

WHAT'S NEW

YEAR END TAX PLANNING - 2004

As the end of 2004 approaches, this WHAT'S NEW is a reminder 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: minimize your tax burden or defer taxes to a later tax year. Tax planning can include

preventing events that could create unwelcome tax consequences.

This WHAT'S NEW will assist residents of Quebec who wish to take advantage of opportunities that exist for minimizing income taxes for 2004 and subsequent years. It is based on existing and proposed legislation and the current interpretation of tax laws by the Canada Revenue Agency (CRA), Revenue Quebec and the courts.

FAMILY TAX PLANNING: 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 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.

Subject to the income splitting tax (the "kiddie tax") (see discussion below), 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. 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 the 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.
- The above attribution rule on income from property to minor children does not apply to: capital gains, 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.

IMPORTANT DATES AND DEADLINES

Many deductions and credits are available only if payments are made by December 31, 2004 or early in 2005. Important deadlines are summarized below.

Amounts to be paid by December 31, 2004

- 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 (office in home, travel expenses, etc.)
- for capital losses and capital gains on most publicly traded securities, the last day for taking a tax loss is December 28, 2004 resulting in a settlement date of December 31, 2004
- contributions to Registered Education Savings Plans to qualify for 2004 Canada Education Savings Grant

Information returns to be filed by January 15, 2005

- an employee must advise his or her employer of his or her intent to elect to defer benefits from stock options exercised in 2004

Amounts to be paid by January 30, 2005

- any interest owing for 2004 on loans to family members (including loans to family trusts) must be paid by January 30, 2005 so that the income attribution rules will not apply for 2004 and subsequent years.
- any interest owing by an employee to his or her employer must be paid by January 30, 2005 in order to reduce the interest benefit on a low-interest or interest-free loan for 2004

Amounts to be paid by February 14, 2005

- If an employee is provided with an automobile for work and uses it for personal use, it may be appropriate for the employee to repay the 2004

personal operating costs paid for by the employer. This benefit must be included in income at the rate of 17 cents (14 cents for an automobile salesperson) per kilometre of personal use.

Information returns to be filed by February 28, 2005

- T4/relevé 1 slips and summaries and T5/relevé 3 slips and summaries for 2004

Amounts to be paid by March 1, 2005

- deductible contributions to an individual's RRSP or a spousal RRSP (for 2004)
- repayments of RRSP Home Buyers Plan (for 2004)

Amount to be paid by March 15, 2005

- first personal income tax instalment for 2004

Amount to be paid by May 2, 2005

- balance outstanding on 2004 personal taxes payable

FAMILY TAX PLANNING

- There is no attribution on gifts to children 18 years of age or older. 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 2004, an individual who has little or no other income can receive approximately \$25,000 in dividends from Canadian corporations while paying little or no income taxes.
- 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, 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.
- You can contribute to a registered education savings plan for your child.
- You can assign half of your Quebec Pension Plan benefits to your spouse, provided that both of you are over 60 years of age.
- Subject to the "income splitting tax" as discussed below, your spouse or your children can participate in your incorporated business through share ownership if they purchased the shares with their own funds.
- You can create multiple testamentary trusts in your will. Each trust would be taxed separately thereby allowing multiple lower-tax-rate brackets.
- Subject to the "Income Splitting Tax" as discussed below, if you are a professional carrying on your practice in your own name, you should consider setting up an entity to provide either management or technical services to your practice.
- In general, the charitable donation credit is maximized by having one spouse claim all donations.
- In general, the lower income spouse should claim all medical expenses to maximize the medical expense credit.

Income splitting tax

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

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 from a partnership or trust 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.

The "kiddie tax" does not apply to:

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

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

REGISTERED RETIREMENT SAVINGS PLANS

Deduction Limits

For 2004, your RRSP deduction limit equals the **lesser of**:

- 18% of your 2003 **earned income** (see below) (i.e., the previous year); and
- \$15,500

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 2004 to restore lost RRSP deduction limit on termination of employment, and

- your unused RRSP deduction limit carried forward since 1991.

The CRA provides the "2004 RRSP deduction limit statement" for you as part of your 2003 notice of assessment. This statement indicates your 2004 deduction limit which is the maximum you can deduct on your 2004 tax return. This statement also indicates RRSP contributions from prior years that you have made but for which you have not claimed a tax deduction.

You should verify the amounts when determining your available RRSP deduction limit for 2004.

Earned income includes: employment income, business income, rental income, disability pension income received under the Quebec Pension Plan, and taxable support receipts. Earned income does not include: business and rental income earned through a limited partnership, interest income,

REGISTERED RETIREMENT SAVINGS PLANS

dividends, capital gains, pension benefits, retiring allowances or severance, death benefits and other amounts received from an RRSP or Deferred Profit Savings Plan (DPSP). It 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.

Where, in prior years, you deducted less than your RRSP deduction limit, the excess creates unused RRSP deduction room.

Your unused RRSP deduction room can be carried forward indefinitely allowing you to contribute to your RRSP in future years when you have more funds available.

The RRSP limits for 2004 and subsequent years, before any pension adjustments, are as follows:

YEAR	LIMIT
2004	\$ 15,500
2005	16,500
2006	18,000
2007	Indexed for wage growth.

Spousal RRSP

You can contribute all or part of your RRSP contribution limit to an RRSP of which your spouse is the annuitant (spousal RRSP). Your ability to contribute to a spousal RRSP is not limited by your spouse's RRSP contribution limit or his or her RRSP contributions. The advantages of a spousal RRSP include: splitting income during retirement and, where your spouse is younger than you, a longer tax-deferral period for income earned in the RRSP.

Finally, if you turned 69 prior to 2004, you can no longer contribute to your own RRSP; however, you can contribute to a spousal RRSP, for which you will receive a deduction, provided that your spouse is 69 or younger at the end of 2004.

Building Unused RRSP Deduction Room for Children

Where you have a child who has earned income and the child is not required to file a personal tax return because his or her income is too low, the child should still file a return and report his or her earned income. In this way, with each year's tax return filed, the child will build up unused RRSP deduction room. The end result of this strategy is a child with a larger RRSP contribution limit available for future years.

Timing of Contributions

Subject to your 2004 RRSP deduction limit, RRSP contributions you make by March 1, 2005 will be deductible for 2004.

If you turn 69 in 2004, your RRSP contribution for 2004 must be made by December 31, 2004.

You should consider making your 2005 RRSP contribution as early as possible in 2005. In doing this, you will benefit from a longer period during which your retirement fund can grow tax deferred.

If you wish to increase your deduction limit to the maximum of \$16,500 for 2005, you will need earned income of \$91,667 in 2004.

WHAT'S NEW
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