RBC Wealth Management Services

The Navigator

2016 Tax Changes

A summary of the key tax measures that may have a direct impact on you

On December 7, Finance Minister, Bill Morneau, held a press conference to talk about a number of tax measures pledged by the Liberal Party and introduced a Notice of Ways and Means Motion (NWMM) to implement some of these changes.

Highlights of the NWMM include:

1. Reducing the second personal income tax rate to 20.5% from 22% effective on January 1, 2016 and for subsequent taxation years.
2. Introducing a 33% personal income tax rate on individual taxable income in excess of $200,000, effective for the 2016 and subsequent taxation years.
3. Returning the Tax-Free Savings Account (TFSA) annual contribution limit to $5,500 from $10,000 and reinstating indexation of the TFSA annual contribution limit, effective for the 2016 and subsequent taxation years.

There were also a number of other amendments proposed that are consequential to the introduction of the new 33% personal income tax rate.

In addition, the Government intends to introduce proposals in the next budget (expected to be Spring 2016) to create a new Canada Child Benefit with payments to begin in July 2016. The Canada Child Benefit would replace the Universal Child Care Benefit and would be income tested. They also intend to introduce legislative amendments to repeal the $2,000 income splitting tax credit ("Family Tax Cut") for families with children for the 2016 and subsequent taxation years. However, pension income splitting will remain.

This article outlines strategies, not all of which will apply to your particular 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 and/or legal advisor before acting on any of the information in this article.

The Government will introduce a new high federal personal tax bracket that will be subject to a tax rate of 33% on taxable income above $200,000.

Changes to Federal Personal Tax Rates

The Government will lower the 22% federal personal tax rate to 20.5% on taxable income between $45,282 and $90,563. If your income is above $90,563, this is expected to provide a tax savings of almost $680.

The Government will introduce a new high federal personal tax bracket that will be subject to a tax rate of 33% on taxable income above $200,000. This new rate is 4% higher than the existing highest federal personal tax rate of 29%. If your total taxable income is less than or equal to $217,000 your overall tax bill will not increase because of the tax cut in the lower bracket. However, if your income is above this threshold for 2016, you will face an increase in your taxes payable.

The combined federal and provincial/territorial top marginal tax rates on various types of income are contained in the Appendix 1.

The change to the tax rates will be effective January 1, 2016.

Consequential Changes Due to the New Higher Personal Tax Rate

The following proposed changes are consequential changes to other tax rules that either use or are affected by the change to the top personal income tax rate.

Charitable Donation Tax Credit

Currently, individuals enjoy a donation tax credit that is equal to the top federal marginal tax rate of 29% on qualifying charitable donations over $200. For donations below $200, individuals receive a federal tax credit of 15%.

With the introduction of the new high tax bracket, a third donation tax credit rate of 33% will be implemented. The new tax credit rate of 33% will apply to gifts in excess of $200 to the extent that you have income that is subject to the new 33% income tax rate. If you do not have income subject to the 33% tax bracket, you will only receive a tax credit of 29% on donations over $200.

As a result of this proposal, the federal donation tax credit is calculated as the total of:

- 15% on the first $200 of total gifts,
- 33% on the lesser of
  - the amount by which the individual's total gifts for the year exceeds $200, and
  - the amount by which the individual's taxable income exceeds the dollar threshold for the top personal tax rate, and
- 29% on the individual's total gifts for the year above $200 that is not eligible for the 33% rate above.

For example, let's assume you have $215,000 of taxable income and you make a charitable donation of $20,000 in 2016. You will receive a federal donation tax credit of $6,372, calculated as follows:

- $30 (15% x $200); plus
- $4,950 (33% x $15,000) -- which is the lesser of $19,800 ($20,000 - $200) or $15,000 ($215,000 - $200,000); plus
- $1,392 (29% x $4,800) -- which is calculated as $20,000 - $200 - $15,000

This change is effective for charitable donations made after 2015. Charitable donations made before 2016 but

The Government will roll back the TFSA contribution limit from $10,000 to $5,500 for 2016 and subsequent years.

carried forward and claimed in 2016 or future years will not be eligible for the new 33% tax credit rate.

Tax on Split Income ("Kiddie Tax")

The *Income Tax Act* contains "tax on split income" or "kiddie tax" rules that limit income-splitting techniques that seek to shift certain types of income from a higher-income individual to a lower-income minor. The federal tax rate that will apply to income subject to kiddie tax will be 33% for 2016 and future tax years.

Tax Payable by Trusts

The income and capital gains earned and retained in a trust, other than a graduated rate estate or a qualified disability trust, is taxed at the top individual marginal tax rate. With the introduction of the new tax rate of 33%, the tax rate on income retained in a trust will be 33% for 2016 and future tax years. Graduated rate estates and qualified disability trusts will continue to benefit from graduated rates.

Investment Income of Private Corporations

Generally, corporate tax rates are lower than personal tax rates. Therefore, refundable taxes are imposed on investment income earned in a private corporation to discourage individuals from holding their investments in a private corporation to defer paying income tax. Because of the proposed new 33% personal tax rate, it is also proposed that refundable taxes and the related refund rate be increased effective January 1, 2016 as follows:

- the refundable additional tax on investment income of Canadian Controlled Private Corporations (CCPCs) will be increased by 4 percentage points (to 10.67% from 6.67%);
- the refundable portion of tax on investment income of CCPCs will be increased by 4 percentage points (to 30.67% from 26.67%);
- the refundable tax on portfolio dividends received by private corporations will be increased by 5 percentage points (to 38.33% from 33.33%); and
- the rate at which refunds are made out of a private corporation's pool of refundable taxes previously paid (known as "Refundable Dividend Tax on Hand") when it pays taxable dividends will be increased by 5 percentage points (to 38.33% from 33.33% of dividends paid).

These changes to corporate tax rates on investment income were necessary to preserve integration so that an individual is somewhat indifferent to earning investment income personally versus through a corporation. The effect of these changes is that it will be more costly to continue to hold investments in your corporation.

However, in a few provinces if you are at the highest tax bracket there is still a deferral of tax if you do not need these funds personally for a long time. For example, if you earn interest income in a corporation in Ontario the new corporate tax rate is 50.17%, however, if you were to earn this income personally and you are at the highest tax bracket you would pay tax at 53.53% – a very small deferral of tax. However, if you need these funds personally, it will cost you more than 53.53% in overall corporate and personal tax.

Appendix 2 contains a chart of the new proposed corporate tax rates on investment income by province.

Reduction to the TFSA Annual Contribution Limit

The Government will roll back the TFSA contribution limit from $10,000 to $5,500 for 2016 and subsequent years. The TFSA annual contribution limit will be indexed to inflation and rounded to the nearest $500.

The TFSA annual contribution limit for 2015 will remain at $10,000. Therefore, the total TFSA contribution limit from 2009 to 2016 is $46,500 ($5,000 for 2009 to 2012, $5,500 for 2013 and 2014, $10,000 for 2015 and $5,500 for 2016).

Changes to the Employee Stock Option Benefit Deduction

The Government's intention to limit the



If you are affected by the new 33% tax rate, consider withdrawing from your RRSP or RRIF in 2015, you may benefit from a potential 4% of tax savings.

stock option deduction on the exercise of employee stock options was not part of the NWMM and no further comment was made on this subject. However, on November 20, 2015, Finance Minister Morneau stated that any changes made to the taxation of employee stock options will be implemented for future tax years, not retroactively. This comment suggests that employee stock options that have already been granted prior to any changes to the rules will be grandfathered. This means that individuals who currently hold employee stock options may still qualify for the full employee stock option benefit deduction even if they exercise the stock options at a later date.

Tax Minimization Strategies for Individuals

Timing of Employment Income and Income from Non-Registered Sources

Consider taking advantage of the lower rates this year by 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

If you are affected by the new 33% tax rate, consider withdrawing from your 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.

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 a qualified tax advisor regarding the timing of your RRSP or RRIF withdrawals.

Timing of Losses and Deductions

If you are affected by the new 33% tax rate, consider taking discretionary tax losses and deductions, like RRSP deductions, in 2016. By deferring your deductions, you can benefit from

If you have a lower-income spouse, consider establishing a spousal loan to shift investment income and capital gains to them.

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 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.

Each person, regardless of age and depending on your province of residence, is able to earn in the range of $7,500 to $11,000 of interest income, $15000 to $22,000 of capital gains or $21,000 to $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 a 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 provides the funds to



As an alternative to cash, consider donating publicly listed securities with unrealized capital gains in-kind to qualified charities.

make the contributions.

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 to ensure your policy will be grandfathered. Speak to a 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

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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.

Review Your Compensation Package With Your Employer

Retirement Compensation Arrangement (RCA)

If you are an executive who is not already part of a supplemental executive retirement plan (SERP) 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 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 may be 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.

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

If you are self-employed and your spouse and children help out in the business, consider paying them a reasonable salary.

RBC advisor for more information regarding IPPs.

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 minimize 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 Government 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.

Conclusion

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 a qualified tax advisor and review your circumstances to address the potential changes to the law.

Appendix 1 – 2015 and Proposed 2016 Top Personal Tax Rates

	Ordinary Income		Eligible Dividends	
	2015	2016	2015	2016
Alberta	40.25%	48.00%	21.02%	31.71%
British Columbia	45.80%	47.70%	28.68%	31.30%
Manitoba	46.40%	50.40%	32.26%	37.78%
New Brunswick	54.75%	58.75%	38.27%	43.79%
Newfoundland & Labrador	43.30%	48.30%	31.57%	38.47%
Northwest Territories	43.05%	47.05%	22.81%	28.33%
Nova Scotia	50.00%	54.00%	36.06%	41.58%
Nunavut	40.50%	44.50%	27.56%	33.08%
Ontario	49.53%	53.53%	33.82%	39.34%
Prince Edward Island	47.37%	51.37%	28.70%	34.22%
Quebec	49.97%	53.31%	35.22%	39.84%
Saskatchewan	44.00%	48.00%	24.81%	30.33%
Yukon	44.00%	48.00%	19.29%	24.81%

	Non-Eligible Dividends		Capital Gains	
	2015	2016	2015	2016
Alberta	30.83%	40.25%	20.13%	24.00%
British Columbia	37.98%	40.61%	22.90%	23.85%
Manitoba	40.77%	45.69%	23.20%	25.20%
New Brunswick	46.89%	51.75%	27.38%	29.38%
Newfoundland & Labrador	33.26%	39.40%	21.65%	24.15%
Northwest Territories	30.72%	35.72%	21.53%	23.53%
Nova Scotia	41.87%	46.97%	25.00%	27.00%
Nunavut	31.19%	36.35%	20.25%	22.25%
Ontario	40.13%	45.30%	24.77%	26.77%
Prince Edward Island	38.74%	43.87%	23.69%	25.69%
Quebec	39.78%	43.85%	24.99%	26.66%
Saskatchewan	34.91%	40.06%	22.00%	24.00%
Yukon	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.

Appendix 2 – 2015 and Proposed 2016 Corporate Tax Rates on Investment Income

2016 Corporate Investment Tax Rate

	Interest		Capital Gains		Canadian Dividend	
	2015	2016	2015	2016	2015	2016
Alberta	45.67%	50.67%	22.84%	25.34%	33.33%	38.33%
British Columbia	45.67%	49.67%	22.84%	24.84%	33.33%	38.33%
Manitoba	46.67%	50.67%	23.34%	25.34%	33.33%	38.33%
New Brunswick	46.67%	50.67%	23.34%	25.34%	33.33%	38.33%
Newfoundland & Labrador	48.67%	52.67%	24.34%	26.34%	33.33%	38.33%
Northwest Territories	46.17%	50.17%	23.09%	25.09%	33.33%	38.33%
Nova Scotia	50.67%	54.67%	25.34%	27.34%	33.33%	38.33%
Nunavut	46.67%	50.67%	23.34%	25.34%	33.33%	38.33%
Ontario	46.17%	50.17%	23.09%	25.09%	33.33%	38.33%
Prince Edward Island	50.67%	54.67%	25.34%	27.34%	33.33%	38.33%
Quebec	46.57%	50.57%	23.29%	25.29%	33.33%	38.33%
Saskatchewan	46.67%	50.67%	23.34%	25.34%	33.33%	38.33%
Yukon	49.67%	53.67%	24.84%	26.84%	33.33%	38.33%

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

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