RBC Wealth Management Services

The Navigator

Early 2016 Tax Tips

Many investors are aware of the importance of tax planning near the end of the year to minimize their income tax liability. However, often-neglected areas of tax planning include meeting the important deadlines for implementing tax planning strategies that may only be available early in the new year. The purpose of this article is to summarize some of the strategies that have deadlines in January and February 2016.

This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.

RRSP Contribution Deadline for the 2015 Tax Year

The deadline for you to make a contribution to a registered retirement savings plan (RRSP) that can be claimed as a 2015 RRSP tax deduction is generally the 60th day after the 2015 year-end, which falls on Monday, February 29, 2016.

In-Kind RRSP and TFSA Contributions

If you do not have sufficient cash on hand to make an RRSP contribution, you can consider making an in-kind contribution of eligible securities from your non-registered account to your RRSP or a spousal RRSP. If you make an in-kind RRSP contribution between January 1, 2016 and the February 29, 2016 deadline, you can claim the fair market value (FMV) of the securities at the time of the transfer to your RRSP, as a deduction on your 2015 income tax return (up to your 2015 RRSP deduction limit).

You can also contribute securities in-kind to your Tax-Free Savings Account (TFSA). Like an RRSP contribution, the amount you contribute will be equal to the FMV of the securities transferred in-kind. Be careful not to contribute more than your TFSA contribution limit or you will have a TFSA over-contribution and may be subject to penalties.

It is important to note that an in-kind transfer from your non-registered account to your RRSP or TFSA account is considered to be a taxable event which may result in a capital gain.

If the security you transfer in-kind to your RRSP or TFSA is in a gain position, you will defer the taxes payable on this gain until 2017, when you file your 2016 tax return.

If the security you transfer in-kind to your RRSP or TFSA is in a loss position, the capital loss is deemed to be nil. You will never be able to use that capital loss to offset any capital gains. If you would like to be able to claim the capital loss on your 2016 tax return, consider selling the securities in your non-registered account for cash and contributing the cash to your RRSP or TFSA instead of making an in-kind transfer. If you would like to repurchase the same security in your RRSP or TFSA due to the investment merits, be careful not to trigger the

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superficial loss rules. Wait at least 30 days after the settlement date before repurchasing the same security in your RRSP or TFSA.

RRSP or TSFA contribution loans are another option to consider. Depending on your specific circumstances, it may make sense to borrow funds to catch up on unused RRSP contributions or to fund this year's contribution.

It is important to note that using borrowed money to finance the purchase of securities involves greater risk than a purchase using your existing resources only. Should you borrow money to purchase securities, your responsibility to repay the loan as required by its terms remains the same even if the value of the securities purchased declines. In addition, interest paid on money borrowed to make an RRSP or TFSA contribution is not deductible for tax purposes.

2016 RRSP Contribution Room Created on January 1, 2016

It is generally a good idea to contribute to an RRSP as soon as possible to maximize the tax-deferred growth in your plan and to avoid the stress of a last minute deadline. January 1 is the earliest date you can make a 2016 RRSP contribution using the new room that is created from your prior year's earnings without triggering an over-contribution penalty.

If you wish to maximize your RRSP contribution for 2016 by making a contribution early in the 2016 calendar year, you will need to estimate your 2016 RRSP deduction limit. You will not have received your 2015 notice of assessment (NOA) which provides a statement of your 2016 RRSP deduction limit.

To estimate your 2016 RRSP deduction limit, take 18% of your previous year's (2015) earned income up to the RRSP dollar limit ($25,370 for 2016), and subtract any 2015 pension adjustment. If you are unsure of your earned income amount or the results of your calculation, you should wait until you receive your NOA from the Canada Revenue Agency (CRA) for your 2015 taxation year. Once you have estimated your available RRSP contribution room, you can consider one of the following two contribution strategies:

1. Make a lump sum contribution for 2016; or
2. Establish a pre-authorized regular (e.g., monthly) RRSP contribution plan.

Consider making an over-contribution by the allowable $2,000 lifetime over-contribution limit which is not subject to the over-contribution penalty tax. Although the additional $2,000 over-contribution amount is not tax-deductible, it can be deducted in a future year if you generate new contribution room in the future. If you decide to make a $2,000 over-contribution, you must ensure that you eventually deduct it from income on a future tax return otherwise you will be double taxed on the $2,000 over-contribution. You never got a tax deduction for the $2,000 and you will be taxed on it eventually when it is withdrawn of your RRSP.

Tax-Free Savings Account (TFSA)

If you are a Canadian resident, 18 years of age or older, with a valid social insurance number, you are eligible to open a TFSA. Once you open a TFSA, The TFSA contribution limit is $5,500 for 2016.

you will be able to contribute the full TFSA dollar limit for that year. Please note that in certain provinces and territories, the age of majority is 19. In these jurisdictions, a person who is 18 will accumulate TFSA contribution room for the year but will not be able to open the TFSA until they reach age of majority.

The contribution limit was $5,000 per year for the years 2009 to 2012 inclusive, $5,500 for 2013 and 2014, $10,000 for 2015 and $5,500 for 2016. The TFSA contribution limit will be indexed to inflation and rounded to the nearest $500. If you did not use your contribution room in a previous year, the unused room is carried forward indefinitely. Consider making a contribution to your TFSA early in the 2016 calendar year to maximize the tax-free growth in your plan. In addition, if you withdrew an amount from your TFSA in 2015 or prior years, you can re-contribute this amount to your TFSA as of January 1, 2016. Be careful when recontributing to your TFSA account as there are penalties for over-contributions.

Family Income Splitting Loans

An effective way to split income with family members involves setting up a prescribed rate loan with your spouse or a family trust. If you previously set up a prescribed rate loan, it is critical that the annual interest on the loan be paid on or before January 30, 2016.

The interest rate charged on the loan is based on the CRA prescribed rate in effect at the time the loan was established. This rate remains in effect until the loan is repaid even if the CRA prescribed rate changes at a future time.

If the January 30th deadline is missed, this may result in attribution back to you (the lender) for the 2015 taxation year and all future years even if your spouse or family trust pays the required interest payments by the deadline in the following years. In other words, the income splitting strategy would become undone. In the case of a spousal loan, there would be attribution of both income (interest and dividends) and capital gains. In the case of a loan to a family trust, there would be attribution of income only where the income of the trust were allocated to minor beneficiaries or a spouse or where taxable capital gains are allocated to a spouse.

Make sure that your spouse or family trust actually issues a payment from their account to yours. A cashed cheque may provide evidence that the interest was paid and received by you.

Eligible Retiring Allowance

If you received an eligible retiring allowance in 2015, you have until February 29, 2016 to transfer your retiring allowance to your own RRSP without affecting your RRSP contribution room. The eligible retiring allowance cannot be transferred to a spousal RRSP. The eligible portion of your retiring allowance is based on $2,000 per year of service before 1996 plus $1,500 per year of service before 1989 if you were not a member of a pension plan. This transfer will allow you to defer taxation on the eligible retiring allowance received until it is withdrawn from your RRSP.

If you received an eligible retiring allowance in 2015, you have until February 29, 2016 to transfer your retiring allowance to your own RRSP without affecting your RRSP contribution room.

Unlike regular unused RRSP deduction room that you can carry forward each year, if you do not make this transfer by February 29, 2016, you will lose the opportunity to do so forever.

If your eligible retiring allowance was paid to you over two years, for example in 2015 and 2016, you would still be able to transfer the 2016 portion to your RRSP any time in 2016 or early in 2017 for the 2016 taxation year.

Labour-Sponsored Investment Fund Purchases

Another strategy for reducing your income tax liability after the 2015 year-end is to consider purchasing shares of labour-sponsored funds by February 29, 2016 to take advantage of a 10% federal labour-sponsored funds tax credit on a maximum contribution of $5,000 (maximum $500 federal tax credit). An additional provincial tax credit may also be available depending on your province of residence and the type of fund purchased. Labour-sponsored funds can be purchased in registered and non-registered accounts. If you purchase them by February 29, 2016, you can claim the tax credits on your 2015 or 2016 tax return. Credits claimed on your 2016 tax return will only be eligible for a 5% tax credit.

The tax advantage of purchasing a labour-sponsored fund must be weighed against the investment merits (generally higher risk) and the requirement to hold the investment for at least eight years. Cashing in all or part of a labour-sponsored fund before the required eight-year holding period has expired will result in a full repayment of the tax credits (except in the case of death). Speak with your RBC advisor to determine if an investment in a labour-sponsored fund is suitable for you.

Locked-In Plan Conversion

If you have a locked-in plan such as a locked-in retirement account (LIRA) or a locked-in RRSP and are planning to convert it to a life income fund (LIF) or restricted life income fund (RLIF) in 2016, then you may want to consider doing so in January 2016, rather than later in the year. This is because the maximum payment available in the first year of the plan is prorated based on the months remaining in the current year, with any part month being equal to a full month. As such, converting to a LIF or RLIF in the first month of the year may allow you to ultimately withdraw more funds for that first year. No proration is required in the first year for an Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia or Quebec LIF.

Note that in the calendar year that the locked-in plan is converted to a LIF or RLIF, there is no minimum payment that must be withdrawn.

Canadian tax rules require that you report the accrued interest annually based on the anniversary date of the security.

Fixed Income Purchases with January Maturities

When you purchase interest accruing securities, such as T-Bills or strip bonds, in a non-registered account, consider purchasing ones with a January maturity date to maximize the tax deferral on interest accruals. Even though you only receive proceeds when you sell the security or the security matures, Canadian tax rules require that you report the accrued interest annually based on the anniversary date of the security. The anniversary date is every calendar year on the day before the issue date. For example, a strip coupon issued on January 16, 2015 has its first anniversary on January 15, 2016.

Assume you purchase that strip coupon on January 16, 2016 with a January 16, 2019 maturity date. You are required to report the accrued interest from January 16, 2016 to January 15, 2017 on your 2017 income tax return. Since you purchased the fixed income instrument after the anniversary date, you will have no interest to report in 2016, the year of purchase.

Ensure that the tax advantages of timing your non-registered account fixed income purchases do not override the investment merits of the fixed income instrument.

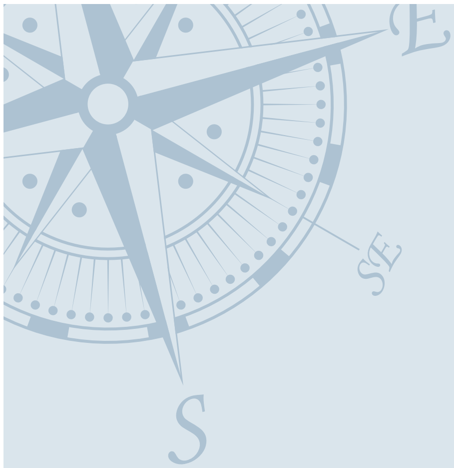
Business Owners

Bonus Planning

If your business has a year-end after June 30, consider paying yourself or your employees a bonus within 179 days after year-end. Canadian tax rules allow a corporation to deduct a bonus paid to an employee on the corporation's previous year's tax return as long as the bonus is paid within 179 days after the corporation's year-end. The employee must declare the bonus for personal tax purposes on their tax return in the year they receive the bonus.

For example, assume your corporation has a December 31, 2015 year-end. It can pay a bonus in January 2016 for services rendered in 2015. Your corporation can deduct this bonus on its 2015 corporate tax return and the employee will report this bonus on their 2016 tax return.

If you or your employee receiving the bonus is subject to the new highest federal tax rate of 33% effective for 2016, this strategy may not be appropriate. In this case, it may be preferred to receive the bonus in 2015 to save some personal income tax. Speak to a qualified tax advisor to determine which strategy would be more relevant for your situation.



Canadian tax rules allow a corporation to deduct a bonus paid to an employee on the corporation's previous year's tax return as long as the bonus is paid within 179 days after the corporation's year-end.

If your corporation pays a bonus directly to you, it is required to withhold the necessary payroll taxes. If you request that the corporation transfer the bonus directly into your RRSP, some or all of the withholding taxes on the bonus can be avoided. Transferring a bonus directly to your RRSP is at the company's discretion and hinges on certain factors. For example, many smaller companies simply do not have the capability to redirect cheques and make direct deposits.

If your company has the capability to make direct deposits and is willing to transfer your bonus directly into your RRSP, you will need to have adequate unused RRSP deduction room in the year of transfer. Some companies request a CRA certified Form T1213, *Request to Reduce Tax Deductions at Source* as proof of sufficient RRSP room. Due to the time required to have the CRA certify your Form T1213, some companies accept a copy of your NOA as proof.

If your company chooses to transfer your bonus directly to your RRSP, it will receive a tax deduction for the year of transfer and you will receive the bonus in your RRSP with no immediate taxes withheld. You essentially get the benefit of investing the full amount of your bonus in your tax-deferred RRSP.

T4 Filing Deadlines for Employers

If you have employees in your own business or you employ a nanny or babysitter, then you must file the appropriate T4 Summary forms to the CRA by February 29, 2016. A copy of the T4 slip must also be delivered or mailed to your employee(s) by this date. If you, as an employer, fail to file the appropriate T4 forms to the CRA by this deadline, you may be subject to penalties.

Sale of Private Business Shares

You may have disposed of "qualified small business corporation" shares in 2015 and realized capital gains that cannot be fully exempt under the $813,600 lifetime capital gains exemption. If this is the case, you may be able to defer all or some portion of the taxable capital gain if you reinvest the proceeds in a new eligible small business corporation any time in the year of disposition or within 120 days after the end of that year. As these deferral rules are complex, consult a qualified tax advisor if you intend to explore this option.

Conclusion

This article covers some common tax planning strategies that you should consider early in the new year. For more information on any of these topics, please speak with your RBC advisor.

If you have employees in your own business or you employ a nanny or babysitter, then you must file the appropriate T4 Summary forms to the CRA by February 29, 2016.

Please contact us for more information about the topics discussed in this article.

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