most tax-efficient manner, you may be able to maximize their after-tax income and government benefits. Scheduled withdrawals, often referred to as a Systematic Withdrawal Plan (SWP), and prescribed annuities are just two examples of ways to generate tax-efficient income.

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