RBC Wealth Management Services

THE NAVIGATOR

2013 YEAR-END TAX PLANNING

THE BARNSDALE & HUSSAIN WEALTH MANAGEMENT GROUP OF RBC DOMINION SECURITIES

DAVID BARNSDALE
CFP,CIM,FCSI,CHFS
Vice President,Investment Advisor
Associate Portfolio Manager

1-866-205-6536
905 822-1793 David
905 822-1372 Q
905 822-1262 Ana Maria

www.davidbarnsdale.com

Opportunities to reduce your 2013 tax bill

As year-end approaches, taking some time to review your financial affairs may yield significant tax savings. To ensure that you leave no stone unturned, we have summarized some common year-end tax planning strategies in the article below.

This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information 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.

REVIEW YOUR PORTFOLIO FOR TAX LOSS SELLING OPPORTUNITIES

If you have sold some assets and realized capital gains during the year, and you are holding other securities with unrealized losses, consider selling them as well. This "tax loss selling" strategy of selling securities at a loss to offset other capital gains realized during the year is a common year-end tax planning technique. Review your securities portfolio with your RBC advisor to determine if any investments are in a loss position and no longer meet your investment objectives. If the investment still has strong fundamentals and meets your investment objectives, consider all costs, including transaction costs before selling investments solely for the purpose of triggering the tax loss.

When disposing of a security, the sale for Canadian tax purposes will be deemed to have taken place on the "settlement date". Assuming the normal three-day settlement period, in order to utilize a tax loss selling strategy for the 2013 tax year, transactions must be initiated by December 24, 2013 for Canadian securities and by December 26, 2013 for U.S. securities in order to settle during 2013. Note that since December 26, 2013 is a holiday in Canada, you may also want to consider placing any U.S. transactions by 1:00pm on December

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24, 2013 to ensure a 2013 settlement. Canadian and U.S. option transactions have a one-day settlement, therefore option transactions must be initiated by December 30, 2013 to ensure 2013 settlements.

Superficial Loss Rules

In order to ensure that your capital loss can be claimed, you must be aware of the "superficial loss" rules. A superficial loss will occur when a security is sold for a loss and both of the following occur:

i) the identical property is acquired or re-acquired during the period beginning 30 days before the disposition and ending 30 days after the disposition of the original security; **and**

ii) at the end of the above period, you still hold the identical property.

Among other situations, the superficial loss rules will also apply if you sell an investment at a loss and it is acquired by an affiliated person during the time period described above. An affiliated person includes your spouse, a corporation controlled by you and/or your spouse, or a trust of which either you or your spouse is a majority-interest beneficiary.

If you trigger a superficial loss your capital loss will be denied. The denied loss amount will then be added to the cost base of the substituted investment effectively resulting in your original cost base being transferred to the newly repurchased shares. However, if you or an affiliated person delays the repurchase until after the 30-day period, you may claim the capital loss.

Note that the 30-day waiting period is counted from settlement day of sale to settlement day of repurchase and includes all holidays and weekends.

Furthermore, the superficial loss rules also apply to mutual funds sold at a loss.

Selling the loss security in a non-registered account and repurchasing the identical security in a registered account where you or your spouse is the annuitant/subscriber (e.g., RRSP/RRIF/TFSA/RESP) within 30 days and owning it on the 30th day after the sale will also cause your capital loss to be denied. Furthermore, when a superficial loss is triggered on the transfer of the loss security to a registered account this will result in the capital loss being permanently lost.

Gifting the loss security in-kind to an individual who is not your spouse (for example, a minor or adult child) will allow you to claim the capital loss as this gift is to a non-affiliated person the superficial loss rules will not be triggered.

Carryforward / Carryback of Capital Losses

A capital loss must first be applied against any capital gains (including capital gain distributions from mutual funds) of the current year. However, once the capital gains of the current year have been offset the balance of the loss can be either carried back three years (to capital gains realized in 2010, 2011, or 2012) or carried forward indefinitely to offset future years' capital gains. When you apply a net capital loss back to a previous year's taxable capital gain, it will reduce your taxable income for that previous year. However, your net income, which is used to calculate certain credits and benefits, will not change. Note that this is the last year in which you can carry your losses back to 2010 and offset them against your 2010 capital gains.

Note that if you plan on triggering a capital loss in a corporation, you

If you have net capital losses in 2013, you can carry back those losses against previously realized capital gains in 2010, 2011 and/or 2012. However, before losses can be carried back, they must first be used to offset capital gains in the current year.

should speak to your accountant prior to triggering the loss as it may be advantageous to pay out the capital dividend account (CDA) balance prior to triggering the loss.

Defer Realizing Capital Gains

Deferring a capital gain to next year is also a common tax planning strategy. As we approach the end of 2013, if you currently have unrealized capital gains you may want to consider deferring the realization of capital gains until 2014 for the following reasons:

a) Your marginal tax rate may be lower in 2014 compared to 2013;

b) Realizing capital gains at the end of this year means that any tax payable associated with the gains would have to be remitted to the Canada Revenue Agency (CRA) by April 30, 2014. Realizing capital gains at the beginning of 2014 means that any tax payable would not have to be paid until April 30, 2015 (unless you are required to make tax instalments); and,

c) If you have net capital losses in 2013, you can carry back those losses against previously realized capital gains in 2010, 2011 and/or 2012. However, before losses can be carried back, they must first be used to offset capital gains in the current year. Therefore, realizing capital gains at the end of 2013 would reduce the amount of capital losses you could carry back.

As always, the investment merits of deferring the sale of a security to the following year for the purpose of deferring the realization of a capital gain must be considered first before looking at the tax benefit.

Year-End Bonus Planning

Receiving a bonus prior to year-end creates additional RRSP deduction room for 2014 if you have not yet reached the maximum 2014 RRSP deduction limit. Furthermore, receiving a bonus prior to year-end may also allow greater employee/employer pension and/or employee profit sharing plan contributions for 2014 if these contributions are based on the prior year's total compensation. However, if you will be receiving a year-end bonus consider deferring the receipt of your bonus (if your employer permits) to early 2014 if you expect to be in a lower tax bracket next year.

If the bonus is paid directly to you there will be withholding taxes at source on the bonus payment. However, if your employer permits, some or all of the withholding taxes on the bonus can be avoided if it is transferred directly to an RRSP. You must have adequate unused RRSP deduction room in the year of transfer.

Note that if your bonus is deferred to 2014 the amount is deductible to the employer in the year it is declared if it is paid within 180 days of the corporation's year-end. The bonus is taxable to you as employment income in the year it is received.

Low-Income Year

If you expect to be in a lower marginal tax bracket in 2013 (i.e., you will be earning less than approximately $40,000 of taxable income) but expect to be in a much higher marginal tax bracket in retirement then you may want to consider making an early withdrawal from your RRSP before year-end. In general, this strategy only makes sense for those individuals who are primarily growth investors outside their RRSP and are nearing retirement. The advantage of this strategy is that you can avoid a higher income tax rate on these RRSP funds if withdrawn in the future when your marginal tax rate may be higher. Furthermore, if the RRSP funds withdrawn are reinvested in a non-registered account, you can take advantage of the preferred income tax treatment on capital gains, Canadian dividends and return of capital. The drawback of this strategy is a prepayment of income tax and lost tax deferral on the RRSP funds withdrawn.

Tax Instalments

If you are required to make quarterly tax instalment payments to the

If you are turning age 71 in 2013, you must convert your RRSP, Individual Pension Plan (IPP), Locked-in Retirement Account (LIRA) or Locked-in RRSP to one of the maturity options that are available by December 31, 2013.

CRA, you should make your final payment on or before December 15, 2013 to avoid late interest charges. If you missed an earlier instalment payment deadline, then you may want to consider making a larger final instalment payment or make your final instalment payment earlier than the December 15, 2013 deadline to minimize late interest charges.

You may have the opportunity to reduce or defer your tax instalment liability by switching the method you use to calculate your instalments. For example, it may be more advantageous to base your instalments on the current year's estimated taxes, rather than on taxes owing for the prior year. However, you must be very careful when paying less than the amount on the CRA tax instalment statements. If you underestimate your tax instalments for the current year based on your own calculation, you could be subject to interest and penalties for not paying the full amount on the CRA tax instalment reminder statements.

Charitable Donations

In addition to RRSP contributions and investment tax shelters (discussed later), making a charitable donation is one of the ways that you can significantly reduce the personal tax you pay. The final day to make contributions to a registered charity in order to claim the donation tax receipt on your 2013 income tax return is December 31, 2013. Due to the calculation of the donation tax credit, donations above $200 can result in a tax savings equal to the top marginal tax rate in your province of residence (except in Alberta, New Brunswick, Ontario and Quebec where the donation tax credits are 50%, 46.95%, 46.41%, and 48.22% respectively). For example, a donation of $10,000 can result in tax savings of approximately $4,300 for residents of British Columbia.

As an alternative to cash, you can also donate publicly listed securities in-kind to qualified charities without being subject to tax on the realized capital gain. You will receive a donation tax receipt equal to the fair market value of the security at the time of the donation, which can help reduce your total taxes payable.

Speak to your RBC advisor on the investment merits of donating securities in-kind to a charity prior to year-end. If you plan on donating securities in-kind before year-end, then due to the administration involved in processing an in-kind donation, ensure that you start this process well in advance of the year-end to ensure that the in-kind donation is recorded as a 2013 donation. If you have thought about leaving a legacy but are unsure of the best way to accomplish this, speak to your RBC advisor on the benefits of donating cash or securities in-kind to your own charitable foundation which can be facilitated through programs such as the RBC Charitable Gift Program.

Steps to Take if You are Turning 71 in 2013

If you are turning age 71 in 2013, you must convert your RRSP, Individual Pension Plan (IPP), Locked-in Retirement Account (LIRA) or Locked-in RRSP to one of the maturity options that are available by December 31, 2013. Keep in mind that if you would like to make a final contribution to an RRSP of which you are the annuitant and be able to claim the contribution on your 2013 tax return, you DO NOT have the extra 60 days after 2013 to make your RRSP contribution. Contributions are not permitted to a RRIF.

If you have not yet done so, you can now make your Tax-Free Savings Account (TFSA) contribution for 2013 (up to $5,500) and catch up on unused contribution room from 2009-2012 (up to $5,000 per year)

In addition, if you are turning age 71 and have earned income in 2013 consider making your 2014 RRSP contribution before your RRSP is converted. The reason for this is that if you have 2013 earned income, your 2014 RRSP contribution room would not be created until January 1, 2014. If you are turning age 71 in 2013, you cannot have an RRSP after December 31, 2013, therefore you should consider making your expected 2014 RRSP contribution in December 2013 before converting your RRSP. This early contribution (sometimes called the "forgotten RRSP contribution") will allow you to claim the RRSP deduction on your 2014 income tax return. Although you have over contributed to your RRSP now, the tax savings realized should easily outweigh the over contribution penalty of 1% per month. For instance, the over contribution penalty on a $24,270 RRSP contribution for 2014 would be $243 (1% of $24,270) if you made this 2014 RRSP contribution in December 2013. However the tax savings on the $24,270 RRSP deduction in 2014 could be as high as $12,135 (depending on your province of residence).

If you have a younger spouse, consider making your RRSP contributions to a spousal RRSP until the year your spouse turns age 71, thereby avoiding the over contribution penalty.

TFSA Contributions

If you have not yet done so, you can now make your Tax-Free Savings Account (TFSA) contribution for 2013 (up to $5,500) and catch up on unused contribution room from 2009-2012 (up to $5,000 per year). The TFSA enables you to earn tax-free investment income, including interest, capital gains and dividends, which results in greater growth compared to a regular taxable account. You can make tax-free withdrawals any time, for any reason, and any amount you withdraw is added back to your available contribution room on January 1 of the following year. If you are thinking of making a withdrawal from your TFSA in the near-term, consider doing so before December 31. This will allow you to recontribute the amount withdrawn as early as January 1, 2014 rather than having to wait to 2015 to recontribute.

RESP Contributions

Registered Education Savings Plans (RESPs) are not only an excellent way to save for a child's post-secondary educations costs – it's also a good income splitting strategy. The lifetime contribution limit is $50,000 per beneficiary and there is no annual contribution limit. RESP contributions are eligible to receive the Canada Education Savings Grant (CESG). The government will match 20% of the first $2,500 in annual contributions to a maximum grant of $500 ($2,500 x 20%) per beneficiary, per year. However, each beneficiary can only receive a lifetime maximum CESG of $7,200. You should consider contributing to your RESP by December 31 if you haven't maximized your contributions. Any unused CESG room can be carried forward until the year the child turns 17, subject to annual maximums.

Additionally, if you have a child or grandchild who turned 15 this year and has yet to benefit from an RESP, then December 31 is your last opportunity to contribute a minimum of $2,000 to an RESP so that you can benefit from the 20% CESG for 2013 and then establish CESG eligibility for 2014 and 2015.

Trigger Capital Gains in a Trust Account

Individuals, including minor children, with no other taxable income can realize approximately $20,000 of capital gains tax-free each year (depending on province of residence) due to their basic personal exemption. If the trust or in-trust is properly structured, capital gains realized by the trust may be allocated and taxed in the hands of the child with little or no taxes payable. If you still favour the security, it can be bought back immediately thereby increasing the adjusted cost base (ACB) of the security. The higher ACB going forward may mean less taxes payable in the future. Of course, a potential disadvantage of this strategy is the incremental transaction fees, if any, associated with the sale and re-purchase. Also note that even though there may be no tax payable on the sale, extra tax return preparation fees may result from this strategy.

Defer Mutual Fund Purchases

If you purchase mutual funds near year-end in a non-registered account you may face an unexpected tax liability next April.

During the year, a mutual fund will earn taxable income and realize taxable capital gains some of which will not be taxed at the mutual fund level but instead will be distributed to the unit holders. This distribution is made to all unit holders at a certain point in time, often at December 15th even if a unit holder only just recently purchased the units. Therefore, if you purchase mutual fund units just prior to the distribution you will pay income tax on the full distribution amount even though the overall value of your holdings may not have changed.

Once the distribution is made, the Net Asset Value of your mutual fund is reduced by the amount of the distribution and generally the distributions are reinvested which will increase your ACB. Therefore, the problem lies in that you receive no benefit from the distribution since you will simply hold additional units with a lower unit price (with the same total value) and yet are left with a tax liability triggered by the taxable distribution.

To avoid this premature tax payment, consider waiting until January to make a mutual fund purchase. Another potential solution is to sell the fund prior to the distribution date to avoid receipt of the distribution and then buy back the same fund after the distribution is made. If you made a recent purchase, this would likely result in little or no income tax since your cost base will likely be close to your sale price. Ensure you determine your potential capital gain prior to implementing this strategy or whether the sale would trigger redemption fees. Transfers within the same family of funds using this strategy may trigger a capital gain/loss without incurring redemption fees, but the previously mentioned superficial loss rules may apply.

If a fund makes regular distributions (monthly or quarterly) then selling it at year-end will allow you to avoid the tax liability associated with any remaining distributions during the year-end and you may not save as much tax as selling a fund that makes one large year-end distribution.

Keep in mind that if the mutual fund is purchased in a registered account, the taxable year-end distribution is not an issue.

Tax Shelters

Many high-income earners will consider purchasing a tax shelter (i.e., limited partnership, flow-through shares, etc.) before year-end in order to receive significant tax deductions. A tax shelter is generally structured so that the expenses incurred by the tax shelter in the first few years are flowed directly to you, the individual investor, so that you may deduct them against any of your taxable income. However, as the saying goes "a good tax shelter that is a bad investment is really a bad tax shelter." In other words the investment potential of the tax shelter and not just the initial tax savings should be your prime consideration when deciding whether to invest in a tax shelter. Before making any investment in a tax shelter, you should consider the following questions:

The investment potential of the tax shelter and not just the initial tax savings should be your prime consideration when deciding whether to invest in a tax shelter.

> Individuals are subject to provincial taxes based on their province of residence on December 31st.

- What are the specific features and inherent risks associated with this investment?
- What is the issuer's track record?
- Is there a prospectus or offering memorandum?
- Has the tax shelter received an Advanced Income Tax Ruling from the CRA regarding certain aspects of the investment? If so, ask to see a copy.
- Is future financing required (i.e., additional future instalment payment or liability for debts incurred by the partnership)?
- When will the tax deductions be available to you?
- Will the tax deductions trigger Alternative Minimum Tax?
- How liquid is your initial investment?
- How does the tax shelter investment affect your overall asset allocation strategy and your risk tolerance?
- How long do you plan to hold the investment and what are the tax implications on disposition?

You should be comfortable with the answers to the above questions before making an investment. Although the temptation may be high to invest in a tax shelter solely for the immediate tax benefits, you should ensure that there is a reasonable expectation of profit after taking the tax benefits into account. In addition, the overall benefits of investing in a particular tax shelter should outweigh the potential benefits of other investment alternatives at that time. Speak with an RBC advisor in order to determine if an investment in a tax shelter is right for you.

Moving Within Canada

Individuals are subject to provincial taxes based on their province of residence on December 31st. Since marginal tax rates vary from province to province (e.g., the top combined federal and provincial tax rate in Alberta is 39% and the top rate in Nova Scotia is 50%), if you are moving to a province with a lower tax rate, you may consider moving prior to year-end. If you are moving to a province with higher tax rates, you may consider delaying your permanent move until early 2014.

Re-File Your Tax Waiver to Get Next Year's Tax Refund Early

If you normally file a tax waiver (CRA Form T1213 "Request to Reduce Tax Deductions at Source") to have your employer reduce taxes withheld at source from your pay, don't forget to re-file this form as it must be submitted and approved by CRA annually. If you have not filed this form in the past, consider doing so if you normally receive a tax refund when you file your tax return. This will allow you to have more cash flow during the year to accomplish various financial goals such as making monthly RRSP contributions, making additional mortgage payments, or reducing or eliminating other personal loans or credit card debt. The CRA will normally approve the tax waiver for individuals who expect the following types of deductions: RRSP contributions, alimony payments, carrying charges, childcare expenses, and employment expenses, among others.

Approval of the tax waiver by the CRA usually takes about six weeks; therefore, for the 2014 tax year you should start applying in late October/ early November 2013.

Other Considerations

You should remember to pay all investment management fees, tuition fees, accounting and legal fees if deductible, childcare expenses, alimony, and any medical expenses by year-end if the intent is to claim them on your 2013 tax return.

Business Owners

Individual Pension Plan

As a shareholder and an employee of your business, you have the option of considering an Individual Pension Plan (IPP) as a method of saving for retirement. An IPP is a registered defined benefit pension plan, similar to many large company sponsored plans, except it is established and sponsored by your company and designed for you as the only member. IPPs generally have only one plan member except certain family members may also

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participate if they are employees of the company.

In order to establish a plan you must receive employment income from your company which is reported on a T4 by the company as a salary and/or annual bonus. An IPP is most suitable for those who have significant T4 income and are at least forty years of age.

If your company is incorporated and you are looking for both year-end corporate income tax deductions and a structured retirement savings plan for yourself, consider establishing an Individual Pension Plan (IPP). Speak to your RBC advisor if you require more information on the benefits and considerations of an IPP and to learn how RBC can help you establish an IPP.

Pay Yourself Before Year-End

If you operate your own business then consider paying salaries to yourself and family members before year-end. This year-end payment will give the family member earned income so they can make an RRSP contribution the following year and will give your business a tax deduction in the current year. Note that the salary paid must be reasonable and based on the services performed by the family member for the business (e.g. in light of what you might have had to pay someone who isn't related to you).

Purchasing Assets For Your Business

If you intend on purchasing assets for your business (i.e., computer, furniture, equipment, etc.), you should consider making this purchase before year-end. If the asset is available for use, this year-end purchase will allow the business to claim depreciation on the asset for tax purposes. However, generally only half of the regular allowable depreciation can be claimed for tax purposes in the first year of an asset purchase.

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