The Navigator

Liberal Party of Canada Tax Pledges

What does Real Change mean for you?

On Monday, October 19, 2015, Canadians elected the Liberal Party to a majority government which has promised to implement "real change". In order to help you understand how these changes may affect you, this article describes some of the key Liberal Party tax pledges and strategies you may want to consider in light of these potential changes.

This article contains pledged tax changes that may not be implemented. This article also 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.

Changes to Federal Personal Tax Rates

The Liberal Party has pledged to lower the 22% federal personal tax rate to 20.5%. Currently, the 22% tax rate applies on taxable income between $44,702 and $89,401 and the lower rate would provide individuals with a maximum tax savings of $671.

The Liberal Party also plans to introduce a new high federal personal tax bracket that will be subject to a tax rate of 33%. This new rate is 4% higher than the existing high federal personal tax rate of 29%. The new 33% rate will apply to taxable income above $200,000.

The combined federal and provincial/territorial top marginal tax rates on various types of income should the Liberal Party implement the pledged changes are contained in the Appendix.

Justin Trudeau is quoted in the media as saying the Liberal government's first legislative bill will include changes to personal income tax rates and tax credits for families. While they have not specified when the bill will be introduced, it appears to be a priority for the Party and it is possible that the changes to personal income tax rates and tax credits will be implemented for 2016.

TFSA Annual Contribution Reduction

The Liberal Party has promised to roll back the current TFSA contribution limit of $10,000 to $5,500. Although the Liberal Party has not explicitly stated the taxation year to which this reduction will occur, it is widely believed that the reduction will be implemented for the 2016 tax year.

Changes to the Employee Stock Option Benefit Deduction

An individual who exercises employee stock options is generally taxed on the difference between the exercise price and the fair market value of the stock as employment income at the time the options are exercised. Under current tax rules the individual may be entitled to a 50% stock option benefit deduction if they meet certain criteria. This effectively allows employees to enjoy capital gains tax rates on part of their compensation.

The Liberal Party has pledged to lower the 22% federal personal tax rate to 20.5% and to introduce a new high federal personal tax rate of 33% for taxable income above $200,000.

The Liberal Party has pledged to limit the amount of stock option deduction that can be claimed. However, they have said that employees with up to $100,000 in annual stock option gains will not be affected by any changes to the stock option benefit deduction.

Assuming the pledged changes take place in 2016 and no grandfathering rules are introduced for existing granted employee stock options, you may be subject to tax on 100% of the employee stock option benefit at the top federal marginal tax rate of 33% if you exercise your employee stock options after 2015. If you currently own unexercised employee stock options and you may be affected by these changes, you may want to consider exercising your options in 2015. However, it is important that you evaluate your own situation with your qualified tax advisor before exercising the options to take into account the effect of the prepayment of tax on exercising your options earlier than planned, how you will be funding the exercise of the stock options, as well as the current and future potential share price for the underlying stock.

Changes to Personal Tax Credits and Benefits

Replace Existing Child Benefits with a new Canada Child Benefit

There are currently three federal child benefit programs in Canada:

- Universal Child Care Benefit (UCCB),
- Canada Child Tax Benefit (CCTB), and
- National Child Benefit Supplement (NCBS)

Some of these are universal benefits meaning they are not income-tested benefits.

The Liberal Party has pledged to replace these benefits with one single benefit, named the Canada Child Benefit, which will be tied to household income. The pledged benefit starts at $6,400 per year, tax-free, per child under the age of 6 and starts at $5,400 per year, tax-free, per child 6 to 17 years old. The benefit will gradually be reduced depending household income as illustrated in the table below.

Household Income	Phase-out rate*
$0 – $30,000	0%
$30,001 – $65,000	
Family with one child	6.8%
Family with two children	13.0%
Family with three (or more) children	16.0%
$65,001+	
Family with one child	3.1%
Family with two children	5.5%
Family with three (or more) children	8.0%

*per $100 of income

Cancel "Family Tax Cut" Income Splitting

The Liberal Party has pledged to eliminate the Family Tax Cut introduced in 2014. The Family Tax Cut was introduced to allow couples with dependent children under 18 years of age to claim a federal non-refundable tax credit to a maximum benefit of $2,000.

Restore the Labour Sponsored Venture Capital Corporations Tax Credit

The Liberal Party has promised to restore the 15% tax credit provided to individuals who acquire shares of Labour Sponsored Venture Capital Corporations as a way to improve the ability for small and medium businesses to obtain financing. This tax credit was scheduled to be eliminated for taxation years after 2016.

> The Liberal Party has promised to roll back the current TFSA contribution limit of $10,000 to $5,500.

Charitable Donation Tax Credit May Be Affected

Currently, individuals enjoy a tax credit that is equal to the top federal marginal tax rate of 29% on qualifying charitable donations over $200. There is no mention whether the charitable donation tax credit rate will be increased to the pledged top federal personal tax rate of 33%.

Small Business Tax Rate Decrease

Currently, the small business deduction reduces the federal corporate income tax rate to 11% on the first $500,000 of qualifying active business income earned by a Canadian-Controlled Private Corporation (CCPC). The 2015 federal budget proposed to decrease this rate to 9%. This decrease was to be implemented gradually from 2016 to 2019.

The Liberal Party also pledges to reduce the small business tax rate from 11% to 9%. However, they have not specified the timing for this change.

The tax benefits offered to CCPCs, such as the small business tax rate, is meant to support small businesses. The Liberal Party has stated that they will look at implementing measures that will prevent high-income individuals from using CCPCs as an income splitting tool. No details have been released regarding the pledged measures.

Currently, a number of tax rules, such as corporate attribution and kiddie tax reduce the shareholder's ability to income split with family members.

Exploring Your Options

In light of the pledged new top federal personal tax rate of 33%, and other possible changes, there are several tax planning strategies you may wish to explore. The following highlights a non-exhaustive list of tax minimization strategies to consider with your qualified tax advisor.

Tax Minimization Strategies for Individuals

Timing of Employment Income and Income from Non-Registered Sources

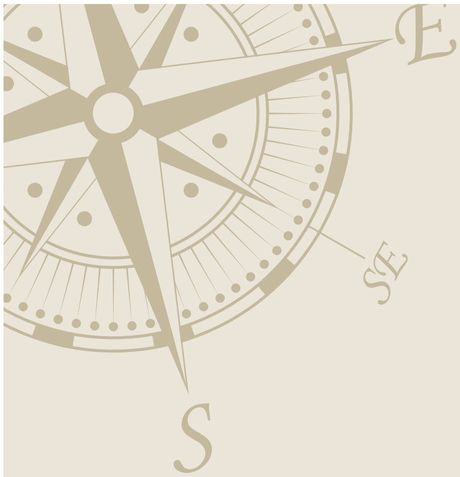
Assuming that the 33% personal tax rate will take effect in 2016 and you are affected by the introduction of this tax rate, consider taking income or realizing capital gains in 2015 that you will need to take in 2016 anyways. For example, if the corporation you work for has declared a bonus for 2015 and provides you with the option to receive the bonus in 2015 or 2016, consider having the corporation pay you in 2015 so that you will not be subject to the 33% tax rate.

If you are entitled to income that can be deferred indefinitely, you may wish to consider continuing to defer that income. For example, if you have preferred shares that you received from a "freeze transaction", and you have been redeeming a portion annually to spread out the tax burden (known as a wasting freeze), you may want to consider slowing or stopping the annual redemption to avoid the high tax bracket.

Timing of Withdrawals from an RRSP or RRIF

Assuming that the 33% personal tax rate will take effect in 2016 and you are affected by the introduction of this tax rate, consider the timing of your Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) withdrawals. By withdrawing from the RRSP or RRIF in 2015, you may benefit from a potential 4% of tax savings.

When deciding whether you should make a withdrawal from your RRSP or RRIF in light of the potential changes in tax rates, consider the taxes you will pay now. When you make a withdrawal, you will be pre-paying taxes at your high marginal tax rate. Further, you will lose the ability to have the funds grow on a tax-deferred basis. You will need to weigh the potential 4% of tax savings against the prepayment of tax and the loss of tax-deferred growth on the funds. Generally, unless you are planning on withdrawing your RRSP or RRIF in the next couple of years, there is an advantage to holding your funds in your RRSP or RRIF to benefit from tax deferral.



In light of the pledged new top federal tax rate, consider tax minimization strategies such as timing of income and deductions.

Finally, consider whether you will be in a lower marginal tax bracket in the future. You may be paying tax at a higher rate by withdrawing now if you expect your income to decrease in the future.

It is very important that you evaluate your own situation before making a withdrawal from your RRSP or RRIF as you cannot make a recontribution into these accounts unless you have available RRSP contribution room and you are age 71 or younger. Speak with your qualified tax advisor regarding the timing of your RRSP or RRIF withdrawals.

Timing of Deductions

Assuming that the changes to federal personal tax rates are implemented for 2016, if you are entitled to take tax deductions that are discretionary, for example, RRSP deductions and you will be affected by the introduction of the new 33% tax rate, consider taking these deductions in 2016. By deferring your deductions, you can benefit from a potential 4% of tax savings. RRSP contributions can be made as soon as contribution room becomes available in order to maximize tax-deferred compounding of investment income, however, the deduction for these contributions may be claimed in any future year.

Income Splitting Non-registered Investment Income With Family Members

Family income splitting is the bread and butter of tax planning in Canada, but many Canadians are not taking advantage of simple income-splitting opportunities that have already been acknowledged by the Canada Revenue Agency (CRA) as acceptable strategies. For example, if you have a lower-income spouse or lower-income children or grandchildren, given the pledged new top personal tax rate now is a great time to consider setting up a prescribed rate loan for income splitting investment income from non-registered accounts.

It is important to understand the impact of the “attribution rules” in the Income Tax Act if you plan to split income with your family members. These rules have the effect of attributing taxable income back to the family member who supplied the capital for investment so that, in effect, no tax savings are achieved.

The attribution rules may be avoided by making a prescribed rate loan to a properly structured family trust or directly to a spouse using a formal loan agreement. The family trust or your spouse would pay you annual interest on the loan. Then you would include the interest you received as income on your tax return. If this strategy is properly implemented, the tax savings should more than compensate for the additional tax you pay.

Family Trust

If you have children, grandchildren, nieces or nephews with little or no income, then you may wish to consider establishing a family trust to shift investment income that would otherwise be taxed in your hands at a high marginal tax rate to the hands of your lower-income family members.

For example: Each person in Ontario, regardless of age, is able to earn about $9,800 of interest income, $19,600 of capital gains or $50,000 of eligible dividends tax-free in 2015 if they have no other income in the year. The income earned in the family trust can be used to pay for your child’s expenses (private school fees, lessons, gifts, etc.) that you may have been paying all these years with your after-tax dollars. Parents and trustees should speak to their qualified legal or tax advisor for further advice and guidance on this matter before using trust income to pay for a child's expenses.

If structured properly, a family trust can allow a parent or grandparent to split income with their lower-income family members. Speak to your RBC advisor about the RBC Family Trust solution to take advantage of this annual income-splitting opportunity.

Spousal Loan

If you have a lower-income spouse, consider establishing a spousal loan to shift investment income and capital gains to them. This will allow you to take advantage of your spouse's lower marginal tax rate. The strategy involves you transferring funds to your lower-income spouse through a formal loan arrangement at the CRA prescribed interest rate. Your spouse is then able to earn investment income on these funds and pay taxes at their lower marginal tax rate.

Invest In Registered Accounts

Tax-Free Savings Account (TFSA)

In addition to investing in a TFSA of your own, consider making a gift to your adult family members to enable them to contribute to a TFSA. All investment income in a TFSA grows tax-free, and future withdrawals are not taxable. Further, there is no income attribution on the withdrawals, regardless of who funds the account.

Registered Retirement Savings Plan (RRSP)

By investing in an RRSP, you can deduct the amount of your RRSP contribution from your taxable income, up to your annual RRSP deduction limit, thereby reducing the taxes you have to pay. In addition, funds in an RRSP grow on a tax-deferred basis. The investment income and capital gains generated in the plan are not subject to tax until you make a withdrawal in the future.

Choose Tax-Efficient Investments

Flow-Through Shares

A flow-through share is a type of tax-advantaged investment designed to encourage investing in resource companies that are engaging in exploration and development in the mining, oil and gas, and renewable energy and energy conservation sectors. If structured properly, the resource company "renounces" or "flows through" the expenses it incurs to you, which you can then deduct personally on your tax return. The maximum amount you can deduct is the amount you paid for the investment. You may apply the deductions against all sources of income, thereby reducing your net income. It is very important to consider the possible drawbacks of flow-through investments including the quality of the investment and not just the potential tax deductions.

Tax-Exempt Life Insurance

If you have surplus assets personally or in your corporation that you plan to pass on to your heirs, consider how these assets are invested. By simply investing the assets in a non-registered account, the income earned will be exposed to your high marginal tax rate. As an alternative, consider placing your surplus assets into a tax-exempt permanent life insurance policy. Permanent life insurance policies (whole life and universal life) provide insurance protection and can act as a savings vehicle to maximize your estate, preserve your estate, and leave a legacy to a charity. The income earned on the savings component of a permanent life insurance policy that is an "exempt policy," as defined in the Income Tax Act, grows on a tax-sheltered basis within policy limits and while the investment remains in the exempt policy. By using insurance, you may be able to transfer income earned on your surplus assets to your beneficiaries in the form of a tax-free death benefit.

New legislation relating to the calculation of the maximum premium (and/or deposit) that may be made to an exempt life insurance policy and the maximum cash value accumulation within an exempt policy is expected to come into force on January 1, 2017. If you are considering a new policy, or are in a position to take advantage of additional room within an existing policy, consider acting before 2017. Speak to your life-licensed insurance representative for more information about tax exempt life insurance.

Donate to Charity

If you are planning to make a donation, consider donating to a registered charity to reduce your taxes payable.

As an alternative to cash, consider donating publicly listed securities with unrealized capital gains in-kind to qualified charities. You can do so without being subject to tax on the capital gains realized when you make the donation. You will also receive a donation tax receipt equal to the fair market value of the security at the time of the donation. This can help reduce your income taxes payable on your other income.

If you have thought about leaving a legacy for charitable purposes but are unsure about the best way to accomplish this, speak to your RBC advisor on the benefits of setting up your own charitable foundation through the RBC Charitable Gift Program.

Advanced planning is the key to success to address the potential changes to the law.

Review Your Compensation Package With Your Employer

Retirement Compensation Arrangement (RCA)

If you are an executive and are in a position to negotiate how your compensation package is structured, consider the pros and cons of having your employer establish an RCA as a component of your compensation. An RCA is a type of employer sponsored retirement savings arrangement that permits larger contributions than would be possible with other registered plans.

Contributions made by the employer to an RCA are not considered taxable income to you. This may reduce the portion of your income that is subject to the higher tax rates. Employers are able to deduct 100% of the contribution they make and, at retirement, distributions you receive from the RCA will be fully taxable as other income. The RCA therefore allows you to defer tax on the amounts contributed to the RCA by your employer. However, contributions made to an RCA and the income and capital gains realized in the RCA is subject to a 50% refundable tax. When the RCA makes a distribution to you, the CRA refunds one dollar of refundable tax for every two dollars of income distributed.

Payments from an RCA are considered eligible pension income and you may be able to split these payments with your spouse for income tax purposes when you reach age 65 in certain circumstances. In addition, an RCA may save you tax if you expect to be in a lower tax bracket or a non-resident of Canada at the time you receive the distributions.

Other Employment Benefits

Consider speaking to your employer about increasing your non-taxable benefits in exchange for salary, bonuses or other taxable benefits. Non-taxable benefits include private health service plans, registered pension plans such as an Individual Pension Plan, group sickness or accident insurance plans and disability insurance, training or education expenses, home computers and the internet, scholarships, and childcare as long as certain conditions are met.

Tax Minimization Strategies For Business Owners

Establish an Individual Pension Plan (IPP)

An IPP is a registered defined benefit pension plan sponsored by an employer, usually for one individual and, in some cases, for that individual's spouse if the spouse also works for the company. IPPs typically suit business owners, incorporated professionals or key employees who are age 40 or older.

An IPP is an alternative to an RRSP that enables your company to make larger tax-deferred annual contributions than those permitted for an RRSP. These contributions are tax-deductible to your corporation and not taxable to you. This allows you to defer your compensation and allow the money to grow in a tax-deferred registered plan until your retirement.

IPPs may provide a number of additional advantages. Contributions increase with the age of the plan holder, allowing for more asset accumulation in the plan. If the investment earnings in the plan are lower than expected, it may be possible to make additional contributions to address the deficit, depending on your province of residence. Please note that in some provinces, your corporation may be required to make a contribution to the IPP if the plan drops in value or returns are lower than expected. Assets in an IPP may also be creditor protected in certain circumstances.

Before establishing an IPP, you should also consider the ongoing fees and costs associated with administering an IPP. An actuarial valuation may be required every three to four years, depending on your province of residence. Speak with your RBC advisor for more information regarding IPPs.

Withdraw Cash from Your Corporation Tax-Efficiently

If you need the corporation's surplus funds for personal use, there are different ways to withdraw those funds, each with different tax implications. Consider using the following strategies first to get funds out of a corporation tax-free or tax-deferred before making a taxable salary or dividend withdrawal:

- Reimburse yourself for business expenses you paid personally
- Repay amounts owed to you by the corporation
- Pay a capital dividend
- Reduce the amount of paid-up capital on your shares

Pay Family Members a Reasonable Salary

If you are self-employed and your spouse and children help out in the business, consider paying them a reasonable salary. Salaries or wages paid to them will reduce your net business income, which is otherwise taxable to you personally. This is an income-splitting strategy that may help your family save tax if your children or your spouse are in a lower tax bracket than you. In addition, a salary or bonus is considered earned income for the purpose of generating RRSP contribution room and pensionable earnings for the Canada Pension Plan (CPP)/Quebec Pension Plan (QPP).

Pay Dividends to Adult Family Members

Consider paying dividends from corporate earnings to your spouse and adult children who are shareholders. If they are not shareholders, consider restructuring your business to incorporate your family members. This will allow you to split some of your business income with them and reduce your taxable income.

Unlike salaries, your family members do not have to work in the business to be able to receive a dividend. By making your family members shareholders of your business, you will have more flexibility in income splitting with them. Further, Canadian dividends are taxed at a lower rate than salary.

However, you should be aware that dividends will not create RRSP contribution room or CPP/QPP pensionable earnings. In addition, dividends that are paid out to related minor children are taxed at the highest marginal tax rate under the "kiddie tax" rules.

Please note that the Liberal Party has stated that they will look at implementing measures that will prevent high-income individuals from using CCPCs as an income splitting tool. It may be possible that income splitting through paying dividends to family members may be affected. Speak with your qualified tax advisor before implementing this strategy.

Plan Now

Tax planning should be an ongoing, dynamic process so you do not overlook opportunities to minimize tax. Whether you are able to take advantage of the tax planning opportunities discussed in this article or pursue other tax planning strategies, advance planning is the key to success. Now is a good time to speak to your accountant and review your circumstances to address the potential changes to the law.

Appendix – 2015 and Pledged 2016 Top Personal Tax Rates

	Ordinary Income		Eligible Dividends		Non-Eligible Dividends		Capital Gains	
	2015	2016	2015	2016	2015	2016	2015	2016
Alberta	40.25%	48.00%	21.02%	31.71%	30.83%	40.40%	20.13%	24.00%
British Columbia	45.80%	47.70%	28.68%	31.30%	37.98%	40.61%	22.90%	23.85%
Manitoba	46.40%	50.40%	32.26%	37.78%	40.77%	45.69%	23.20%	25.20%
New Brunswick	54.75%	58.75%	38.27%	43.79%	46.89%	51.75%	27.38%	29.38%
Newfoundland & Labrador	43.30%	48.30%	31.57%	38.47%	33.26%	39.40%	21.65%	24.15%
Northwest Territories	43.05%	47.05%	22.81%	28.33%	30.72%	35.72%	21.53%	23.53%
Nova Scotia	50.00%	54.00%	36.06%	41.58%	41.87%	46.97%	25.00%	27.00%
Nunavut	40.50%	44.50%	27.56%	33.08%	31.19%	36.35%	20.25%	22.25%
Ontario	49.53%	53.53%	33.82%	39.34%	40.13%	45.30%	24.77%	26.77%
Prince Edward Island	47.37%	51.37%	28.70%	34.22%	38.74%	43.87%	23.69%	25.69%
Quebec	49.97%	53.31%	35.22%	39.84%	39.78%	43.85%	24.99%	26.66%
Saskatchewan	44.00%	48.00%	24.81%	30.33%	34.91%	40.06%	22.00%	24.00%
Yukon	44.00%	48.00%	19.29%	24.81%	35.18%	40.18%	22.00%	24.00%

Note: The 2016 rates take into account provincial and territorial changes to be implemented in 2016. The 2016 rates also take into account the decrease in the non-eligible dividend gross-up factor and non-eligible dividend tax credit announced in the 2015 federal budget.

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

NAV0179-EN (11/2015)